JUNE 2006

THE SPANISH ECONOMY

Monthly Report

NUMBER 292

RESEARCH DEPARTMENT

"la Caixa"

Forecast

% change over same period year before unless otherwise noted

	2004	2005	2006	2005				2006		
				1Q	2Q	3Q	4Q	1Q	2Q	3Q
INTERNATIONAL ECONOMY			Forecast						Forecast	
Gross domestic product										
United States	4.2	3.5	3.5	3.6	3.6	3.6	3.2	3.6	3.6	3.5
Japan	2.3	2.6	2.6	1.1	2.7	2.7	4.0	3.0	2.7	2.6
United Kingdom	3.1	1.8	2.3	1.9	1.7	1.9	1.8	2.2	2.3	2.3
Euro area	1.8	1.4	2.0	1.2	1.2	1.6	1.8	1.9	2.0	1.9
Germany	*1.1*	*1.1*	*1.6*	*0.6*	*0.8*	*1.5*	*1.7*	*1.4*	*1.7*	*1.6*
France	*2.0*	*1.2*	*1.8*	*1.6*	*0.8*	*1.4*	*1.1*	*1.5*	*2.0*	*1.9*
Consumer prices										
United States	2.7	3.4	3.4	3.0	3.0	3.8	3.7	3.7	3.8	3.0
Japan	0.0	–0.3	0.4	–0.2	–0.1	–0.3	–0.5	0.4	0.4	0.3
United Kingdom	2.2	2.3	2.3	2.2	2.2	2.4	2.2	2.2	2.4	2.4
Euro area	2.1	2.2	2.3	2.0	2.0	2.3	2.3	2.3	2.4	2.2
Germany	*1.7*	*2.0*	*1.8*	*1.7*	*1.7*	*2.1*	*2.3*	*2.0*	*2.0*	*1.7*
France	*2.1*	*1.7*	*1.8*	*1.7*	*1.7*	*1.9*	*1.6*	*1.8*	*1.7*	*1.8*
SPANISH ECONOMY			Forecast						Forecast	
Macroeconomic figures										
Household consumption	4.4	4.4	3.6	4.6	4.6	4.3	4.0	4.0	3.8	3.5
Government consumption	6.0	4.5	4.5	5.2	4.0	4.2	4.6	4.7	4.6	4.5
Gross fixed capital formation	4.9	7.2	5.7	7.0	7.6	7.3	6.8	6.2	6.0	5.4
Capital goods	*3.7*	*9.5*	*7.6*	*9.8*	*10.4*	*8.9*	*9.1*	*8.3*	*7.9*	*7.4*
Construction	*5.5*	*6.0*	*4.8*	*6.0*	*6.2*	*6.3*	*5.6*	*5.8*	*5.3*	*4.5*
Domestic demand (contribution to GDP growth)	4.9	5.3	4.6	5.5	5.4	5.3	5.0	5.0	4.8	4.4
Exports of goods and services	3.3	1.0	8.4	–1.4	1.3	2.1	1.9	9.1	8.8	8.1
Imports of goods and services	9.3	7.1	11.3	6.2	7.9	7.8	6.6	12.4	11.8	11.0
Gross domestic product	**3.1**	**3.4**	**3.2**	**3.3**	**3.4**	**3.5**	**3.5**	**3.5**	**3.4**	**3.1**
Other variables										
Employment	2.6	3.1	2.9	3.0	3.2	3.2	3.2	3.2	3.1	2.8
Unemployment (% labour force)	11.0	9.2	9.0	10.2	9.3	8.4	8.7	9.1	9.0	8.9
Consumer price index	3.0	3.4	3.8	3.3	3.2	3.4	3.6	4.0	4.0	3.7
Unit labour costs	2.8	2.3	2.5	2.5	2.4	2.0	2.2	2.3		
Current account balance (% GDP)	–5.8	–7.4	–8.9	–8.4	–7.8	–6.7	–6.8	–10.6		
Not lending or net borrowing rest of the world (% GDP)	–4.8	–6.5	–8.0	–7.8	–6.6	–5.8	–5.8	–10.2		
Government balance (% GDP)	–0.1	1.1	0.5							
FINANCIAL MARKETS			Forecast						Forecast	
Interest rates										
Federal Funds	1.3	3.2	4.9	2.4	2.9	3.4	4.0	4.4	4.9	5.2
ECB repo	2.0	2.0	2.7	2.0	2.0	2.0	2.1	2.3	2.6	2.8
10-year US bonds	4.3	4.3	5.3	4.3	4.2	4.2	4.5	4.6	5.1	5.5
10-year German bonds	4.1	3.4	4.2	3.6	3.3	3.2	3.4	3.5	4.0	4.5
10-year Spanish bonds	4.1	3.4	4.2	3.6	3.3	3.2	3.4	3.5	4.0	4.5
Exchange rate										
$/Euro	1.24	1.25	1.28	1.31	1.26	1.22	1.19	1.20	1.27	1.31

THE SPANISH ECONOMY
MONTHLY REPORT
June 2006

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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: 2006 BUDGET	Million euros
Activities	
Social	160
Cultural	70
Science and environmental	54
Educational	19
TOTAL BUDGET	**303**

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Contents

The annual invasion

Mass tourism as we know it today is a relatively recent happening in the history of mankind. In order to find any precedent for the current phenomenon we have to go back to England in the 16th century. At that time, an era dominated by the long reign of Queen Elizabeth I, there arose the custom of making the Grand Tour widely adopted by young English aristocrats. The tour could last for months and served to complete the education of the heirs of the British nobility. This custom became widespread in the 18th century when it was taken up by the offspring of the upper middle class. From then on the English word *tourist* spread over Europe (touriste, torista, turista, etc.) to denote this type of travel. A century later, Thomas Cook set an important landmark as the person to organize the first group train trip (from Leicester to Loughborough). The initial success of this trip encouraged him (and again he was a pioneer) to create an organized system of tourist services very much like present-day travel agencies. In 1890 there were already nearly 1,200 hotels around the world that would accept vouchers issued by Thomas Cook offices.

The big development in tourism, however, took place at the end of the Fifties in the last century. What was the reason for the tourist boom at that specific time? Probably it was a combination of a series of factors involving a new international order aimed at maintaining peace, the economic prosperity of the post-war period, the spread of paid holidays in the modern industrial societies and the revolution in transport and communications. Adding to this was the boom in the private car and the growth of commercial aviation. In the Sixties, foreign tourists (along with emigrant remittances) came like manna from heaven for the incipient development of Spain's economy. At the end of the Sixties tourist inflows covered nearly 80% of Spain's trade deficit.

Of course, times have changed but tourist activity continues to be a strategic support of Spain's economy to which it contributes 11% of the gross domestic product while generating a major «drag» effect on other related activities. Spain today is the second leading destination of international tourism in order of importance, coming behind France and ahead of the United States. As happens each year, we are now faced with another tourist «invasion» given that the seasonal nature of the Spanish tourist model means that nearly half of the more than 55 million foreign visitors arriving in Spain this year will time their stay for the summer months.

The sector, however, is undergoing change. On the one hand, Spanish tourists are becoming more and more important while the foreign tourist is being tempted by other tourist destinations that are both attractive and cheap. It also seems that the tourist coming to Spain is changing from the traditional pattern (a family that spends its holidays on Spain's sunny beaches) to the tourist who arranges the whole trip on Internet, with low-cost airline companies, visits that do not necessarily take place in the holiday period and in lodgings that are different from the usual. On top of these trends comes the group of Europeans who chose Spain as a place to live on retirement, which is generating heavy demand for holiday homes and profoundly changing certain coastal areas. The relative weight of tourism in Spain's economy demands the carrying out of a careful overall analysis and the adoption of suitable measures to consolidate its present leadership and respond to the challenges being faced.

May 27, 2006

OVERALL SUMMARY

Increases on stock markets continued in early May, along with rise in raw materials, in environment of confidence due to excellent prospects set out by International Monetary Fund.

But suddenly markets slip into unexpected stage of drops which may be seen as correction of past excesses.

In fact, figures for economic situation still good, both in United States...

Markets nervous

The month of May will likely be remembered for the financial upsets which broke out at the end of the second week. Up to then, everything went along the bubbling normalcy seen in recent months. That is to say, the stock markets on the rise, raw materials at all-time high levels and yields on long-term bonds settling into an upward course. Furthermore, the International Monetary Fund had certified the strength of the current expansionist stage of the world economy and it even seemed that something of an international consensus had been reached on suitably rearranging the exchange rate risks connected to the dollar.

But as of the third week of May everything changed. The stock markets suffered a notable punishment with some markets seeing their cumulative gains for the year being lost in just a few days. Emerging country markets were the ones to suffer the biggest drops. Russia, India, Indonesia and Brazil dipped sharply after having marked up all-time highs in the second week of the month. Something similar happened with raw materials which recently have become subject to speculation. Both crude oil and industrial metals and precious metals suffered a notable drop since May 12.

Why did such major corrections take place? There is no single reason. We should probably seek the cause in the correction of past excesses. The most widely-held impression is that investors were understating the risks and almost becoming reckless. Up to now, the rise in share quotations had paid little attention to the gradual tightening of monetary policies, the high prices reached for oil and other raw materials, the worsening of world discrepancies in balance of payments and tenuous signs of inflation. The risk premiums on bonds of emerging countries had reached all-time lows. The perception of risk was practically non-existent.

In May nothing substantially changed on the international economic scene. However, the more that companies record exceptional profits and their financial situation shows as excellent, the immediate future now cannot be better. We are going to see somewhat less growth, somewhat more inflation and higher interest rates. We therefore must be more selective. US inflation and uncertainty about the coming action of the Fed has set off a state of nerves which has spread rapidly to the markets provoking moves which are probably excessive.

In fact, the figures for the economic situation continue to be splendid. For example, growth in the United States. In the first quarter, the gross domestic product (GDP) was up more than 5% at annualized rate compared with the previous quarter, thus creating fears about an early slowdown. Indeed, a slowdown is noted in the real estate field (less demand, little increase in prices) but all at the rate of a «soft landing». In any case, job creation is still going full-steam-

ahead and the unemployment rate stands at low levels.

In Japan, the figures are also favourable. The growth of neighbouring China, with a figure of 10%, has a lot to do with this. But the important factor is that domestic demand has decided to come out from under. Japan's economy seems on the way to becoming normal following many years in the mire. In the first quarter of 2006 growth was 3.0% at year-to-year rate, not as sharp an increase as in the fourth quarter (rise of 4.0%) but one that allowed the labour market to put the unemployment rate at 4.1%, the lowest in the past eight years.

There is also good news from the Euro Area. Growth of 2% seems assured in 2006. Keeping in mind that this is close to potential growth estimated for the 12 member states with the euro as currency, the current situation must be seen as positive. No problems with inflation are foreseen although no one should let down their guard because there could still arise some so-called «second round» effects arising from the rise in oil prices (wage increases, increases in government charges, etc.).

We should also pay attention to German recovery. While at this moment economic situation indicators in Germany are very favourable, the impact of the tax package adopted by the coalition government could distort the current good course being followed. The latest warning comes from the mediocre results in the other two large Euro Area economies, France and Italy. The most recent indicators point in a good direction but what is troubling is the strange French political situation which comes on top of elections expected in 2007, all of which does not contribute to bringing about reform policies. In Italy, the political situation has cleared following the recent elections but some aspects of the policy of the new cabinet are still to be firmed up.

...and in Japan and Euro Area where recovery now established.

It is a pity that the small Euro Area economies cannot set themselves up as engines of growth, given that they present prospects that are much clearer. The European Commission foresees major growth for Ireland (nearly 5% in 2006) and for Luxembourg (4.4%), while in Greece and Finland it will be around 3.5%.

Spain's economy: high growth has its price

Growth forecasts for Spain in 2006 are also favourable and run within a narrow margin between 3.1% and 3.3%. Because of its size and strength, Spain's economy now indeed constitutes a pillar of recovery in the Euro Area. The forecast would be excellent if it were not for the persistence or worsening of foreign and inflationary imbalances.

Doubts persist about future course of German, French and Italian economies, the three «big boys» of Euro Area...

As the Bank of Spain had indicated, GDP growth in the first quarter stood at 3.5%, according to the early estimates from the National Institute of Statistics. This rate was the same as that recorded in the second half of last year. Stability is therefore the characteristic note of the figures for national accounting in recent quarters. And not only in terms of growth. What also is a constant is the contribution of national demand to growth (5 percentage points) and that of foreign demand, which draws off 1.5 points from the growth rate of the gross domestic product.

By components at a broken down level, what stands out is the strength still being maintained by private consumption which is growing by 4.0%. The biggest drive is coming from

...while Spain's economy runs full-steam-ahead at 3.5% with no substantial changes over last year's trends.

Household consumption gradually moderating while general government enjoying excellent financial situation.

services while the part corresponding to durable goods seems to be slackening, as can be seen in the most recent indicators for car sales and retail buying. The slightly downward profile of consumer spending by households is in contrast to the rise in consumption by general government. In this case, the substantial increase in salaries of public servants is not affecting the excellent situation of the public sector accounts. The increase in central government tax collections has made it possible to present a notable increase in the Treasury surplus in the first quarter.

Far from moderating, home purchase maintains full strength, helped by interest rates still below inflation rate as well as job creation.

Investment is also going through a splendid moment. Spending on equipment and machinery grew somewhat less than in previous quarters but it is still at rates of more than 8% in real terms. On the other hand, investment in construction has again gone against forecasts that were betting on a slowdown. In the first quarter of the year, residential building increased its year-to-year growth rate to 7.4% in real terms. In fact, demand for housing continues very strong if we are to judge by the rate at which mortgage loans are being granted. By March, loans by banks and savings banks for home purchase continued to grow at the same rate as at the end of 2005, that is to say, an above 24%. And this despite the fact that interest rates have risen. The Bank of Spain calculates that while last summer credit institutions were lending at an interest rate of 3.2%, in March they raised the rate to 3.7% and the trend is to further increases.

Counteracting good results in growth and employment comes surprisingly rapid worsening of foreign deficit and persistence of higher inflation than among neighbouring countries.

Interest rates with mortgage security still stand below the inflation rate. And employment does not stop rising which also represents a stimulus and support for housing demand. The rate of job creation for some months has been stable at 3.2%, which has meant the creation of 575,000 new full-time jobs in the past year. According to the Labour Force Survey, the number of persons with jobs in the first quarter amounted to 19.4 million, nearly 5% more than one year earlier. Immigrants accounted for a good part of the new jobs created.

The excellent results in terms of growth and employment have their negative side. Or, rather, two negative sides, namely foreign deficit and inflation. In the first quarter of 2006, exports of goods showed very favourable results seeing that they rose by 12.7% at constant prices. However, the poor situation in exports of services (affected by the drop in inflows from tourism) and the renewed drive in imports resulted in a rapid worsening of the foreign balance for goods and services. If we add to this the negative trend in other operations with abroad, the result is a current account deficit equivalent to 10.6%. This is an all-time high and may be affected by seasonal factors but it is troubling if we take into account that in 2005 there was a deficit of only 7.4% of the GDP.

With regard to inflation, in recent months the GDP deflator has stood close to 4.5%, a very high level indeed. The level of unit labour costs, which are a significant indicator of competitiveness in terms of abroad, growth stood at 2.3% in the first quarter, a rate in contrast with the lower growth for the Euro Area as a whole at 1.2%. Inflation and the foreign deficit, in fact, are two imbalances that partly arise from the sharp drive in domestic demand but not for that reason are they any less troubling because of their potentially adverse effect on the present favourable economic situation.

CHRONOLOGY

2005

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	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%.
March	2	**European Central Bank** raises official interest rate to 2.50%.
	28	**Federal Reserve** raises reference interest rates to 4.75%.
	31	Government approves **economic policy package** including budgetary measures and others on mortgage market, energy sector and rail transport.
May	2	One-month forward price of Brent quality **oil** goes up to all-time high of 74.28 dollars a barrel.
	4	Agreement between government, business organizations and trade unions on **labour reform** aimed at reducing extent of temporary work.
	9	IBEX 35 index for **Spanish stock exchange** marks up annual high (12,083.3) with cumulative gains of 12.6% over end of December 2005.
	10	**Federal Reserve** raises reference rate to 5%. Dow Jones index for **New York stock exchange** records annual high (11,642.7), a rise of 8.6% compared with end of 2005.

