APRIL 2006

THE SPANISH ECONOMY

Monthly Report

NUMBER 290

RESEARCH DEPARTMENT

"la Caixa"

Forecast

% change over same period year before unless otherwise noted

	2004	2005	2006	2005 1Q	2005 2Q	2005 3Q	2005 4Q	2006 1Q	2006 2Q
INTERNATIONAL ECONOMY			Forecast					Forecast	
Gross domestic product									
United States	4.2	3.5	3.4	3.6	3.6	3.6	3.2	3.4	3.5
Japan	2.3	2.7	3.2	1.1	2.7	2.8	4.3	4.3	3.5
United Kingdom	3.2	1.8	2.1	2.0	1.6	1.8	1.8	2.1	2.1
Euro area	1.8	1.4	1.8	1.2	1.2	1.6	1.7	1.8	1.9
Germany	*1.1*	*1.1*	*1.6*	*0.6*	*0.8*	*1.5*	*1.6*	*1.4*	*1.7*
France	*2.1*	*1.4*	*1.7*	*1.7*	*1.0*	*1.7*	*1.2*	*1.4*	*1.7*
Consumer prices									
United States	2.7	3.4	2.6	3.0	2.9	3.8	3.7	3.6	2.7
Japan	0.0	–0.3	0.1	–0.2	–0.1	–0.3	–0.5	0.3	0.0
United Kingdom	2.2	2.3	2.2	2.2	2.2	2.4	2.2	2.2	2.1
Euro area	2.1	2.2	2.1	2.0	2.0	2.3	2.3	2.3	2.0
Germany	*1.7*	*2.0*	*1.7*	*1.7*	*1.7*	*2.1*	*2.3*	*2.1*	*1.8*
France	*2.1*	*1.7*	*1.7*	*1.7*	*1.7*	*1.9*	*1.6*	*1.8*	*1.7*
SPANISH ECONOMY			Forecast					Forecast	
Macroeconomic figures									
Household consumption	4.4	4.4	3.4	4.6	4.6	4.3	4.0	3.8	3.5
Government consumption	6.0	4.5	4.4	5.2	4.0	4.2	4.6	4.5	4.4
Gross fixed capital formation	4.9	7.2	5.7	7.0	7.6	7.3	6.8	6.4	5.9
Capital goods	*3.7*	*9.5*	*7.9*	*9.8*	*10.4*	*8.9*	*9.1*	*8.7*	*8.0*
Construction	*5.5*	*6.0*	*4.6*	*6.0*	*6.2*	*6.3*	*5.6*	*5.2*	*4.8*
Domestic demand (contribution to GDP growth)	4.9	5.3	4.6	5.5	5.4	5.3	5.0	4.8	4.5
Exports of goods and services	3.3	1.0	2.8	–1.4	1.3	2.1	1.9	2.0	2.5
Imports of goods and services	9.3	7.1	6.8	6.2	7.9	7.8	6.6	6.3	6.5
Gross domestic product	**3.1**	**3.4**	**3.0**	**3.3**	**3.4**	**3.5**	**3.5**	**3.4**	**3.2**
Other variables									
Employment	2.6	3.1	2.7	3.0	3.2	3.2	3.1	3.0	2.9
Unemployment (% labour force)	11.0	9.2	8.7	10.2	9.3	8.4	8.7	8.7	8.6
Consumer price index	3.0	3.4	3.4	3.3	3.2	3.4	3.6	4.0	3.5
Unit labour costs	2.8	2.3	2.5	2.5	2.4	2.0	2.2		
Current account balance (% GDP)	–5.8	–7.4	–7.2	–8.4	–7.8	–6.7	–6.8		
Not lending or net borrowing rest of the world (% GDP)	–4.8	–6.5	–6.3	–7.8	–6.6	–5.8	–5.8		
Government balance (% GDP)	–0.1	1.1	0.5						
FINANCIAL MARKETS			Forecast					Forecast	
Interest rates									
Federal Funds	1.3	3.2	5.0	2.4	2.9	3.4	4.0	4.4	4.9
ECB repo	2.0	2.0	2.7	2.0	2.0	2.0	2.1	2.3	2.7
10-year US bonds	4.3	4.3	4.9	4.3	4.2	4.2	4.5	4.6	4.8
10-year German bonds	4.1	3.4	3.8	3.6	3.3	3.2	3.4	3.5	3.7
10-year Spanish bonds	4.1	3.4	3.8	3.6	3.3	3.2	3.4	3.5	3.7
Exchange rate									
$/Euro	1.24	1.25	1.21	1.31	1.26	1.22	1.19	1.20	1.21

THE SPANISH ECONOMY
MONTHLY REPORT
April 2006

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Y PENSIONES
DE BARCELONA

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"la Caixa" GROUP: KEY FIGURES

As of December 31, 2005

FINANCIAL ACTIVITY	Million euros
Total customer funds	169,470
Receivable from customers	113,857
Profit attributable to Group	1,495

STAFF, BRANCHES AND MEANS OF PAYMENT	Million euros
Staff	25,254
Branches	5,053
Self-service terminals	7,208
Cards	8,408,956

COMMUNITY PROJECTS: 2005 BUDGET	Million euros
Activities	
Social	160
Cultural	70
Science and environmental	54
Educational	19
TOTAL BUDGET	**303**

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Contents

Home, sweet home (but very expensive)

Few economic questions unleash as much controversy as the real-estate boom that many countries have been enjoying or suffering now for a number of years. The size and duration of the present upward real-estate cycle has no recorded precedents. Prices of housing in some developed countries have risen by more than 50%. Mortgage borrowing has reached record levels. The degree to which the movements in real prices of housing in various countries have been in synchronization is also unusual. All these circumstances are creating concern about the consequences an eventual bursting of the real-estate bubble could have on the rest of the economy. Central banks and national and supra-national economic authorities keep launching warnings and cautions in the hope of trying to stave off this danger.

Construction fever has also spread across Spain, without a doubt. By number of housing units built and growth of prices, Spain heads the European ranking by a long shot. Is there really a bubble? So far as demand is concerned, growth seems to be quite justified. The favourable state of the economy, a stage of job creation without precedent and an unrepeatable drop in interest rates (thanks to adoption of the euro) have come together with an unexpected influx of immigrants. The fact that the number of housing units per household has not gone up during this cycle would suggest that the speculative component of the Spanish boom cannot be very high. With regard to the rise in prices, it should be noted that the financial effort required of an average household to buy a home has gone up moderately compared with that at the beginning of the upward housing cycle.

All of this makes it necessary to discard forecasts of a catastrophe ahead. Not that it is impossible for a real-estate crisis to happen. But in Spain, in a situation of moderate inflation and contained increases in interest rates, there is reason to expect a gradual slowdown in the sector with very limited consequences for the rest of the economy. In fact, those countries where construction activity has recently slowed down have not suffered from any significant drop in prices nor has the rest of the economy dipped in terms of growth.

The real problem created by the housing boom in Spain's economy has been the enormous shift of resources into an activity such as construction which, while it has the virtue of generating employment and creating add-on effects in other sectors, it does not raise growth potential over the long term. Today, housing construction absorbs all household savings and therefore makes financing difficult for other production sectors, pushes up the foreign deficit and slows the growth of productivity. The increased price of housing extends to land and to industrial and commercial properties, thus distorting the costs of those activities and reducing their competitiveness. The odd case of industrial relocation has had something to do with the rise in real-estate prices. Certainly, the nature of the current real-estate cycle would make us hope for a gradual slowdown. The question is what will become the engine of growth once we have left behind the sweet years of real-estate.

March 27, 2006

OVERALL SUMMARY

Japan and euro area join world growth

In context of favourable world economic situation, economies of Japan and euro area confirm signs of recovery.

At the end of December we were daring enough to predict a relatively calm economic year in 2006 without substantial changes over 2005, in spite of the risks facing the world economy. Now that the first quarter is practically finished we have not seen any factors that would cause us to change that general economic perspective. Let's look at one thing at a time.

In the first place, growth. Here the big news is that Japan and the euro area have joined in the race for economic growth after going through a long wait in the boxes. The most surprising case, because of the good level of the figures, has been Japan due to the strong boost recorded in the economy in the final quarter of 2005, which was much stronger than expected.

Continental Europe creating jobs despite modest growth but unemployment still high.

In the euro area, on the other hand, the poor advance in the fourth quarter represented something of a let-down in the course of recovery which had been discernible in recent quarters. Private consumption went through a substantial slowdown with growth going from 1.9% to 0.8%, a performance very much influenced by the performance of households in Germany. The other components showed a somewhat more positive result, especially investment and exports. Nevertheless, the figures for the first quarter again point to a growth situation, as indicated by retail sales and indicators of business confidence.

We should mention the fact that even with the poor growth rate in recent quarters, the euro area had managed to slightly reduce the level of unemployment, now at 8.3% of the labour force. In spite of all, social unrest continues which is reflected in the response aroused in France to the «Villepin hiring contract», a contract covering young people getting their first job which allows them to be fired without cause in the first two years of the contract. Nor has the labour market stabilized in Germany, which shows up in the announcement that elimination of restrictions on the entry of workers from countries joining the EU in the recent extension would be delayed until 2009. Belgium and Austria also will not relax controls whereas Spain, Finland and Portugal have joined the United Kingdom, Ireland and Sweden in removing all restrictions.

In any case, growth leaders still China and United States.

In any case, the growth race continues to be dominated by China and the United States, the *Formula 1* driver leading all other participants. The first as the great emerging manufacturing power and the second as the top world consumer. Latest available indicators from China, such as industrial production and retail sales, point to maintenance of growth full-speed-ahead, that is to say, with growth of the order of 9-10% real. In the United States, the first quarter turned out positive following a temporary dip in the fourth quarter of 2005. The usual optimism of people in the United States continues to show up as a high rate of household consumption with some business executives believing in the future and continuing to invest and hire workers. In the course of the year, the trend will be to a gradual moderation of growth but this will not manage to turn around the trade deficit which month after month keeps on marking up new records. Nor is the other deficit, that for the public accounts, being put in order.

The second point of interest is inflation. So far this year, the picture is not very different from that at the end of last year. Contributing a great deal to this is the relative stabilization of oil prices. In recent weeks the price per barrel of crude oil has swung somewhat above 60 dollars and the forecast is that it will stay at these levels. The Organization of Petroleum Exporting Countries (OPEC) itself seems to feel comfortable with this level given that at the beginning of March it decided to maintain its production quota at 28 million barrels a day. This was a decision which, for the moment, avoids eventual increases in crude oil prices in a context of strong world demand, weak increases in non-OPEC production and open or potential conflicts in Nigeria, Iran or Iraq.

If the price of oil holds at these levels over coming months, inflation rates should show substantial moderation. Something of this kind already began to happen in February. Now, however, attention is centred on indirect and *second round* effects of oil price increases. If we look at price indices excluding the energy component, it would seem that for the moment the situation is calm. Both in the United States and the EU, core inflation is tending to moderate while wage demands remain contained.

This takes us to the third point, namely, monetary policy. The central banks, guardians of inflation, are those who are most anxious to detect any rise in price indices. Just in case, the Federal Reserve decided months ago to gradually give up its very easy money policy and for the moment is following the course set out which is expected to end up with a reference rate of 5% before the summer. More recently, the European Central Bank began its upward stage and on March 2 decided on a second increase in reference rate putting it at 2.50%. The market is discounting further increases in a course that could lead to a level of 3% at the end of the year.

Inflation remains contained while for now oil price seems relative calm.

But the most outstanding case is that of the Bank of Japan which at the beginning of March announced that it was putting an end to a long stage of monetary policy under which it provided practically all the liquidity requested by the monetary system at a nil rate of interest. Why has it done this? The spark came with the January inflation figure which showed an increase of 0.5% year-to-year, a positive rate for the first time since 1998 (with the odd parenthesis), which has been interpreted as the end of the years of deflation and the official stamp on the recovery of Japan's economy.

But central banks not satisfied and give up easy money policies.

Not everyone is in agreement with the restrictive position of the central banks. In a recent report, the Organization of Economic Cooperation and Development (OECD) asked for caution on the part of the monetary authorities given that excessive tightening of monetary conditions could bring about an undesirable slowdown in economic activity. Against the OECD view we could lay the objection that, in spite of the increases in monetary rates in Europe and the United States, long-term interest rates have scarcely moved and are still close to all-time lows, although in recent weeks they have risen to a notable extent. Something similar is happening with risk premiums demanded on bonds of certain countries or companies. The stock markets, in turn, have not suffered from the rise in monetary rates and in the first quarter generally obtained notable price increases, helped along by excellent corporate profits and a flood of corporate acquisition operations.

Rise in monetary interest rates fails to boost long-term rates while stock markets record excellent first quarter.

Spain's economy: competitiveness threatened

Spain's economy maintains strong growth rate although some indicators beginning to weaken.

One of the stock markets to record the best results in the first three months of the year was indeed that of Spain which showed a rise of more than 10% one week from the end of the quarter. Behind this result was an economy that is maintaining a notable growth rate and companies that generally obtained excellent profits in 2005.

Economic activity indicators for the first quarter are still scattered but we note a continuation of the process of job creation, if we are to go by the trend in registrations with Social Security as well as an incipient improvement in the industry sector, according to results of the industrial production index and the business volume of industrial companies drawn up by the National Institute of Statistics.

Main concerns remain focussed on imbalances: very high inflation differential...

On the other hand, some indicators have had their negative surprises. The economic sentiment index prepared by the European Commission show a notable drop in February, brought about by the decrease in those components relating to construction and services. In addition, in the first two months passenger car registrations were down slightly compared with the same period the year before. At the same time, hotel occupation rates for foreign tourists were down in January and February while car production dropped in February. Along the same lines, we should add the gradual slowdown seen in the rate of mortgage loans granted in January, possibly related to the increase in the 1-year Euribor interest rate, although that growth rate was still well above 20% year-to-year. In any case, this was a matter of isolated figures which did not in any way darken the impression of an economy in growth although, indeed, one with a tendency to moderate from the strong drive shown in domestic demand in recent quarters.

In any case, concern is still focussed on inflation and the foreign deficit. Growth of prices moderated in February to a year-to-year rate of 4.0%, according to the consumer price index. This was an improvement over the 4.2% recorded in January, which may continue in coming months if oil prices hold more or less stable. The question, however, is in the apparent unsolvable inflation differential separating Spain from the euro area average which in February stood at 1.7 percentage points. This is a differential which little by little is reducing the competitive position of Spanish companies abroad.

...and foreign imbalance running right across all headings in balance of payments.

This gradual loss of competitiveness keeps showing up in figures for the balance of payments. In 2005 as a whole, the current account with abroad ended with a deficit of 69 billion euros, 55% more than in 2004, according to the Bank of Spain. In terms of the gross domestic product, the figure is equivalent to 7.6% and, as well as being an all-time high, is one of the highest among the developed countries.

The foreign deficit and inflation are imbalances which are partly due to the strong drive in domestic demand. This long period of growth is an outstanding event in the context of mediocre performance by most of the European economies. This has largely been possible because of the reforms adopted some years ago aimed at opening up the economy and giving more flexibility to markets of factors and products. Nevertheless, those reforms should continue so that the imbalances mentioned do not end up stripping down the present growth stage.

CHRONOLOGY

2005

March	4	Dow Jones index for **New York stock exchange** marks up annual high (10,940.55), a rise of 1.5% over end of 2004.
	22	**Federal Reserve** raises reference rate by quarter point to 2.75%.
	23	Heads of state and government of European Union member states approve reform of **Stability and Growth Pact** introducing more flexibility.
April	20	Dow Jones index for **New York stock exchange** marks up annual low (10,012.36) with 7.1% drop compared with end of 2004.
May	2	**Cypriot pound**, **Latvian lat** and **Maltese lira** join Exchange Rate Mechanism.
	3	**Federal Reserve** raises reference rate by quarter point to 3%.
June	30	**Federal Reserve** raises reference rate by quarter point to 3.25%.
August	9	**Federal Reserve** raises reference rate by quarter point to 3.5%.
September	1	One-month forward price of Brent quality **oil** goes up to all-time high level of 67.48 dollars a barrel.
	17	Increase in **special taxes** on alcohol and tobacco to finance health (BOE 17-9-05).
	20	**Federal Reserve** raises reference rate a quarter-point to 3.75%.
October	4	IBEX 35 index for **Spanish stock exchange** marks up annual high (10,919.2) with cumulative gains of 20.2%.
	13	Government approves **National Reform Programme for Spain**.
November	1	**Federal Reserve** raises reference rate to 4%.
	28	**Slovak crown** joins Exchange Rate Mechanism.
December	1	**European Central Bank** raises official interest rate to 2.25%.
	13	**Federal Reserve** raises reference rate to 4.25%.
	17	European Council approves **2007-2013 Budget**.
	18	Hong Kong Summit of **World Trade Organization** agrees to removal of all aids to agricultural exports of developed countries in 2013.

2006

January	20	Government presents bills for reform of **personal income tax** and **corporate tax.**
	31	**Federal Reserve** raises reference rate to 4.50%.
February	22	Dow-Jones index for **New York stock exchange** records annual high (11,137.2) with rise of 3.9% compared with end of 2005.
	27	IBEX 35 index for **Spanish stock exchange** marks up annual high (11,832.8) with cumulative gains of 10.2% compared with end of December 2005.
March	2	**European Central Bank** raises official interest rate to 2.50%.
	22	Dow Jones index for **New York stock** exchange records annual high (11,317.4), an increase of 5.6% compared with end of 2005.
	24	IBEX 35 index for **Spanish stock** market marks up annual high (11,954.4), a cumulative gain of 11.4% over the end of December 2005.
	28	**Federal Reserve** raises reference interest rates to 4.75%.

AGENDA

April

5 Industrial production index (February).
6 Meeting of Governing Board of European Central Bank.
12 Consumer price index (March).
20 Harmonized consumer price index for European Union (March).
25 Producer price index (March).
28 Labour Force Survey (1st Quarter).
US GDP (1st Quarter).
Early HCPI indicator (April).

May

4 Meeting of Governing Board of European Central Bank.
5 Industrial Production Index (March).
10 Meeting of Open Market Committee of Federal Reserve.
11 Early Quarterly National Accounts (1st Quarter).
Early GDP of euro area (1st Quarter).
12 Consumer price index (April).
24 Quarterly National Accounts (1st Quarter).
25 Producer price index (April).

INTERNATIONAL REVIEW

United States doing fine... for now

United States growing without inflation...

In Washington there is a man who is both satisfied and troubled. These are the two quite opposing faces of the current situation in the US economy. Ben Bernanke, chairman of the Fed and the person responsible for price stability, calmly sees how inflationary trends are keeping away and growth is holding to a good path. But George W. Bush is a president under pressure and with reason. The Federal government budget for 2006 will be 400 billion dollars and what is more noone believes in him.

...but trade deficit and fiscal deficit show poor prospects.

At the beginning of the month, George Bush asked Congress for veto right to halt the increase in certain budget headings, an initiative that goes back to the days of Ronald Reagan. The fact is that there are few occasions when the president shows any concientious zeal for budget austerity. The tax cuts, Iraq, the *Katrina* hurricane and national security are burdens that are too heavy. The forecasts by the Congress Budget Office estimate that the federal deficit will go from the current 2.8% of the gross domestic product (GDP) to 1.0% in the next five years but this is an optimistic view few people agree with. What people feel is that health costs will continue to soar and that, in the second year of the mandate of Bush's replacement, we shall see big numbers of the Baby Boom generation taking retirement. All of this will increase the budgetary imbalance that in no way is helping to wipe out the current account deficit, which in the fourth quarter of 2005 came to 7.0% of the GDP.

Growth is solid and there is no sign of any continuation of the slowdown seen

UNITED STATES: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005				2006	
			1Q	2Q	3Q	4Q	January	February
Real GDP	4.2	3.5	3.6	3.6	3.6	3.2	–	...
Retail sales	7.3	7.5	7.2	8.4	8.4	6.2	9.4	6.7
Consumer confidence (*)	96.1	100.3	104.2	102.3	98.9	95.8	106.8	101.7
Industrial production	4.1	3.2	4.0	3.1	2.7	3.0	3.0	3.3
Industrial activity index (ISM) (*)	60.5	55.5	55.7	53.2	56.0	57.0	54.8	56.7
Sales of single-family homes	10.0	6.9	5.1	6.9	11.5	4.5	3.3	...
Unemployment rate (**)	5.5	5.1	5.2	5.1	5.0	4.9	4.7	4.8
Consumer prices	2.7	3.4	3.0	3.0	3.8	3.7	4.0	3.6
Trade balance (***)	–618	–724	–651	–672	–695	–724	–734	...

NOTES: (*) Value.
(**) Percentage of labour force.
(***) Cumulative balance for 12 months. Billion dollars.
SOURCE: OECD, national statistical bodies and internal figures.

in the fourth quarter. Supporting this consensus, the trend for that period was revised upward going from 1.1% year-to-year annualized to 1.7%. Most of the revision came from an upward adjustment of the volatile component of motor vehicle sales and sales of transportation equipment, both by individuals and companies which was the key element in the decrease in growth.

The fact is that demand continues very strong. Following the consumer peak in the *hot* month of January, the levels reached continued in February which indicates that willingness to buy is due to something more than weather factors. Excluding cars and petrol, the increase in February was 8.0% year-to-year. Home goods held very strong and the only climatic effect was that people preferred to eat at home rather than eating out. The present moment continues to be seen as better that the future which could have something to do with the improvement in financial outlay for those who live in rental homes (which may be considered as one more mental attitude of living day-by-day) compared with the financial commitments of those who own their own homes who have to pay more attentiont to the future prospects of their properties.

Just as in the case of consumers, business executives continue to see things in optimistic vein, even more so than last month. As has become normal during this growth period, the most optimistic are the non-manufacturers to whom we should pay more and more attention. A result of the loss of relative weight of industry and the manufacturing sector in general, right from the start, the economic sentiment of non-manufacturers has been in step with the general progress of the economy, a sharp correlation which, in spite of the distortion seen in the last quarter, has

Consumers have better opinion about present than the future.

Non-manufacturing business executives in step with economic situation and not seeing things so bad.

THOSE LIVING IN RENTAL HOUSING NOT DOING SO BADLY

Financial obligations with regard to disposable household income (*)

NOTES: (*) As well as interest and repayments of debt contracted, Federal Reserve includes car leasing, home rental and insurance and taxes arising from home ownership.
SOURCE: Federal Reserve and internal figures.

Disparities in real-estate market in United States

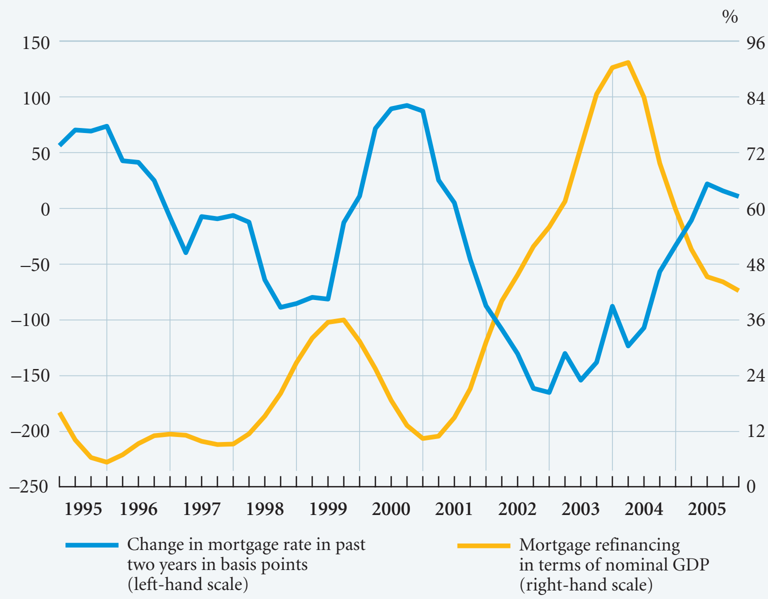
The beaches of Malibu, the views in San Francisco, the casinos in Las Vegas, the sun of Florida and the Grand Canyon are favourite destinations for tourists wanting to visit the United States. Going beyond what is normally taken for granted, it now turns out that tourists and those who live there are more in agreement than ever given that these are the preferred places for Americans to buy a house.