AGENDA

June

- **5** Industrial production index (April).
- **8** Meeting of Governing Board of European Central Bank.
- **13** Consumer price index (May).
- **14** Quarterly survey of labour costs (1st Quarter).
- **15** HCPI for European Union (May).
- **26** Producer price index (May).
- **29** Early HCPI indicator (June). Meeting of Open Market Committee of Federal Reserve.

July

- **5** Industrial production index (May).
- **6** Meeting of Governing Board of European Central Bank.
- **14** Consumer Price Index (June).
- **17** Harmonized Consumer Price Index for EU (June).
- **25** Producer Price Index (June).
- **28** Labour Force Survey (2nd Quarter). Early HCPI indicator (May).

INTERNATIONAL REVIEW

OECD forecasts: a rosy prospect but with increased risks

OECD raises growth forecast for 2006.

The Organization for Economic Cooperation and Development (OECD) again raised its growth forecast for 2006 from 2.9% to 3.1%. For 2007 it foresees a slight easing off to rates o 2.9%. We thus continue to see confirmation of the capacity of the world economy to maintain a strong level of activity in spite of natural catastrophes and rises in energy prices. The latest consumer and business surveys also indicate a process of convergence in growth rates. While in the United States the tightening of monetary policy should lead to a «soft landing», in Japan growth has been revised upward and in Europe, despite political uncertainty and the absence of economic reforms, demand likely will give support to growth.

Growth spreads to various regions.

The United States continues to lead world growth, with a figure of 3.6% in 2006, which will ease to 3.1% in 2007. In turn, the Euro Area supported by its consumers including in Germany, will grow by 2.2% in 2006 although economic activity will not go higher with a growth rate of 2.1% in 2007. By country, Spain will grow by 3.3% in 2006, higher than the European average. France and Germany will slightly recover drive with growth of 2.1% and 1.8% respectively. Thanks to consumers, Japan will grow more than expected earlier with the forecast for 2006 going from 2.0% to 2.8%, a rate that will lead to full utilization of production capacity and will ease to 2.2% in 2007.

Oil permitting, inflation presents kindly face but trade imbalances widening and housing unstoppable.

The inflationary picture will be kindly so long as the price of oil holds in the range of 70 dollars a barrel. Japan will move out of its deflationary stage with price increases that should stabilize at 1%. In Europe, if we discount the distortions resulting from the increase in the value added tax in Germany, inflation in 2007 should tend to rates below the 2% threshold. In the United States, price moderation will be delayed somewhat longer with a forecast for 3.3% in 2006 and 2.4% in 2007.

The scenario remains clearly positive but the risks have increased. The top risk continues to be the foreign imbalances which have grown. The United States will see it current account deficit go to 7.5% of it gross domestic product (GDP) in 2007 and in Spain the foreign deficit will come close to 10% of the GDP. By contrast, Germany's foreign surplus will go up to 4.5% while those of China and Japan will exceed 5% of the level to their respective economies. More than a reflection of the free movement of goods and capital, these imbalances are the result of general deficiencies in fiscal policy and structural reforms. Any sudden correction of these imbalances would have detrimental effects on the state of the economy and on share/bond prices.

The second key risk lies in inflation of real estate assets. While an orderly slowdown should not bring about macroeconomic instability, as shown in the cases of the United Kingdom and Australia, the fact is that housing is generally going up rather than

OECD: ECONOMIC OUTLOOK (1)

	2003	2004	2005	2006	2007
GDP (2)					
United States	2.7	4.2	3.5	3.6	3.1
Japan	1.8	2.3	2.7	2.8	2.2
Germany	–0.2	1.1	1.1	1.8	1.6
France	0.9	2.1	1.4	2.1	2.2
Italy	0.1	0.9	0.1	1.4	1.3
United Kingdom	2.5	3.1	1.8	2.4	2.9
Spain	3.0	3.1	3.4	3.3	3.0
Euro area	**0.7**	**1.8**	**1.4**	**2.2**	**2.1**
OECD	**2.0**	**3.3**	**2.8**	**3.1**	**2.9**
Inflation (3)					
United States	2.3	2.7	3.4	3.3	2.4
Japan	–0.3	0.0	–0.3	0.7	0.8
Germany	1.0	1.8	1.9	1.6	2.1
France	2.2	2.3	1.9	1.7	1.4
Italy	2.8	2.3	2.2	2.4	2.1
United Kingdom	1.4	1.3	2.0	2.2	1.6
Spain	3.1	3.1	3.4	3.6	3.7
Euro area	**2.0**	**2.1**	**2.2**	**2.1**	**2.0**
OECD	**2.3**	**2.3**	**2.0**	**2.2**	**2.0**
Unemployment (4)					
United States	6.0	5.5	5.1	4.7	4.7
Japan	5.3	4.7	4.4	4.0	3.5
Germany	8.7	9.2	9.1	8.5	8.1
France	9.8	10.0	9.9	9.5	9.2
Italy	8.6	8.1	7.8	7.7	7.6
United Kingdom	5.0	4.7	4.8	5.3	5.2
Spain	11.0	10.5	9.2	8.7	8.6
Euro area	**8.7**	**8.9**	**8.6**	**8.2**	**7.9**
OECD	**6.9**	**6.7**	**6.5**	**6.2**	**6.0**
Current account balance (5)					
United States	–4.7	–5.7	–6.4	–7.2	–7.6
Japan	3.2	3.7	3.6	4.3	5.5
Germany	1.9	3.7	4.2	4.0	4.6
France	0.4	–0.4	–1.9	–2.6	–2.3
Italy	–1.3	–0.9	–1.6	–2.1	–2.2
United Kingdom	–1.4	–2.0	–2.6	–2.4	–2.9
Spain	–3.6	–5.3	–7.4	–8.9	–9.8
Euro area	**0.4**	**0.8**	**–0.2**	**–0.4**	**–0.3**
OECD	**–1.1**	**–1.2**	**–1.8**	**–2.1**	**–2.1**
World trade (6)	**5.1**	**10.3**	**7.5**	**9.3**	**9.1**

NOTES: (1) Starting hypothesis: a) Fiscal policies in force or announced will not change; b) Exchange rates will not change from level on May 4, 2006 (1 dollar = 113.5 yen = 0.790 euros); c) Closing date of publication and for including figures was May 17, 2006.
(2) All percentage change rates in real tems.
(3) Percentage change rates in GDP deflator.
(4) As percentage of labour force.
(5) As percentage of GDP.
(6) Arithmetical average of percentage annual growth rates of world imports and exports by volume.
SOURCE: Organization for Economic Cooperation and Development.

OECD: FINANCIAL OUTLOOK (1)

	2002	2003	2004	2005	2006	2007
Government deficit (–) or surplus (+) (2)						
United States	–3.8	–5.0	–4.7	–3.7	–4.2	–3.9
Japan	–7.9	–7.7	–6.5	–6.5	–6.0	–6.0
Germany	–3.7	–4.0	–3.7	–3.9	–3.6	–2.6
France	–3.2	–4.2	–3.6	–3.2	–3.2	–3.0
Italy	–2.9	–3.3	–3.3	–4.3	–4.2	–4.8
United Kingdom	–1.7	–3.3	–3.2	–3.1	–3.0	–3.2
Spain	–0.3	0.0	–0.2	0.3	0.3	0.2
Euro area	**–2.5**	**3.0**	**–2.7**	**–2.9**	**–2.7**	**–2.5**
OECD	**–3.2**	**–4.0**	**–3.6**	**–3.2**	**–3.2**	**–3.1**
Short-term interest rates (3)						
United States	1.8	1.2	1.6	3.5	4.8	4.9
Japan	0.1	0.0	0.0	0.0	0.0	0.7
United Kingdom	4.0	3.7	4.6	4.7	4.5	4.5
Euro area	**3.3**	**2.3**	**2.1**	**2.2**	**2.2**	**2.9**
Long-term interest rates (4)						
United States	4.6	4.0	4.3	4.3	4.7	4.8
Japan	1.3	1.0	1.5	1.4	1.8	2.3
Germany	4.8	4.1	4.0	3.4	3.7	4.0
France	4.9	4.1	4.1	3.5	3.7	4.1
Italy	5.0	4.3	4.3	3.6	3.9	4.2
United Kingdom	4.9	4.5	4.9	4.5	4.5	4.7
Spain	5.0	4.1	4.1	3.4	3.7	4.1
Euro area	**4.9**	**4.1**	**4.1**	**3.4**	**3.7**	**4.1**

NOTES: (1) Starting hypothesis: a) Fiscal policies in force or announced will not change; b) Exchange rates will not change from level on November 5, 2004 (1 dollar = 105.7 yen = 0.780 euros); c) Closing date of publication and for including figures was May 20, 2005.
(2) As percentage of GDP.
(3) 3-month interest rates on national money markets.
(4) Government bond interest rates on most representative issues in each country.
SOURCE: Organization for Economic Cooperation and Development.

moderating. The third risk is imposed by prices of oil and raw materials which, if they keep rising, will oblige the central banks to tighten their monetary policies, especially in the United States.

United States: growth shines brightly but inflation again troubling

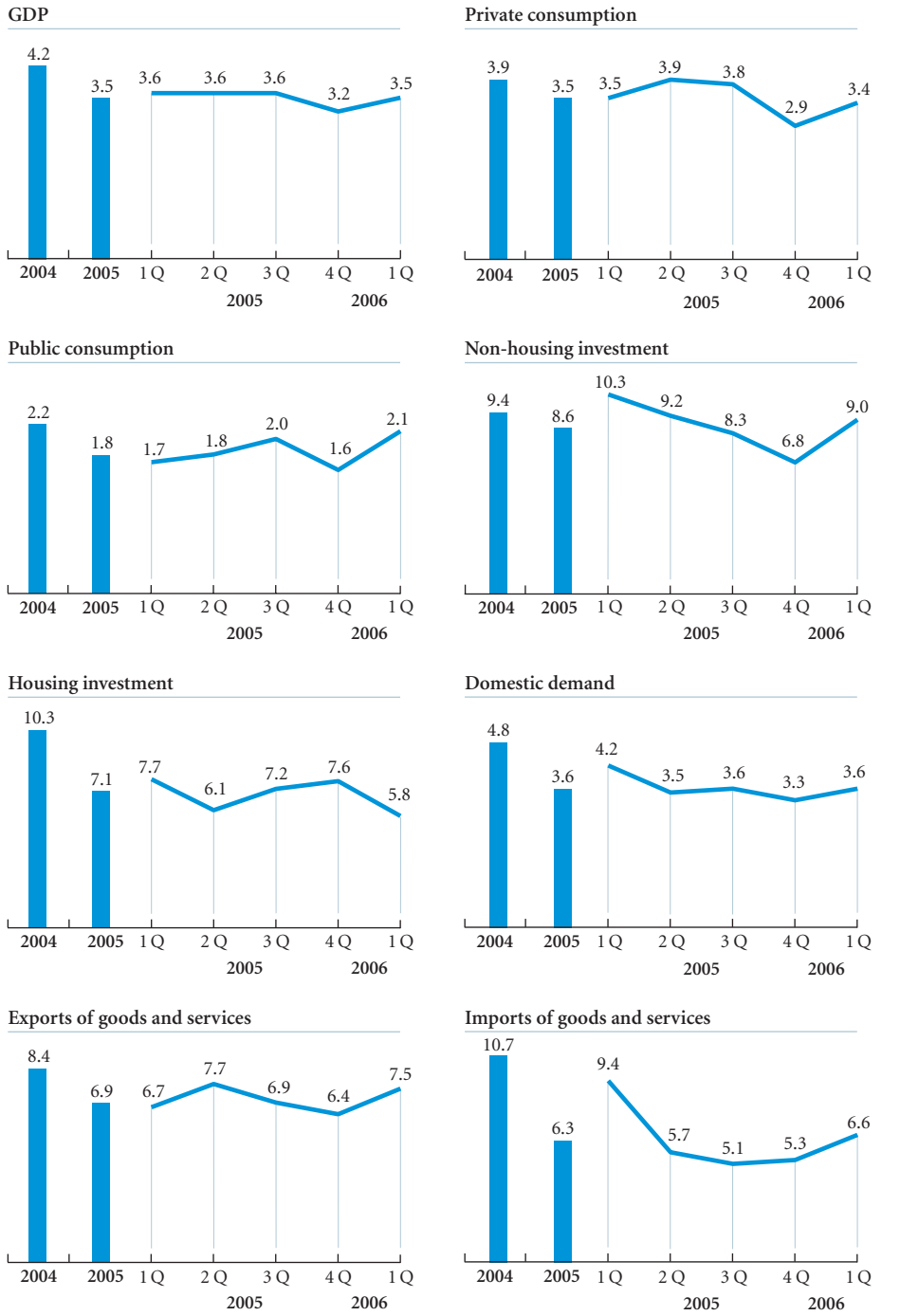
A well-known Western recounts the story of a man who threw himself out of a high building. As he drops past each floor, people call out «How are you doing?» and he replies «All right for now; all right for now». That is how the US economy is doing (all right for now) and while it is still a long way from falling off a building there are risks that must be taken into account, some more than others. In the first quarter, the GDP grew by a strong 3.5% year-to-year. Compared with the previous weak quarter, the annualized increase was 4.8%, which raises concerns about an early slowdown. The main contributions to growth came from private consumption of durable goods, in which car sales had especially weakened in the previous quarter, and capital goods investment, especially that related to information technology.

United States grows by 3.5% because of strength of consumption and capital goods investment...

The foreign sector improved although it continued to drain off growth while the public sector increased defence spending. The «soft landing» in the real

TREND IN UNITED STATES GDP BY COMPONENT

Percentage year-to-year change in real terms



SOURCE: Bureau of Economic Analysis and internal figures.

UNITED STATES: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005			2006			
			2Q	3Q	4Q	January	February	March	April
Real GDP	4.2	3.5	3.6	3.6	3.2	–	3.5	–	–
Retail sales	6.2	7.2	7.9	8.2	6.2	9.4	7.4	7.9	6.6
Consumer confidence (*)	96.1	100.3	102.3	98.9	95.8	106.8	102.7	107.5	109.6
Industrial production	4.1	3.2	3.1	2.7	3.0	3.2	3.2	3.8	4.7
Industrial activity index (ISM) (*)	60.5	55.5	53.2	56.0	57.0	54.8	56.7	55.2	57.3
Sales of single-family homes	10.0	6.6	6.9	11.5	3.2	0.3	–14.5	–7.2	...
Unemployment rate (**)	5.5	5.1	5.1	5.0	4.9	4.7	4.8	4.7	4.7
Consumer prices	2.7	3.4	3.0	3.8	3.7	4.0	3.6	3.4	3.6
Trade balance (***)	–618	–724	–672	–695	–724	–734	–739	–748	...

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

estate market, so devoutly wished by the monetary authorities, has also been confirmed. Adding to the robust advance of the economy now comes the industrial sector. Industrial production, which has been languishing, moved up in April to show growth of 4.7% year-to-year, the highest rate in the past six years.

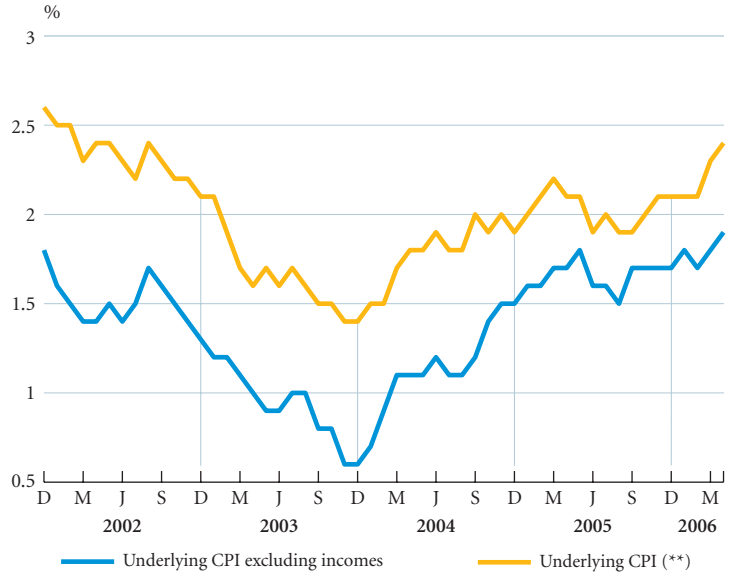
...but slight rise in inflation undermining confidence.

However, if we look at the state of public opinion, things seem to be seen as substantially worse. The popularity of the US president stands at all-time lows, exceptionally so given present growth. A lack of confidence also has pervaded the markets since the end of April. Why is this so? Where is the danger? In recent years, the biggest risk to the US economy has been the foreign imbalance but in this respect what has worked miracles has been the lack of any big change and especially the easy financing of the trade deficit. While in December and January net financial inflows were less than the trade deficit, in February and March the situation returned to normal with inflows 37.9% and 12.5% higher respectively than the trade deficit for the corresponding period.

Just when it seems that by this everyone must have become used to this situation, the much-feared spectre of inflation has returned to freeze hearts in the engine of world growth. This old customer so ill-remembered has made a new appearance. In April, the consumer price index (CPI) rose to 3.6% year-to-year but it was the underlying component for the period, which moved up to 2.3% (2.2% in March), that set off the alarm bells. Within a moderate upward trend with more and more definite signs, some increase is foreseen in coming months. Backing up this trend, producer prices rose by 4.0% in April. One of the preferred yardsticks used by the Fed, the GDP private consumption deflator, has gone up from 1.2% to 3.0% in four years. Three factors may be contributing to reawaken the inflation monster, namely, oil, regular residence rentals and a remaining component which includes the level of economic activity, imports and productivity.

UNITED STATES: SLIGHT RISE IN INFLATION AND CAUSES

Month-to-month change in prices annualized (*)



NOTES: (*) Cycle-trend series.
(**) Underlying inflation excludes food and energy.
SOURCES: Department of Commerce and internal figures.

Energy prices in April rose by 3.9% compared with March and, looking ahead, we can see only high-cost oil. In four years, energy has doubled its weighting in the US CPI with a cumulative price rise of 65% in that period. Nevertheless, the harshness of the energy sector has not shifted to other sectors of the economy, which should be cause more for confidence rather than for nervousness, although because of delays in the price chain there may be «second round» effects that could bring some shocks. But things are «all right for now».

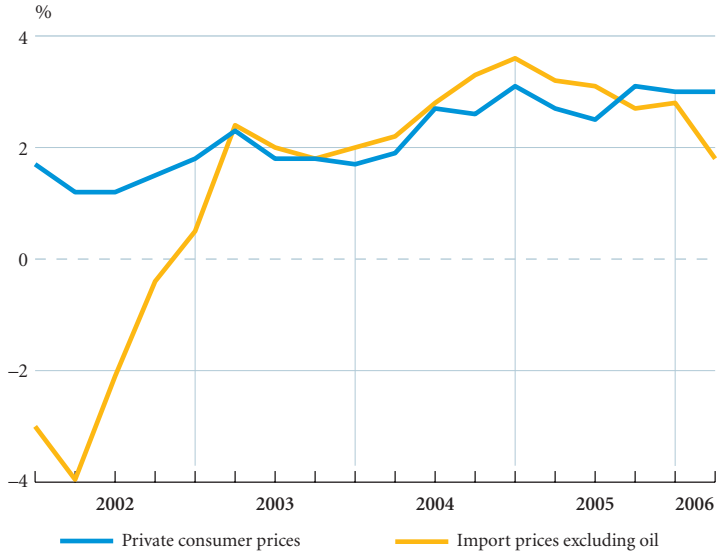
The second factor is more troubling but neither should this have disastrous results. Rentals are going up precisely because of the slowdown in the real estate market. It is now less attractive to buy or, if you will, more difficult, and this means that the public tends toward rental. The weighting of this component in the CPI is 5.8% but it directly affects the inferred rental of those who own their own homes, which runs at 23.4%, with a considerable effect which combines higher inflation with lower growth. However, in spite of the bubbly state of the indicator in recent months and its size, inferred rentals are not prices paid out in cash but rather an accounting approximation whose direct effects on the index (while important at this time) must be limited over the long term because of the very dynamic of the slowdown in the market, with a lower wealth effect on consumption.

Energy, rentals, level of economic activity and more expensive imports push up prices.

Not including energy, food and rentals, there remains only 47% of the CPI and it is here where the risk lies with a well-defined upward tendency which, should it continue, would present a real problem. What are the causes? First of all, the strength of economic activity. In the first quarter

UNITED STATES: IMPORTS NOT WHAT THEY USED TO BE

Year-to-year change



SOURCE: Bureau of Economic Analysis and internal figures.

of the year consumption has been very strong. Rather squeezed household budgets have enjoyed support in the form of discounts and efficient application of advantageous consumer loans favouring solvent customers. To meet this demand, levels of utilization of production capacity are running high. Latest figures, however, point to some moderation in coming months which should have beneficial effects on prices. In April, retail sales (excluding cars and petrol) were up 7.5% year-to-year, a notable rate but not up to the growth at the beginning of the year. All, still all right for now.

But biggest risks remain deficit and exchange rate stability.

Up to now, the CPI has benefited from gains in productivity and from globalization. The former has run hand-in-hand with recovery of the labour market with wages practically stable. Some 138,000 jobs were created in April and wages continued without regaining purchasing power although unit labour costs indicate that this process is coming to an end. Another support that may be wearing out comes from globalization. If we exclude oil, another old companion has been an important moderator of prices, namely, the trade deficit. In spite of the improvement in March because of a temporary dip in the price paid for imported oil, the trade imbalance does not appear to have hit bottom. If, as some analysts maintain, the solution lies in a weaker dollar, imports will be more costly and prices will rise even though the level of activity may moderate. This means that now things are not going so well.

As a result, in spite of Springtime fears of inflation, the main risk continues to be the current account deficit. It is not surprising that the public has lost confidence in the latest tax cuts as they see they are not making the future any clearer. The Western «The Magnificent Seven» had a happy ending but it was not without its suspense.

Japan: where optimism meets reality

Cautious Japan was the prodigal son of the world economy, thanks to the optimism of consumers and business executives who seemed able to carry out miracles. In the first quarter of 2006 the change of attitude continued strongly and consumer confidence reached the level of 48.2 points, the highest since the Spring in 1991.

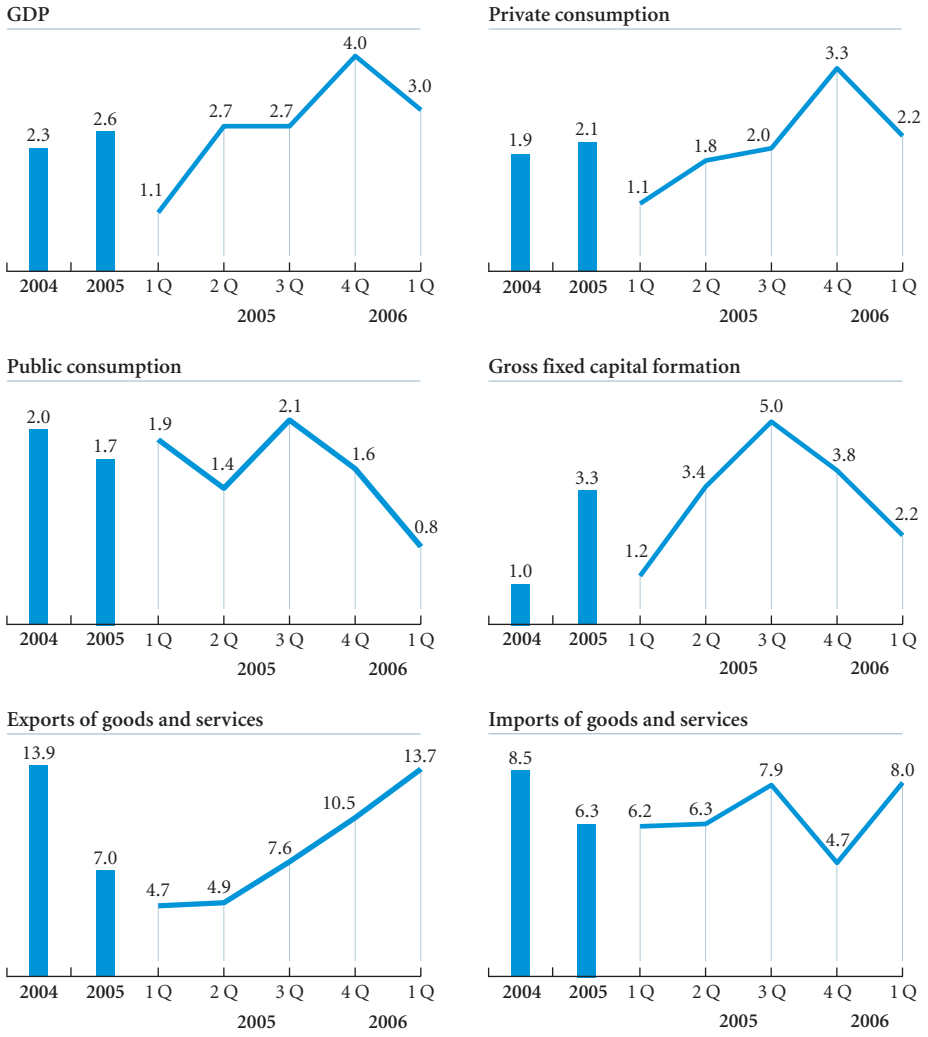
Nevertheless, everything has its limit. Japan is still Japan and its limit is its growth potential, the rate of sustainable advance of an economy, beyond which the engine overheats, begins to exhibit inflation and bottlenecks occur. Without stating exactly where things are in the case of Japan, it is clear that the trend to ageing of the population imposes on Japan a limit which will only be overcome through gains in productivity

Japan continues to grow but growth rate moderating.

Investment most active component in an economy growing above its potential.

TREND IN JAPAN'S GDP BY COMPONENT

Percentage year-to-year change in real terms



SOURCE: Institute of Economic and Social Investigation and internal figures.

of capital and labour or structural changes which so provide. None of this is taking place to an excessive extent.

In the first quarter, Japan's economy grew by 3.0% year-to-year, 1.9% in quarter-to-quarter terms annualized. We may assume that the Japanese recovery will last but not with strong growth.

Reforms that could strengthen growth potential still awaited.

Private consumption held up, consumption and public investment continued to drop, while the foreign sector showed a listless performance. The main engine of growth was private investment in capital goods which contributed to half the growth of the economy in real terms, thus going beyond forecasts. Following the marked downward trend throughout 2005, with a decrease in the fourth quarter, the Tankan survey and machinery orders were already showing this hunger for investment, common for an economy growing above its potential. This increased capital formation should contribute to broaden production capacity but it also denotes a continuation of the old Japan that still has reforms to carry out. Investment represents 15% of the economy, whereas in the United States it fails to reach 12%, and the fact is that the yield on this investment in Japan continues to be low with market mechanisms functioning poorly.

Labour market continues tight while inflation stays on positive ground.

The labour market continued to tighten in March with an unemployment rate of 4.1%, the lowest in the last eight years, with 0.9% more non-farm jobs compared with the same period last year. This is where the demographic factor begins to count. Scarcity of labour will begin to be a growing problem as of 2007 with the beginning of retirements among the baby boom generation. The tightening of the labour market is bringing about wage increases which are strengthening consumption. Because of this, inflation is likely to go up thanks to the negative GDP deflators and the volatile prices for energy. The CPI grew by 0.3% year-to-year in March, somewhat lower than the 0.4% in February, while Tokyo prices showed a repeat of last year's level. The foreign sector continues to show the recovery in

JAPAN: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005				2006		
			1Q	2Q	3Q	4Q	January	February	March
Real GDP	2.3	2.6	1.1	2.7	2.7	4.0	–	3.0	–
Retail sales	–0.9	1.4	0.6	3.1	1.1	0.7	0.0	0.9	1.1
Industrial production	5.3	1.5	2.3	0.3	–0.1	3.6	2.8	2.5	3.1
Tankan company index (*)	20.5	18.0	14.0	18.0	19.0	21.0	–	20.0	–
Housing construction	2.6	3.8	1.4	2.2	4.9	6.9	–2.4	13.7	3.4
Unemployment rate (**)	4.7	4.4	4.5	4.3	4.3	4.5	4.5	4.1	4.1
Consumer prices	0.0	–0.3	–0.2	–0.1	–0.3	–0.5	0.5	0.4	0.3
Trade balance (***)	13.9	10.2	13.2	12.1	10.9	10.2	9.9	9.7	9.5

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

exports but the strength of imports means that the trade surplus for the last 12 months ending in March continues to drop.

China: in search of a «soft landing»

In the first quarter the GDP rose by 10.2% year-to-year. This rate, without being anything new, is even substantially higher than forecasts from here and there for 2006. Nevertheless, news in recent weeks has been dominated by the controversy over lowering the exchange rate for the Chinese currency, the renminbi, and the share issue of the Bank of China available to international investors. This is one of the four large state banks whose solvency constitutes one of the risks for the macroeconomic stability of the country.

Diplomacy has won out and, in making its bi-annual Treasury Department evaluation, the United States avoided branding China as a foreign exchange «manipulator», which has brought some criticism to George Bush. China is the world's largest holder of foreign reserves with 22% of the global total, thus guaranteeing the growth of its exports. Nevertheless, the Chinese Central Bank recently raised its interest rates and the authorities are in agreement with regard to tightening monetary policy in order to slow its sharp growth. The foreseeable revaluation of the Chinese currency before the end of the year falls within this tighter policy, the only question being when.

China growing at 10% as authorities try to ease economic drive.

In spite of officially having prices under control, with industrial production continuing to grow by 16.6% in April and production of cement and computers moving ahead to 13.4% and 49.7% respectively in the past 12 months, the need to slow down the march of the economy is quite clear. Nevertheless, the history of the Chinese surplus is made up of two quite different parts. On the one hand there is the surplus with the United States and Europe which continues to increase because of the increase of manufactures, and on the other hand there is the growing deficit with the rest of the world because of the importation of raw materials.

Pressure to appreciate renminbi continues but diplomacy takes precedence.

The other important question for the Chinese economy is the solvency of its financial system, specifically the loans which the four large state banks have been granting to the state conglomerates which possess low credit rating. China's foreign debt is only 11.9% of the GDP, half that shown by the most solvent

China has trade surplus with Europe and United States but deficit with rest of world.

CHINA: MAIN ECONOMIC INDICATORS

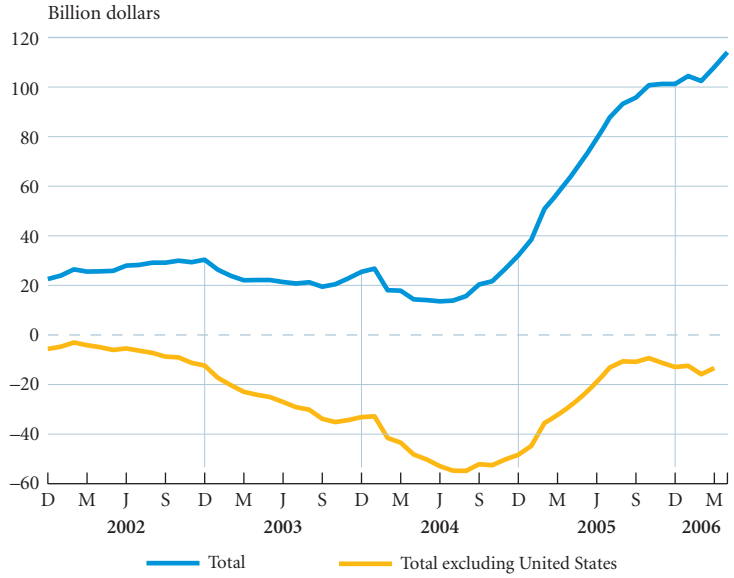
Percentage change over same period year before unless otherwise indicated

	2004	2005	2005			2006			
			2Q	3Q	4Q	January	February	March	April
Real GDP	9.5	9.9	10.1	9.8	9.9	–	10.2	–	–
Industrial production	16.3	15.9	16.5	16.2	16.4	12.6	20.1	17.8	16.6
Electrical power production	15.0	13.4	13.7	13.6	11.8	7.8	22.5	11.4	11.9
Consumer prices	3.9	1.9	1.7	1.7	1.4	1.9	0.9	0.8	1.2
Trade balance (*)	32.1	101.3	79.2	95.8	101.3	104.5	102.5	108.1	114.1

NOTES: (*) Cumulative balance for 12 months. Billion dollars.
SOURCE: National Statistics Office of China, Thomson Financial Datastream and internal figures.

CHINA: TRADE SURPLUS DEPENDS ON HOW YOU LOOK AT IT

Trade balance for past 12 months



SOURCE: Chinese National Statistics Office and internal figures.