The real estate market in the United States has also been an engine of economic growth in recent years largely due to low interest rates. Compared with the 2000 average, at the end of 2005 prices had risen by 62%, mortgage borrowing by households in this period had gone from 65% to 93% of disposable income and the effort necessary to buy a house on the part of an average family has risen between 15% and 22%, depending on whether the mortgage was of fixed or variable interest. These are big figures which have made many people think of the possibility of a real estate bubble.

Somewhat higher interest rates and perhaps doubts about the bubble have meant that the public may have decided that enough is enough. To the pleasure of the Federal Reserve, since the end of the summer in 2005 there has been something of an orderly retreat. Existing housing sales in January dropped by 5.2% year-to-year and sales of new houses (representing a fifth of existing housing sales which show a more erratic performance) went to a very low 3.3%. The slowdown in sales coincides with an easing of prices although the latter factor is coming relatively later. While the growth rate is lower than in previous months, it still stood at 11% in January. The slowdown is certainly quite gradual which implies that the effects on the economy are being mitigated.

This cooling off also shows up in the lesser extent of a key support of consumption, namely refinancing of mortgages (loans obtained not to buy new real estate but, by taking advantage of lower interest rates, increase the debt on a house

IF INTEREST RATES RISE MORTGAGE REFINANCING DROPS



SOURCE: Bureau of Economic Analysis, Mortgage Bankers Association and internal figures.

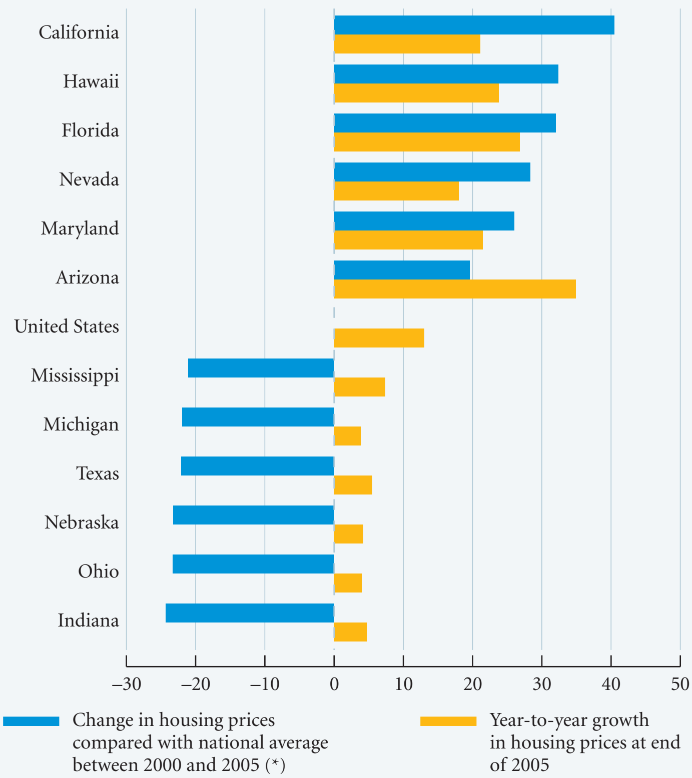
raising the principal without pushing up the monthly repayment). According to the Mortgage Bankers Association, capital obtained through refinancing of mortgages in 2005 was 42% of the GDP, substantially lower than the 91% in 2003 when interest rates were dropping, and forecasts for 2006 suggest a tendency to less refinancing.

Is it to be hoped that this orderly retreat will continue? This is what everyone would like, Americans and others, and the answer to this question implies discerning if there was a bubble or not. At the national level there are factors inducing calm. Mortgage repayments deflated by the consumer price index (CPI) at the end of 2005 came to only 9.9% higher than in 2000, 13% below the figure at the end of 1989 when a sharp price correction began. Furthermore, thanks to the reduction of the proportion of mortgages at variable interest rate, the sensitivity of monthly repayments to changes in interest rates dropped by 25% in 2005, and now is half what it was in the disastrous year 1989.

Someone will undoubtedly ask whether or not a real bubble exists and, in the best tradition of economists, we would have to reply that «it depends». The trend in prices has been very uneven depending on geographical location, which in many cases may be due to demographic factors and economic objectives. The northern industrial states, such as Ohio, Michigan and Illinois, have dropped behind. They are losing population in relative terms and

SOME GET SO MUCH, OTHERS SO LITTLE

As percentage

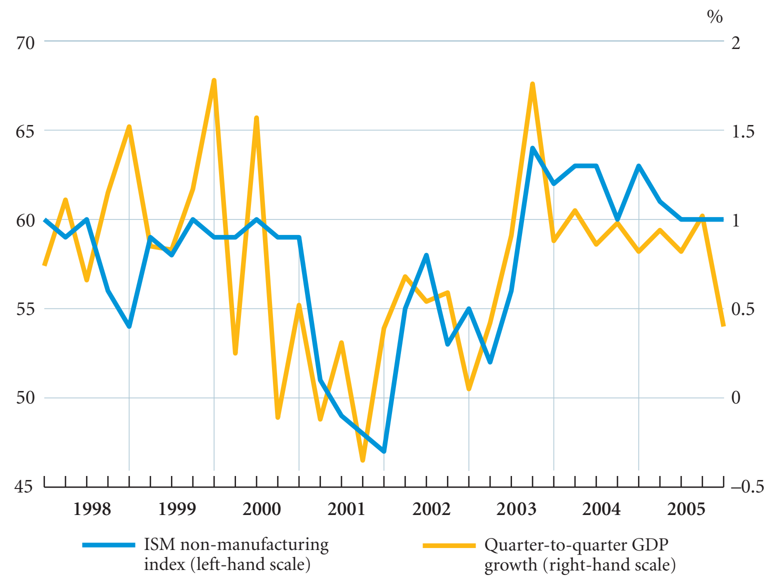


NOTES: (*) Percentage increase of quotient obtained by dividing price of housing in each state by price of housing in United States between average for 2000 and end of 2005.
SOURCE: Federal Housing Finance Board, Census and internal figures.

lower prices there reflect the poor situation in the industrial sector. The metropolitan areas of Detroit and Flint, once bastions of the world motor vehicle industry, have seen their prices drop by 24% compared with the national average between 2000 and 2005. On the other hand, Florida and Hawaii, the destinations of a growing retiree population, have grown by 32% above the average and California 40%. Those states where prices have gone up most also show a higher number of transactions. California and Florida represent a quarter of all new mortgages.

Leaving aside tourist attractions, the difference in prices in terms of geographical location has risen greatly since 2000. Where they have grown most is where there has been less of an economic slowdown: in December prices grew by 21% year-to-year in California, 18% in Nevada, 27% in Florida and 34% in beautiful Arizona. The real estate market is easing off but the process of geographical divergence seems a long way from ending. Regarding the bubble we may therefore say that, while at the national level there is an impression of some order and rationality, seeing what is happening in extreme cases it is logical to think that in certain households, in spite of their charm, some owners may come out badly.

UNITED STATES: NON-MANUFACTURING BUSINESS EXECUTIVES HAVE SOMETHING TO SAY



SOURCE: Bureau of Economic Analysis, Labor Department and internal figures.

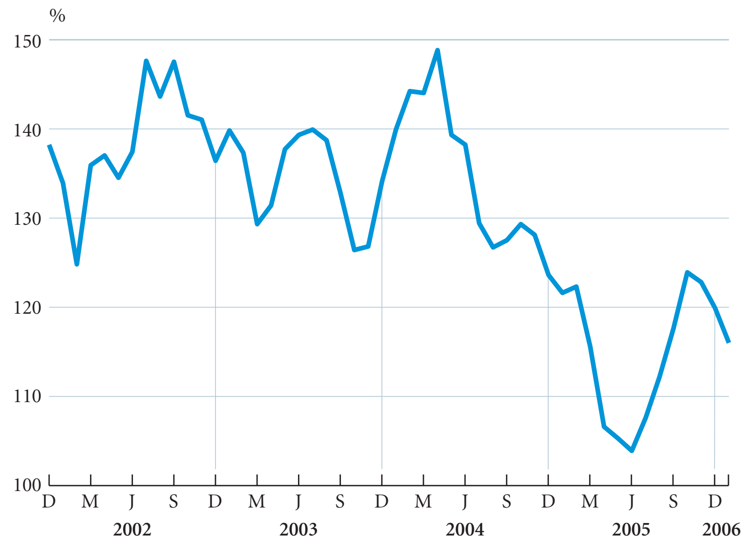
kept moving upward. The lower degree of swings in business sentiment and the maintenance of this sentiment have been helping to reinforce the feelings of confidence of Ben Bernanke.

Inflation still not showing problems.

This positive view is strengthened by news of a slight slowdown in the real-estate sector and the trend in prices in the past month. Thanks to moderation in energy prices, the growth of the consumer price index in February went from 4.0% to 3.6% year-to-year but what was more significant was maintenance of the increase in the core component (excluding food and energy) at 2.1%. Producer prices were down in February with the year-to-year change going from 5.7% to 3.8%. For the moment, it would seem we can ask for little more.

PORTFOLIO INVESTMENT IN UNITED STATES FINANCING TRADE DEFICIT

Net investment in financial assets in terms of trade deficit (*)



NOTES: (*) 12-month moving average. Above 100, net inflow of investment exceeds trade deficit.
SOURCE: Treasury Department and internal figures.

The labour market continued to show the sustained improvement of recent months with 243,000 new jobs in February and moderate year-to-year growth of 1.5%. What is most significant is the maintenance of purchasing power of wages, which although they did not recover the levels in 2003 and 2004 at least stopped dropping.

Where doubts arise about the economic boom is in the foreign sector which grows somewhat darker because of the budgetary prospects mentioned above. The deficit in the current account balance reached 7.0% of the GDP in the fourth quarter of 2005 while the negative trade balance continued to break records in February. Apart from the constant growth from this imbalance lies the question of how it is financed. While in January and February the net inflow of portfolio investment was lower than the trade deficit, up to now the US economy has still been able to attract sufficient capital to finance the foreign sector deficit given that net inflows of portfolio investment in the past 12 months was 16% higher than the trade deficit. Once again, doubts arise not about the present situation, which is good, but about the possibility that in the near future, bigger difficulties in foreign financing could coincide with a possible budgetary imbalance which could be the end of the present *status quo*.

United States financing trade deficit without any problem but margin now narrower.

Japan follows the growth sun

Japan maintaining growth.

Growth in Japan continues strong although the central bank and the government have not yet come to any agreement. The former, in line with its conviction that deflation is over, is planning to end its policy of easy money. The problem will be the following logical step that would imply interest rate increases which would not be to the liking of the government in a country whose public debt is higher than the GDP.

Japan's growth would appear to be well established and the trend in the nominal

Consumption remains strong, foreign sector improving but investment slowing down.

GDP, the original figure, apart from the recent polemical hypotheses regarding prices, is the best indicator of this (with growth of 2.6% year-to-year in the final quarter of 2005) and a solid trend to recovery.

Growth of the GDP in the fourth quarter in real terms was revised slightly downward from 4.5% to 4.3% year-to-year. The amount of the revision does not seem to be overly important but the revision by components is another matter given that Japan is consuming more and investing less. Private consumption in the same period went on increasing at 3.2% to a figure of 3.5%, which continues giving support to recovery, something which was not the case in times past. Nevertheless, in terms of the previous quarter, annualized growth of private investment in capital goods dropped from 7.2% to 1.4%. The downward revision of investment also took place, although to a lesser extent, in the three previous quarters and is putting a somewhat lower ceiling on the growth rate.

With end of deflation, Japan's sun shining but normalization of energy prices could darken it.

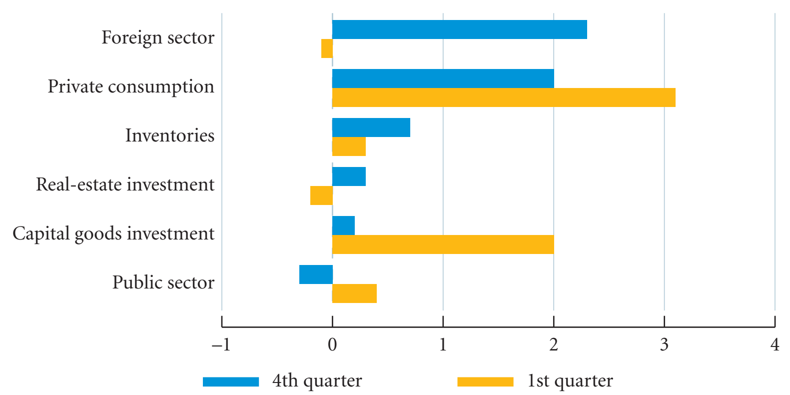
Along these lines, the contrast between growth in the first quarter and the last quarter of 2005, also indicates that it may be reaching highs with growing dependence on the foreign sector and once more with lower investment. Quarter-to-quarter growth figures for the overall economy are very similar but the contribution of the various components has drastically changed. Private consumption, while lower, is holding up but capital goods investment, which at the beginning of the year was contributing 40% of all growth, is now only showing 4%. The foreign sector has changed from being a brake on the growth engine and is thus replacing capital formation in that area. Along the same lines, we see real-estate investment and inventories although the increases are much lower.

Demand indicators in January looked very grey. Retail sales were stagnant and industrial production moved down with growth of 2.0% while the trend in the real-estate market continued to show a moderation in prospects without a severe break, there being decreases in housing starts, slight decreases in prices and a major drop in sales in Tokyo.

Inflation is providing the most joy at the start of the year. For the first time in five

JAPAN: INVESTMENT DOWN WHILE CONSUMPTION HOLDING UP

Contribution to quarter-to-quarter growth annualized of GDP, as percentage



SOURCE: Japanese Ministry of Communications, National Office of Statistics and internal figures.

JAPAN: MAIN ECONOMIC INDICATORS

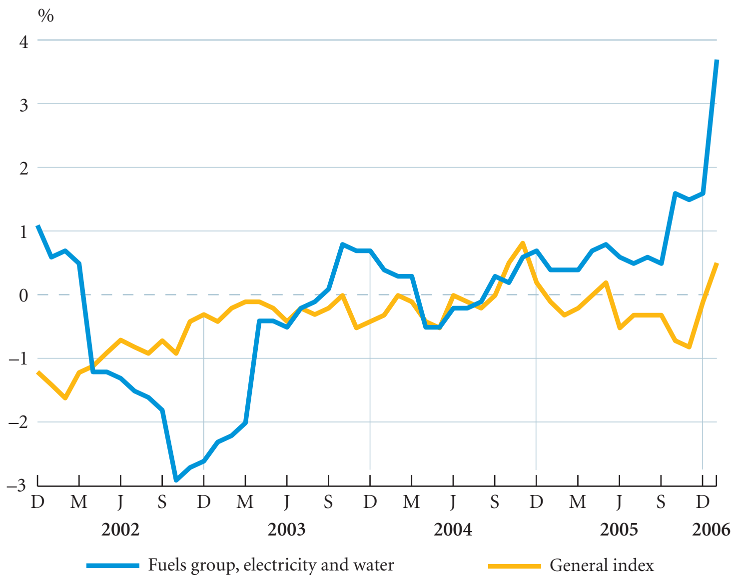
Percentage change over same period year before unless otherwise indicated

	2004	2005	2005				2006
			1Q	2Q	3Q	4Q	January
Real GDP	2.3	2.7	1.1	2.7	2.8	4.3	–
Retail sales	–0.9	1.4	0.6	3.1	1.1	0.7	0.0
Industrial production	5.3	1.7	2.7	0.3	0.2	3.8	2.0
Tankan company index (*)	20.5	18.0	14.0	18.0	19.0	21.0	–
Housing construction	2.6	3.8	1.4	2.2	4.9	6.9	–2.4
Unemployment rate (**)	4.7	4.4	4.5	4.3	4.3	4.5	4.5
Consumer prices	0.0	–0.3	–0.2	–0.1	–0.3	–0.5	0.5
Trade balance (***)	13.8	10.3	13.2	12.1	10.9	10.3	9.9

NOTES: (*) Value.
(**) Percentage of labour force.
(***) Cumulative balance for 12 months. Billion yen.
SOURCE: OECD, national statistical bodies and internal figures.

JAPAN: END OF DEFLATION OR RISE IN ENERGY COSTS?

Year-to-year change in consumer price index



SOURCE: Japanese Ministry of Communications, National Statistics Office and internal figures.

years prices are growing above the levels of last year, which means getting out of the vicious circle which was curbing the propensity of consumers to buy. The January CPI grew by 0.5% year-to-year while the component, excluding volatile foods, was also up to the same extent.

But satisfaction is never complete. Leaving apart the lack of any correspondence between the CPI and the GDP deflator, the rise in January was greatly helped by the increase in energy prices which made the component of fuels, electricity and water grow by 3.7%

year-to-year, a rate not seen since the first Gulf war. This situation would indicate that along with the likely moderation in an increase in energy prices, drops in the general index are possible.

In the foreign sector, which had been improving in 2005, January showed a downward trend. The trade surplus dropped by 39% year-to-year although the positive side was to be found in that the reduction was due more to the strength of imports than to weakenss in exports. According to initial statistics for February, exports were up and helped slow down the drop in surplus.

China growing at 9.9% but investment has priority over consumption.

China growing but many Chinese miss out

On March 5, the budget for 2006 was presented at a moment when China was going through one of the best periods of growth in its history with an economy growing by 9.9% year-to-year in the fourth quarter and inflation under control, if we are to go by official figures. Nevertheless, prime minister Wen Jiabao was a troubled man because something wasn't working. Consumption represented only 39% of the economy, well below the pattern in the rest of the world and much of the blame for that lay in the growing inequality between the country and the cities. Some 800 million rural Chinese are not participating at all in the increase in wellbeing and wealth of recent years and practically cannot be counted as consumers.

Gap between rich and poor and between country and city requires reform and threatening stability.

China's budget for 2006 increases the allocation for easing rural poverty to 8.9% of the total figure, going up to 42 million dollars. However, there are too many beneficiaries and the improvement will mean only 7 dollars more per person per year. neither do other measures approved bring about major changes. The reduction in farm taxes will mean another 19 dollars per person per year while increased spending on education will have limited effect.

The problem is an institutional one in three basic senses. In the first place, defence of property rights in farm land is very weak. Secondly, budgetary resources are managed by local governors whose interests in many cases are doubtful. Thirdly, the lack of freedom is obvious in that it is practically obligatory for people to stay in the country and there are many difficulties in the way of moving to the cities. These rural dwellers are obliged to that life in a country with little arable land per capita and low farm productivity. Thus, with pending reforms

CHINA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

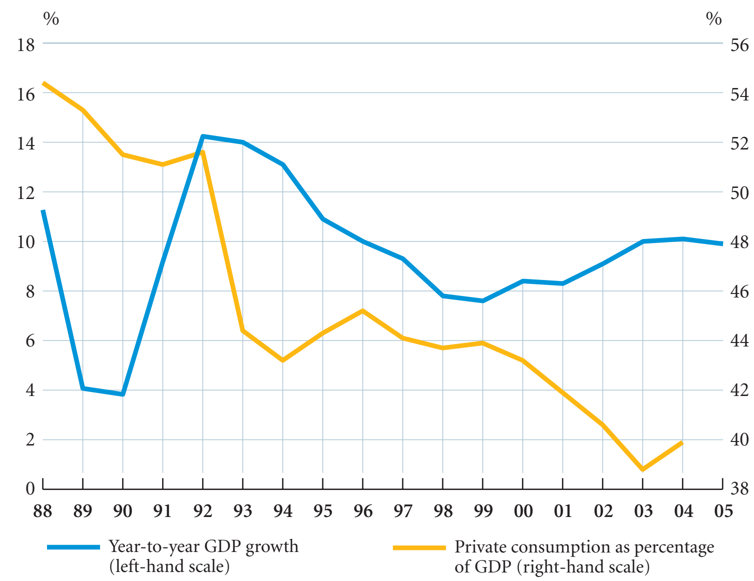
	2004	2005	2005				2006	
			1Q	2Q	3Q	4Q	January	February
Real GDP	9.5	9.9	9.9	10.1	9.8	9.9	–	...
Industrial production	16.3	15.9	14.5	16.5	16.2	16.4	12.6	20.1
Electrical power production	15.0	13.4	14.7	13.7	13.6	11.8	7.8	22.5
Consumer prices	3.9	1.9	2.8	1.7	1.7	1.4	1.9	0.9
Trade balance (*)	32.1	101.5	57.2	79.5	96.1	101.5	104.5	102.6

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

SOURCE: National Statistics Office of China, Thomson Financial Datastream and internal figures.

CHINA LACKS 800 MILLION CONSUMERS

Comparison between GDP growth and quota representing consumption



SOURCE: Chinese National Statistics Office.

consumption will continue behind investment, the trade surplus will keep growing, tensions arising from the surplus with the United States will continue and Wen Jiabao will have to do better.

Latest GDP figures give a picture of continuity. In the lead we still see investment and the industrial sector which, with 11.4%, is growing well above services and agriculture. Along similar

Heavy industry continues as sector showing most growth.

IN CHINA IT IS BETTER TO LIVE IN THE CITIES

Retail consumption in rural areas compared with that in cities

SOURCE: Chinese National Statistics Office.

Trade balance stabilizes but China has deficit with Asia and surplus with Europe and United States.

lines, industrial production which because of the effect of the new Chinese year had moderated its strong progress in January, rose again and settled into levels close to the 16% which is becoming normal. Heavy industry continues as the sector to show most growth with the state-run companies stuck at a share of close to 40% of the total.

Demand indicators also echo the agricultural problems and, although retail sales continue to move up strongly, they are always doing so behind the industrial indicators, and growth of consumption in the urban areas is higher than rural consumption. Price stability is complete and, even if we have doubts about official figures, the increase of 0.9% year-to-year in the CPI in February would suggest inflationary pressures are far off. Food, the component showing the highest rise, was up by 1.2% whereas at the middle of 2004 it rose by 10%.

In the foreign sector, the trade surplus for February (2.45 billion dollars) was the smallest since the summer of 2004 and may be seen as leaving behind the explosive growth in 2005 with stabilization at a level somewhat above 100 billion dollars in annual terms. The problem of China's trade surplus is clearly reflected in the increase in savings in the emerging countries compared with the rich countries. China's trade deficit with Asia in the 12 months ending in January reached 76 billion dollars, a deficit compensated by growing surpluses with the United States (117 billion dollars) and Europe (71 billion dollars), and it is here that it is doing damage.

Mexico is growing and also investing

Mexico maintaining growth thanks to domestic demand.

The Mexican economy grew by 2.7% year-to-year in the fourth quarter of 2005. While domestic demand continues to show something of a growth trend, it is the foreign sector that is undermining growth and, at the same time, making Mexico an atypical country in the region, more like the rich nations with a current account deficit than the other economies in Latin America which, at this time, are combining economic growth with positive foreign balances. Mexico's special situation within the framework of the free trade agreement with United States and Canada (NAFTA) puts it in a unique position which, although it helps maintain a favourable trade relation, also involves a loss of competitiveness. This is a weakness that, for now, is compensated by another important factor which has supported growth in recent months, namely oil exports which in two years have practically doubled in monetary terms.