Share issue by Bank of China offers sop to financial sector.

economies in Latin America. Nevertheless, if we add those loans, the figures would triple in any conservative estimate. The sale of Bank of China shares for an amount of 11 billion dollars is a sop in this regard and the prices being paid for those shares (double their face value) indicate that prospects are far from being catastrophic. The Chinese banking sector, with 11,000 branches and 200,000 employees, continues to be one of the biggest risks in the Chinese economy and a less-than-soft landing with an abrupt halt to growth could have serious consequences. China's prudence regarding its currency is understandable.

Mexico growing and improving foreign position

Mexico increases growth while awaiting elections which could make little change.

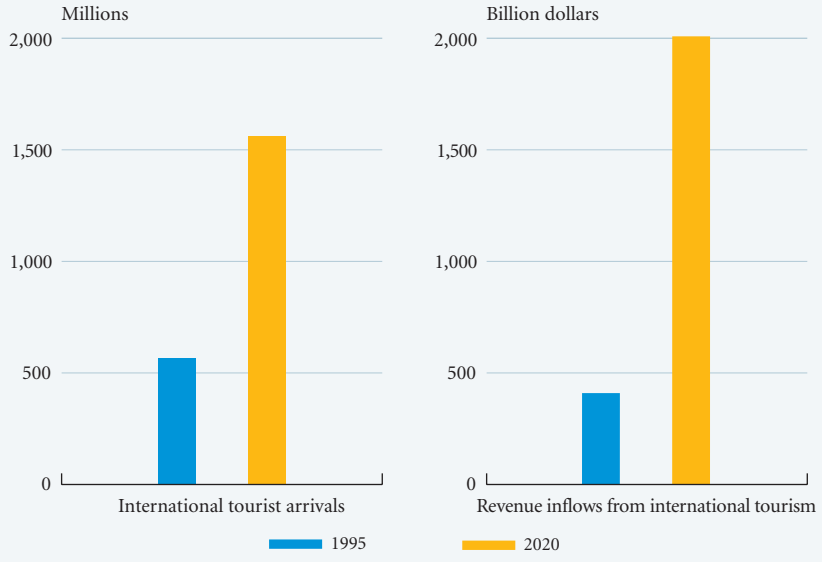
The Mexican economy grew by 5.5% year-to-year in the first quarter of 2006, a strong advance giving support to Felipe Calderón, the candidate for the governing party (National Action Party) in the presidential elections on July 2. The other favourite is Andrés Manuel López Obrador of the Democratic Revolution Party. Whoever wins is not likely to allow himself to be carried away by populist sentiment but neither can we expect that he will efficiently resolve problems of corruption, in spite of the image of austerity and honesty cultivated by both candidates. This is a solution Mexico really needs due to its major dependence on oil exports, a sector dominated by PEMEX, the state monopoly. Along with this dependence on oil, Mexico still lacks competitiveness and carries the biggest trade deficit in a region where surpluses are predominating.

In the early months of 2006 Mexico's competitiveness was helped by gains in productivity. Unit labour costs grew by 6.4% in February, a rate considerably lower than the 7.8% seen at the end of

Tourism in the 21st century: engine of world growth

Tourism is a sector which can provide a major economic drive for developing countries. Through tourism it is possible to obtain an inflow of foreign currency without making huge investment sand without having the most advanced technologies, while at the same time creating a high volume of employment. These inflows represent a substantial aid for the importation of goods and services necessary for development to those sectors with higher value added or a higher level of technology. In the case of Spain, this is a paradigm. Tourism played a major role in its development in the 60's, contributing to allow the Spanish economy to put itself, in a few decades, among the group of advanced countries. Today, the tourist sector continues to play a major role in the country's economy. As opposed to the middle of the last century, however, the higher income level of the population today makes it possible for Spain to also be a notable source market for tourists.

INTERNATIONAL TOURISM: SECTOR WITH HIGH GROWTH POTENTIAL



SOURCE: World Tourism Organization.

The role tourism has represented in the development of Spain's economy is also taking place in other developing economies. The forecasts by the World Tourism Organization indicate that in the initial decades of the current century the rapid growth of tourism will continue with a growth rate in the number of international tourists slightly above the rate of increase in the world gross domestic product. Nevertheless, this growth will not be equally distributed. Outstanding among those areas receiving tourism we see Oriental Asia and the Pacific which, with growth well above the average rate, will exceed the American hemisphere as the second major receiving region, going to a quota of 25% in 2020 as against 18% for that area. Africa and the Middle East also present good prospects with growth above average. With regard to Europe, while it is believed that growth will be below the average, it will continue to be the most visited region in the world. Its market share will go from 60% in 1995 to 46% in 2020.

By country, the biggest receiving areas today will remain at the head of the classification but there will be changes. China will go up to heading the classification. Another notable contender for a leading place will be the Russian Federation which will come into 9th position.

CHINA TO BE TOP WORLD TOURIST DESTINATION IN 2020

Main world destinations: International tourist arrivals

	Base year Million	Projection Million	Average annual growth rate (%)	Market share (%)	
	1995	2020	1995-2020	1995	2020
1. China	20.0	130.0	7.8	3.5	8.3
2. France	60.0	106.1	2.3	10.6	6.8
3. United States	43.3	102.4	3.5	7.7	6.6
4. Spain	38.8	73.9	2.6	6.9	4.7
5. Hong Kong (China)	10.2	56.6	7.1	1.8	3.6
6. Italy	31.1	52.5	2.1	5.5	3.4
7. United Kingdom	23.5	53.8	3.4	4.2	3.4
8. Mexico	20.2	48.9	3.6	3.6	3.1
9. Russian Federation	9.3	48.0	6.8	1.6	3.1
10. Czech Republic	16.5	44.0	4.0	2.9	2.8
TOTAL (1-10)	273.0	716.2	3.9	48.3	45.9

SOURCE: World Tourist Organization.

The higher economic growth of the emerging countries will mean that substantial levels of the population in various parts of the world will spend part of their income on trips abroad. As a result, there will also be changes in the make-up of source areas of tourists. In the early decades of the 21st century the increase in demand for international travel arising from Eastern Asia and the Pacific will mean that this region will come to be the second tourist source thus replacing the American Hemisphere. In spite of lower growth, Europe will continue to be the largest source area in the world, with a 47% share. By country, the main change is that China will move into fourth place, with a forecast of 100 million trips in 2020, mainly to nearby destinations.

On the other hand, the «sun and beaches» segment will take on greater importance in far-off destinations. At the same time, it is expected that the demand for holidays combined with tourist trips of special interest will increase. Adventure tourism will take on greater importance because of increased awareness of the value of the environment. Cultural tourism is also expected to become popular with the ageing of the baby-boom generation. At the same time, pleasure tourism provided by cruise ships will show a notable increase given that this makes it possible to visit various places in a short time. Theme parks, which bring together many activities, will also maintain growth.

Furthermore, among the trends indicated for the early decades of this century attention is given to technological developments. These, for example, allow immediate interactive access to travel plans through Internet. It is also expected that technological advances will reduce transportation costs and therefore foster travel demand. The trend in work and social customs with the tendency to split up holidays will encourage

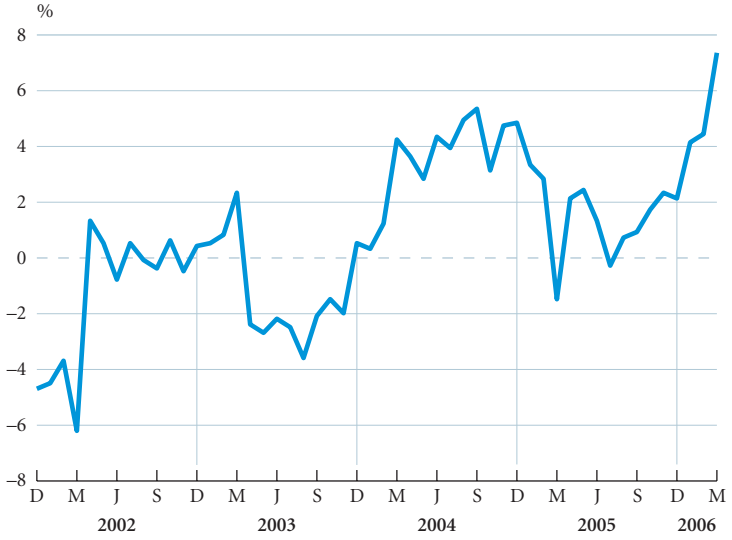
more distant and more frequent trips with shorter stays. On the other hand, the desire for trips offering unique experiences will take on greater importance.

Finally, the growth potential of tourism is very high, especially in the developing countries. For this to happen, however, certain conditions must be met. Among these conditions, establishing a stable economic and socio-political environment is absolutely essential. Those places that are seen as dangerous for visitor safety, either from the threat of terrorist bombings or kidnappings or from health risks, will not be able to make progress as tourist destinations. Such risks have to be controlled by the local authorities but in these days of globalization multilateral coordination in also needed. In the new millennium we have already seen some global shocks, such as that in the United States on September 11, 2001 or the SARS outbreak in Asia in 2003.

Fortunately, measures taken made it possible that the tourist sector was only temporarily affected and its growth has continued. In order for this to benefit developing countries, however, it will also be necessary for them to invest more in infrastructures and in tourist promotion. If these requirements are met, the future of tourism looks brilliant and it could be an important engine of world growth.

INDUSTRIAL PRODUCTION UP SHARPLY

Year-to-year change in manufacturing industrial production (*)



NOTES: (*) Cycle-trend series.
SOURCE: Central Bank of Mexico and internal figures.

2005. The weakness of the dollar to which the Mexican peso is linked also lowered the cost of exports and improved the trade balance, excluding oil exports, in the first quarter of 2006.

So far as concerns demand indicators, retail sales moved up slightly. It is on the supply side, however, where growth shows up more strongly with manufacturing industrial production

Competitiveness improving and trade deficit down.

MEXICO: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005			2006			
			2Q	3Q	4Q	January	February	March	April
Real GDP	4.2	3.0	3.3	3.4	2.7	–	5.5	–	–
Industrial production	4.2	1.6	3.1	0.8	2.7	6.0	5.3	9.6	...
General unemployment rate (*)	3.9	3.6	3.5	3.8	3.1	3.5	3.6	...	...
Consumer prices	4.7	4.0	4.5	4.0	3.1	3.9	3.7	3.4	3.2
Trade balance (**)	–8.8	–7.6	–9.7	–9.4	–7.6	–5.7	–4.8	–4.8	...

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

Strength in industry goes side-by-side with price stability.

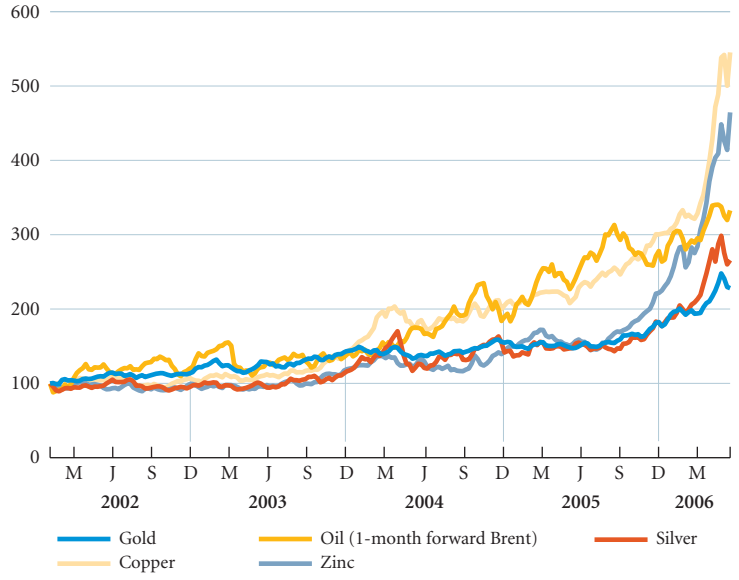
sharpening increases in March to 10.2% year-to-year. On the credit side of stability investment and unemployment reported a good performance, although the cumulative negative government balance in the first quarter of 2006 was twice that for the same period last year and, whoever wins the elections, will have work to do.

Raw materials: halt to the upward rally in metals

After breaking down various highs (some of them all– time highs, others highs for decades), metal raw materials showed a strong up and down movement in the second half of May. Industrial metals as a whole fell by 10%

RAW MATERIALS TAKE A BREATHER

January 2002 = 100. Weekly average quotations in US dollars



SOURCE: Thomson Financial Datastream and internal figures.

between May 12 and May 22 while precious metals showed an 8% drop. In terms of products, the one most hurt was silver (decrease of 19% between those dates), followed by a group of industrial metals (copper, zinc and aluminium) which lost around 13% in price quotations. Gold, in turn, was down by 9%. The later recovery did not compensate for these sharp drops.

The change in scenario was not due to any modification in the basic aspects of the market. Demand for industrial raw materials continues strong with special preponderance of Chinese purchases going into construction and production. The correction, therefore, has come as a result of a change in financial expectations. Increased aversion to risk taking place in financial markets in recent weeks, which has been reflected in adjustments in other segments such as the stock market, and the conviction that the upward rally in raw materials had been excessive led the more speculative investment monies to carry out profit taking, thus pushing down prices.

Metal quotations, both industrial and precious, show halt due to profit-taking by more speculative investors.

Oil also partly corrected the all-time highs seen in earlier weeks, dropping from 74 dollars a barrel for 1-month delivery of Brent quality product on May 2 to levels of 71 dollars on May 30. In contrast to metals, this move was basically due to seasonal factors and others of a geopolitical nature. Following the winter season high, Spring prices normally moderate and this cycle has taken place on this occasion. This move was aided by some easing in the nuclear conflict between the western countries and Iran which, although still an open question, seems to have stabilized.

Oil loses some drive due to change of seasons and easing of nuclear confrontation with Iran.

EUROPEAN UNION

European Commission forecasts increase in economic activity in 2006 giving way to moderate slowdown in 2007...

...thanks to better state of investment and foreign demand.

European Commission forecasts: moderate growth along with high uncertainty

In its Spring forecasts, the European Commission has come out with its pronouncement: the often looked for but much delayed economic recovery in Europe is finally happening. According to the EU executive, this year the European Union (EU-25) will grow by 2.3% year-to-year (1.6% in 2005) to later decrease its drive slightly with a projected rise in gross domestic product (GDP) of 2.2% in 2007. The Euro Area will follow this cycle with growth of 2.1% in 2006 and 1.8% in 2007. In 2005, growth recorded in the Euro Area was 1.3%.

What will be the engines of this growth? The same as those showing up in recent months: investment will increase and exports are moving into a stage of higher growth. Following this drive we should see a recovery of private consumption although the growth rate will be more contained.

So far we have looked at the good news. Now we shall examine some less promising factors. The first threat to carrying out this relatively benign scenario is the much-mentioned

MACROECONOMIC FORECASTS OF EURO AREA COUNTRIES

Spring 2006

	GDP (*)			Inflation (**)			Unemployment (***)		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
Belgium	1.2	2.3	2.1	2.5	2.4	2.1	8.4	8.0	7.6
Germany	0.9	1.7	1.0	1.9	1.7	2.3	9.5	9.4	9.2
Greece	3.6	3.5	3.4	3.5	3.3	3.3	9.8	9.5	9.1
Spain	3.4	3.1	2.8	3.4	3.6	3.1	9.2	8.7	8.3
France	1.4	1.9	2.0	1.9	1.9	1.8	9.5	9.4	9.3
Ireland	4.7	4.9	5.1	2.2	2.4	2.3	4.3	4.4	4.4
Italy	0.0	1.3	1.2	2.2	2.2	2.0	7.7	7.7	7.7
Luxembourg	4.2	4.4	4.5	3.8	4.1	3.4	5.3	5.7	5.8
Netherlands	1.1	2.6	2.6	1.5	1.8	2.1	4.7	4.3	3.9
Austria	1.9	2.5	2.2	2.1	1.7	1.6	5.2	5.2	5.2
Portugal	0.3	0.9	1.1	2.1	2.7	2.4	7.6	8.1	8.3
Finland	2.1	3.6	2.9	0.8	1.4	1.4	8.4	7.9	7.6
Euro area	**1.3**	**2.1**	**1.8**	**2.2**	**2.2**	**2.2**	**8.6**	**8.4**	**8.2**

NOTES: (*) Percentage real change.
(**) Percentage change in harmonized consumer price index.
(***) Percentage of labour force.
SOURCE: European Commission.

upturn in oil prices. The European Commission, in an effort to make amends for previous predictions, this time around is assuming that the energy picture will continue to be complicated in coming years. For this reason, its forecasts for the per barrel price of Brent quality oil are 69 dollars in 2006 and 71 dollars in 2007.

In spite of this, the European Commission estimates that the inflationary effect will be negligible. Harmonized inflation for the Euro Area at annual average will hold at 2.2% in 2006 and 2007. While it is true that up to now evidence of «second round» effects (that is to say, of the shift of increases in energy prices to other types of prices) is lacking, the European Commission forecasts look a little like wishful thinking.

A second disquieting factor the EC executive raises is the impact of the tax package Germany has adopted. The uncertainty arising from the carrying out of a broad range of budgetary consolidation measures could change the expected pattern of recovery with effects not only restricted to the German economy.

This look ahead is especially relevant if we take into consideration that under the umbrella of recovery of the European Union as a whole we may find hidden substantially different national situations. In the group of the four countries in the Euro Area to grow

Foreign risk (oil) and domestic risk (uncertainty about German economy) key factors.

MACROECONOMIC FORECASTS FOR EU COUNTRIES OUTSIDE EURO AREA

Spring 2006

	GDP (*)			Inflation (**)			Unemployment (***)		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
Czech Republic	6.0	5.3	4.7	1.6	2.5	2.7	7.9	7.7	7.6
Denmark	3.1	3.2	2.3	1.7	2.1	2.0	4.8	4.0	3.8
Estonia	9.8	8.9	7.9	4.1	3.6	2.9	7.9	7.0	6.3
Cyprus	3.8	3.8	3.8	2.0	2.4	2.2	5.3	5.4	5.4
Latvia	10.2	8.5	7.6	6.9	6.7	5.6	9.0	8.4	7.9
Lithuania	7.5	6.5	6.2	2.7	3.5	3.3	8.2	7.1	6.5
Hungary	4.1	4.6	4.2	3.5	2.3	3.3	7.2	7.7	7.6
Malta	2.5	1.7	1.9	2.5	2.9	2.7	7.3	7.4	7.4
Poland	3.2	4.5	4.6	2.2	1.0	2.0	17.7	16.2	15.2
Slovenia	3.9	4.3	4.1	2.5	2.4	2.5	6.3	6.3	6.3
Slovakia	6.0	6.1	6.5	2.8	4.4	2.7	16.4	15.5	14.8
Sweden	2.7	3.4	3.0	0.8	1.1	1.8	7.8	7.0	6.7
United Kingdom	1.8	2.4	2.8	2.1	2.0	2.0	4.7	5.0	4.8
EU-25	**1.6**	**2.3**	**2.2**	**2.2**	**2.1**	**2.2**	**8.7**	**8.5**	**8.2**
EU-15	**1.5**	**2.2**	**2.0**	**2.1**	**2.1**	**2.2**	**7.9**	**7.8**	**7.6**
United States	*3.5*	*3.2*	*2.7*	*3.4*	*2.9*	*1.6*	*5.1*	*4.8*	*5.1*
Japan	*2.7*	*2.8*	*2.4*	*–0.3*	*0.7*	*1.0*	*4.4*	*4.3*	*4.3*

NOTES: (*) Percentage real change.
(**) Percentage change in harmonized consumer price index, except United States and Japan, in which cases it is national consumer price index.
(***) Percentage of labour force.
SOURCE: European Commission.

Recovery of Euro Area confirmed with growth of 2.0% in first quarter.

below the average in 2006 we discover the three large economies, namely Germany, France and Italy, along with Portugal. This adds a factor of disquiet, given that, if the «big boys» should perform below expectations, it will be difficult for the other economies to avoid the downward drift of the whole group. It is in this context of a lack of counterweights to a potential slack in these three economies that we can understand concern in the EC with regard to Germany.

Euro Area: inflation showing its teeth

Europe's ability to greatly increase rate of economic activity limited due to low growth potential.

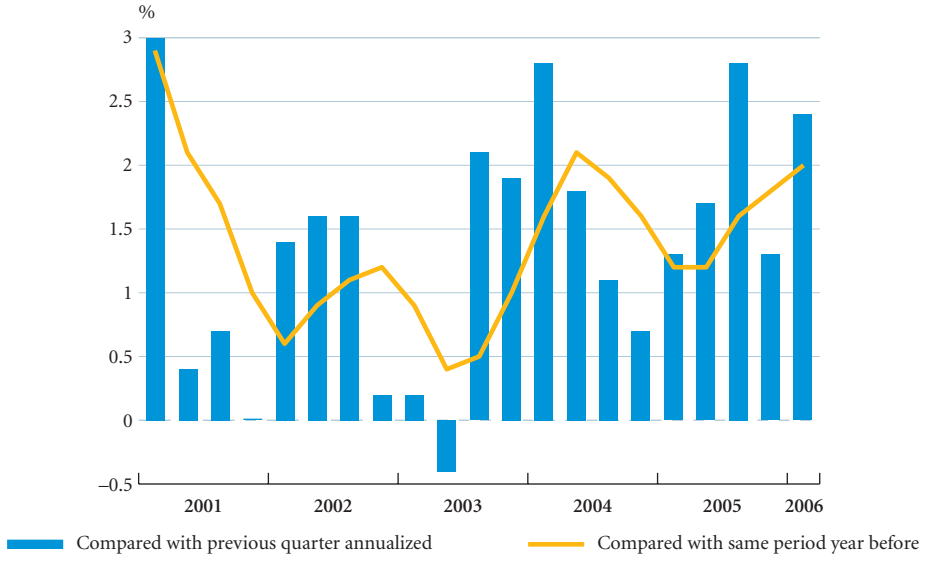
From the figures now available, everything suggests that in the first quarter of 2006 the results in terms of growth have been satisfactory but the disappointment that came in the fourth quarter urged prudence. Events confirmed those favourable predictions. In the first quarter, the Euro Area GDP grew by 2.4% quarter-to-quarter annualized, practically twice the rate in the fourth quarter, which put the year-to-year rate at 2.0%. No higher rate had been recorded since the second quarter of 2004.

Given the main figure, a less favourable factor must be mentioned. The upward stage still remaining for recovery will in all likelihood be limited. The forecasts point to a high quarterly growth scarcely above the current 2% year-to-year. In fact, the economy will grow less as we come close to the end of the year. How can we explain this short life? The low growth potential of the Euro Area economy, which both the International Monetary Fund and the European Central Bank put at levels of the order of 2%, is precisely the rate currently showing up.

The monthly indicators, mainly those for the end of the first quarter, show a scenario of continuing growth. In this

EURO AREA CONFIRMS RECOVERY

Change in gross domestic product in real terms



SOURCE: Eurostat and internal figures.

EURO AREA: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005				2006			
			1Q	2Q	3Q	4Q	January	February	March	April
GDP	1.8	1.4	1.2	1.2	1.6	1.8	–	2.0	–	–
Retail sales	1.5	1.3	1.7	0.8	1.5	1.3	1.4	1.4	0.0	...
Consumer confidence (*)	–14	–14	–13	–14	–15	–12	–11	–10	–11	–10
Industrial production	2.0	1.2	0.7	0.7	1.5	2.1	2.9	3.2	3.8	...
Economic sentiment indicator (*)	99.4	98.1	98.7	96.1	97.7	100.1	101.5	102.7	103.6	105.3
Unemployment rate (**)	8.9	8.6	8.8	8.7	8.5	8.3	8.2	8.2	8.1	...
Consumer prices	2.1	2.2	2.0	2.0	2.3	2.3	2.4	2.3	2.2	2.4
Trade balance (***)	80.4	45.4	64.3	50.1	39.2	28.0	14.5	8.0	5.3	...

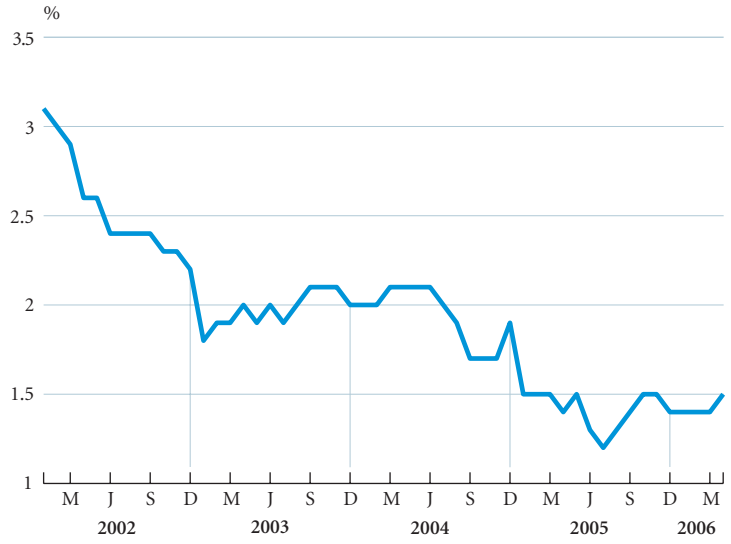
NOTES: (*) Value.
(**) Percentage of labour force.
(***) Cumulative balance for 12 months. Billion euros.
SOURCE: Eurostat, European Central Bank, European Commission and internal figures.

respect, the prospect for supply is gathering increased evidence of the growth pattern. Industrial production grew by close to 4% year-to-year in March and the strong recovery in the portfolio of industrial orders suggests maintenance of the good state of the secondary sector. After promising something of a recovery in March, confidence in services fully showed up in the upward trend in April. Even prospects in construction are the best in recent months.

Industry, services and even faltering construction industry now showing better state.

ENERGY NO LONGER ONLY CAUSE OF INCREASED INFLATION IN EURO AREA

Year-to-year change in harmonized consumer price index excluding energy component



SOURCE: Eurostat and internal figures.

Demand indicators are less definite in pointing to growth. Consumption has scarcely begun to recover, as reflected in the fact that retail sales in the first quarter grew at a rate practically identical to that in the fourth quarter. On the other hand, investment is shining more brightly and exports are showing a positive trend (growth of 16% year-to-year between January and March).

Nasty surprise from inflation with rise in April not caused only by increased price of oil.

With things as they are, the negative player of the month was inflation. Apart from the rise in the general index in April to 2.4% year-to-year (2.2% year-to-year in March), what is troubling is the performance of the underlying core. Discounting energy, tobacco and food, the resulting rate rose for the second consecutive month to stand at 1.5% year-to-year, two decimals more than in March. As a result, we are seeing a more complex scenario in prices than in previous months. Things have gone from one situation in which, apart from more costly energy, there were no pressures to another offering a wider range of sources of inflationary trends.

In turn, the labour market is continuing to appreciably improve. While the unemployment rate dropped by one decimal in March (to 8.1%), job creation continues to be disappointing. In the third quarter of 2005, employment was barely 0.8% higher than that recorded one year earlier. In view of these figures, we can understand the reluctance of the European consumer to spend more recklessly.

Germany: taxpayers, to the payments counter!

Following approval of the 3-point increase in the ordinary value added tax (VAT) for the coming year, the Grand Coalition headed by Angela Merkel has also decided to raise the tax rate on wage incomes by three points as of 2007. Both measures have been justified by the government because of the increase in tax collections but the critics of this restrictive turn in fiscal policy argue that the increase in economic activity will in itself raise collections and that the heavier tax

GERMANY: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005				2006			
			1Q	2Q	3Q	4Q	January	February	March	April
GDP	1.1	1.2	0.6	0.8	1.6	1.7	–	1.4	–	–
Retail sales	2.1	1.5	1.0	2.7	1.8	0.3	2.1	0.8	–1.2	...
Industrial production	2.4	2.9	1.8	1.9	3.3	4.6	3.6	6.3	3.9	...
Industrial activity index (IFO) (*)	95.4	95.5	95.1	93.0	95.4	98.7	101.8	103.4	105.4	105.9
Unemployment rate (**)	10.5	11.7	11.8	11.9	11.7	11.4	11.3	11.3	11.4	11.3
Consumer prices	1.7	2.0	1.7	1.6	2.2	2.3	2.2	2.1	1.8	1.9
Trade balance (***)	149	157.1	156.6	154.4	157.2	160.2	158.8	157.9	154.5	...

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

load could affect future growth and raise prices.

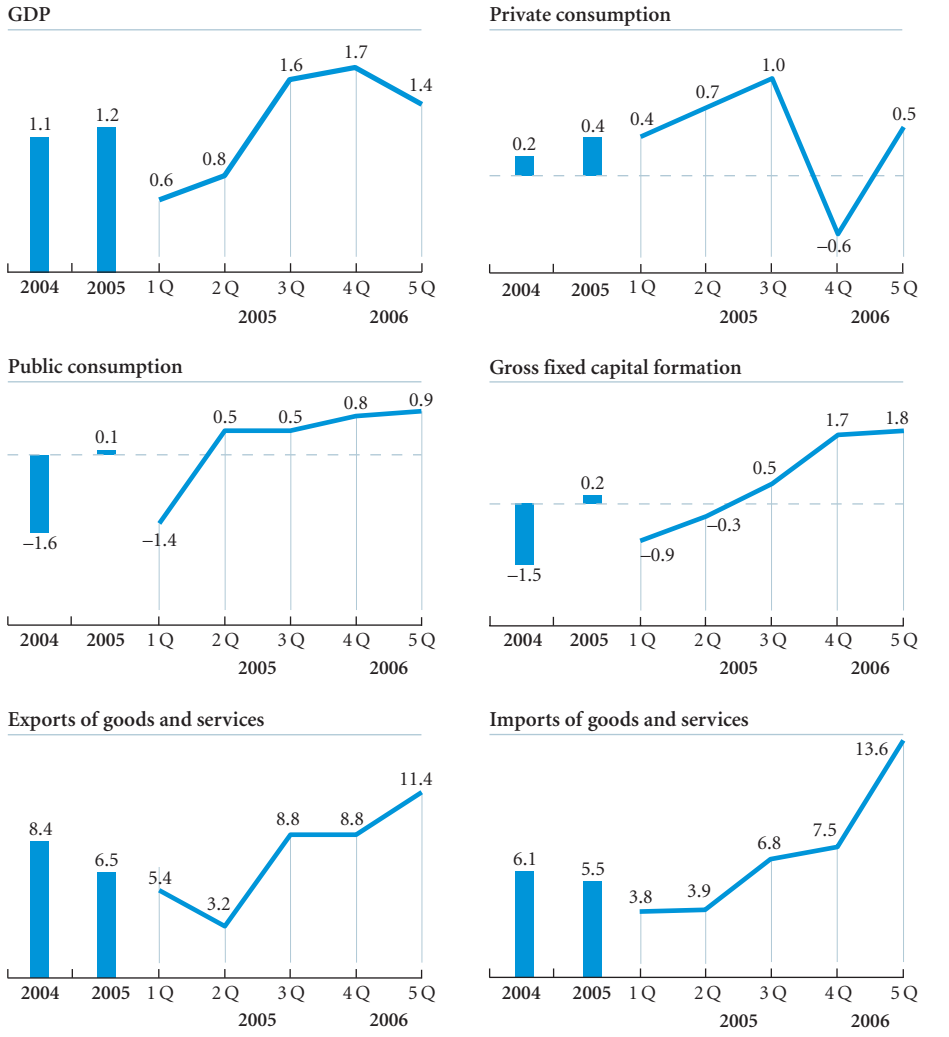
Paradoxically, the first criticism has received support from the half-yearly forecasts of tax collections put out by the government itself. At the beginning of May, the estimate for revenues in 2006 was revised upward by 8.1 billion euros, an amount equivalent to 0.4% of the GDP. Criticisms of the fiscal adjustment and its effect on growth and inflation would seem to have less basis given that available estimates point to a temporary and rather limited effect.

The battery of figures recently becoming available, although these may be open to various interpretations, has not served to temper the debate. The GDP grew by 1.4% year-to-year in the first quarter thus losing some of its previous drive (advance of 1.7% in the

Further increase in German taxes, this time affecting highest wage earnings.

TREND IN GERMANY'S GDP BY COMPONENT

Percentage year-to-year change



SOURCE: Federal Statistics Office and internal figures.

Growth of 1.4% in first quarter slightly below expected level but consumption taking off again.

fourth quarter). Nevertheless, the composition of that growth incorporates some new factors. In the first place, what stands out is the rise in private consumption which made it possible to compensate for the sharp drop in the previous quarter. A second factor, which is less positive, was the slowdown in investment, the result of the poor performance of construction investment. The other components have gone long expected lines. Public consumption is tending to stabilize and exports and imports continue along an upward course.