Investment at all-time highs in relation to GDP and industry recovering.

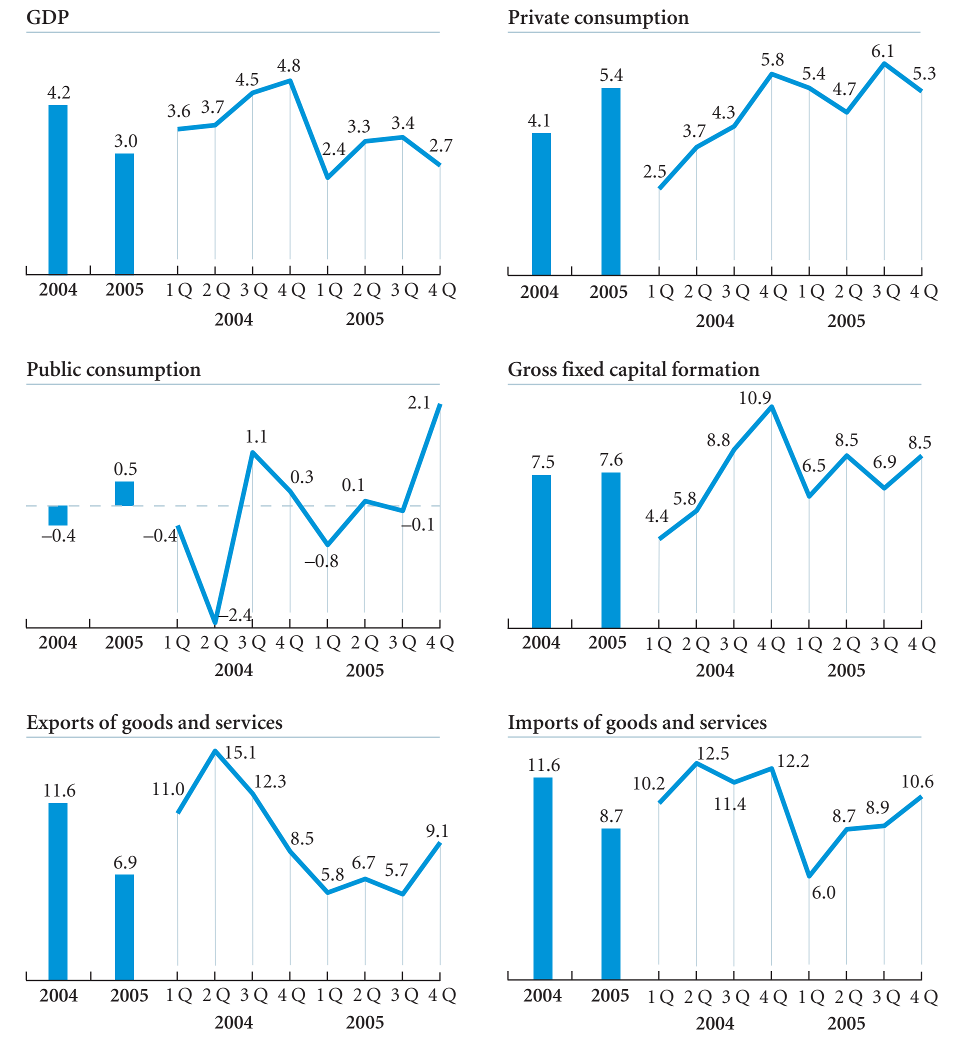
While the deficit in the foreign sector and the dependence on oil make up the risks for the economy, the strongest point is gross capital formation which, in terms of the GDP, now stands at 21%, an all-time high, which makes Mexico the biggest investor in Latin America. Transportation, construction and finance are the sectors showing most growth.

On the supply side, confirming the strength of investment, industrial production in January showed a marked rise with growth of 6.0% year-to-year. This move, which took place mainly in manufacturing, came on top of the good performance that the machinery and metals sector showed in the national accounts for the fourth quarter.

Inflation showed a positive performance. The general index was 3.7% year-to-year in February but most significant was that the core component held at 2.9%, dropping below the 3% level for the first time since the index was established in

TREND IN MEXICO'S GDP BY COMPONENT

Percentage year-to-year change in real terms



SOURCE: Central Bank of Mexic and internal figures.

MEXICO: MAIN ECONOMIC INDICATORS

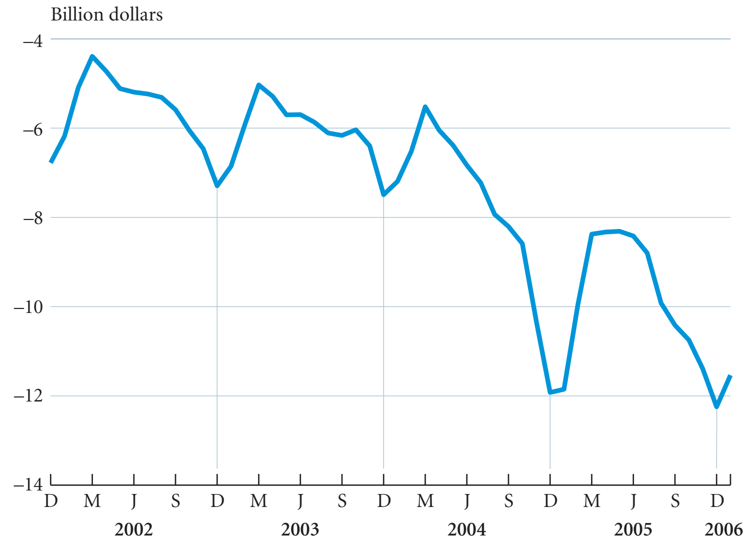
Percentage change over same period year before unless otherwise indicated

	2004	2005	2005				2006	
			1 Q	2 Q	3 Q	4 Q	January	February
Real GDP	4.2	3.0	2.4	3.3	3.4	2.7	–	...
Industrial production	4.2	1.6	–0.4	3.1	0.8	2.7	6.0	...
General unemployment rate (*)	3.7	...	3.9	4.0	3.8	...	...	...
Consumer prices	4.7	4.0	4.4	4.5	4.0	3.1	3.9	3.7
Trade balance (**)	–8.8	–7.6	–10.2	–9.7	–9.4	–7.6	–6.0	...

NOTES: (*) Percentage of labour force.
(**) Cumulative balance for 12 months. Billion dollars.
SOURCE: Central Bank of Mexico.

TRADE DEFICIT STILL NOT HITTING BOTTOM

Cumulative 3-month figure for trade balance not including oil exports



SOURCE: Banco Central de México and internal figures.

Competitiveness being lost and trade deficit fails to hit bottom.

1983. The only cloud in the good picture of prices was in unit labour costs that grew by 7.8% year-to-year in January, which means a loss of competitiveness and an increase in pressure on the foreign sector already in deficit.

The foreign sector, although it broke with the negative trend in recent times, remains without improvement. In the 12 months ending January, the trade deficit was 6 billion dollars, a notable improvement since mid-2005, largely aided by major oil exports. Nevertheless, if we exclude the oil component, the foreign sector is still failing to hit bottom with a deficit close to 40 billion dollars for the last 12 months.

Raw materials: prices rising

Oil prices again rise in first quarter of 2006.

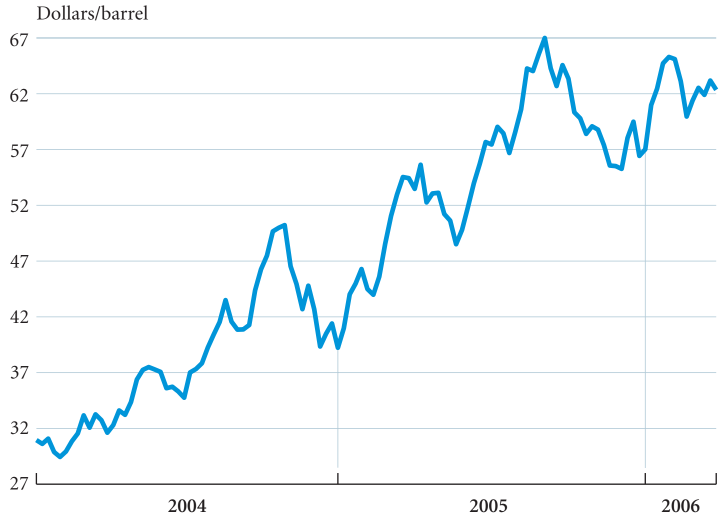
Following the relative breather in the price of oil in the fourth quarter of 2005, in the first three months of the current year prices have gone back, returning to levels of above 60 dollars a barrel for 1-month forward Brent quality oil. At the end of March, the price was 62 dollars, 17% more than that recorded one year earlier.

The factors behind maintenance of these levels, which are historically high, are not anything new. World demand for oil, in spite of the prospect of some moderation in major markets such as that of the United States, will continue to grow in 2006 above the forecast increase in supply. Geopolitical uncertainty remains high given that, on top of the continuing conflict in Iraq, there is the tension between the Western countries and Iran and the background instability which continues to exist in Nigeria.

Finally, the attitude of the Organization of Petroleum Exporting Countries (OPEC) continues to be one of vigilance regarding any sign of an excessive correction of prices. The OPEC announcement on March 14, that it would take action in the market when oil moved away from the price range of

OIL PRICES RISE AGAIN

One-month forward price for Brent quality oil as weekly averages



SOURCE: Thomsom Financial Datastream.

RAW MATERIALS PRICES

	2004	2005	2005				2006		
			1 Q	2 Q	3 Q	4 Q	January	February	March
«The Economist» index in dollars (*)									
General	**17.4**	**3.6**	**–2.3**	**–1.8**	**6.2**	**12.1**	**19.8**	**22.2**	**11.7**
Food	11.2	–1.3	–8.5	–7.7	3.2	8.0	12.6	14.3	2.4
Industrials	26.1	9.7	5.9	6.3	10.0	16.8	28.0	31.3	22.8
Non-food agricultural	*9.2*	*–1.9*	*–10.7*	*–8.6*	*0.8*	*10.9*	*16.9*	*17.4*	*13.0*
Metals	*38.2*	*16.5*	*16.1*	*15.5*	*15.0*	*19.5*	*33.3*	*37.9*	*27.4*
«The Economist» index in euros (*)	**6.7**	**4.0**	**–6.4**	**–6.0**	**6.6**	**22.0**	**30.0**	**32.8**	**23.3**
Oil (**)									
Dollars/barrel	38.0	55.1	47.8	53.1	62.0	57.7	63.5	61.9	62.5
Change rate	34.4	46.5	52.7	50.9	52.5	29.9	44.2	34.8	17.3
Gold									
Dollars/ounce	409.6	445.1	427.3	427.8	439.6	485.6	549.3	555.6	552.3
Change rate	12.7	8.6	4.6	8.6	9.4	11.9	29.5	31.1	27.3

NOTES: (*) Year-to-year change rate.
(**) Brent quality: one-month forward price.
SOURCE: «The Economist», Thomson Financial Datastream and internal figures.

55-65 dollars a barrel, must be understood in this sense. For the moment, the latest OPEC meeting ended with a decision to maintain official production quotas unchanged (that is at 28 million barrels a day) in order to deal with both the effects of the geo-strategic problems mentioned earlier and the

Other raw materials, with metals in lead, not free of upward trend arising from continued demand pressure.

pumping difficulties recently being experienced in Russia and Norway.

Apart from oil, raw materials are holding to an equallty notable growth path. In March, *The Economist* index stood at a growth rate above 11% year-to-year mainly as a result of the drive in industrial raw materials. In the latter group the notable leadership came in metals which overeall added up to a year-to-year increase scarcely below 30%. Apart from the case of gold, which continues to benefit from its nature as a reserve asset, the basic reason for this rise was the notable drive in demand now being shown.

EUROPEAN UNION

Euro area: dip in fourth quarter left behind

At this stage of the year, two questions arise. First, in the fourth quarter of 2005 growth was disappointing. Second, this relative let-down was corrected in the first quarter of this year. All of this strengthens the recovery scenario which is showing a profile of progressive growth so that, starting out the 1.7% in the fourth quarter of 2005, by the end of the current year it would be growing at levels close to 2% year-to-year.

With regard to the first point, the breakdown of growth into components in the fourth quarter show that the moderate rise in the gross domestic product (GDP) in the fourth quarter (1.7% as against 1.6% in the third quarter) was largely due to the drag from private consumption which showed a reduction in growth rate to less than half. On the other hand, the remaining components of domestic demand (with investment especially strong) moved up. In line with the improvement in recent quarters, the foreign sector made its first positive contribution to the change in GDP since the second quarter of 2004.

Euro area consolidating recovery in first quarter of 2006 thanks to rise in investment and foreign sector.

On what do we base our view that this weak fourth quarter did not spoil the prospects for recovery in 2006 as a whole? To start off with, the background factors of a fundamental kind, remain favourable. In the first place, financial terms are still good in spite of the hardening of monetary policy. Secondly, the trend in corporate profits remains positive.

Favourable financial terms and positive trend in corporate profits building up scenario of increasing recovery.

Furthermore, over the shorter term, the recent trend in current indicators has

EURO AREA: MAIN ECONOMIC INDICATORS

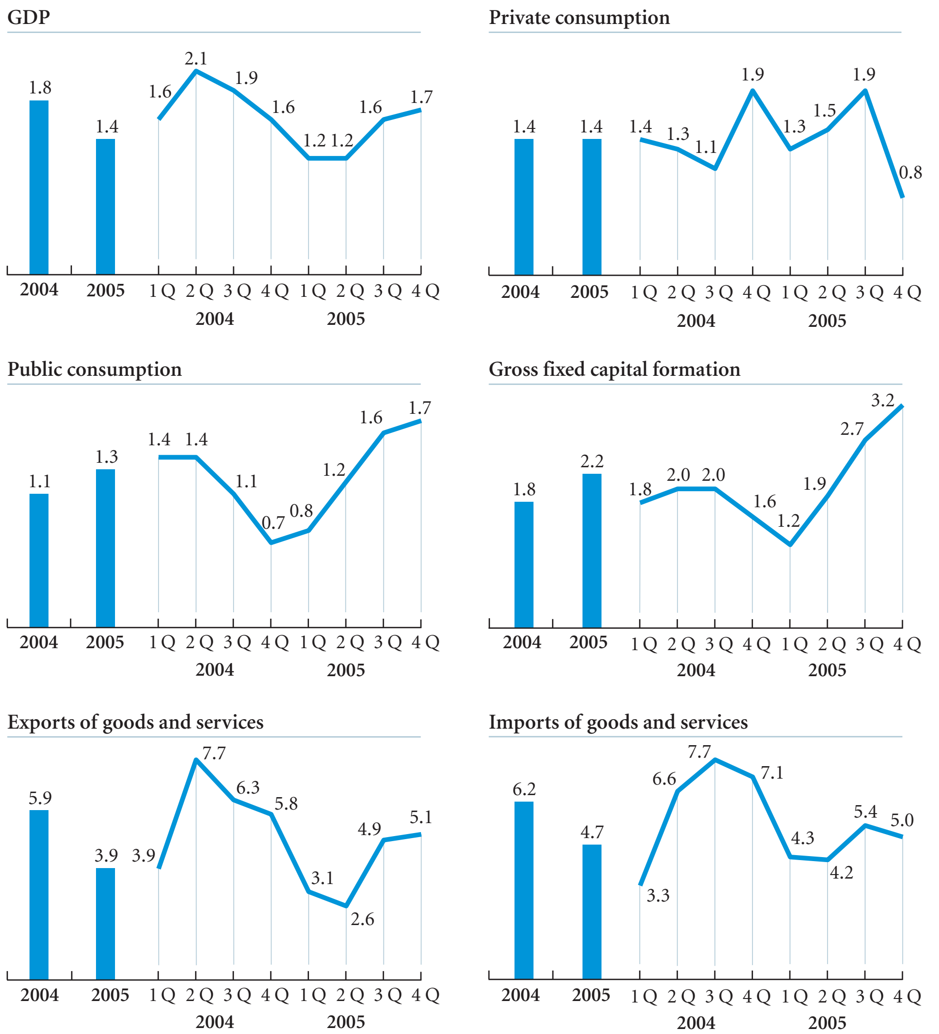
Percentage change over same period year before unless otherwise indicated

	2004	2005	2005				2006	
			1 Q	2 Q	3 Q	4 Q	January	February
GDP	1.8	1.4	1.2	1.2	1.6	1.7	–	...
Retail sales	1.1	0.9	1.3	0.7	1.1	0.5	1.0	...
Consumer confidence (*)	–14	–14	–13	–14	–15	–12	–11	–10
Industrial production	1.9	1.2	0.6	0.7	1.5	2.0	2.5	...
Economic sentiment indicator (*)	99.4	98.1	98.7	96.1	97.7	100.1	101.5	102.7
Unemployment rate (**)	8.9	8.5	8.8	8.6	8.4	8.3	8.3	...
Consumer prices	2.1	2.2	2.0	2.0	2.3	2.3	2.4	2.3
Trade balance (***)	80.4	45.7	64.4	50.2	39.4	28.8	...	...

NOTES: (*) Value.
(**) Percentage of labour force.
(***) Cumulative balance for 12 months. Billion euros.
SOURCE: Eurostat, European Central Bank, European Commission and internal figures.

TREND IN GDP IN EURO AREA BY COMPONENT

Percentage year-to-year change



SOURCE: Eurostat and internal figures.

been satisfactory, given that, while the present engines of growth (investment and exports) remain active, consumer indicators for the first time in a long period are pointing upward. Specifically in January, retail sales doubled the growth rate in the fourth quarter. The recovery of consumer confidence as of February, a month when it stood at the highest level since September 2002, makes it possible to expect a continuation of this positive trend.

Increase in oil prices still main factor behind current inflation level.

Supply indicators have now hammered in the shining nail of confidence. Economic sentiment in February reported its third consecutive month on the rise showing the highest figures since mid-2001. This rise was largely due to the better state of industry, as shown both by sector confidence indicators and those for real economic activity (industrial production grew by 2.5% year-to-year in January, compared with 2.0% in the fourth quarter of 2005).

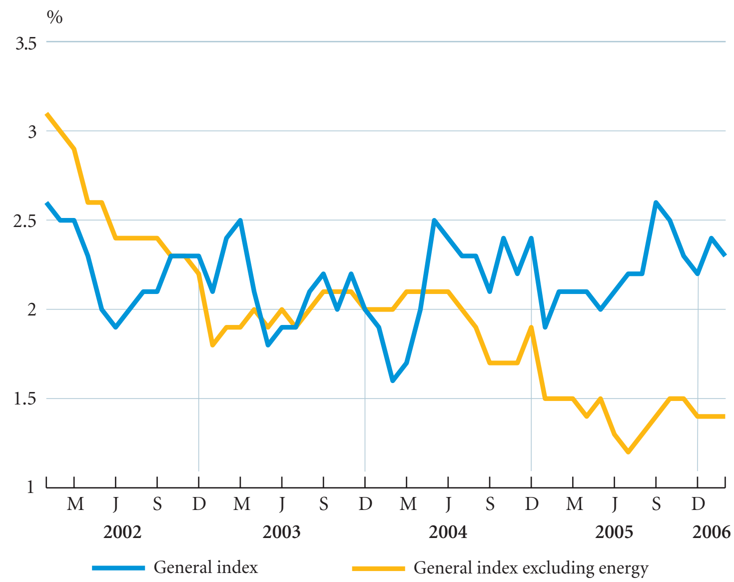
There are fewer new factors on the prices and unemployment fronts. Whereas unemployment rates in the euro area held at 8.3% of the labour force in January, with no change over December, consumer prices lost part of the rise seen in January and in February stood at 2.3% year-to-year. The slowdown was not greater because the energy contribution is holding at very high levels, as shown by the fact that the resulting rate (discounting energy) stood at a modest 1.4%.

This stage of recovery should not paint a picture of complaisance about the European economy. At the meeting of the Council of Ministers of Economy and Finance on March 14 the economists André Sapir and Jean Pisani-Ferry presented a report on the trend in the Lisbon Agenda (the medium-term economic programme of the EU that brings together measures to improve its growth potential). The result is not very encouraging and it would seem especially alarming that the institutional measures proposed a year ago to improve the operation of this strategy are scarcely being implemented. For example, only 11 of the 25 member states have named national representatives responsible for structural reforms.

Apart from immediate improvement, background economic problems in euro area not going away because of difficulties in moving ahead structural reforms.

ENERGY MAIN INFLATION FACTOR IN EURO AREA

Year-to-year change in harmonized consumer price index



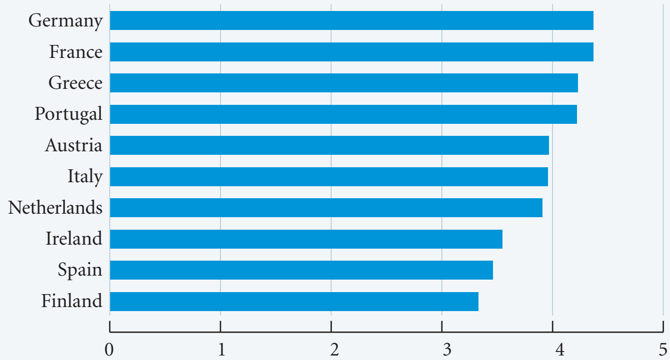
SOURCE: Eurostat and internal figures.

European mortgage market, not a very common market

John Smith wants to buy a house in London. To do so, he needs a mortgage loan. Could we imagine him carrying out such a financial transaction outside of the United Kingdom? Probably not. Will he find cheaper mortgages with better advantages in the United Kingdom? Certainly not. But most likely he will go to some local lending institution. In fact, less than 1% of mortgages signed in the European Union in 2003 were cross-border in nature, that is to say, the institution granting the loan was in a country other than that of the borrower. While in recent years there has been some trend to convergence, the European mortgage market is still characterized by a high degree of fragmentation. This is due to the fact that borrowers prefer to deal with someone face-to-face and sign a deal for which the legal framework is familiar. On the other hand, lenders may feel that anyone going abroad for a mortgage has likely been rejected by local institutions because of financial insolvency. But the problems do not end there.

SPANISH MORTGAGE INTEREST RATES AMONG LOWEST IN EURO AREA

Mortgage interest rates for home purchase (harmonized), as annual percentage.
December 2005



SOURCE: Eurostat.

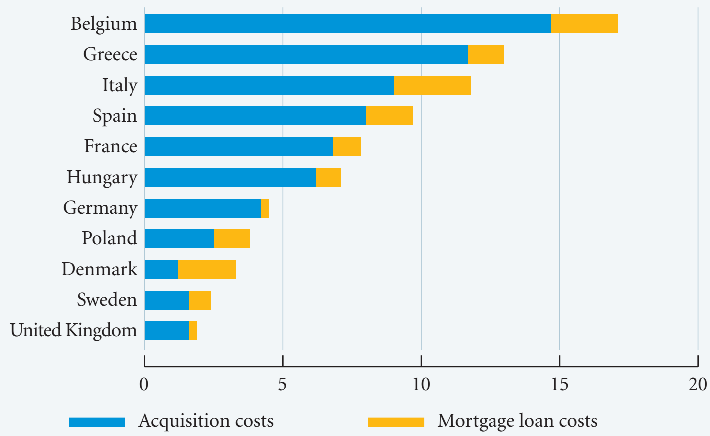
In the European market, the range of mortgage loans and their characteristics now available to the public is very different depending on each country. They may differ according to whether they are of fixed or variable interest, according to maximum amount of loan in relation to house valuation, depending on term, the borrower's needs, whether or not they allow the borrower to obtain loans for other needs against the part of the principal already paid off using the house as security and whether there is the possibility of early repayment. Furthermore, there is a wide range of methods of calculating interest rates, the frequency these can be adjusted and repayment terms. They may also include options such as maximum limits for interest rates and repayments may be linked to trends on the stock market. At the same time, there may be special mortgages which as those granted for buying rental properties or those linked to a pre-purchase savings plan. The greatest range of mortgage plans is generally to be found in the most developed mortgage markets as this provides access to mortgage loans to the largest segments of the population.