Drive in industry remains excellent, as proved by both figures recorded and business executive expectations.

Figures at the point between the end of the first quarter and start of the second are also positive. In May, the IFO index held close to the 106 points level, a milestone not see for 15 years, while the consumer confidence indicator that month marked up its highest figure since September 2002.

First-quarter recovery in France fails to dissipate lack of general confidence in country's economic future.

Other indicators, however, were less definite. In spite of the good figure in the first quarter, the hesitation in consumption still remains, if we are to go by the drop in passenger car registrations in April. Industrial activity has been surprising because of some slowing down in March when it grew by 3.9% (6.3% in February). Overall, it would seem that the basic trend is still for recovery but the truth is that the second quarter could be definitive in giving a feeling of the real strength of the German economy.

In turn, inflation rose moderately going to 1.9%, but this level is not alarming. Meanwhile, the unemployment rate continues to move within the range of values above 11% of the labour force (11.3% in April).

France: comme ci comme ça

While the French economy partially recovered in the first quarter with growth of 1.5% year-to-year (1.1% in the fourth quarter), the sensation of a country that is inward looking and rudderless is not going away.

Figures for national accounting in the first quarter clearly indicate that the pattern of French growth continues to lean basically on private consumption. As a result, with a rise of 2.2% year-to-year (as against 1.9% previous), this macroeconomic figure has more than compensated for the slowdown in investment and the higher negative

FRANCE: MAIN ECONOMIC INDICATORS

Percentage change over same period year before unless otherwise indicated

	2004	2005	2005				2006			
			1Q	2Q	3Q	4Q	January	February	March	April
GDP	2.0	1.2	1.6	0.8	1.4	1.1	–	1.5	–	–
Domestic consumption	3.8	2.9	3.4	1.8	4.2	2.2	2.2	3.8	3.5	4.3
Industrial production	2.0	0.2	1.0	–0.2	0.5	–0.7	0.1	–0.9	1.9	...
Unemployment rate (*)	10.0	9.9	10.1	10.1	9.9	9.7	9.6	9.6	9.5	...
Consumer prices	2.1	1.7	1.7	1.7	1.9	1.6	2.0	1.9	1.5	1.7
Trade balance (**)	0.0	–1.3	–0.8	–1.2	–1.5	–1.7	–1.9	–2.0	–2.0	...

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

contributions to GDP growth coming from the foreign sector and the change in inventories.

With regard to the latest available monthly indicators, the most significant concerns industrial recovery. Along with the rise in industrial production (growth of 1.9% year-to-year in March, nearly two percentage points above the February rate), we should mention the improvement seen in industrial orders. In addition, both the trend in unemployment and in consumer prices are similar to that seen in most of the large European economies. The unemployment rate is being maintained in spite of a reduction of one decimal in March, at levels still high (9.5% in that month), while inflation is rising (1.7% year-to-year in April), the result not only of higher-cost energy but also of the underlying core (which does not include the more volatile components).

Italy taking off

Finally, Italy has come up with positive economic news. In the first quarter of the year the GDP grew by 1.5% year-to-year, thus going above the forecasts and beating the slim results in the fourth quarter (0.5% year-to-year). In spite of the fact that we still have no breakdown by component, the trend in the monthly indicators, especially for consumption and foreign trade, indicate that the foreign sector and investment must have been the sources of the rise in the first quarter.

Underlying core of CPI increasing while unemployment rate holds close to all-time high levels.

What can we hope for the second quarter? Two favourable factors dominate the economic scenario. In the first place, once doubts about the election were cleared up, the country's confidence moved clearly into an upward phase.

Italy grows by 1.5% in first quarter (more than expected) thanks to drive in exports and investment.

A second positive factor is the better performance in industry which, after too many months reporting drops or with practically no growth, since the end of 2005 has broken with this negative trend. To be specific, industrial production went from growth of 0.2% year-to-year in November to 3.2% year-to-year in March.

Country's confidence benefits from end to electoral uncertainty...

Finally, we may end this review with a reminder that inflation showed moderate growth in April (2.2% year-to-year compared with 2.1% in March), while the unemployment rate again reported 7.7% in the fourth

...while industry puts on best face in many 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	March	April
GDP	0.9	0.1	–0.3	0.1	0.1	0.5	–	1.5	–	–
Retail sales	–0.4	0.4	0.1	–1.2	0.3	1.9	2.0	1.5	...	...
Industrial production	–0.5	–0.9	–2.6	–1.3	–0.1	0.4	2.4	3.1	3.2	...
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	2.1	2.2
Trade balance (**)	2.0	–5.8	–1.9	–5.1	–7.0	–9.3	–11.7	–13.4	–14.5	...

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

While United Kingdom undergoes substantial improvement in first quarter...

quarter, with no change from the level reported in the second and third quarters in 2005.

United Kingdom: consumption under scrutiny

...worsening of labour market takes away from strength of economic recovery at beginning of 2006.

With announcement of growth in the first quarter (2.2% year-to-year, an increase of four decimals over the fourth quarter), the main doubt about the state of the British economy remains the real state of private consumption. Available indicators, especially industrial production of consumer goods and the figure for retail sales in March, suggest that household consumption has improved as the first quarter has advanced.

Industry may be leaving behind stage of lack of strength seen in recent quarters but inflation troubling Bank of England.

Immediate prospects are for a continuation of recovery, if we are to go by the increase in consumer confidence in April. Nevertheless, the slowdown in employment (a drop of three decimals in the fourth quarter to 0.6%) and stagnation in the unemployment rate (3.0% in April with no change over March) make it clear that the final bases for a consistent recovery of consumption are still not settled.

With regard to other matters of interest, we should point out that, without stepping out of the present crisis stage in activity, industrial production marked up an advance of 0.3% year-to-year in March, the first positive figure since December 2004. On a less positive note, the rise in inflation in April (2.4% year-to-year as against 2.1% in March) was troubling, something that explains the signs recently given out by the Bank of England of a more restrictive turn in monetary policy.

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	March	April
GDP	3.1	1.8	1.9	1.7	1.9	1.8	–	2.2	–	–
Retail sales	6.0	1.9	2.7	1.4	0.6	2.7	1.0	1.6	2.8	3.0
Industrial production	0.6	–1.9	–1.3	–2.0	–1.6	–2.8	–1.4	–1.6	0.3	...
Unemployment rate (*)	2.7	2.7	2.6	2.7	2.7	2.8	2.9	2.9	3.0	3.0
Consumer prices	2.2	2.2	2.2	2.2	2.4	2.3	2.3	2.3	2.1	2.4
Trade balance (**)	–55.6	–63.2	–61.8	–62.9	–63.5	–64.7	–66.7	–68.1	–68.9	...

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

FINANCIAL MARKETS

Monetary and capital markets

Federal Reserve maintains upward trend in interest rates

As widely expected, the US Federal Reserve Board raised the objective level for overnight interbank interest rates by 25 basis points to 5% at its meeting on May 10. Something not so clear was the sign coming from its press release and whether it was suggesting a pause in or the end of the upward cycle.

In its press release, the Federal Reserve Board indicated that, while inflation prospects were still contained, there were inflationary risks arising from the level of utilization of production facilities and the high prices of energy and other raw materials. As a result, it repeated that it might still be necessary to again tighten monetary policy but that, in any case, this would depend on developments in the economic situation.

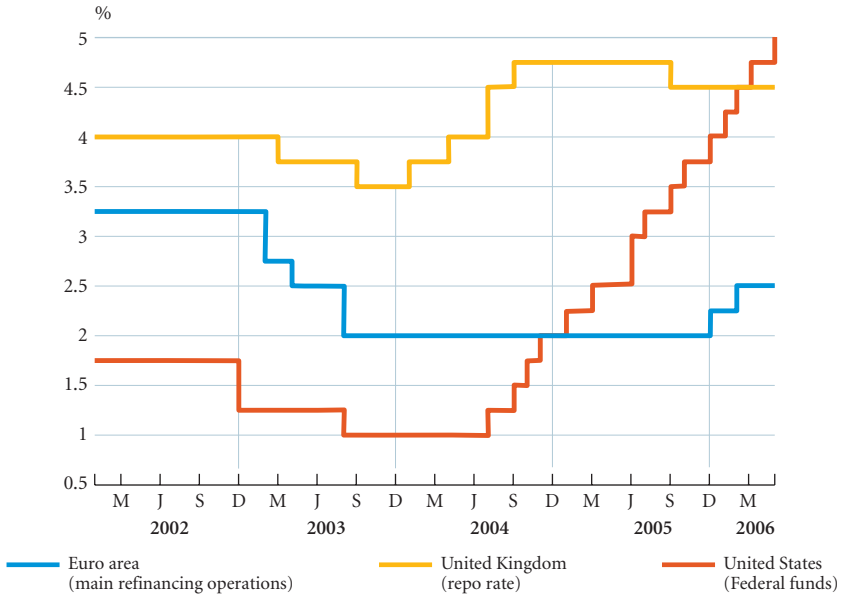
US reference rate reaches 5%.

The money market reacted with an increase in upward expectations. The figure for underlying inflation for April, which was worse than expected, also had an influence in this respect. Nevertheless, later on there was some easing of inflationary prospects due to signs of an easing off in the economy and a decrease in raw material prices. In any case, the market is continuing to discount that the Federal Reserve official interest rate will stand at 5.25%

Further increases possible...

FEDERAL RESERVE RAISES OFFICIAL INTEREST RATE TO 5.00%

Monetary policy reference interest rates



SOURCE: National central banks.

...but Fed could take a break before continuing to raise rates.

in the summer but the big question is whether the Fed will take a pause before embarking on a further move following 16 consecutive increases.

The European Central Bank (ECB), in turn, kept its reference rate at 2.50% at its May 4 meeting. Nevertheless, at the later press conference, the chairman, Jean-Claude Trichet, indicated a rise in June and speculated a that the increase could even be 50 basis points. Later on, other ECB executives indicated that, in fact, the ECB had no predetermined calendar of increases and that it would decide on the course of interest rates according to economic trends, without giving any clear signs to the market. The strength of the euro in recent weeks would suggest an increase of only 25 basis points in June. This increase would be followed by others in the second half-year thus putting the rate slightly above 3% at the end of the year.

Trichet indicates a rise in Eurosystem interest rates in June.

The quarterly report on inflation prospects published by the Bank of England drew a rate above the objective of 2% in the next two years working on the supposition that the official interest rate held at 4.50%, which indicates a possible increase in the interest rate. Along the same lines, the minutes of the

SHORT-TERM INTEREST RATES IN NATIONAL MARKETS

Monthly averages as annual percentage

	Euro area			United States		Japan	United Kingdom		Switzerland
	ECB auctions (2)	Euríbor (5) 3-month	Euríbor (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									
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	2.56	2.72	3.11	4.54	4.92	0.12	4.50	4.59	1.21
April (*)	2.58	2.79	3.22	4.75	5.07	0.13	4.50	4.63	1.28
May (1)	2.58	2.91	3.29	5.00	5.21	0.20	4.50	4.71	1.41

NOTES: (*) Provisional figures.
(1) May 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: 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%), 28-3-06 (4,75%), 10-5-06 (5,00%).
(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: National central banks, Thomson Financial Datastream and internal figures.

last meeting of the Monetary Policy Committee of the Bank of England indicated that, for the first time since it began to reduce reference rates in August 2005, a member of the committee voted in favour of a rate increase. This increased expectations in the market that the next move by the monetary authorities would be upward, as opposed to what was expected only a few months ago.

In Japan, the central bank is continuing to drain off excess liquidity. While the governor of the central bank, Toshiniko Fukui, has stated that no date had been set for the next move, the market is already anticipating an increase in the reference rate in the summer, up from the current level close to 0%. At the same time, it is not expected that the rate will go above 1% in 2007.

Furthermore, other central banks joined the upward moves in May. On May 3, the Bank of Australia raised the official interest rate by 25 basis points to 5.75%. And on May 24 the Bank of Canada also raised its reference rate by a quarter-point to 4.25%.

Bank of England suggests its next move will be a rise.

Dollar halts decline

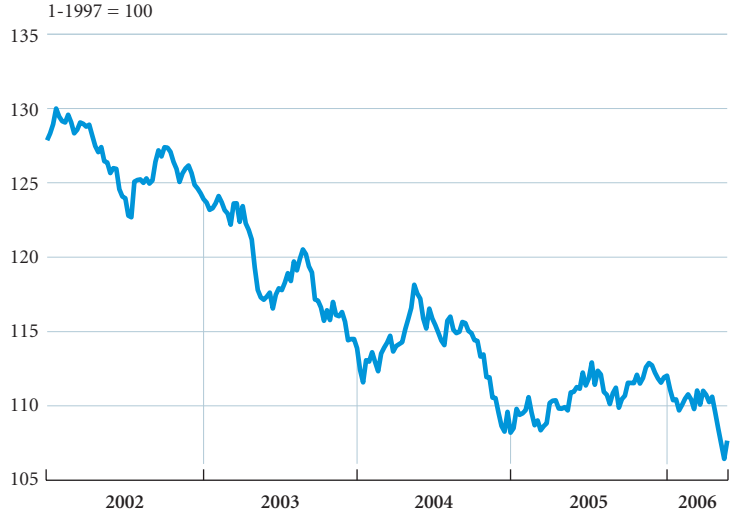
In the early weeks of May the dollar continued the downward path begun early in 2006 and sharpened it drop from mid-April on. As background to this downward move there is the pressure to correct the enormous foreign current account deficit of the United States which reached 7% of the gross domestic product in the fourth quarter of 2005. The pronouncement by the Group of the seven most developed countries (G-7) in the fourth week of April was interpreted as giving support to the drop in the greenback. On May 11, the US currency marked up its lowest level since 1997 in terms of a broad basket of currencies.

Dollar marks up lowest level in overall terms since 1997.

Nevertheless, the dollar later bounced back to some extent aided both by statements by Japanese and European political leaders that they were not in

DOLLAR RESUMES DOWNWARD TREND

Effective nominal dollar exchange rate



NOTES: Figures go up to May 18.
SOURCE: US Federal Reserve.

EXCHANGE RATES OF MAIN CURRENCIES

April 2006

	Final session of month		Monthly figures				*Exchange rate May 24, 2006*
	Exchange rate	% monthly change (2)	Average exchange rate	% change (2)			
				Monthly	Over December 2005	Annual	
Against US dollar							
Japanese yen	113.8	–3.4	117.0	–0.3	–1.2	9.1	*112.9*
Pound sterling (1)	1.826	5.1	1.769	1.4	1.3	–6.7	*1.869*
Swiss franc	1.238	–5.1	1.282	–1.7	–1.8	7.2	*1.218*
Canadian dollar	1.118	–4.3	1.144	–1.1	–1.6	–7.5	*1.120*
Mexican peso	11.09	1.8	11.05	2.8	4.0	–0.6	*11.31*
Nominal effective index (4)	*108.1*	*–2.4*	*109.8*	*–0.7*	*–1.7*	*–0.2*	*108.4*
Against euro							
US dollar	1.254	3.6	1.225	1.9	3.4	–5.3	*1.285*
Japanese yen	143.3	0.6	143.6	1.9	2.2	3.4	*143.9*
Swiss franc	1.571	–0.6	1.574	0.3	1.7	1.7	*1.551*
Pound sterling	0.694	–0.3	0.694	0.7	2.2	1.6	*0.683*
Swedish krona	9.297	–1.4	9.334	–0.7	–1.1	1.8	*9.319*
Danish krone (3)	7.461	0.0	7.462	0.0	0.1	0.2	*7.456*
Polish zloty	3.875	–1.7	3.921	1.0	1.8	–5.7	*3.960*
Czech crown	28.42	–0.6	28.52	–0.5	–1.6	–5.4	*28.21*
Hungarian forint	264.1	–0.6	265.7	1.9	5.2	7.1	*263.3*
Nominal effective index (5)	*103.4*	*1.1*	*102.6*	*1.1*	*1.9*	*–2.4*	*104.3*

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.