In the European Union the size of the mortgage market changes greatly, depending on each member state. According to the European Mortgage Federation, home mortgage borrowing in relation to the gross domestic product swings from 111% in the Netherlands, 90% in Denmark and 73% in the United Kingdom to 2% in Slovenia in 2004. There are also big differences in terms of population. Residential mortgage borrowing per capita in 2004 varied from 32,290 euros in Denmark to 190 euros in Slovenia. Spain occupied an intermediate place with 9,080 euros.

With regard to mortgage interest rates, in recent times there has been some convergence, this being notable in the euro area since the introduction of the single currency. Mortgage spreads over reference interest rates are very similar in the euro area but naturally there are wide differences in the European Union as a whole.

WIDE RANGE OF TRANSACTION COSTS IN BUYING A HOME IN EUROPE

Transaction costs as percentage of total cost of buying a house. 2004 (*)



NOTES: (*) In purchase of a typical house, commissions to real-estate agents not included.
SOURCE: European Mortgage Federation.

In the area of transaction costs related to the buying of a house there are also big differences. According to a recent study by the European Mortgage Federation, transaction costs (taxes and legal costs) incurred in buying a house amount to 17% of the total cost in Belgium whereas in the United Kingdom they come to less than 2%. The greater part of these costs is for taxes which in Belgium, for example, make up 13% of the cost of buying a house.

With regard to the obstacles working against greater integration of mortgage markets in the European Union, a recent study commissioned by the European Commission to the London Economics consulting house classified these according to availability of loan products, the development of the secondary mortgage market and the entry of foreign financial institutions.

With regard to obstacles in the way of a wider range of mortgage loan products, it was found that many countries put legal restraints on specific aspects of such products. For example, in some countries there are restrictions on the adjustment of variable interest rates and maximum rates.

With regard to the development of the secondary mortgage market, which is still very fragmented, it was pointed out that in various countries bank regulations go against the use of secondary market instruments for financing mortgages while favouring deposits. It was also pointed out that in some member states there is no legislation covering mortgage bonds and that there are no minimum standards in Europe. In spite of this, in some member states securitizations and issues of mortgage bonds have grown rapidly.

With regard to obstacles in the way of the entry of foreign financial institutions, regulations drawn up for the creation of a single financial market guarantee the free establishment of financial institutions. Nevertheless, serious legal and regulatory barriers do exist. For example, there continue to be big differences in national systems for the valuation of houses and the registering of mortgage securities. This makes the evaluation of risk in a mortgage loan difficult for foreign institutions which do not know all the national idiosyncrasies. In addition, while introduction of the euro in 1999 eliminated exchange rate risk in twelve member states of the European Union, the existence of different currencies in the other countries does not facilitate market penetration by foreign institutions.

The London Economics study mentioned earlier estimates that the integration of European mortgage markets, by increasing the availability of products to the existing maximum and reducing interest rate spreads to the minimum would make it possible to increase consumption in the European Union by 0.5% by 2015. In order to achieve greater integration there are various means and a number of recommendations are made. But it is difficult to reach a consensus. For example, the recommendations of consumer organizations working to defend consumer rights do not always coincide with those put forward by sector representatives. In this framework, it is hoped that in 2006 the European Commission will adopt legislative measures promoting higher levels of integration in the mortgage market than now exist. In any case, some time is likely to go by before John Smith or François Dupont or José Pérez will be able to enjoy the advantages a European mortgage market could provide.

Germany: government goes into action

German government approves 3-point increase in VAT starting in 2007 along with first budget.

The German government has decided to go to work. After several months of announcing important measures in economic policy, the government began to take action. First of all, on February 22 it approved an increase in the value added tax of 3 points (from 16% to 19%) which comes into force in 2007. On the same day, it adopted the first budget of the «Grand Coalition», that for 2006, in which the main emphasis is on control of spending which will increase by only 0.7% over 2005. This adjustment, however, has been considered insufficient by the Council of Ministers Economy and Finance of the EU which has urged Germany to put the public deficit at 3% of the GDP in 2007 at the latest (in 2005 the deficit was 3.3% of the GDP).

Reform of public pension system seeks to reduce costs by delaying retirement age, freezing pensions and maintaining those over 50 in labour market.

Later, on March 9, the Minister of Labour, Franz Müntefering, set out the reforms planned for the pension system. The main aspects are raising the legal retirement age from 65 to 67 years (a progression to be made one year at a time, completing the process in 2030), the freezing of incomes retired persons receive in nominal terms until 2009 (which represents a drop in real terms) and a programme of incentives to keep those over 50 in the labour market (known as Initiative 50+).

These measures, with a heavy cost in political terms, have been taken in a context of a notable resurgence of corporate expectations (the IFO index in

GERMANY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005				2006	
			1Q	2Q	3Q	4Q	January	February
GDP	1.1	1.1	0.6	0.8	1.5	1.6	–	...
Retail sales	2.1	1.1	0.8	2.4	1.5	–0.4	1.7	...
Industrial production	2.4	2.9	1.8	1.9	3.3	4.5	3.2	...
Industrial activity index (IFO) (*)	95.4	95.5	95.0	93.0	95.4	98.6	101.8	103.4
Unemployment rate (**)	10.5	11.7	11.8	11.9	11.7	11.4	11.3	11.3
Consumer prices	1.7	2.0	1.7	1.7	2.2	2.3	2.2	2.1
Trade balance (***)	149	157.1	157.0	154.4	157.2	160.2	158.7	...

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

GERMAN RECOVERY GATHERS STRENGTH

Value of IFO industrial activity index

SOURCE: IFO Institute.

March went to its highest level since 1991) as well those of consumers (consumer confidence in February was at its highest level since 2002).

Furthermore, the improved economic perception is starting to be accompanied by clearer signs of an economic boom. Retail sales in January grew by 1.7% year-to-year in sharp contrast to the drop of 0.4% year-to-year in the fourth quarter. Industrial production in January, for the fifth consecutive month, held above 3% year-to-year. Inflation was down by one decimal in February going to 2.1%. On the other hand, as a reminder of the course still to be covered by the German economy, there is the

Following several months with confidence indicators moving up strongly, real figures are beginning to reflect increased strength of economic activity.

lack of improvement in the unemployment rate which in February was again 11.3%, an historically high level.

France: signs of improvement in the first quarter

In first quarter of 2006 France recovers part of ground lost in fourth quarter of 2005.

Following a disappointing fourth quarter in 2005, the first quarter holds special importance in determining the recovery potential of France. Figures available to date seem to incline the balance to the growth side. Consumer indicators particularly point to an upward move in household spending with domestic consumption moving up strongly in January and February, consumer confidence showing three consecutive months of recovery from December to February and vehicle registrations again also going up to the range of year-to-year increases in February.

Industry and construction indicate better situation while inflation follows European levels with a slowdown in February.

Even the unsteady state of industrial activity seems to be moving onto a recovery path. Industrial production grew by 0.1% year-to-year in January in contrast to a year-to-year drop of 0.4% in December. Furthermore, this is not an isolated figure but comes on top of notable recovery in industrial orders and in industrial confidence. Construction also is showing more positive prospects, going by the renewed strength in building permits.

With regard to inflation, the French economy has not been far from the results seen in the euro area as a whole. In February, the CPI grew by 1.9%, one decimal less than in January but, if we discount the more volatile elements, the resulting rate, as well as being much lower, showed a sharper downward profile going from 1.2% year-to-year in January to 0.8%. The unemployment rate, in turn, held at 9.6% in January, the same figure as in December.

Unions and students protest against new First Job Contract.

In this context of improved prospects, the social protest by unions and student associations resulting from the new First Job Contract represents something of a shock. To start off with, it is weakening the government which was slow to react and ended by offering a chance to negotiate the more controversial aspects of the project. Secondly, it is hurting the confidence of the country in its own possibilities. None of these events should

FRANCE: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005				2006	
			1Q	2Q	3Q	4Q	January	February
GDP	2.1	1.4	1.7	1.0	1.7	1.2	–	...
Domestic consumption	3.2	3.0	3.3	1.7	4.4	2.4	2.1	4.5
Industrial production	1.7	0.0	0.7	–0.3	0.5	–0.8	0.1	...
Unemployment rate (*)	10.0	9.9	10.1	10.1	9.9	9.7	9.6	...
Consumer prices	2.1	1.7	1.6	1.6	1.9	1.6	2.0	1.9
Trade balance (**)	0.1	–1.3	–0.7	–1.2	–1.5	–1.8	–2.0	...

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

hurt economic recovery but it is certainly not positive for a country that still remembers the social disturbances in the suburbs just a few months ago.

Italy: waiting for the elections

Just a few weeks from the elections on April 9-10, the latest economic figures are showing some relief from the disappointments over various months of extreme weakness. While the period of extreme slack in private consumption cannot yet be considered at an end, it seems to be somewhat eased. Retail sales have been up for two months running (November and December) and the recovery of consumer confidence in February brightens the prospect of increased household spending.

Another area that seems to be clearing up is exports. After several months of losing ground, December and January saw a substantial growth in exports which showed an increase of close to 11% year-to-year in January. One result of this increased international activity is the improvement in Italian industry, which is very much oriented abroad. Following negative growth between September and November, in December and January industrial production moved in the growth range of 2% year-to-year, a rate not recorded since January 2001.

With regard to the labour market, the stagnation of the unemployment rate at 7.7% of the labour force between the second and fourth quarters of 2005 suggests that economic activity will have to recover more strongly before bringing any further reductions. On the other hand, there is a better trend in prices which are still contained. In February, the CPI was down by one decimal to stand at 2.1% year-to-year.

With these figures to hand, the immediate prospects are for some increase in economic activity. The index made up of early indicators of the Organization for Economic Cooperation and Development shows two consecutive months (December and January) in recovery, which would indicate a first half-year in 2006 showing moderate growth.

With general elections near, most recent figures for Italian economy are the least disappointing in recent months.

Recovery of exports boosting level of industrial drive while unemployment stagnant and inflation contained.

Recovery expected to gradually consolidate in coming months.

ITALY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005				2006	
			1Q	2Q	3Q	4Q	January	February
GDP	1.0	...	–0.3	0.2	0.1	...	–	...
Retail sales	–0.4	0.4	0.1	–1.2	0.3	1.9	...	...
Industrial production	–0.6	–1.0	–2.7	–1.2	–0.2	0.1	2.0	...
Unemployment rate (*)	8.0	7.7	7.8	7.7	7.7	7.7	–	...
Consumer prices	2.2	1.9	1.9	1.8	2.0	2.2	2.2	2.1
Trade balance (**)	2.0	–5.8	–1.9	–5.1	–7.0	–9.3	–11.8	...

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

Following various poor quarters, consumption may be moving up, going by retail sales and consumer confidence.

Definitive consolidation will require labour market in better state.

Construction, industry and services begin to show better growth rates.

United Kingdom: is consumption recovering?

Private consumption is the subject of sharp examination in recent months. The notable slowdown in British household spending in the second half of 2005 had set off the alarm bells. On top of this, the Christmas season showed a mediocre result. The latest news represents a change of stage, with retail sales moving up in February and consumer confidence marking up three consecutive months (December to February) on the rise. The stabilization of consumer prices at relatively contained prices (in February it was again 2.3% year-to-year with no change over January) represents a further positive factor.

In any case, the final verdict is still up in the air given that the latest bases of consumption continue without either improving (the unemployment rate held at 2.9% in February which represents the fifth consecutive month with no change) or worsening (employment slowed in the fourth quarter to 0.6% year-to-year as against 0.9% in the third quarter).

The signs of incipient recovery also extend to the various sectors of the economy. Construction orders have recovered in the early part of 2006, confidence in services has left behind the relative dip seen in the fourth quarter and even industry, the sector which has long suffered the worse decline, may be changing step. In January, the drop in industrial production was approximately half that recorded in December and the trend in industrial orders and sector confidence (two early indicators) tend to confirm a recovery in secondary industry.

UNITED KINGDOM: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005				2006	
			1Q	2Q	3Q	4Q	January	February
GDP	3.2	1.8	2.0	1.6	1.8	1.8	–	...
Retail sales	6.0	2.0	2.8	1.5	0.8	2.8	1.3	2.1
Industrial production	0.6	–1.9	–1.3	–2.0	–1.6	–2.8	–1.3	...
Unemployment rate (*)	2.7	2.8	2.6	2.7	2.8	2.9	2.9	2.9
Consumer prices	2.2	2.2	2.2	2.2	2.4	2.3	2.3	2.3
Trade balance (**)	–55.6	–63.2	–61.8	–62.9	–63.5	–64.7	–66.0	...

NOTES: (*) Percentage of labour force.
(**) Cumulative balance for 12 months. Billion pounds.
SOURCE: OECD, national statistical bodies and internal figures.

Monetary and capital markets

Bank of Japan announces end of quantitative easing policy

The upward move in interest rates continues. The relaunching of the world economy and the rise in oil and other raw materials, with the resulting possibility of inflationary pressures, is prompting the main central banks to modify the expansionist nature of their monetary policies. As a result, they are setting the bases for removing the excessive world liquidity now existing. The only exception among the major economies is the Bank of England, which is well ahead in the cycle and will likely maintain its official interest rate over coming months.

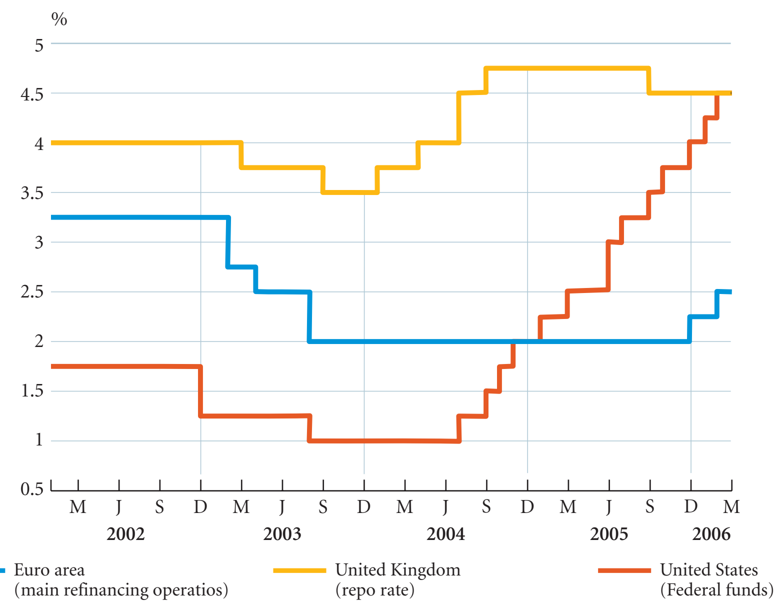
Intervention rates of central banks keep rising.

At the end of February, the Japanese government stated that it would not interfere in the decision of the central bank with regard to a change in monetary policy following some confrontation between a number of institutions relating to the course to be taken on interest rates. In this framework, on March 9, following a meeting of its monetary policy committee, the Bank of Japan announced that it was putting an end to its monetary policy based on setting a quantitative objective for liquidity and that it would again take direct control of the overnight interest rate. In this way, there was official acknowledgement of the relaunching of Japan's economy and the end of five years of deflation.

Japan's monetary policy takes first step toward normal state.

EUROPEAN CENTRAL BANK RAISES REFERENCE RATE TO 2.50%

Monetary policy reference rates



SOURCE: National central banks.

In practical terms, however, short-term interest rates will continue close to 0% for some time seeing that the Japanese central bank indicated that the process of draining off excess liquidity would be gradual and suggested there was going to be a stepped course of interest rate increases. On the other hand, it stated that it felt prices would remain stable if the annual change in the consumer price index stood in the range of 0%-2%.

European Central Bank again raises reference rate...

In turn, on March 2, the Governing Board of the European Central Bank (ECB) held to the expected course and raised the Eurosystem interest rate by 25 basis points to 2.50%. This was the second increase in reference interest rates in three months. This measure was justified by the economic recovery of the area, the major growth of credit to the private sector (which was up by 9.7% in the past 12 months ended January) and because of existing fears of inflation.

As a result, the latest projections by ECB experts put economic growth of the euro area for 2006 in the range of 1.7%-2.5% and 1.5%-2.5% in 2007, slightly above previous figures. With regard to inflation, the projections are also slightly higher than before going to the range of 1.9%-2.5% in 2006 and 1.6%-2.8% in 2007.

SHORT-TERM INTEREST RATES IN NATIONAL MARKETS

Monthly averages as annual percentage

	Euro area			United States		Japan	United Kingdom		Switzerland
	ECB auctions (2)	Euribor (5) 3-month	Euribor (5) 1-year	Federal Reserve Board target level (3)	3-month (5)	3-month (5)	Bank of England repo rate (4)	3-month (5)	3-month (5)
2005									
February	2.06	2.14	2.31	2.50	2.82	0.10	4.75	4.89	0.75
March	2.05	2.14	2.33	2.59	3.03	0.09	4.75	4.99	0.75
April	2.05	2.14	2.27	2.75	3.15	0.08	4.75	4.94	0.76
May	2.05	2.13	2.19	2.99	3.27	0.08	4.75	4.89	0.76
June	2.05	2.11	2.10	3.01	3.43	0.08	4.75	4.84	0.75
July	2.05	2.12	2.17	3.25	3.61	0.09	4.75	4.66	0.75
August	2.05	2.13	2.22	3.43	3.80	0.09	4.53	4.59	0.76
September	2.06	2.14	2.22	3.60	3.91	0.09	4.50	4.60	0.76
October	2.06	2.20	2.41	3.75	4.17	0.09	4.50	4.59	0.81
November	2.06	2.36	2.68	4.00	4.35	0.09	4.50	4.62	0.95
December	2.28	2.47	2.78	4.16	4.49	0.09	4.50	4.64	1.02
2006									
January	2.30	2.51	2.83	4.26	4.60	0.10	4.50	4.60	1.01
February (*)	2.31	2.60	2.91	4.50	4.76	0.11	4.50	4.58	1.09
March (1)	2.56	2.74	3.14	4.50	4.96	0.13	4.50	4.59	1.23

NOTES: (*) Provisional figures.
(1) March 24.
(2) Marginal interest rate. Latest dates showing change in minimum rate: 6-3-03 (2.50%), 5-6-03 (2.00%), 1-12-05 (2.25%), 2-3-06 (2. 50%).
(3) Latest dates showing change: 22-3-05 (2.75%), 3-5-05 (3.00%), 30-6-05 (3.25%), 9-8-05 (3.50%), 20-9-05 (3.75%), 1-11-05 (4.00%), 13-12-05 (4.25%), 31-1-06 (4.50%).
(4) Latest dates showing change: 10-7-03 (3.50%), 6-11-03 (3.75%), 5-2-04 (4.00%), 6-5-04 (4.25%), 10-6-04 (4.50%), 5-8-04 (4.75%), 4-8-05 (4.50%).
(5) Interbank offer rate.
SOURCE: European Central Bank, Thomson Financial Datastream and internal figures.

Within this picture, ECB chairman Jean-Claude Trichet indicated new increases would come in the official interest rate in coming months. He pointed out that, in fact, the present level stood at the lowest point ever recorded by the reference rate of Germany's central bank (which may be considered the antecedent of the ECB) from its creation up to the launching of the euro. There is no doubt that euro area monetary policy continues easy with a real short-term interest rate (that is, discounting inflation) that is just slightly positive. As a result, as is being discounted by the market, it is likely that the reference rate will stand close to 3% at the end of this year.

...and indicates new increases that could put it at 3% in December.

In the United States, the Federal Reserve is expected to raise the objective level of Federal Funds (overnight inter-bank deposits) by 25 basis points on March 28 putting it at 4.75%. And it will likely go to 5% in May. This is the level it is expected to reach that is currently being discounted by the market whereas in the second week of the month it was betting on a high of 5.25% following publication of a higher-than-expected figure for job creation in February. Nevertheless, publication of a mild figure for inflation cooled off upward expectations on interest rates. These again sharpened, however, in the fourth week of March following statements by Ben Bernanke, chairman of the Federal Reserve Board, which showed an optimistic view of the US economy.

Other central banks have joined the upward trend in interest rate in recent weeks. At the beginning of March, the Slovak Central Bank raised its reference rate. On March 2, the Bank of Denmark followed suit. Then, on March 7, it was the Bank of Canada. Finally, on March 16 the monetary authorities of Norway and Switzerland also raised their official interest rates starting out from very low levels.

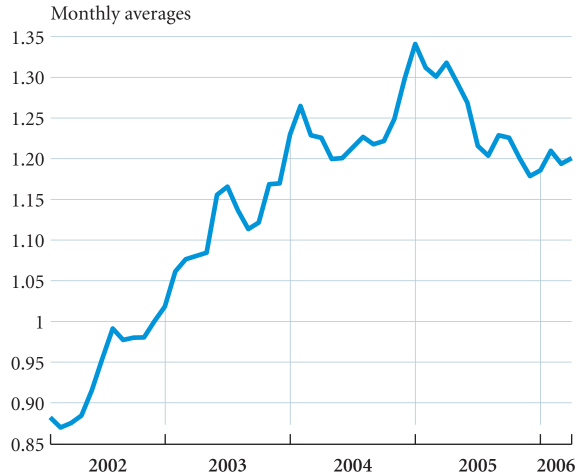
Federal Reserve raises official interest rate to 4.75% on March 28 and this probably not end of upward stage.

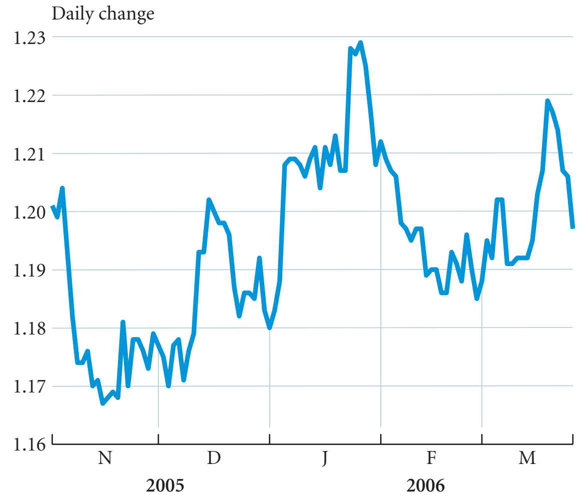
Foreign current account deficit again pushing down dollar

In the second week of March the increased upward expectations on

EURO RECOVERS SOME GROUND AGAINST DOLLAR

US dollars to euro





NOTES: Figures go up to March 24.
SOURCE: OECD, Thomson Financial Datastream and internal figures.

EXCHANGE RATES OF MAIN CURRENCIES

February 2006

	Final session of month		Monthly figures				Exchange rate March 24, 2006
	Exchange rate	% monthly change (2)	Average exchange rate	% change (2) Monthly	Over December 2005	Annual	
Against US dollar							
Japanese yen	115.8	–1.3	117.9	2.0	–0.5	12.3	*117.5*
Pound sterling (1)	1.754	–1.4	1.748	–1.0	0.1	–7.4	*1.742*
Swiss franc	1.311	2.5	1.305	2.1	0.0	9.6	*1.311*
Canadian dollar	1.137	–0.2	1.149	–0.7	–1.1	–7.3	*1.168*
Mexican peso	10.45	0.1	10.48	–0.6	–1.4	–5.9	*10.86*
Nominal effective index (4)	*110.0*	*0.3*	*110.5*	*0.2*	*–1.2*	*0.8*	*111.0*
Against euro							
US dollar	1.188	–2.0	1.194	–1.4	0.7	–8.3	*1.197*
Japanese yen	138.2	–2.8	140.8	0.7	0.2	3.1	*141.5*
Swiss franc	1.566	0.7	1.558	0.6	0.6	0.5	*1.576*
Pound sterling	0.680	–0.7	0.683	–0.4	0.5	–1.0	*0.691*
Swedish krona	9.449	2.1	9.341	0.3	–1.0	2.8	*9.373*
Danish krone (3)	7.461	0.0	7.464	0.0	0.1	0.3	*7.461*
Polish zloty	3.788	–1.3	3.794	–0.7	–1.4	–4.8	*3.908*
Czech crown	28.32	–0.3	28.41	–1.1	–1.9	–5.2	*28.70*
Hungarian forint	253.2	0.2	251.6	0.3	–0.4	3.2	*264.5*
Nominal effective index (5)	*100.2*	*–1.3*	*100.7*	*–0.7*	*0.0*	*–4.2*	*101.5*

NOTES: (1) Units to pound sterling.
(2) Percentages of change refer to rates as shown in table.
(3) Danish krone has central parity of 7.46038 against euro with fluctuation band of ±2.25%.
(4) Broad nominal effective index of US Federal Reserve Board. Calculated as a weighted average of the foreign exchange value of the US dollar against the 26 currencies of those countries with greatest volume of trade with the United States. Base: 1-1997 = 100.
(5) European Central Bank nominal effective exchange rate index for the euro. Calculated as a weighted average of the bilateral value of the euro against the currencies of the 23 main trading partners of the euro area. Base: I-1999 = 100.
SOURCE: Thomson Financial Datastream and internal figures.

Euro moves close to annual high against dollar but later drops.

Federal Reserve interest rates pushed the dollar up to close to the level at the beginning of the year in global terms. Nevertheless, publication of a figure for the foreign current account deficit for the fourth quarter of 2005 that was above 7% of the gross domestic product and a report that showed that net inflows of foreign capital for acquisition of financial assets were lower than the figures for the trade deficit in January for the second consecutive month, weakened the dollar. Furthermore, the figure for inflation in February was lower so that the prospect of a Fed official interest rate above 5% disappeared. As a result, in the third week of the month, the greenback slipped down but still stood above the annual low marked up in the fourth quarter of January. Nevertheless, in the fourth week of March the US currency recovered with renewed upward prospects for the Fed interest rate.

The euro received a boost with the increase in interest rates by the European Central Bank at the beginning of March and with the prospect of further increases. Against the dollar, the single European currency regained the level of 1,21 dollars at the end of the third week of the month, coming close to the annual high in the fourth week in January. Nevertheless, it later lost steam and dropped to 1.20 dollars.

At the end of the third week in March, the pound sterling recorded its lowest level since August 2005 compared with a broad group of currencies. It was precisely last August when the Bank of England reduced its official interest rate following an upward course which had taken it to 4.75%. The British currency is being affected by speculation about a further cut in the reference rate. In recent weeks, while holding up against the dollar, the pound has depreciated against the euro going to the lowest level in the past seven months.

In turn, the yen came close to the annual high of 119 units to the dollar following the decision of the Bank of Japan to soon put an end to its policy of interest rates close to 0%. Nevertheless, the caution taken by the Japanese central bank had its effect on the currency. As a result, the yen lost strength and continued to swing in the range of 115-119 units to the dollar.

Yield on US Treasury bonds marks up highest level since June 2004

In recent weeks, the yield on US Treasury bonds has continued the moderately upward course begun in the middle of last year. As a result, on March 13 it went to 4.78%, the highest level since June 2004 when the Federal Reserve began its restrictive course in monetary policy.

Two factors served to push up the yield on US government bonds, namely, macroeconomic indicators showing the strength of the US economy (with the subsequent increase in upward expectations on Fed interest rates) and then the beginning of the end of Japan's extra-easy monetary policy. Nevertheless, the yield on US bonds later dropped to some extent when operators began to see a 5% ceiling on the Fed official interest rate.

On this side of the Atlantic, the yield on German government bonds rose to 3.70% on March 13, the highest level since March 2005 while also moving along a gradual upward course. The differential with similar US bonds has decreased slightly in recent weeks and it is likely that this will continue for the rest of the year.

Japanese government bonds underwent some ups and downs as a result of the change in the country's monetary policy. The yield on 10-year bonds went up to 1.71% at the beginning of the third week in March , 25 basis points more than two months earlier. Nevertheless, the governor of the central bank, Toshiniko Fukui, did everything possible to calm everyone down by insisting that the changes in monetary policy would be very gradual and the increase in long-term interest rates came to a halt.

The prospect of reduced global easy-money conditions had its effect on emerging markets. The risk premium on emerging country bonds, measured by the JP Morgan EMBI+ index, dropped to an all-time low of 186 basis points against US government bonds at the end of February. Contributing to this were announcements of the repurchase of bonds by the governments of Brazil and Mexico. Later on, however, the differential recovered somewhat.

Pound sterling marks up low against euro in past seven months.

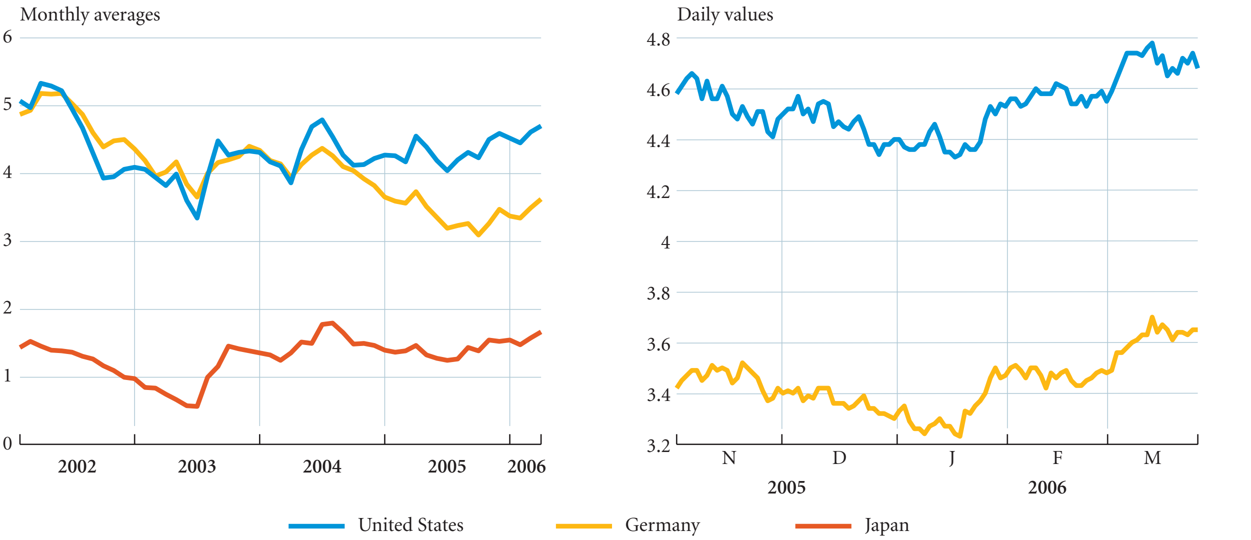
Subsiding prospects of more increases by Fed push down yield on US bonds in third week of March.

Drop in long-term interest rate differential between dollar and euro.

Increase in risk premium on emerging country bonds.

YIELD ON EUROPEAN GOVERNMENT BONDS FOLLOWS IN WAKE OF US BONDS

Yield on 10-year government bonds as annual percentage



NOTES: Rates go up to March 24.
SOURCE: Bank of Spain and Thomson Financial Datastream.

LONG-TERM INTEREST RATES IN NATIONAL MARKETS

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

	2003	2004	2005				2006		
			1 Q	2 Q	3 Q	4Q	January	February	March 24
United States	4.04	4.31	4.34	4.21	4.25	4.54	4.45	4.61	4.68
Japan	0.99	1.50	1.41	1.28	1.36	1.53	1.47	1.57	1.72
Germany	4.10	4.07	3.63	3.35	3.19	3.37	3.34	3.49	3.65
France	4.13	4.10	3.64	3.38	3.23	3.39	3.34	3.51	3.69
Italy	4.24	4.24	3.75	3.53	3.40	3.56	3.55	3.70	3.88
Spain	4.12	4.10	3.63	3.36	3.18	3.37	3.33	3.48	3.66
United Kingdom	4.53	4.93	4.72	4.50	4.32	4.34	4.12	4.21	4.33
Switzerland	2.47	2.57	2.15	2.04	1.90	2.05	2.02	2.18	2.42

SOURCE: Bank of Spain, Thomson Financial Datastream and internal figures.

Notable cumulative gains on US and European stock markets.

Stock markets continue upward move

The upward move on the stock markets had to face increased yields on bonds and a rise in oil prices in recent weeks. Most stock markets, however, managed to ride out the storm thanks to the favourable trend in corporate profits and a wave of corporate take-overs. At the end of the fourth week in March most US stock markets showed notable gains over December. The cumulative balance for the stock markets in the euro area was still higher helped by the lower interest rates in that area.

INDICES OF MAIN WORLD STOCK EXCHANGES

February 28, 2006

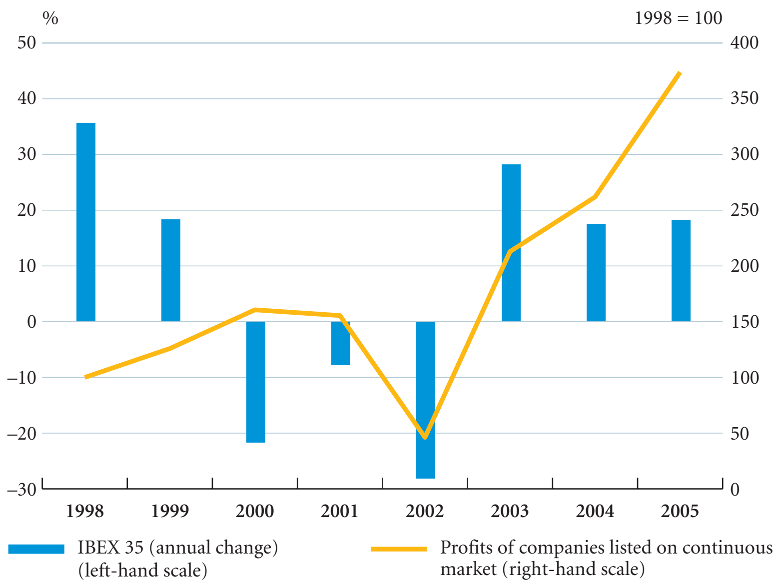
	Index (*)	% monthly change	% cumulative change	% annual change	*Figures on March 24, 2006* % cumulative change	*% change over same date in 2003*
New York						
Dow Jones	*10,993.4*	*1.2*	*2.6*	*2.1*	*5.2*	*37.3*
Standard & Poor's	*1,280.7*	*0.0*	*2.6*	*6.4*	*4.4*	*50.8*
Nasdaq	*2,281.4*	*–1.1*	*3.4*	*11.2*	*4.9*	*68.8*
Tokyo	16,205.4	–2.7	0.6	38.0	2.8	96.3
London	5,791.5	0.5	3.1	16.6	7.4	61.3
Euro area	3,774.5	2.3	5.5	23.4	8.2	82.2
Frankfurt	*5,796.0*	*2.1*	*7.2*	*33.2*	*10.4*	*134.4*
Paris	*5,000.5*	*1.1*	*6.0*	*24.2*	*10.7*	*91.4*
Amsterdam	*458.7*	*1.8*	*5.0*	*22.5*	*8.1*	*81.3*
Milan	*28,784.0*	*3.5*	*7.5*	*18.0*	*10.2*	*79.8*
Madrid	*11,740.7*	*5.7*	*9.4*	*25.0*	*11.4*	*99.1*
Zurich	7,892.6	1.0	4.1	33.1	6.1	90.2
Hong Kong	15,918.5	1.0	7.0	12.1	5.6	72.5
Buenos Aires	1,714.1	–4.5	11.1	10.0	16.3	214.9
São Paulo	38,610.0	0.6	15.4	37.2	12.3	240.0

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

SOURCE: Thomson Financial Datastream and internal figures.

SPECTACULAR GROWTH OF PROFITS OF COMPANIES LISTED ON SPANISH STOCK EXCHANGE IN 2005

Prices and profits of listed companies



SOURCE: Sociedad de Bolsas and internal figures.

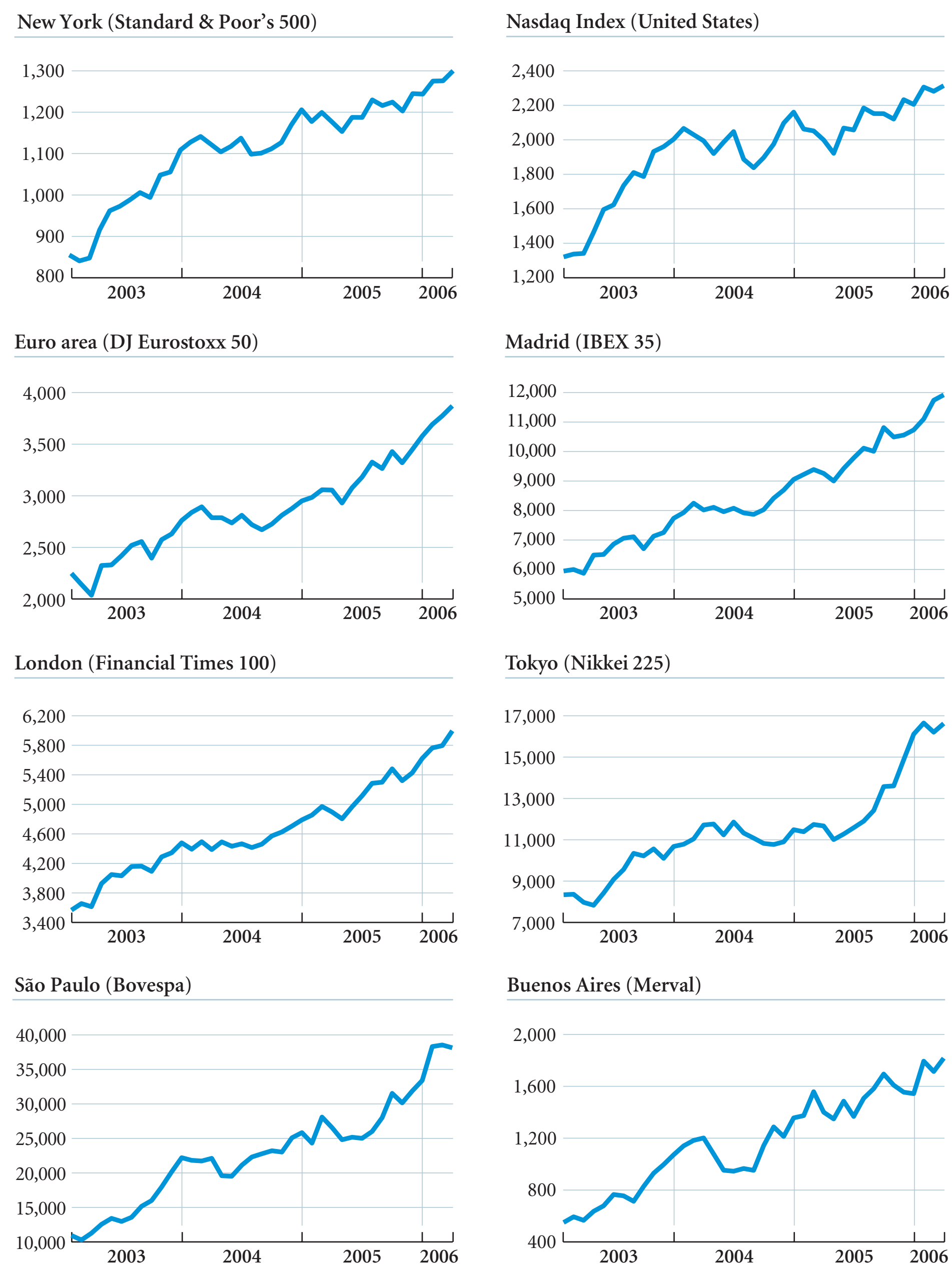
IBEX 35 index comes close to 12,000 level.

The trend in the Spanish stock market may be termed spectacular seeing that, before the end of the first quarter, it showed an advance of 11% over the end of 2005 and the IBEX 35 index came close to 12,000 points. Also in this case, a series of take-overs contributed to animate the stock markets.

There was a notable trend in corporate profits in 2005. The Spanish companies included in the IBEX 35 index recorded

INTERNATIONAL STOCK EXCHANGES

Indices at month-end



NOTES: March 24, 2006.
SOURCE: Thomson Financial Datastream.

profits of more than 37 billion euros last year, an increase of 44% compared with 2004. The good state of the economy (sales were up 23%) and extraordinary profits made all this possible. Companies listed on the Spanish stock exchange also obtained marvellous profits with an annual increase similar to the large companies.

Outside the euro area, the British and Swiss stock exchanges also continued to show considerable progress. In addition, the Tokyo stock exchange managed to recover its level at the start of the year. Economic recovery and the possibility of a gradual process of interest rate increases gave a boost to investors.

Tokyo stock exchange recovers its level at the start of the year.

With regard to emerging markets, following the sharp increases in recent times, many underwent corrections in the early weeks of March because of fears of interest rate increases. For example, stock markets in Brazil, Turkey and some in the Middle East showed drops. Others, such as Mexico, continued to mark up new all-time highs.

Many emerging country stock markets undergo correction in early weeks of March.

Economic activity

Economic sentiment index prepared by European Commission draws troubling picture of Spain's economy...

Spain's economy still maintaining considerable strength

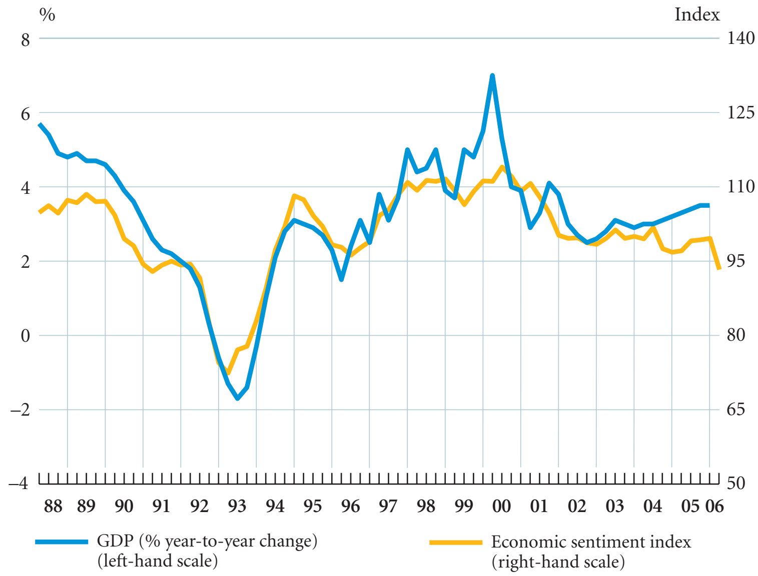
If we were to firmly believe the figure for the February economic sentiment indicator prepared by the European Commission it would be bad news for Spain's economy. In fact, the picture painted by the European Commission survey would be quite negative, following the decrease shown by this indicator in February which was down to the 91.2 points level, nearly 10 points lower than at the end of the year before.

The biggest correction in absolute terms showed up in the indices for construction and services (included in that indicator) which in those two months lost 18 and 17 points respectively but still without leaving positive figures. The retail sales index also showed a sudden worsening going to –13 points, a figure identical to that for consumer confidence but with the difference that the latter has been showing great stability for some time.

Have the first alarm bells thus begun to ring? For the moment, not too loud considering that the ability of that indicator to forecast the future has proven to be very limited in recent years, as shown by its uneven trend compared with growth of the gross domestic product (GDP), as shown in the graph. In addition, without dismissing the signs of a slowdown in growth as seen in activity indicators, the results of the European

SHARP DROP IN ECONOMIC SENTIMENT INDEX FOR SPAIN

Year-to-year change in GDP and figure for economic sentiment index



SOURCE: INE, European Comission and internal figures.

Commission survey seem to be distorted with regard to the decreases in construction and services, sectors which together are continuing to show considerable strength. Finally, we should consider the figures mentioned as a mere warning sign while waiting for further news.

Along the same lines, the European Commission survey shows a slight worsening of the situation in industry which does not correspond to the recovery suggested by the industrial production index which in this case is drawn up by the National Institute of Statistics (INE). According to figures available as of now, this recovery would have shown up most strongly in energy branches and in production of capital goods and consumer durables.

With regard to construction, we still do not have sufficient information to

...which does not agree with trend in main economic activity indicators.

SUPPLY INDICATORS

Percentage change over same period year before, unless other wise indicated

	2004	2005	2005				2006	
			1Q	2Q	3Q	4Q	January	February
Industry								
Electricity consumption (1)	4.0	3.5	4.5	2.7	3.2	3.7	3.2	3.6
Industrial production index (2)	1.6	0.7	0.3	0.1	0.7	1.6	3.4	...
Confidence indicator for industry (3)	–2.5	–4.9	–3.6	–7.0	–4.8	–4.0	–7.3	–5.6
Utilization of production capacity (4)	79.8	80.2	79.4	79.5	81.1	80.7	–	79.7
Imports of non-energy intermediate goods (5)	6.6	1.6	0.7	3.6	0.6	1.1	1.7	...
Construction								
Cement consumption	3.7	5.1	–0.2	11.2	5.2	3.7	14.3	12.5
Confidence indicator for construction (3)	13.6	22.4	23.7	15.0	22.7	28.3	21.0	6.0
Housing (new construction approvals)	8.0	6.2	3.7	7.6	2.8	10.6	24.5	...
Government tendering	18.3	18.5	5.8	36.6	3.1	36.9	18.8	...
Services								
Retail sales	5.5	4.4	4.1	5.4	4.4	3.8	4.6	3.7
Foreign tourists	3.1	6.1	8.0	4.6	7.0	4.9	–0.1	2.0
Tourist revenue inflows	3.8	3.8	–0.8	–0.3	6.6	9.0	...	...
Goods carried by rail (km-tonnes)	–3.5	–3.2	–14.3	–4.7	–2.3	11.0	...	...
Air passenger traffic	8.0	9.1	8.4	8.5	10.2	9.1	7.7	5.5
Motor vehicle diesel fuel consumption	7.2	4.8	2.5	7.5	4.9	3.7	...	...

NOTES: (1) Adjusted for number of working days and temperature.
(2) Adjusted for difference in number of working days.
(3) European Commission survey: difference between percentage of positive and negative replies.
(4) Business survey: percentage of utilization inferred from replies.
(5) By volume.
SOURCE: Red Eléctrica Española, OFICEMEN, AENA, National Institute of Statistics, Bank of Spain, European Commission, Ministry of Public Works, Ministry of Industry, Commerce and Tourism, Ministry of Economy and Finances and internal figures.