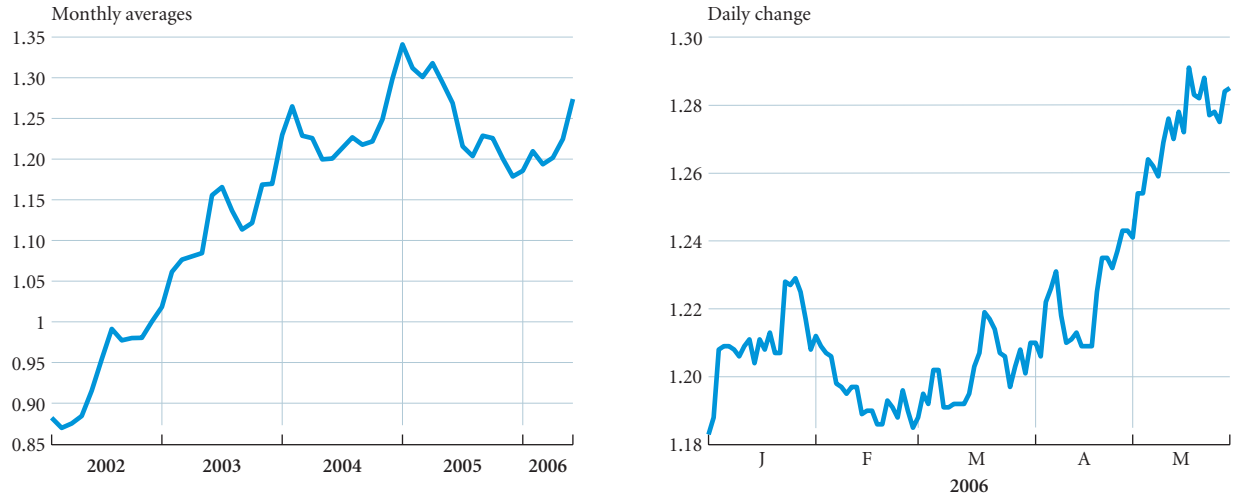
Euro and yen carry weight of dollar depreciation while yuan scarcely showing any change.

agreement with any excessive appreciation of their currencies in terms of the dollar and by the increased upward prospects for interest rates in the United States. Furthermore, the dollar also benefited from the withdrawal of investors from high-risk assets. In any case, at the middle of the fourth week in May the US currency showed a drop of 3% since the beginning of the year compared with a broad group of currencies. However, the drop of the dollar against the euro was notably higher (8%) and against the Japanese yen (4%), whereas against the Chinese yuan it was barely 1%, which shows the unequal adjustment taking place, something which was not in proportion to the size of the bilateral trade deficits.

In this respect, we should point out that the exchange rate for the euro against the dollar went above the level of 1.29 dollars on May 12, the highest level in the past 12 months. Nevertheless, the euro later dropped in view of the recovery of the dollar. In any case, in terms of the currencies of its main trading partners, the euro showed an appreciation of 4% since the beginning of the year.

EURO MARKS UP HIGHEST LEVEL AGAINST DOLLAR FOR PAST 12 MONTHS

US dollars to euro



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

The pound sterling has strengthened considerably in recent weeks with consolidation of the prospect that the next move in Bank of England interest rates would be upward. As a result, the British currency has risen both against the dollar and the euro.

Among other matters, Slovenia has obtained the blessing of the European Commission and the European Central Bank in their respective convergence reports for the Slovenian tolar to become incorporated in the euro. If the European Union Council approves, the Euro Area will widen to 13 countries in January 2007. On the other hand, Lithuania did not pass the test due to excessive inflation.

Slovenia to be 13th country in Euro Area in January 2007.

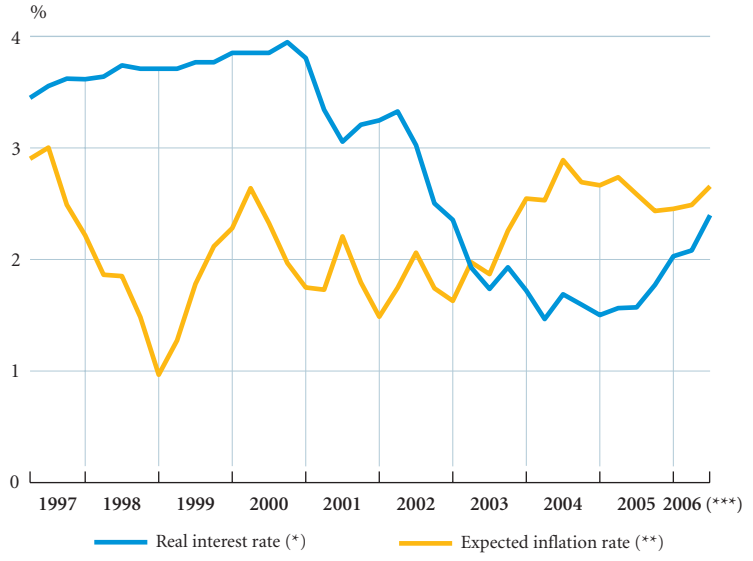
Safe haven effect moderates rise in yields on government bonds

In the early weeks of May, the yield on US Treasury bonds followed the upward path set in recent months driven by increased upward expectations on Federal Reserve interest rates. As a result, on May 12 the yield on US 10-year Treasury bonds rose to 5.21%, marking up the highest level since May 2002. It should be pointed out that the increase in the nominal yield on government bonds in recent months was due to the increase in real interest rates, which were depressed to an anomalous degree, and to a lesser extent to the higher inflation expected. Nevertheless, later on the yield on long-term government bonds dropped due to the shift from high-risk investments (such as emerging country bonds and shares) toward US bonds.

In fact, toward mid-May there was an increase in aversion to risk on the part of investors so that the risk premium on emerging country bonds left behind the all-time low marked up on May 1. With regard to the risk premium on corporate bonds, this also rose toward mid-May.

Yield on US 10-year Treasury bonds marks up highest level since May 2002 going to 5.2%.

RISE IN REAL INTEREST RATE AND INFLATION PROSPECTS IN UNITED STATES



NOTES: (*) According to Merrill Lynch bond indices indexed to inflation.
(**) Based on nominal interest rate of Treasury bonds and real interest rate.
(***) May 24.
SOURCE: Merrill Lynch, Thomson Financial Datastream and internal figures.

LONG-TERM INTEREST RATES IN NATIONAL MARKETS

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

	2003	2004	2005			2006		
			2Q	3Q	4Q	1Q	April	May 24
United States	4.04	4.31	4.21	4.25	4.54	4.61	5.04	5.03
Japan	0.99	1.50	1.28	1.36	1.53	1.58	1.91	1.83
Germany	4.10	4.07	3.35	3.19	3.37	3.50	3.91	3.85
France	4.13	4.10	3.38	3.23	3.39	3.51	3.95	3.90
Italy	4.24	4.24	3.53	3.40	3.56	3.71	4.23	4.13
Spain	4.12	4.10	3.36	3.18	3.37	3.49	3.92	3.86
United Kingdom	4.53	4.93	4.50	4.32	4.34	4.23	4.56	4.59
Switzerland	2.47	2.57	2.04	1.90	2.05	2.18	2.59	2.68

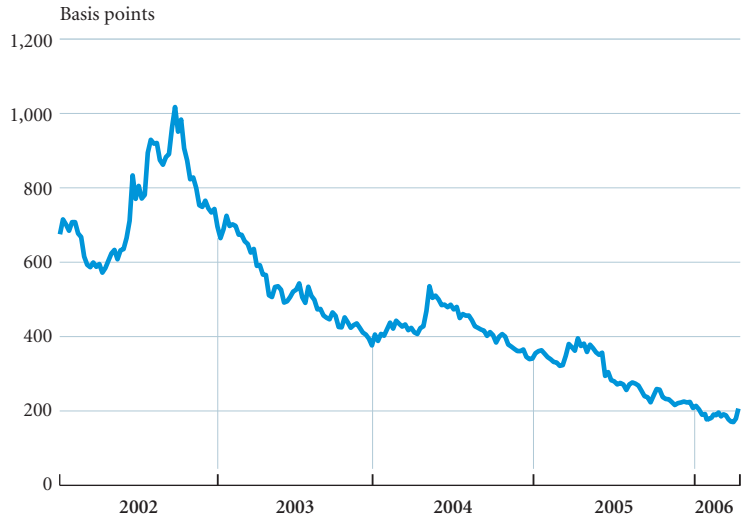
SOURCE: Bank of Spain, Thomson Financial Datastream and internal figures.

Increased aversion to risk affecting emerging country bonds and corporate bonds.

In April, the default rate on high-yield global bonds dropped by one decimal to 1.6%, according to Moody's rating agency, to stand close to the all-time low. Nevertheless, this rating agency expects that this ratio will stand at around 3% at year-end.

RISK PREMIUM APPLIED TO EMERGING COUNTRIES HITS BOTTOM

Differential between sovereign bonds of emerging countries and US Treasury bonds measured by JP Morgan EMBI + index



NOTES: Figures go up to May 19.
SOURCE: JP Morgan and Thomson Financial Datastream.

Sharp correction on stock markets in May

In the first week and a half of May the stock markets continued their upward trend and some indices in the United States and Europe marked up the highest levels in the past six years while some emerging country stock exchanges even beat all-time records in a situation of favourable corporate profits. Nevertheless, later on the renewal of upward prospects on interest rates in the United States and concern about inflation risks made a dent in financial markets which underwent substantial corrections.

Many stock markets mark up highs in second week of May only to later show sharp drops.

After ending the first four months of the year with cumulative gains of more than 5%, the main US stock market indices saw their capital gains being cut back as the following month advanced, although this was quite uneven. The index to best weather the storm was the traditional Dow Jones, whereas the Nasdaq general index, based on high-technology and more volatile shares, ended up losing par for the year. By sector, energy was the one to show the biggest capital gains so far this year while the biggest losses showed up in the pharmaceutical and health sector.

Nasdaq index loses par for year.

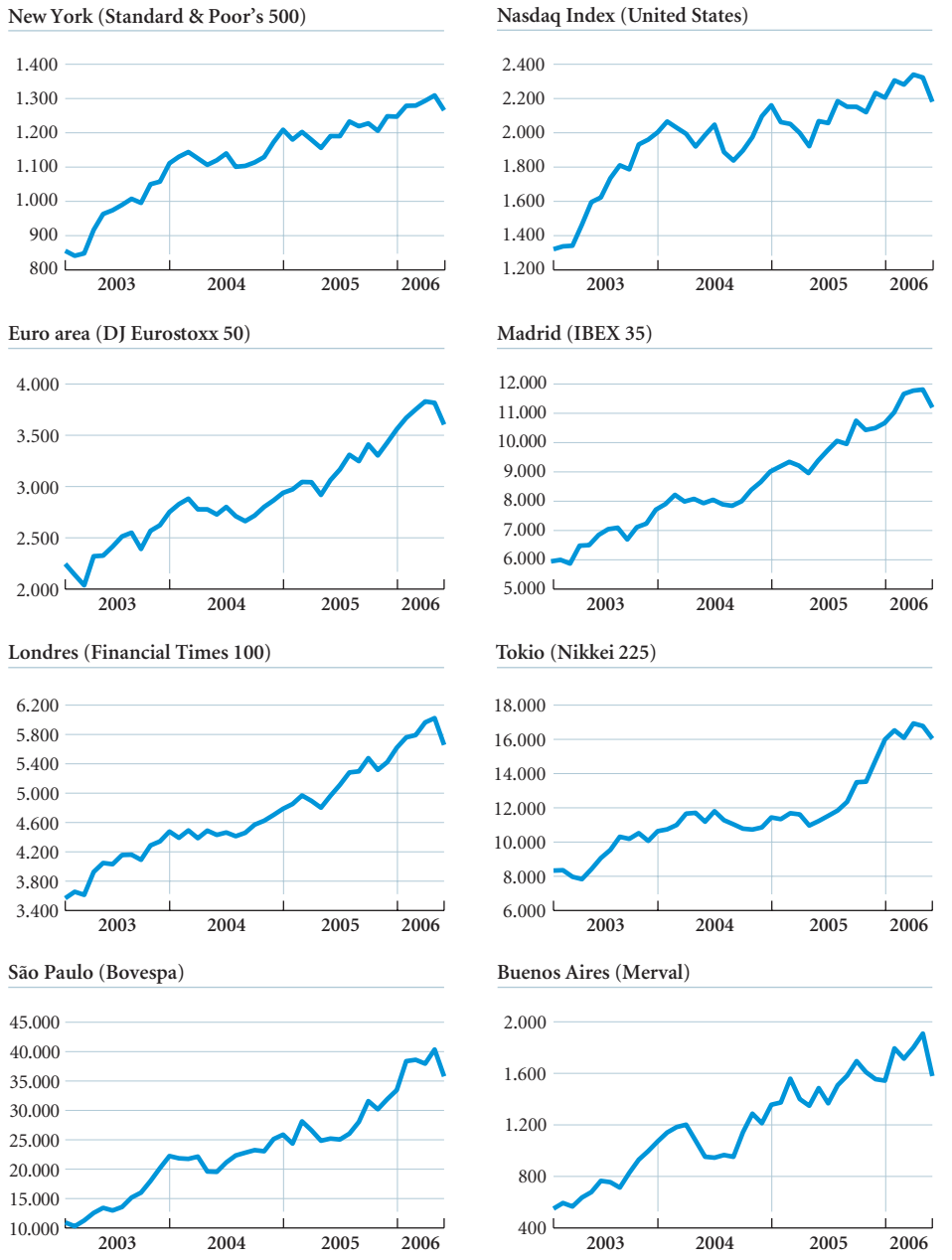
Corporate operations, such as the attempt by Mittal to take over the Arcelor steel complex, helped to enliven European stock exchanges. Nevertheless, the European markets suffered a substantial punishment and markets in Zurich, London and Amsterdam showed a cumulative negative balance halfway through the fourth week of May.

In the first week of May, the selective IBEX 35 index for the Spanish stock market went above 12,000 points for the first time since March 2000. Nevertheless, the general move to correction meant it lost this level at the end of the second week in the month. As a result, toward the fourth week of the month 14 shares out of the 35 making up

IBEX 35 briefly hits 12,000 points.

INTERNATIONAL STOCK EXCHANGES

Indices at month-end



NOTES: May 24, 2006.
SOURCE: National stock exchanges.

Emerging country stock markets undergo sharp punishment.

the index came out in the red compared with December.

In the upsets in May, the emerging country stock exchanges were the ones to suffer the biggest drops. As a result, stock exchanges in Russia, India, Indonesia and Brazil dropped sharply after having marked up all-time highs in the second week of the month.

INDICES OF MAIN WORLD STOCK EXCHANGES

April 28, 2006

	Index (*)	% monthly change	% cumulative change	% annual change	*Figures on May 24, 2006*	
					% cumulative change	*% change over same date in 2003*
New York						
Dow Jones	*11,367.1*	*2.3*	*6.1*	*11.5*	*3.7*	*29.3*
Standard & Poor's	*1,310.6*	*1.2*	*5.0*	*13.3*	*0.8*	*34.9*
Nasdaq	*2,322.6*	*–0.7*	*5.3*	*20.9*	*–1.6*	*43.6*
Tokyo	16,906.2	–0.9	4.9	53.6	–1.3	*94.4*
London	6,023.1	1.0	7.2	25.4	–0.6	*40.4*
Euro area	3,839.9	–0.4	7.3	31.1	–0.1	*59.1*
Frankfurt	*6,009.9*	*0.7*	*11.1*	*43.6*	*3.3*	*97.9*
Paris	*5,188.4*	*–0.6*	*10.0*	*32.6*	*3.3*	*68.1*
Amsterdam	*469.4*	*0.2*	*7.5*	*34.8*	*–0.2*	*61.2*
Milan	*29,422.0*	*0.4*	*9.9*	*24.5*	*1.9*	*53.6*
Madrid	*11,892.5*	*0.3*	*10.8*	*32.1*	*2.9*	*74.1*
Zurich	8,047.3	0.3	6.1	37.1	–1.4	*63.6*
Hong Kong	16,661.3	5.4	12.0	19.8	6.4	*70.1*
Buenos Aires	1,908.6	6.0	23.7	41.6	2.3	*141.7*
São Paulo	40,363.0	6.4	20.6	62.5	7.0	*172.3*

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

SOURCE: National stock exchanges and internal figures.

SPAIN: OVERALL ANALYSIS

Economic activity

Few changes in performance of Spain's economy: activity continues to grow sharply but leaves major imbalances.

Light and shade in a growth economy

The figures for the Quarterly National Accounts for the first quarter of 2005 supplied by the National Institute of Statistics provide a picture of Spain's economy not very different from the photo taken in recent months. That is to say, economic activity continues to move ahead at a very lively rate and employment is showing strong growth. However, the basic imbalances, foreign deficit and excessive inflation, continue to stand out and the growth of productivity is insignificant. What weighs heaviest on the scale? For the moment, the positive elements do. In fact, the strength shown by domestic demand in the past three years has been extraordinary to the point where the growth rate has been three times that of the Euro Area. Nearly two million jobs have been created (nearly 60% of all jobs created in the whole Euro Area). To consolidate these achievements, however, or to broaden them in the future, it is essential to halt the imbalances mentioned above which could hurt the potential growth of Spain's economy over the medium and long term.