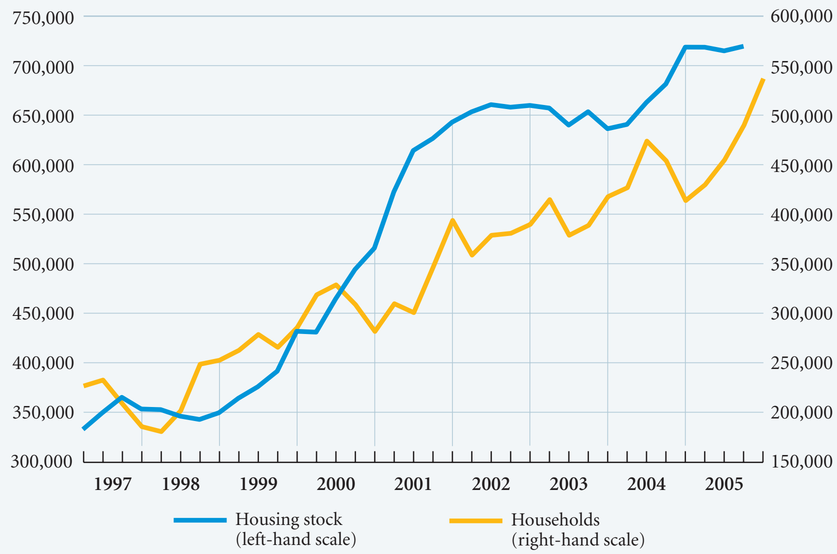
Population growth behind housing boom in Spain

In the past five years we have seen frenetic growth in construction. As a sample, here is something to start with. In the period under consideration, the total housing stock increased by nearly 3.5 million units and in recent months the rate of increase has tended to stabilize above 700,000 housing units a year, that is to say, practically twice the historical average recorded since the beginning of the Seventies. Is this formidable increase justified?

The first consideration is that the sharp increase in the housing stock has coincided with the simultaneous growth of the main types of buildings (main residence, holiday home, unoccupied house). The highest relative increase came in the segment of unoccupied housing units but naturally, in absolute terms, most building was taken up by main residences. According to information supplied by the ten-year census of population and housing by the National Institute of Statistics (INE), we note an historic trend to a decrease in the percentage of main residences (79.8% in 1970; 67.7% in 2001) especially in favour of holiday homes (7.5% and 16.0% in the years mentioned) and to a lesser extent of unoccupied housing units (12.7% and 16.2%). The latter group is more opaque as it covers a great range of situations which run from undeclared rental housing to housing units occasionally empty.

FORMATION OF NEW HOUSEHOLDS HAS BOOSTED HOUSING MARKET IN SPAIN

Annual change in absolute figures



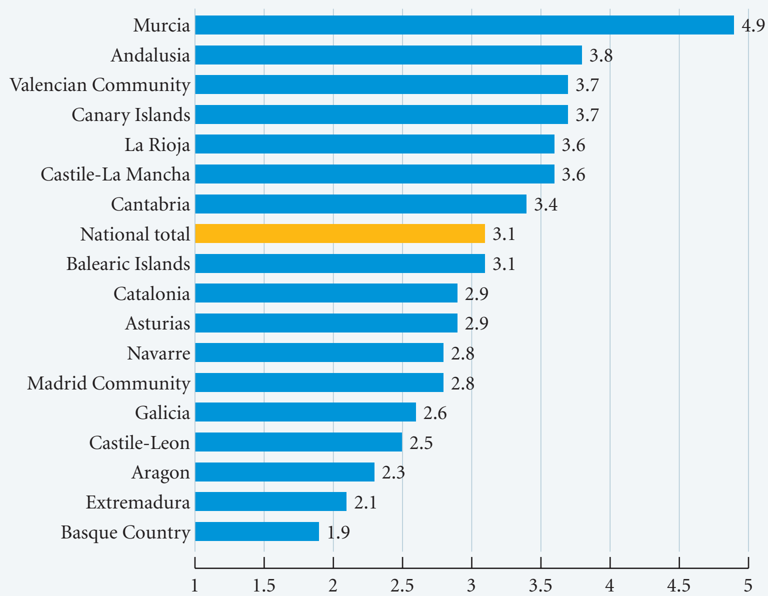
SOURCE: INE, Bank of Spain and internal figures.

A number of factors have been at play in this real-estate boom, for example, the low interest rates, the favourable situation of household incomes, lower unemployment, etc. Here we shall concentrate on population growth and to what extent this explains the construction boom or otherwise. In this respect, we should first point out that demand for main residences is directly related to population increase, with the composition of the age pyramid being a very key factor. In general terms, the population between 25 and 64 years of age is the one which to the greatest extent makes up the demand of main residences, this demand being especially heavy in the group between 35 and 44 years of age. This is precisely the *quid* of the question, the emergence in this group of the *baby-boom* generation from the Sixties and Seventies. Along with this, the heavy flow of immigrants in Spain is also a notable factor. In January 2005, foreigners living in Spain numbered close to 3,700,000, twice that in 2002. The low purchasing power of part of this group (made up mainly of young people) initially puts them within the scope of rental housing but there is no doubt that this group has made a significant contribution to driving the market.

Sociological factors also have a special significance due to their effect on the setting up of new households and therefore in final demand for housing. To be specific, worthy of particular attention are factors such as the increase in life expectancy, delay in age at which offspring leave home (which increases potential demand which may *explode* at any particular moment) and, what is quite relevant, the increase in single-parent and single-person homes. The effect of all these factors adds up to the observed trend toward a decrease in the number of persons per household, which in 2005 stood below 3, in contrast to an average of close to 4.5 persons recorded at the beginning of the Sixties. All together, the demographic changes and the socio-cultural factors mentioned in recent years have pushed up the formation of new households, the net growth of which today is close to 550,000, some 100,000 more than five years ago, thus creating a very solid base for demand.

TOURIST REGIONS ATTRACT BIGGEST GROWTH OF HOUSING

Housing plans approved per 1,000 existing houses (*)



NOTES: (*) Average approvals 2000-2005 over housing stock shown in 2001 Census.
SOURCE: INE, Ministry of Public Works and internal figures.

To complete the picture, we should point out that demand for holiday homes is very much linked to the trend in the population within the age 45-64 year age bracket, which is the one enjoying relatively high income and a higher than average rate of savings. In the past ten years, this population segment has increased by more than 1.5 million persons. Another aspect of special importance is the increase in the number of foreigners who reside temporarily in their own homes when holidaying in Spain. Some estimates put this number today at around two million persons, a figure well above that some years ago.

All of these aspects bear out the fact that over the years a fundamental relation has been maintained unchanged, namely, the number of housing units per household, which today stands at 1.53, is practically equal to that 10 years ago. This fact suggests that the housing boom would be justified from a demographic perspective, leaving the speculation component in second place.

Industry recovers while construction and services maintain notable growth rate with tendency to very moderate slowdown up to now.

precisely evaluate the progress of activity in the initial stages of the year. Keeping in mind the trend being shown by the main indicators at the end of 2005, and looking at things from a more up-to-date perspective, the performance of employment in the sector in the first two months of 2006 (total registrations at Social Security continues to grow and downward trend in registered unemployment is being maintained) it would seem that the growth rate continues to be very high.

Some private consumption indicators show gradual moderation in growth.

With regard to services, the overall trend in the index of business volume (drawn up by the INE on basis of the survey of main sector activities) points to a progressive slowdown of growth in nearly all branches but with fairly high rates of advance in most. In 2005 as a whole, the overall business volume in the sector grew by 6.6%. Those activities falling under information technology and communications showed the biggest increase (9.0%), followed by services to companies (7.7%), retail sales (6.7%), transport (5.8%) and tourism (3.4%). In the sector of information technology and communications, the most dynamic were telecommunications and data-processing services while in services to companies what stood out were judicial and accounting services, personnel search and placing, research and safety, architecture and technical surveys.

On the demand side, some indicators for consumption also are showing a gradual moderation of growth rate, although this was fairly uneven. To be specific, figures for consumer durables were less dynamic that some months back and even recorded the odd drop. This was the case with passenger cars, for example, which were down 1.4% in the first two months of 2006. On the other hand, registrations of motor-cycles are maintaining a notable rise although more moderate than in 2005 following the boom brought about by new regulations related to driving licences. With regard to investment, while reliable data is still not available, we estimate that it is maintaining a substantial growth rate, if we are to go by the trend in the industrial production index, which has been very positive in the last two months, and the trend in exports.

Finally, the most recent of the main indicators of activity and the trends implicit in those indicators do not give credence to the troubling prophecies set

DEMAND INDICATORS

Percentage change over same period year before

	2004	2005	2005				2006	
			1 Q	2 Q	3 Q	4 Q	January	February
Consumption								
Production of consumer goods (*)	–0.1	1.1	0.1	1.1	1.4	0.8	0.0	...
Imports of consumer goods (**)	13.4	7.9	6.5	8.4	7.8	8.6	40.4	...
Car registrations	9.8	0.8	–0.0	4.9	2.3	–4.5	–0.3	–2.3
Credit for consumer durables	5.5	13.3	8.8	13.7	17.2	...	–	–
Consumer confidence index (***)	–10.5	–10.8	–9.3	–11.3	–11.4	–11.2	–12.4	–13.0
Investment								
Capital goods production (*)	1.9	–0.1	–0.8	0.6	–1.3	0.8	10.1	...
Imports of capital goods (**)	14.9	20.4	28.6	36.0	13.5	8.2	20.8	...
Commercial vehicle registrations	11.7	13.2	9.2	17.9	13.9	11.5	–5.8	6.5
Foreign trade (**)								
Non-energy imports	9.8	6.0	5.7	9.0	4.7	4.5	16.2	...
Exports	5.2	0.2	–3.1	2.5	1.2	0.1	12.2	...

NOTES: (*) Adjusted for difference in number of working days.
(**) By volume.
(***) European Commission survey: difference between percentage of positive and negative replies.
SOURCE: ANFAC, National Institute of Statistics, Bank of Spain, Ministry of Economy and Finance, European Commission and internal figures.

out in the survey of the European Commission mentioned at the beginning. Everything points to the rate of economic activity continuing very high and that the trend to a slowdown in growth is still very moderate. Along these lines, the International Monetary Fund has revised upward its forecast for growth of Spain's GDP which is now puts at 3.25%, only slightly lower than that recorded in 2005.

IMF evaluates present situation with more optimism than a few months ago and revises upward growth forecast for Spain's GDP in 2006.

Labour market

Employment continues strong at start of 2006

Registrations with Social Security up 2.7% after discounting employment coming to surface with process of giving normal status to foreigner workers.

The growth rate of employment held stable in the early stages of 2006, if we are to go by figures for registrations with Social Security. Those registered reached a figure of 18,238,966 at the end of February, an increase of 5.5% over the same month the year before. This growth was biased upward by the process of giving normal status to foreign workers begun in February 2005 which ended with more than 550,000 persons newly registered at Social Security.

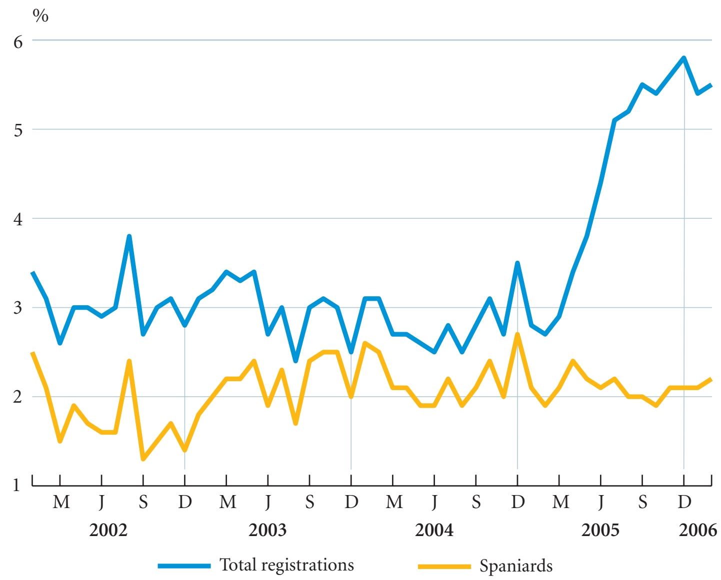
Among those foreign workers registered, however, there have of course been changes in their work situation since the end of the period allowed for getting regular status. As a result, at the end of February only 478,439 were still enrolled so that total registration in one year (excluding those newly registered who had previously been working illegally) was up by only 2.7% (2.2% for Spaniards and 10.9% for foreign workers). In any case, the figures for registrations in February confirm a profile of stability of this variable in recent months.

Job hirings handled through Public Employment Service give strong start to year.

Figures for job hirings registered at Public Employment Service office were also very positive. In the first two months of 2006, hiring contracts registered rose by 12.9%, thanks to the sharp increase in permanent job contracts. Part-time work came to represent 21.5% of all job placements.

GIVING NORMAL STATUS TO FOREIGN WORKERS RAISES REGISTRATIONS WITH SOCIAL SECURITY

Annual change in number of persons registered with Social Security



SOURCE: Social Security and internal figures.

EMPLOYMENT INDICATORS

Percentage change over same period year before

	2004	2005	2005				2006	
			1 Q	2 Q	3 Q	4 Q	January	February
Persons registered with Social Security								
Wage-earners	2.7	4.8	2.8	4.2	5.9	6.3	6.2	6.2
Industry	*–0.5*	*–0.5*	*–0.8*	*–0.7*	*–0.3*	*–0.4*	*–0.5*	*–0.5*
Construction	*5.6*	*8.6*	*5.6*	*7.9*	*10.0*	*10.9*	*10.8*	*10.8*
Services	*3.9*	*5.7*	*4.2*	*5.2*	*6.4*	*6.8*	*6.6*	*6.6*
Non-wage-earners	3.2	2.6	2.9	2.7	2.5	2.4	2.3	2.3
Total	**2.8**	**4.4**	**2.8**	**3.9**	**5.3**	**5.6**	**5.4**	**5.5**
Persons employed (*)	**3.9**	**5.6**	**5.1**	**5.8**	**5.9**	**5.6**	–	–
Jobs (**)	**2.6**	**3.1**	**3.0**	**3.2**	**3.2**	**3.2**	–	–
Hiring contracts registered (***)								
Permanent	11.8	8.7	0.6	9.2	10.0	16.1	33.6	18.8
Temporary	11.4	4.6	–9.8	10.1	9.7	8.9	12.6	10.1
Total	**11.5**	**5.0**	**–8.8**	**10.0**	**9.8**	**9.5**	**14.6**	**11.1**

NOTES: (*) Estimate from Labour Force Survey.
(**) Equivalent to full-time work. National Accounting estimate; figures adjusted for seasonal effects and number of working days.
(***) At INEM.
SOURCE: National Institute of Statistics, Ministry of Labour and Social Services, National Employment Institute and internal figures.

Registered unemployment holds stable

The favourable situation in the labour market did not show up in the figures for registered unemployment which, for the first time in a year and a half stood slightly above the same month last year. In fact, the 2,169,277 persons registered at offices of the Public Employment Service in February 2006 was 0.2% higher than the figure for the same month in 2005.

Nevertheless, the figures for the first two months were somewhat distorted by farm unemployment which was up sharply and by the sharp increase in figures for those seeking a first job. It is still too early to say if this sharp increase came as a result of a slowdown in job placements or on the other hand came as a result of the growing flow of persons to employment services attracted by the favourable state of the labour market or to a situation brought about by the strong influx of immigrants now taking place in Spain, which may help increase the figures. In fact, this group made up 17% of the increase in unemployment in the first two months of the year.

Farm unemployment slightly darkens registrations in first two months of year.

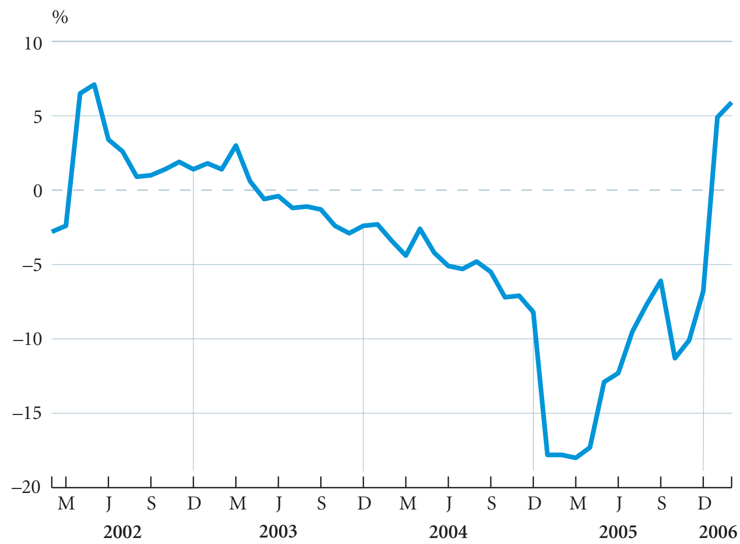
If we look only at non-farm unemployment (it is still not possible to segregate the figures for foreign workers), the trend is somewhat more stable and the figure is more favourable to the extent that it is holding below the level last year, specifically 1.2%.

From a regional perspective, the least favourable trends showed up in Andalusia and Murcia. In both communities the level of unemployment stood above last year, as well as in Valencia, Aragon, La Rioja and Canary Islands. In the other autonomous communities the situation was more favourable than in February 2006 although in some of these regions the

Foreign workers make up 17% of new unemployment in 2006.

IS FINDING A FIRST JOB GETTING HARDER?

Annual change in those registered at employment offices in search of a first job



SOURCE: Employment Institute and internal figures.

REGISTERED UNEMPLOYMENT BY SECTOR, SEX AND AGE

February 2006

	No. of unemployed	Change over December 2005		Change over same period year before		% share
		Absolute	%	Absolute	%	
By sector						
Agriculture	67,906	2,679	4.1	13,823	25.6	3.1
Industry	303,153	1,834	0.6	–6,012	–1.9	14.0
Construction	234,506	–10,594	–4.3	–13,105	–5.3	10.8
Services	1,329,703	63,314	5.0	–3,787	–0.3	61.3
First job	234,009	9,107	4.0	12,938	5.9	10.8
By sex						
Males	852,501	538	0.1	–19,825	–2.3	39.3
Females	1,316,776	65,802	5.3	23,682	1.8	60.7
By age						
Under 25 years	290,364	12,708	4.6	7,059	2.5	13.4
All other ages	1,878,913	53,632	2.9	–3,202	–0.2	86.6
TOTAL	**2,169,277**	**66,340**	**3.2**	**3,857**	**0.2**	**100.0**

SOURCE: INEM and internal figures.

downward trend in unemployment moderated appreciably.

Wages: tendency to moderation in private sector

Wages are generally tending to moderate, according to the main wage indicators for 2005.

Where this trend is not so clear is in collective bargaining. According to figures for collective bargaining contracts gathered by the Ministry of Labour and Social Affairs, the average increase in wages agreed upon, including review clauses, was 4.0% in 2005, four decimals more than in 2004. As a result, wages maintained purchasing power. In any case, it should be kept in mind that agreements cover the situation of 8.7 million persons, that is to say, somewhat more than 56% of all wage employees.

On the other hand, according to figures from National Accounting drawn up by the National Institute of Statistics, wages per job equivalent to full-time work not only slowed down sharply in 2005 but also grew very much below inflation. Specifically, by 2.5% on annual average, eight decimals less than in 2004. This performance was not general for all sectors of the economy. Wage-earners in the energy and public utilities branches enjoyed pay increases higher than those in the rest of the economy and, furthermore, the trend in 2005 was to an increase. On the other hand, in industry, construction and market services, the situation was the other way around, that is to say, relatively modest increases with a tendency to moderation. Naturally, the play of the market and the greater ease for incoming immigrants to move into market activities explains this duality in the model of wage levels.

Wage moderation not running right across whole economy and differences due to situations of competition and different nature of jobs offered.

COLLECTIVE BARGAINING AGREEMENTS REFLECT HIGHER INFLATION

Annual change

NOTES: (*) Includes wage revision clauses.
(**) Average annual increase.
SOURCE: Ministry of Labour and Social Affairs, National Institute of Statistics and internal figures.

The results of the wages survey for the fourth quarter run along the same lines as those for National Accounting. What shows up is moderation and relatively modest increases in industry and construction with an opposite situation in services. For the year as a whole, this indicator showed a 2.6% average wage increase, two decimals below 2004.

WAGE INDICATORS

Percentage change over same period year before

	2004	2005	2005				2006
			1 Q	2 Q	3 Q	4 Q	1 Q
Increase under general wage agreements (*)	**3.0**	**3.0**	**2.9**	**2.9**	**2.9**	**3.0**	**3.0**
Wage per job equivalent to full-time work (**)	**3.3**	**2.5**	**2.6**	**2.6**	**2.3**	**2.4**	...
Quarterly labour cost survey							
Wage costs							
Total	2.8	2.6	2.5	3.4	1.9	2.5	...
Industry	*3.3*	*2.7*	*3.2*	*3.1*	*1.5*	*3.0*	...
Construction	*4.2*	*2.3*	*2.4*	*3.3*	*1.3*	*2.0*	...
Services	*2.5*	*2.9*	*2.5*	*3.8*	*2.6*	*2.8*	...
Average wages per hour worked	3.6	3.2	5.8	1.5	2.8	2.9	...
Other labour costs	3.6	3.6	4.2	3.5	3.7	3.1	...
Work day (***)	–0.8	–0.6	–3.1	1.9	–0.9	–0.4	...
Farm wages	**2.8**	**3.1**	**3.6**	**3.0**	**2.7**	**3.0**	...
Labour cost in construction	**4.8**	**2.3**	**1.4**	**2.1**	**2.9**	**2.9**	...

NOTES: (*) Does not include wage revision clauses.
(**) Quarterly National Accounts: figures adjusted for seasonal and calendar differences.
(***) Effective hours worked per worker per month.
SOURCE: National Institute of Statistics, Ministry of Labour and Social Affairs, Ministry of Agriculture, Fishing and Food, Ministry of Public Works and internal figures.

Prices

Inflation rate indicates start of moderation in February

In February, the consumer price index (CPI) brought forward the start of a trend to moderation that should take place in coming months, if there is no hardening in the oil market. Nevertheless, the slight improvement in the year-to-year inflation rate (two decimals to 4.0%) failed to reduce the differential with the euro area which stood at 1.7 percentage points.

CPI moderates slightly but still at 4%.

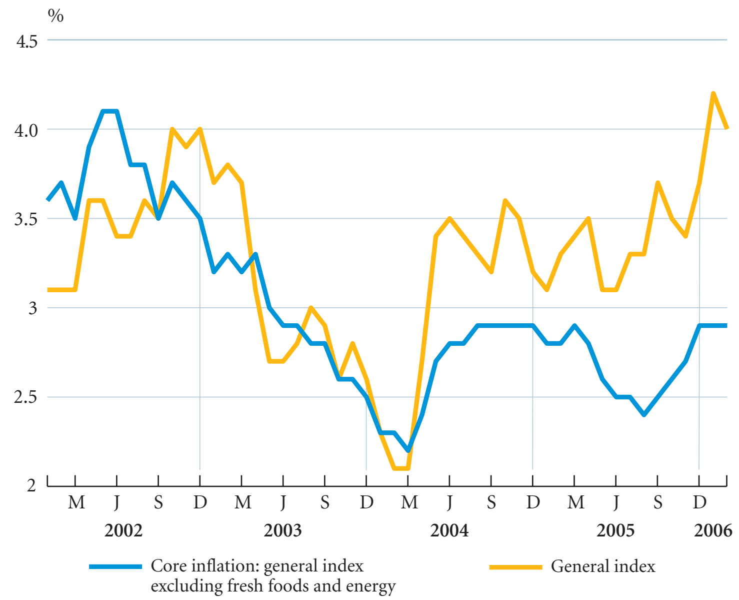
The improvement in the CPI in February saw prices of fresh foods and tobacco taking a key role although fuels also contributed very slightly to containing the CPI by moving up less than in February 2005. As for the rest, the situation is holding to the state of affairs in previous months with a continuation of the sustained increase in non-energy industrial goods and downward resistance in services prices.

Tobacco and fresh foods help contain index...

The rise in non-energy industrial goods continues to be very modest and is affecting almost all products with the exception of data-processing, sound and audiovisual equipment which is showing major decreases as a result of the unique characteristics of those markets. The increases are in keeping with the modest rises reflected in producer prices within Spain as well as a slightly upward trend in import prices.

CPI DROPS DOWN FROM HIGHS BUT CORE INFLATION REMAINS STABLE

Year-to-year change in general CPI and core inflation



SOURCE: National Institute of Statistics.

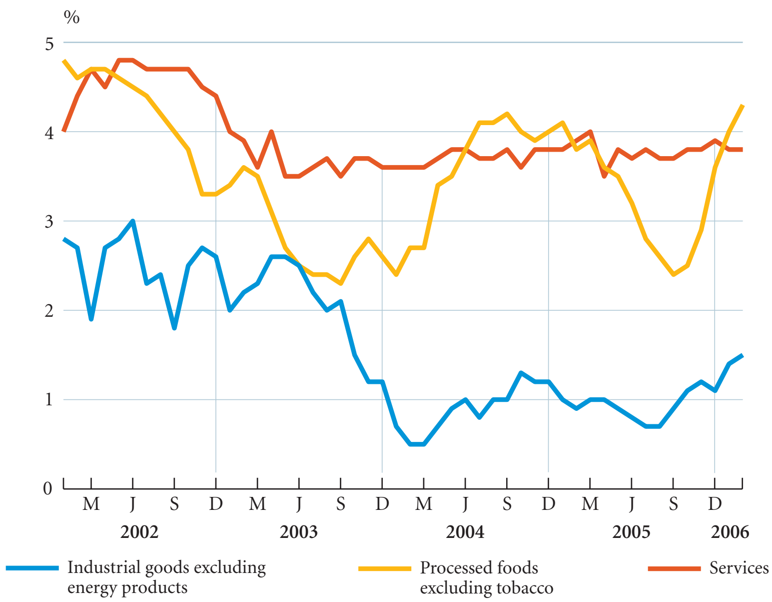
CONSUMER PRICE INDEX

	2005			2006		
	% monthly change	% change over December 2004	% annual change	% monthly change	% change over December 2005	% annual change
January	–0.8	–0.8	3.1	–0.4	–0.4	4.2
February	0.3	–0.6	3.3	0.0	–0.4	4.0
March	0.8	0.2	3.4			
April	1.4	1.6	3.5			
May	0.2	1.8	3.1			
June	0.2	2.1	3.1			
July	–0.6	1.5	3.3			
August	0.4	1.9	3.3			
September	0.6	2.5	3.7			
October	0.8	3.4	3.5			
November	0.2	3.5	3.4			
December	0.2	3.7	3.7			

SOURCE: National Institute of Statistics.

SERVICES PRICES: HIGH BUT STABLE GROWTH

Year-to-year change in some CPI components



SOURCE: National Institute of Statistics.

...while industrial goods move up and services prices show stable growth at 3.8%.

In the area of services, the situation remains defined by growth of prices stable at 3.8% year-to-year. Fields where there is little competition, mainly in personal services and repairs and markets with controlled prices make it possible to shift increases in costs and margins to final prices. There were

CONSUMER PRICE INDEX BY COMPONENT GROUP

February

	Indices (*)	% monthly change		% change over previous December		% annual change	
		2005	2006	2005	2006	2005	2006
By type of spending							
Food and non-alcoholic beverages	120.2	–0.2	–0.3	0.5	0.7	3.5	4.3
Alcoholic beverages and tobacco	115.7	0.2	–2.9	0.3	–5.0	5.5	–0.5
Clothing and footwear	105.5	–0.9	–0.9	–12.2	–12.5	1.3	1.1
Housing	120.2	0.4	0.4	0.9	2.6	4.1	7.8
Household equipment	109.1	0.1	0.3	–0.3	–0.1	2.1	2.4
Health	107.1	0.0	0.4	0.3	0.7	1.6	1.0
Transport	119.3	1.4	0.7	1.2	2.2	5.9	7.2
Communications	91.6	–0.2	–0.2	0.1	0.1	–0.4	–1.6
Recreation and culture	102.5	0.3	0.3	–0.9	–1.4	0.1	0.2
Education	121.4	0.0	0.1	0.4	0.2	4.2	3.9
Hotels, cafés and restaurants	122.3	0.5	0.6	0.9	1.1	4.0	4.5
Other	117.1	0.6	0.2	2.1	1.8	3.0	3.1
By group							
Processed foods	117.3	0.1	–0.1	0.6	0.2	3.8	3.4
Unprocessed foods	124.5	–0.7	–1.5	0.3	–0.4	3.5	4.5
Non-food products	114.0	0.4	0.3	–1.0	–0.5	3.2	4.1
Industrial goods	109.5	0.3	0.1	–2.8	–1.8	2.5	4.3
Energy products	*123.1*	*2.0*	*0.7*	*1.1*	*4.2*	*7.6*	*13.3*
Fuels and oils	*128.4*	*2.7*	*0.9*	*0.9*	*4.2*	*9.8*	*16.6*
Industrial goods excluding energy products	*105.3*	*–0.2*	*–0.1*	*–4.0*	*–3.7*	*0.9*	*1.5*
Services	119.4	0.5	0.5	1.1	1.0	3.9	3.8
Underlying inflation (**)	113.7	0.2	0.1	–0.9	–0.9	2.8	2.9
GENERAL INDEX	**115.5**	**0.3**	**0.0**	**–0.6**	**–0.4**	**3.3**	**4.0**

NOTES: (*) Base 2001 = 100.
(**) General index excluding energy products and unprocessed foods.
SOURCE: National Institute of Statistics.

notable increases in inter-urban public transport (6.5%), postal services (6.2%), higher education, insurance, hospital services, car repairs and urban public transport, all at around 5%.

In this context, the key to moderation in the CPI in coming months will be in energy products, so long as the situations in foreign exchange and oil markets hold steady or improve. Therefore, if energy prices stabilize, the effect on the year-to-year CPI rate could be to take off more than a half percentage point. What will be more difficult is to obtain improvements in other headings over the medium term. In industrial goods, the process of a turnaround of the upward trend will be slow. In services there is considerable inertia and this means substantial difficulty in bringing about appreciable improvement.

Inflation may keep moderating if oil brings no surprises.

Will 2006 be year bringing correction of housing prices?

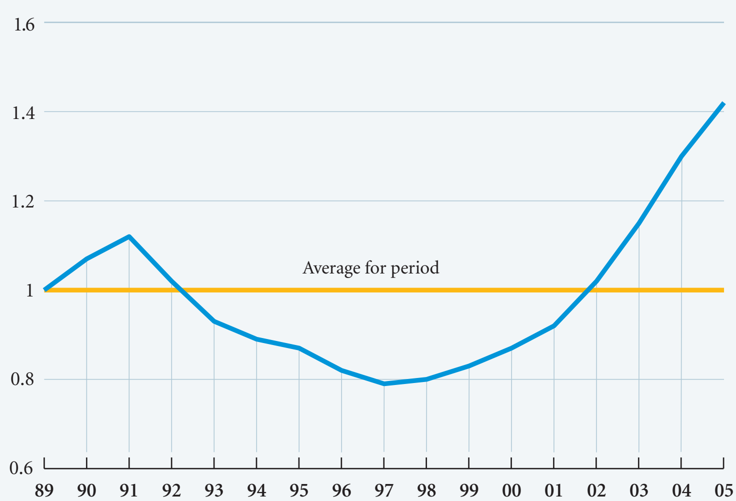
The sharp rise in real-estate prices in Spain and the growth of debt contracted by households to buy a house has set off fears in some national and international bodies of a sharp collapse in the market and the consequences this could have for the rest of the economy. The increase in housing prices (15% on annual average since 1999) may be explained for several reasons. The macroeconomic stability achieved following adoption of the euro, which led to a sharp reduction in interest rates, and the major demographic changes that have taken place in Spain have given the main boost to demand. Household indebtedness has shot up, while at the same time the range of financial facilities provided by the banking sector has eased recourse to loans.

Is it possible that prices have grown to an excessive degree and, therefore, we could move into a stage of general decrease? From an analytical point of view, the response may be dealt with from differing perspectives. One of the points often used is the application of a *model for valuation of assets*. The basis of this approach, which takes into account the role of the house as an investment good, is that its price should not be very different from the discounted yield from its income, in this case, future rentals. Put another way, under normal conditions, on balance, the cost of acquiring a house should be equal to the present value of the cost of renting that house in the future.

As with any measure of asset valuation, this approach is not exempt from qualifications. In fact, both the housing market for buying or for renting are a long way from being perfect markets as there are transaction costs and regulations which may justify differences between the price of the house and the actual cost of renting. Furthermore, it is difficult to value the rate of discount of the model (the rate at which to discount the flows from future rentals) which must keep in mind the risk premium on the house, that is to say, the

RELATION BETWEEN PRICE OF HOUSING AND RENTALS SUGGESTS AN INCREASE IN PAST THREE YEARS

Housing price/rental cost ratio (1989 Ratio=1) (*)



NOTES: (*) The ratio housing price/rental is an index calculated by dividing the price per m^2 of housing (based on 1989) by the CPI component for rentals (which takes the same year as base).
SOURCE: Ministry of Housing, Bank of Spain and internal figures.

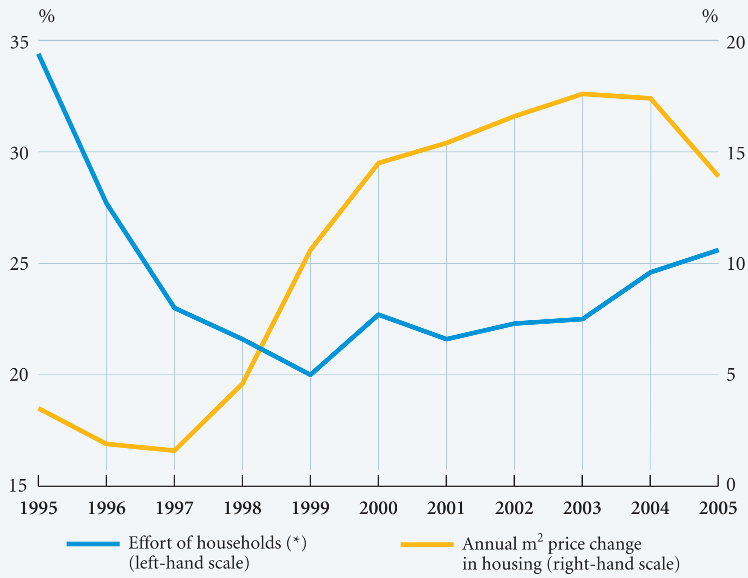
additional rentability above the no-risk interest rate that investors demand for assuming risks inherent in residential investment.

In spite of these complications, a very simple version of this model, a simple calculation of the quotient between price and rental, may be equally useful for illustrating what has happened in Spain's real-estate market. As may be seen in the previous graph, in the early years or the real-estate growth cycle (1999-2002) the ratio stood below the historic average (which may serve as an approximation of the balance ratio). This situation, perhaps, is the result of an excessive correction of the price of housing following the boom at the end of the Eighties. In the last three years, however, the relation between the price-rental ratio and the historic average was turned around so that it is possible that there has been an excessive appreciation of housing, an hypothesis that also is supported by more technical analysis, such as that carried out by the Bank of Spain. The exact degree of this appreciation is very difficult to arrive at precisely.

In any case, the increase in loan facilities (decrease in interest rates and longer repayment periods) has meant that the effort made by households (defined as the cost of repayment instalments, net of tax deductions, to be paid in the first year by an average household, as a percentage of household disposable income) has shown a very moderate increase in recent years.

In view of the foregoing, what can we expect of the future? Population projections and the trend forecast for other factors which determine demand would indicate that in the next five years growth will lose strength although maintaining a very firm base. In this context, the most likely scenario is that the path of moderation in prices already begun will continue without there being the sharp readjustment that some people fear. In 2005, the price per m^2 for non-subsidized housing rose by 13.9%, which was the lowest growth in the past four years.

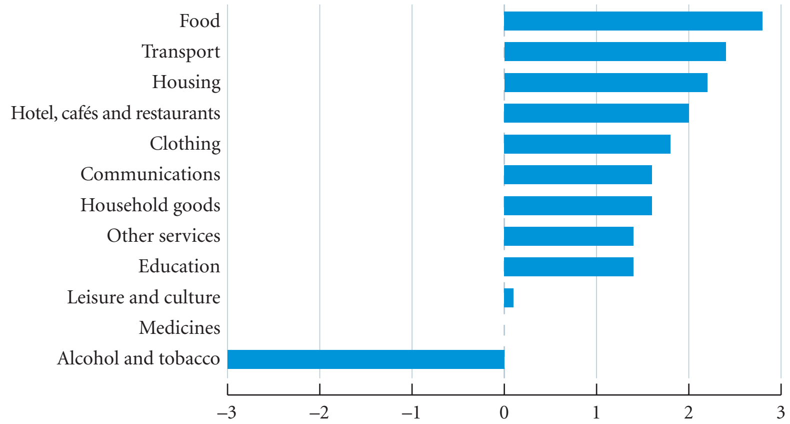
EFFORT OF HOUSEHOLDS HAS SHOWN A MODERATE INCREASE DUE TO IMPROVED BORROWING TERMS



NOTES: (*) Effort of households is defined as amount of instalments, net of tax deductions, to be paid in first year by an average household, as a percentage of annual household disposable income.
SOURCE: Ministry of Housing, Bank of Spain and internal figures.

DROP IN TOBACCO EASES DIFFERENTIAL WITH EURO AREA

Differential between Spain's harmonized CPI and that of euro area, by component.
In percentage points



SOURCE: National Institute of Statistics and internal figures.

Inflation differential with euro area especially wide in food, housing and transport.

In any case, the reference is the euro area. In February, groups such as transport, housing and foods showed a differential of more than two percentage points, according to the harmonized consumer price index. Most headings showed between one and two points. Only in leisure, culture and medical costs was there a similar increase in prices. Finally, the only competitive advantage showed up in the area of tobacco and was due to sharp price cuts applied by the tobacco companies last month.

Big increase in energy prices has negative effect on producer price index.

Wholesale prices continue to push up inflation

The producer price index in February held at the 6.3% figure seen the month before. The slight moderation in energy prices, within very high growth levels, compensated for the slight increases in other products with the exception of non-durable consumer goods. The most notable increases came about in consumer durables and food products.

Import prices not troubling except in energy field.

The sharp growth in producer prices, however, is having limited effects on final consumer prices. For the moment, the most evident effects show up in foods (as reflected in the CPI) given that in other goods, in spite of increases in production costs, both in wages and energy, logistics and distribution, the increases seem to have lesser effect on final consumer prices.

This lower impact may be partly due to the relative moderation in prices for imports of consumer goods which also are not showing any appreciable effects of energy price increases. In January, prices of consumer goods import rose by only 1.6% year-to-year, reflecting a drop in foods and a moderate increase in non-food items.

INFLATION INDICATORS

Percentage change over same period year before

	Farm prices	Producer price index					Import prices				GDP deflator (*)
		General index	Consumer goods	Capital goods	Intermediate goods	Energy goods	Total	Consumer goods	Capital goods	Intermediate goods	
2004											
December	2.5	5.0	2.8	1.6	6.2	10.6	5.8	4.2	–3.7	9.4	–
2005											
January	8.4	4.8	3.2	1.8	6.2	8.7	5.0	3.4	–1.6	7.2	–
February	12.2	4.9	3.2	1.9	5.5	11.0	5.4	1.0	–1.9	9.3	4.4
March	13.2	5.1	2.8	2.0	4.9	13.1	5.3	2.6	–7.6	9.7	–
April	6.6	5.0	2.8	2.0	3.7	14.5	4.6	0.9	–7.5	9.1	–
May	–0.9	4.2	2.5	2.1	3.3	11.0	0.9	–3.2	–6.5	4.7	4.4
June	–11.9	4.4	2.2	2.1	3.1	13.5	5.3	3.6	–1.3	7.7	–
July	–5.1	4.6	2.1	1.9	3.0	15.7	8.2	0.6	10.4	11.7	–
August	9.2	4.9	2.5	1.8	2.9	16.4	6.1	–0.2	–0.4	11.0	4.5
September	6.7	5.4	2.6	1.9	3.2	17.9	4.3	–0.6	4.2	7.0	–
October	–0.8	5.0	3.0	1.8	3.1	15.2	4.8	0.8	14.0	5.3	–
November	2.0	4.9	3.1	2.0	3.2	14.7	3.8	3.3	–0.8	5.6	4.4
December	2.1	5.2	3.2	2.0	3.2	15.6	7.1	0.9	10.2	8.9	–
2006											
January	...	6.3	3.5	2.1	3.6	20.6	1.5	–6.5	–5.1	7.5	–
February	...	6.3	3.6	2.1	3.8	20.1	...	...	...	...	...

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

SOURCE: National Institute of Statistics, Ministry of Economy and internal figures.

Foreign sector

Few changes in foreign trade picture in first month of year except in odd export transaction.

Exports recover in January but less than imports

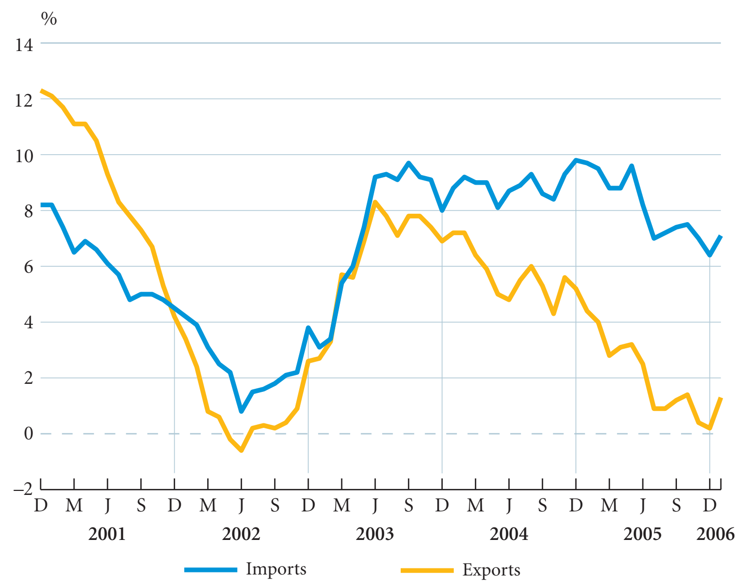
Early figures for 2006 relating to foreign trade in goods show no big changes over the situation in previous months except in the area of exports where there was some improvement. In spite of this, the deficit has continud to show strong growth because of the high level of imports. In fact, the trade imbalance in January was 6.58 billion euros, 24.7% more than in the same month in 2005.

The improvement in exports in January, however, was due to very specific factors which do not seem to be the result of any substantial change in the coordinates of relative weakness in which foreign sales held in 2005. On the one hand, the figure for January 2006 benefits from comparison with January 2005 which was very poor. Additionally, part of the increase in exports was based on the inclusion of a specific sale of ships, a transaction which did not take place in the reference period the year before. This meant that foreign sales of capital goods showed very big growth. In any case, in contrast to the immediate past, there was a recovery in exports related to motor vehicles which, if it consolidates, could bring a turnaround in the foreign trade balance.

In addition, the improvement in exports was mainly concentrated in markets outside the European Union (EU), an

EXPORTS STAGNANT

Change in foreign trade by volume



SOURCE: Ministry of Economy and Finances and internal figures.

FOREIGN TRADE

January 2006

	Imports			Exports			Balance	Export/ Import ratio (%)
	Million euros	% annual change in value	% share	Million euros	% annual change in value	% share	Million euros	
By product group								
Energy products	3,128	46.8	16.2	601	37.1	4.7	–2,527	19.2
Consumer goods	5,924	31.2	30.6	4,702	8.8	36.9	–1,222	79.4
Food	*971*	*13.3*	*5.0*	*1,645*	*2.1*	*12.9*	*674*	*169.4*
Non-foods	*4,953*	*35.0*	*25.6*	*3,057*	*10.1*	*24.0*	*–1,896*	*61.7*
Capital goods	1,867	14.6	9.7	1,338	71.1	10.5	–529	71.7
Non-energy intermediate goods	8,418	6.4	43.5	6,113	14.0	47.9	–2,305	72.6
By geographical area								
European Union (EU-15)	11,162	13.8	57.7	9,049	7.6	71.0	–2,113	81.1
Euro area	*9,449*	*13.8*	*48.9*	*7,116*	*5.1*	*55.8*	*–2,333*	*75.3*
Other countries	8,175	28.2	42.3	3,705	48.7	29.0	–4,470	45.3
Russia	*557*	*48.3*	*2.9*	*79*	*35.3*	*0.6*	*–478*	*14.1*
United States	*673*	*18.2*	*3.5*	*611*	*52.6*	*4.8*	*–63*	*90.7*
Japan	*447*	*–17.1*	*2.3*	*117*	*42.8*	*0.9*	*–330*	*26.1*
Latin America	*1,064*	*68.3*	*5.5*	*800*	*76.7*	*6.3*	*–264*	*75.2*
OPEC	*1,642*	*43.7*	*8.5*	*264*	*6.3*	*2.1*	*–1,378*	*16.1*
Rest	*3,792*	*21.6*	*19.6*	*1,835*	*46.7*	*14.4*	*–1,958*	*48.4*
TOTAL	**19,337**	**19.5**	**100.0**	**12,754**	**17.0**	**100.0**	**–6,583**	**66.0**

SOURCE: Department of Customs and Special Taxes and internal figures.

area where growth by volume was 35%, more than 30 points above the increase recorded in shipments to the EU. Growth of sales to euro area countries was even weaker at 2.5% by volume.

On the import side, there were two key developments. On the one hand, the high oil bill continues to represent a notable proportion of total purchases. In January, imports of energy products was 46.8% higher than in the same month the year before, pushed up by the sharp increase in the average price of imported oil (65%) puttng it at 348.1 euros per ton. Secondly, there was a notable flood of non-food consumer goods which benefitted from the rise in purchases of clothing products. In January, these grew by 130% and came to represent more than 7% of all imports.

Flood of clothing imports in first month of year.

Foreign imbalance worsens in 2005

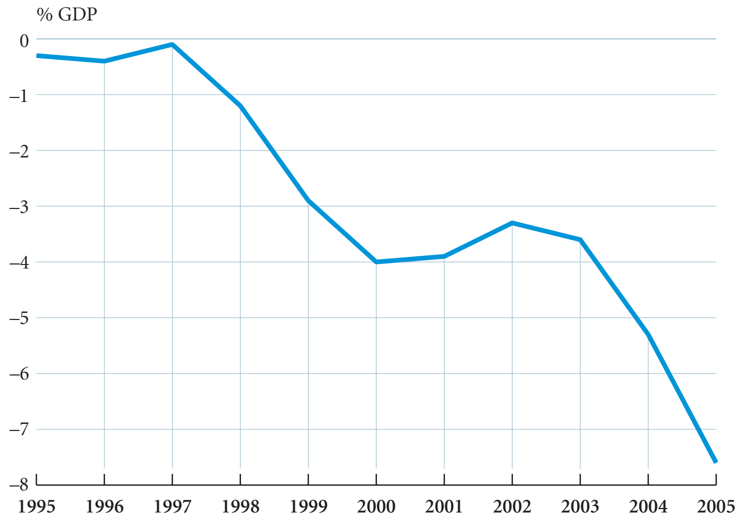
The current account balance ended 2005 with the highest deficit in history (68.95 billion euros), some 55.1% more than in the same period the year before. In relative terms, this figure was equivalent to 7.6% of the gross domestic product so that the imbalance is one of the highest among the developed countries.

The increase in the current account deficit has been especially notable in the past two years but it began quite decidedly as of 1997. The worsening of the current account balance reflects both the growth stage that Spain's economy has gone through in recent years and the brake put on improvements in terms of competitiveness.

Current account balance reflects change in Spain's economy in recent years.

CURRENT ACCOUNT DEFICIT DROPS INTO ABYSS

Current account balance



SOURCE: Bank of Spain, National Institute of Statistics and internal figures.

BALANCE OF PAYMENTS

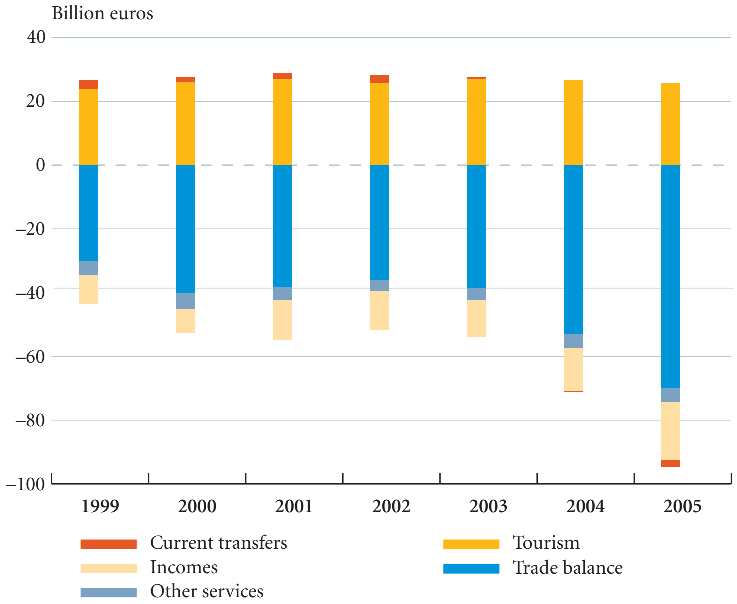
Cumulative figure for last 12 months in million euros

	December 2004	December 2005	% change
Current account balance			
Trade balance	–52,937	–69,834	31.9
Services			
Tourism	*26,604*	*25,668*	*–3.5*
Other services	*–4,373*	*–4,579*	*4.7*
Total	22,231	21,089	–5.1
Income	–13,701	–18,164	32.6
Transfers	–44	–2,043	–
Total	**–44,451**	**–68,952**	**55.1**
Capital account	**8,548**	**8,163**	**–4.5**
Financial balance			
Direct investment	–26,345	–10,593	–59.8
Portfolio investment	85,804	45,596	–46.9
Other investment	–8,616	27,752	–
Total	**50,843**	**62,755**	**23.4**
Errors and omissions	–931	147	–
Change in assets of Bank of Spain	–14,009	–2,113	–84.9

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

ONLY TOURISM SAVES SITUATION

Figures of various current account balances



SOURCE: Bank of Spain and internal figures.

The first sign of this change is the unstoppable rise of the trade deficit which alone accounted for 69% of the increase in the current account deficit in 2005. The arrival of low-cost producing countries on the scene and very strong domestic demand have favoured the spectacular rise in imports that has not been compensated by exports which have been affected by relocation of plants and some loss of competitiveness.

Secondly, the increase in the incomes deficit, which made up 18% of the increase in the current account balance, reflects the financial situation of an economy compelled to obtain funding from abroad in order to sustain the growth of domestic credit. This is reflected in the sharp increase in interest payments on loans and borrowing abroad by the private and public sectors.

In the same way, under the transfers heading, the current account balance shows the worsening of the transfers balance with the European Union. Furthermore, outflows for remittances abroad by immigrants have increased. In fact, this balance, that has traditionally had a comfortable surplus, now is showing a notable deficit for the second year in a row.

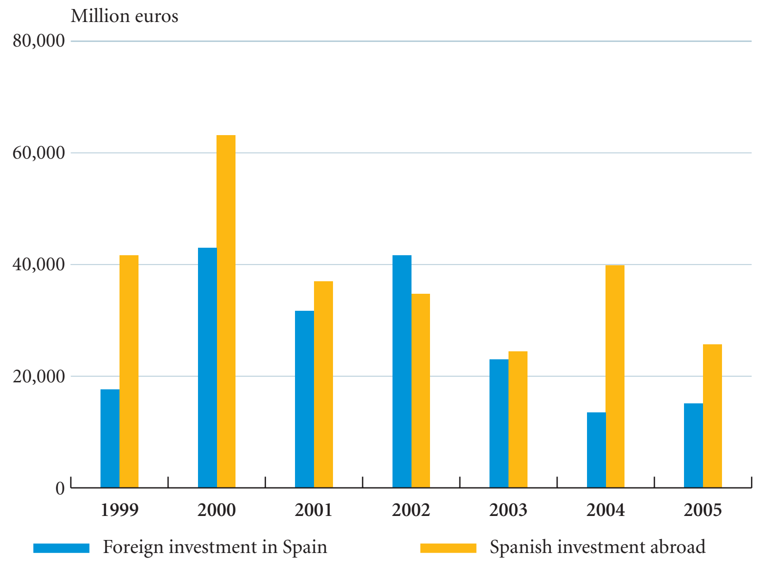
Finally, the soft cushion of the tourist balance, which was able to fully compensate the trade deficit in the early Nineties, has lost something of its bounciness. The containment of tourist inflows, in spite of the rise in sector prices and the growing inflow of foreign tourists (6.1% in 2005) is being wiped out by the increase in payments due the increasing desire of Spaniards to travel abroad.

In the financial sphere, the moderate recovery in direct foreign investment in Spanish companies was notable although it did not reach the levels at the

Globalization hurts trade balance and growth through foreign borrowing has hard effect on incomes heading.

DIRECT FOREIGN INVESTMENT IN SPAIN RECOVERS WHILE SPANISH DIRECT INVESTMENT ABROAD WEAKENS

Direct foreign investment



SOURCE: Bank of Spain and internal figures.

Immigration and European extension affecting transfers balance while tourist balance no longer what it was.

end of the previous decade. On the other hand, Spanish investment abroad fell susbtantially to stand at one of the lowest levels in recent years. In the real estate field, the situation is the other way around given that foreign capital seems to be less in favour of the Spanish market whereas the Spanish sector is showing increasing interest in investing abroad.

Public sector

Economic boom and inflation put government accounts on track in 2005

General government ended the 2005 budget year with a surplus of 1.1% of the gross domestic product (GDP), a result the economic authorities hastened to point out as the first surplus since the Seventies. In fact, this announcement had been made in previous years but later reviews of the figures had corrected the initial estimates downward.

By administration, as in previous years, Social Security again presented a notable surplus, although this time accompanied by a central government surplus. On the other hand, the autonomous communities and local government showed negative balances worse than the year before.

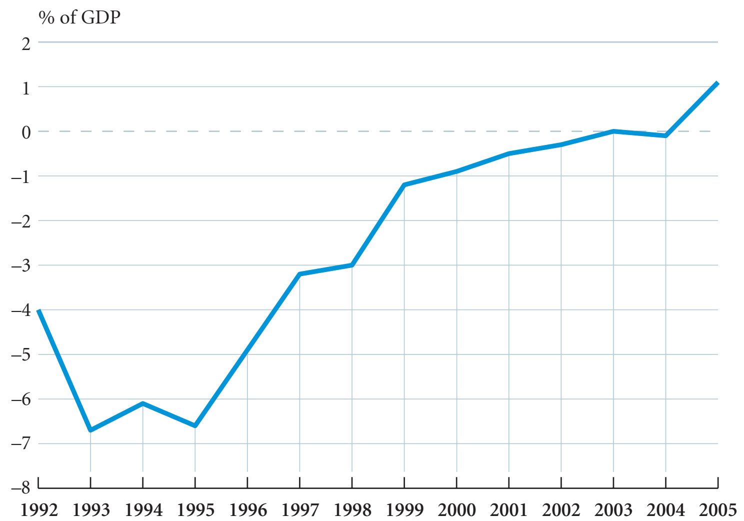
The favourable result of the balance for general government as a whole was due to the extraordinary growth of revenues, particularly tax collections which, according to the Ministry of Finance rose by 14.1%, nearly five points above growth of domestic demand. In the case of spending, the few figures available, covering only the central government segment, point to upward deviations except in the area of interest on the government debt.

Economic boom favours sharp rise in tax collections...

The rise in revenues of general government was across the board in the various tax headings. Strong job creation and giving foreign workers legal working status raised collections for Social Security while this also had an important effect on collections for personal income tax. The good state of business in general

GOVERNMENT ACCOUNTS REGAIN POSITIVE GROUND

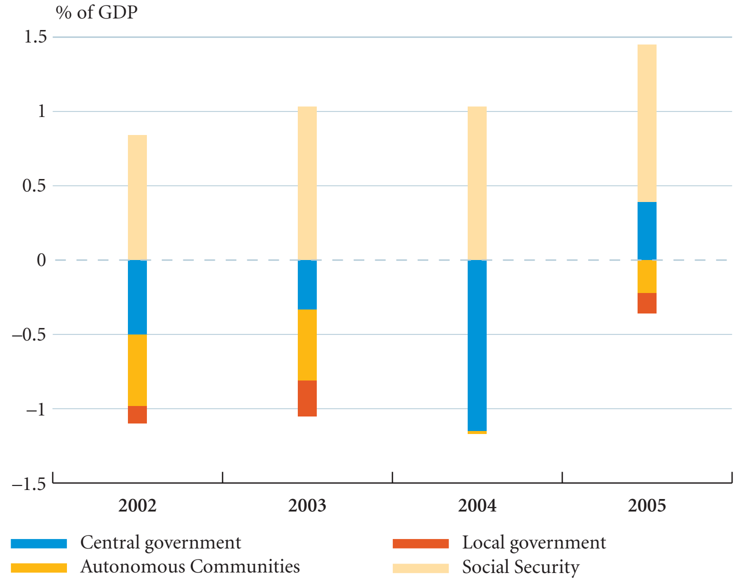
Balance for general government



SOURCE: Ministry of Economy and Finances and Bank of Spain.

SOCIAL SECURITY AND CENTRAL GOVERNMENT SURPASS BUDGET LEVELS

Budgetary balance by level of government



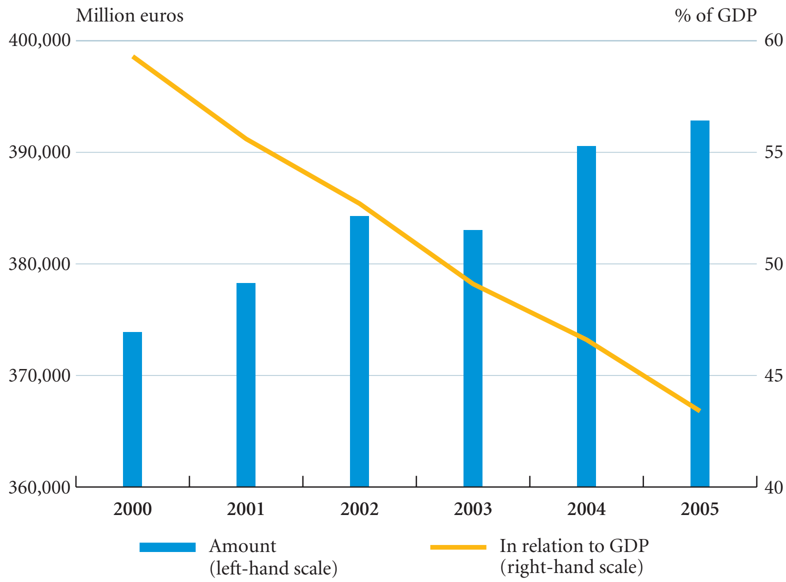
SOURCE: Ministry of Economy and Finance and internal figures.

gave a decided boost to collections for corporation tax.

At the same time, rises on the stock market and the continued strength of the real-estate market also had an effect on

GOVERNMENT DEBT MODERATING

General government debt



SOURCE: Ministry of Economy and Finance and internal figures.

taxation for capital gains under income headings. Overall, direct taxation moved up a rate of 17.7% while Social Security contributions (according to provisional figures) were up 7.8%.

In the matter of indirect taxes, the sharp increase in domestic demand, along with the growth of imports, was decisive. Furthermore, the high inflation rate, in general, and the rise in oil prices and fuel costs in particular brought about a substantial increase in revenues obtained by the public purse, mainly through the value added tax (VAT) for which collections were up 12.1%. In addition, the increase in amounts coming from foreign trade as 18.6%.

The outstanding balance of the public debt of all general government stood at 392.8 billion euros at the end of 2005, that is to say, 43.4% of the GDP, two points and two decimals less than in the year before. Of this proportion, 6.2% were for autonomous communities and municipalities and the rest (37.2 points) corresponded to the central government, including Social Security. In any case, the level of debt of Spain's general government is substantially lower than the average for the euro area at 72% in 2005.

...which has positive effect on balance of government accounts.

Savings and financing

Funding for companies showing great strength

Financing of companies records highest growth since July 1999.

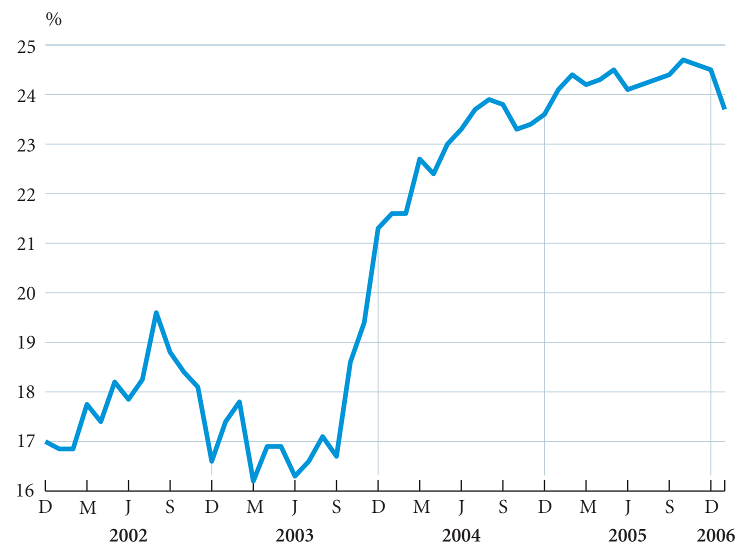
Demand for funding by the private sector remains strong. In January, financing granted to companies and households grew at an annual rate of 20.4%, only two decimals lower than the high for the past decade noted in December. The good state of the economy and current low interest rates were behind this trend.

Funds going to companies were up 20.2% in the last 12 months ending in January. This was the highest annual rate recorded since July 1999. With regard to funds going to households, these were up 20.7% compared with January 2005, a half-point less than in the month before. This gradual decrease was noted in housing loans which went to 23.7% in January, one point less than in October 2005. As a result, while the increase in mortgage loans remains very high, the forecast slowdown may have begun.

On the other hand, 2005 saw the signing of 1,752,947 mortgages on rural and urban properties in Spain, according to the National Institute of Statistics, which was 10.5% more than the year before. The total amount of new mortgage loans rose by 25.7% compared with 2004. The average amount per mortgage loan was 137,707 euros in 2005, to show an annual rise of 13.7%. The average amount per mortgage loan on housing

SOME SIGNS OF SLOWDOWN IN BANK LOANS FOR HOUSING

Year-to-year change in loans by resident credit institutions and mortgaged backed securities issued against housing loans



SOURCE: Bank of Spain.

was 124,538 euros, to show growth of 13% over the year before. By institution, savings banks were those granting the largest number of mortgage loans in 2005 (54% of the total) followed by banks (36%) and other financial institutions (10%).

The average term of mortgage loans at banks and savings banks was 24 years. Nevertheless, most mortgages are repaid before maturity so that the average repayment period stood at 8 years. On the other hand, 97.5% of mortgages taken out last year were made at variable interest rate, while 2.5% were at fixed interest rate. The Euribor continued to be the most usual reference index and was used in 81.9% of all mortgages signed.

With regard to geographical distribution of mortgages in 2005, the autonomous communities where the most mortgages were taken out in relative terms were the Balearic Islands (7,089 for each 100,000 population) and Murcia (6,771 for each 100,000). The Balearic Islands was also the autonomous community to show the biggest annual increase in the number of mortgages, followed by Castile-La Mancha, Extremadura, Aragon and Valencian Community. On the other hand, there were drops in the number of mortgages in Ceuta and Melilla, Navarre and Galicia.

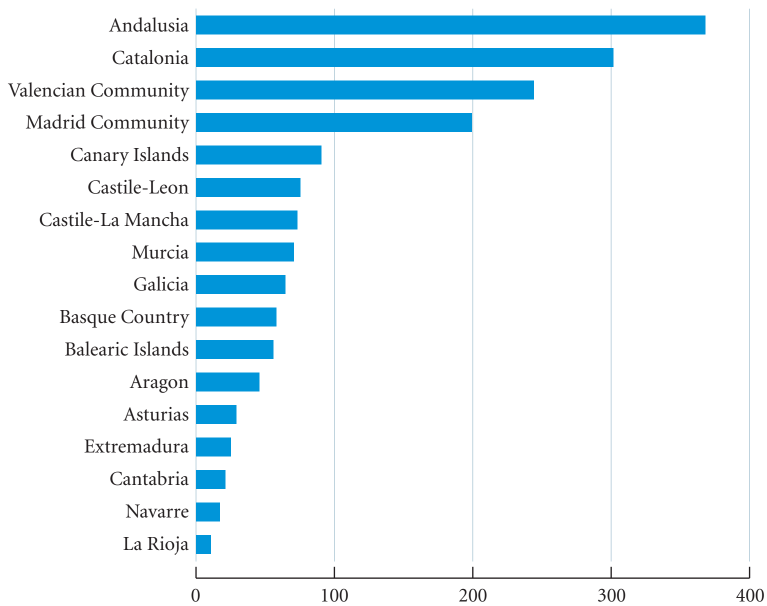
In addition, consumer credit is showing a strong drive. The amount of new consumer loan and credit transactions for households to buy cars, motor-cycles, appliances, furniture, travel, etc. amounted to 3.81 billion euros in January 2006. This figure meant a year-to-year increase of 34.6%. It should be pointed out that financial institutions have also eased financing conditions by increasing maturity periods and in some cases allowing modification of repayment instalments up or down. On

98% of mortgages taken out in 2005 were at variable interest rate.

Biggest increases in number of mortgages in 2005 recorded in Balearic Islands, Castile-La Mancha and Extremadura.

NEARLY TWO-THIRDS OF MORTGAGES CONCENTRATED IN FOUR AUTONOMOUS COMMUNITIES

Funds lent on mortgage guarantee in 2005, in million euros



SOURCE: National Institute of Statistics.

Consumer credit shoots up.

the other hand, new loan and credit transactions for households for other purposes (buying securities, land, etc.) amounted to 4.63 billion euros in the first month of the year, a year-to-year increase of 8.4%.

Interest rates on bank loans and credits continued to rise in January following the upturn by the European Central Bank in December 2005. In any case, the average rate still stood below the level of inflation, meaning that real interest rates were slightly negative. As a result, bank interest rates in 2006 will probably continue to rise although only moderately.

Extraordinary growth of bank deposits

Total deposits of resident companies and households are showing vigorous growth, well above those for the euro area as a whole, thus reflecting the good state of Spain's economy. Deposit accounts for more than a two-year term, which enjoy a tax deduction of 40% on interest, showed spectacular growth. On the other hand, on-demand deposits and savings deposits rose by 13.5% in January compared with the same month the year before.

Investment funds are also a preferred vehicle for savers. Assets of securities mutual funds rose by 3.9 billion euros in February going to 252,04 billion euros, according to Inverco, the sector organization. As a result, total assets of securities mutual funds grew by 12.2% in the past 12 months. Net subscriptions recorded in the first two months of the year amounted to 1.89 billion euros. As a result, more than half the increase in assets was made up of capital gains, largely due to the good state of the stock markets. Most of the net acquisitions of shares was directed to global funds and international share-based funds in search of higher yields. Average annual yield on securities mutual funds in February was 5.4%, a figure above inflation.

Moderate growth in savings life insurance premiums in 2005.

In another sphere, premiums on savings life insurance rose to 17.65 million euros in 2005, a year-to-year increase of 7.4%. Of these, those for retirement insurance

DEPOSITS OF COMPANIES AND HOUSEHOLDS AT CREDIT INSTITUTIONS

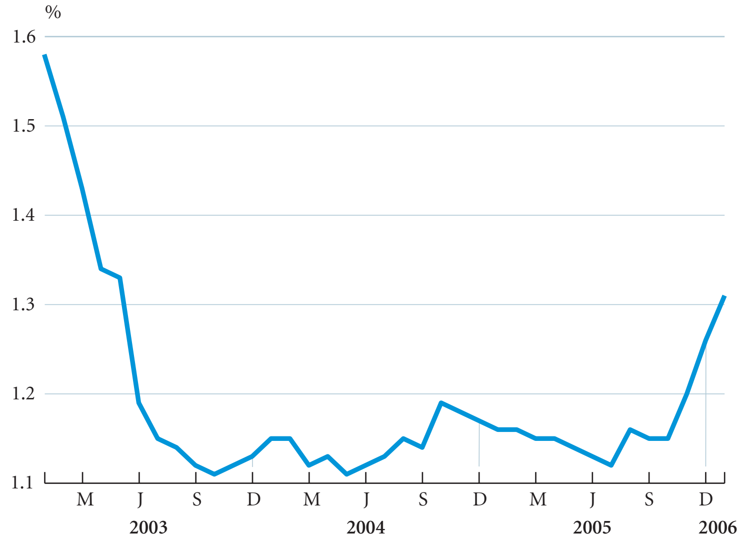
January 2006

	Total	Change this year		Change over 12 months		% share
	Million euros	Million euros	%	Million euros	%	
On-demand savings (**)	387,595	–8,760	–2.2	46,060	13.5	42.5
Up to 2 years (*)	191,935	1,419	0.7	30,706	19.0	21.0
More than 2-year term (*)	241,475	4,719	2.0	112,807	87.7	26.5
Repos	74,209	1,157	1.6	–1,972	–2.6	8.1
Total (*)	**895,215**	**–1,464**	**–0.2**	**187,603**	**26.5**	**98.2**
Deposits in currencies other than euro	**16,649**	**1,010**	**6.5**	**10,613**	**175.8**	**1.8**
TOTAL (*)	**911,864**	**–454**	**0.0**	**198,216**	**27.8**	**100.0**

NOTES: (*) As a result of the coming into force of new regulations in application of the International Accounting Standards, as of June 2005, increases in time-deposits as a cross-entry to entries on the assets side of securitizations that had been taken out of the balance sheet make comparison difficult.
(**) Includes deposits redeemable at notice, according to ECB definition.
SOURCE: Bank of Spain and internal figures.

RISE IN INTEREST RATES ON BANK DEPOSITS

Interest rates applied by credit institutions on private sector deposits (*)



NOTES: (*) Equivalent annual rate excluding commissions.
SOURCE: Bank of Spain.

amounted to 9.58 billion euros, 5.0% more than in 2004.

In addition, on March 10 the government approved a bill to reform personal income tax. This measure proposes some important changes in the tax treatment of savings. As a result, it will establish a single tax rate of 18% for earnings on all types of savings accounts. Up until now, the treatment has been different for those products that generate a yield, such as deposits, and gains on property, and varies according to the period during which those gains are made. The new bill reorients tax incentives applied to complementary social purposes, such as pension funds, toward instruments for which gains are received in the form of income. At the same time, we will see the disappearance of deductions applied to yields obtained on life insurance with terms of more than two years made with a single premium payment. The law provides for a new account to foster long-term savings in the form of an individual systematic savings account. Nevertheless, this law, if passed, would respect rights acquired before January 20, 2006.

New treatment for savings in personal income tax law to be based on single 18% rate.

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