In the first quarter of 2006, the gross domestic product (GDP) grew by 3.5% year-to-year, the same as in the last

DEMAND INDICATORS

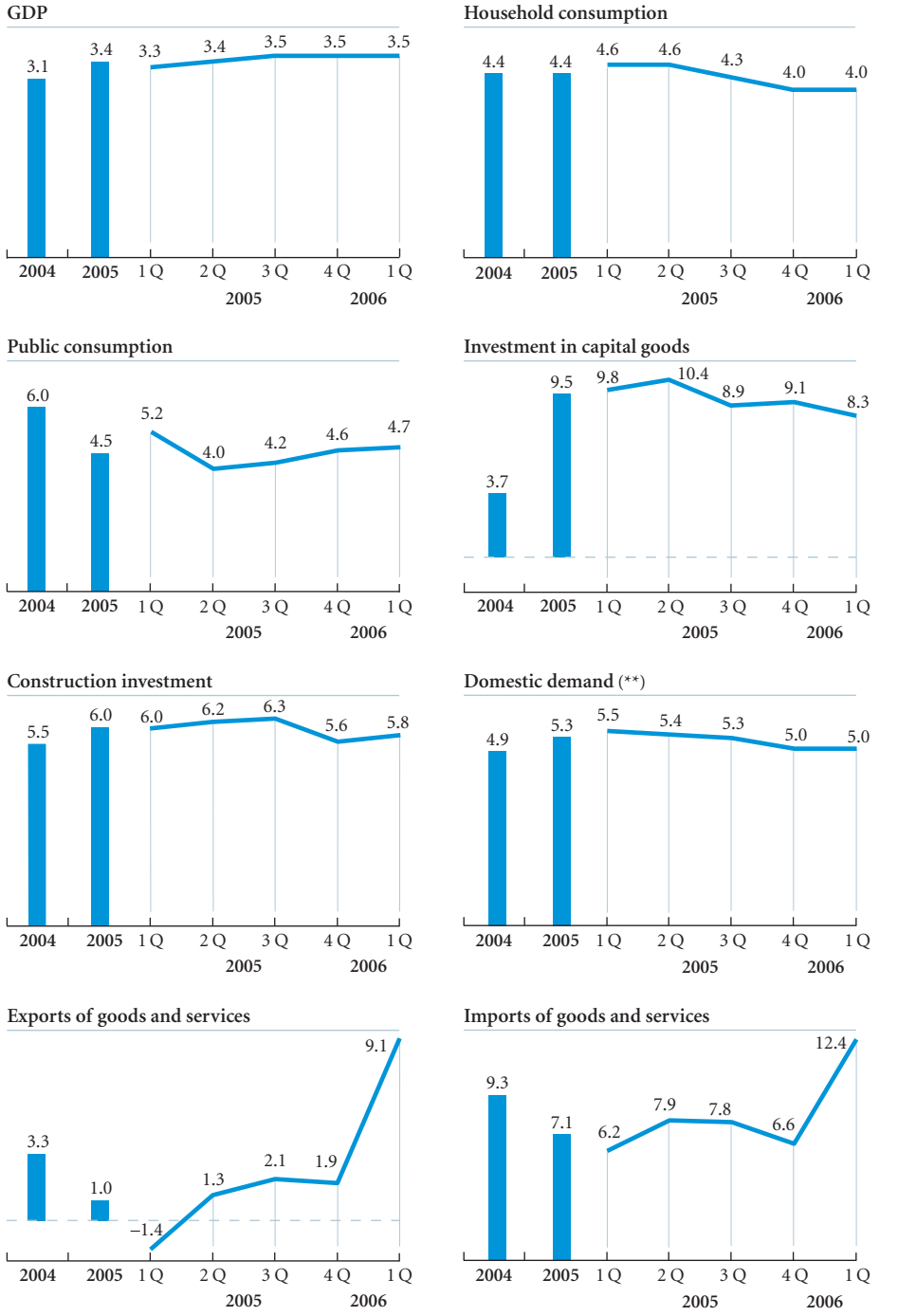
Percentage change over same period year before

	2004	2005	2005				2006			
			1Q	2Q	3Q	4Q	January	February	March	April
Consumption										
Production of consumer goods (*)	–0.1	0.9	0.1	1.1	1.4	0.9	0.7	1.7	–0.4	...
Imports of consumer goods (**)	13.4	7.9	6.5	8.4	7.8	8.6	40.4	9.3	14.4	...
Car registrations	9.8	0.8	–0.0	4.9	2.3	–4.5	–0.3	–2.3	8.3	–10.5
Credit for consumer durables	5.5	12.5	8.8	13.7	17.2	10.1	–	–	–	–
Consumer confidence index (***)	–10.5	–10.8	–9.3	–11.3	–11.4	–11.2	–12.4	–13.0	–12.0	–10.0
Investment										
Capital goods production (*)	1.9	–0.1	–0.8	0.6	–1.3	0.8	10.1	4.6	5.4	...
Imports of capital goods (**)	14.9	20.4	28.6	36.0	13.5	8.2	20.7	10.0	2.8	...
Commercial vehicle registrations	11.7	13.2	9.2	17.9	13.9	11.5	–5.8	6.5	19.2	–12.1
Foreign trade (**)										
Non-energy imports	9.8	6.0	5.7	9.0	4.7	4.5	14.7	11.5	14.9	...
Exports	5.2	0.2	–3.1	2.5	1.2	0.1	12.2	11.6	14.2	...

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.

TREND IN SPAIN'S GDP BY COMPONENT

Percentage year-to-year change (*)



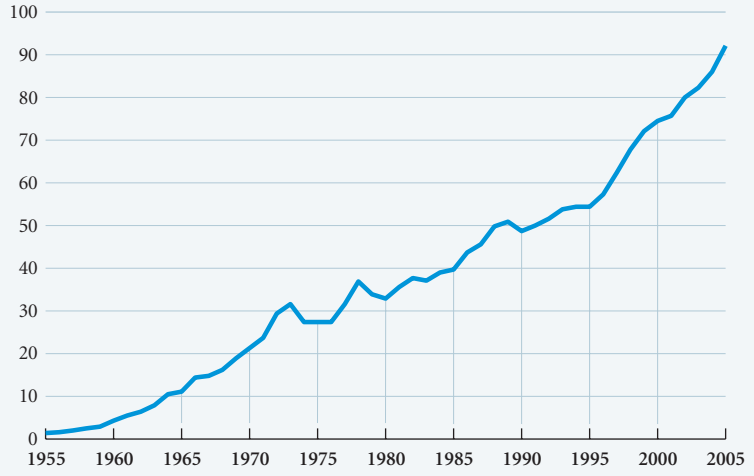
NOTES: (*) Figures adjusted for seasonal and calendar effects.
(**) Contribution to GDP growth.
SOURCE: National Institute of Statistics.

Spanish tourists gaining over foreign visitors

Tourist activity contributed 11.0% to Spain's GDP in 2004, according to the Tourist Satellite Count prepared by the National Institute of Statistics which includes the indirect effects of tourism on other closely related sectors (retail trade, restaurant trade, etc.). The contribution in 2004 was slightly lower than in previous years mainly due to the lower contribution from foreign tourism (4.9% of the GDP, nearly one percentage point less than in 2000). On the other hand, in recent years the other components of tourist demand (consumption by Spaniards within Spain and gross capital formation) have gone through extraordinary growth, thanks to the strength of domestic tourism which has now become the main engine of growth in Spain's tourist sector. In 2004, these components together contributed 6.1% to the GDP, three decimals more than four years earlier, thus increasing their contribution to the product generated by the tourist system as a whole to 55%. Also in parallel tourist consumption of Spaniards abroad has grown sharply to the point where payments of this type recorded in the balance of payments have practically doubled in the past five years.

FOREIGN TOURISM KEEPS ON GROWING

Number of foreign visitors. Million persons

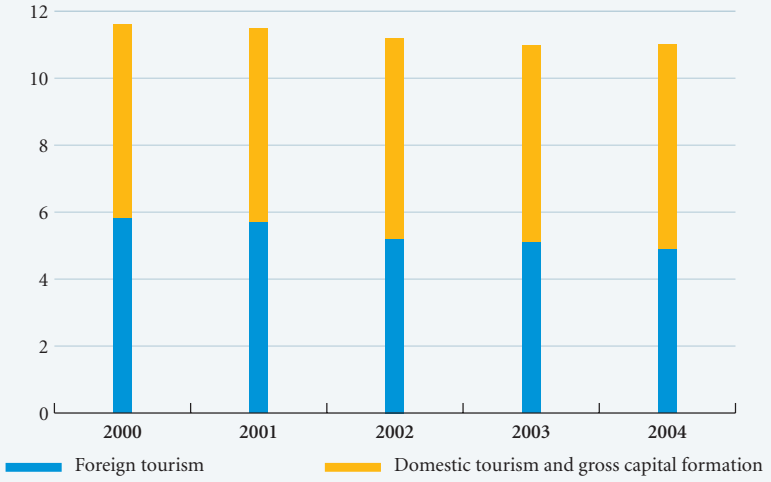


SOURCE: INE and internal figures.

What are the reasons for this spectacular growth of tourist consumption by Spaniards? Undoubtedly, the main factor is the high elasticity of tourist demand in terms of income, falling within the framework of the growth cycle of Spain's economy. In addition, in domestic tourism, growth of residential real estate investment (combining tourist pleasure and reasons of family investment) also holds special importance. With regard to incoming tourism, the loss of relative weight noted in terms of the Spanish economy as a whole is mainly due to the trend toward more contained spending. In 2005, for example, average spending per tourist was down by 2% (tourists spent more per day but reduced their average length of stay). This fact could be linked to the change in the sociological profile of visitors to Spain and the development of new habits in which the development of low-cost airlines (referred to in another chapter of this report) could be playing a key role.

DOMESTIC TOURISM IS NOW MAIN SUPPORT OF SPAIN'S TOURIST SECTOR

Contribution to GDP as percentage



SOURCE: INE and internal figures.

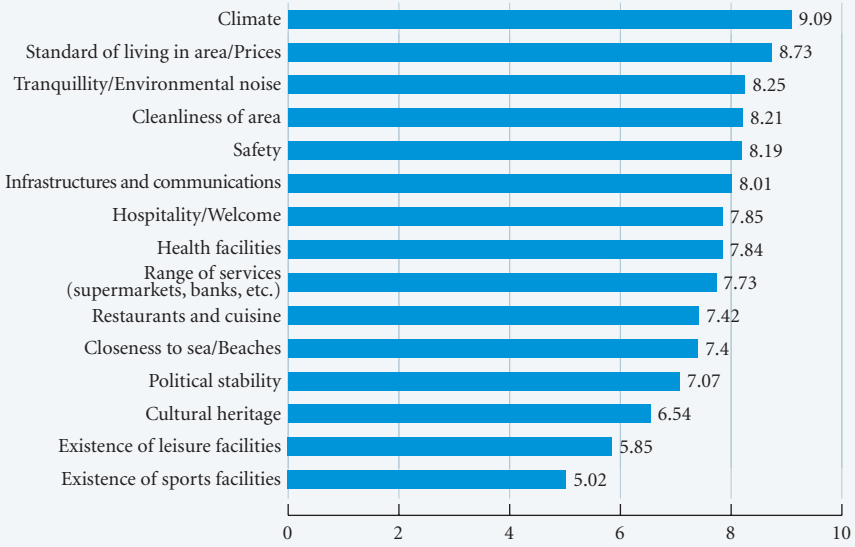
In any case, we should not have any doubts about the importance of the effect of foreign tourism for the direct and indirect activity generated by the sector. We may ask whether the bases of Spain's tourism are sufficiently solid to guarantee its future success? The most widely held view is that it is at the point of ending a cycle and that it is necessary to face the future with new approaches. Everything would indicate that the «sun and beaches» model, the big leader in what Spanish tourism had to offer until recently, is wearing out its growth possibilities. Countries that are cheaper are competing with considerable success and, furthermore, the profile of the tourist is changing at a rapid rate. In general, the *new active tourist* wants to make the most of the holiday time spent which includes a wide range of complementary activities related to sport (golf, cycling tours, hiking, etc.), culture, health, enjoyment of nature, etc. We should not forget either that tourism has moved right into the technological age. It is enough to note that in 2004 more than 41 million Europeans used Internet to plan their holidays and nearly a third of those travelling to Spain used the net to plan their stay. This new reality imposes drastic changes on traditional systems of marketing which were very dependent on large European operators.

In an attempt to respond to these challenges, some months ago the Ministry of Industry, Trade and Tourism set up the Spanish Tourism Council. This body (made up of 54 members with representation from the central government, autonomous communities, local government and the private sector) has as its mission the task of analyzing, debating, proposing and coordinating policy related to tourism. Its main objective at this moment is the preparation of a White Book on Tourism in which it will establish the bases for consolidating Spain's present leadership in the sector (the country is now the second leading destination of international tourism in order of importance after France and ahead of the United States). Of course, the list of problems is very important. In addition to those aspects mentioned above we should add other burning questions, such as the obsolescence of certain facilities, the deterioration of the environment in some areas, etc. What is needed then is the carrying out of a careful overall analysis along with rapid implementation of adequate measures in order to avoid (as has happened on other occasions) that everything ends up merely being a declaration of good intentions.

At this very moment, millions of Europeans (mainly British and German) are weighing the possibility of spending their retirement in another country, a warmer country with a good living standard and where prices are reasonable. This is something normal in the United States where the state of Florida has become the destination of a vast number of Americans who chose to spend their retirement there. In addition, right across Europe economic and financial conditions in recent years have encouraged a growing inclination to home purchase and part of this demand has gone into a holiday home far from the retiree's country of origin.

This is a relatively new phenomenon, at least in quantitative terms. Having a significant effect on this are the low-cost airlines which make it possible to make two or three-hour flights at very low cost. Because of this, an important factor for a foreigner in buying a house is that it is located within a radius of approximately one hour by car from the airport. From the point of view of product, the demands of customers become more and more clear. They do not want isolated houses, they want services and they want to have safe environments with diversion and entertainment and, when it comes to actually buying, the variety of activities becomes one of the main demands.

FOREIGN CUSTOMER PREFERENCES WHEN CHOOSING A HOLIDAY HOME



SOURCE: Live in Spain.

Given these circumstances, it is not surprising that a good part of this demand is channelled toward Spain. In the current construction boom in the Spanish economy, holiday homes are playing a key role and, within this segment, an important part of demand is of European origin. This demand, of course, comes on top of that from national customers. This is a phenomenon which is not spread right across the country but rather is concentrated on the Mediterranean littoral. Those areas with a heavy concentration of tourists

include the Balearic Islands, the Canary Islands, the Costa Brava and the Costa Dorada in Catalonia, the Costa Blanca in Alicante, the Costa Cálida in Murcia, the Costa del Sol in Málaga and the Costa Tropical in Granada. In recent years, more than half of housing starts in Spain were in provinces forming part of the Mediterranean littoral or the islands. This is a strong trend given that the potential for urban development in coming years is high, which has raised concern about the effects this may have in terms of the landscape and the environment.

Adding to these trends, in recent years the number of foreign tourists who decide to spend their holidays in Spain in their own house or in a rented one has done nothing but increase. This type of tourism, apart form its direct economic impact on the real estate sector, because of home purchase or rental, also has important indirect effects on the restaurant trade, retail trade and on the leisure sector.

In addition, given the increased life-expectancy in Europe and the progressive increase in the number of elderly persons, it is quite plausible that health tourism or a combination of holiday and health tourism will become more and more important. Health tourism deals with the needs of tourists who come in order to obtain medical treatment and is partly met by clinics and hospitals. But as well as health tourism and, given the needs of elderly persons who often need medical services more frequently than young people, the health component in tourism for the elderly is undoubtedly important.

One of the areas which has had a notable development with the aim of meeting this complex series of needs is the health resort, a tourist real estate complex that is partly residential with another part which may combine sports and leisure facilities, entertainment and rest. The special feature of these establishments lies in that they involve overall and coordinated management of the premises covering the entire facility.

Whatever model of development adopted in the residential tourist sector, the fact is that these new trends are profoundly changing the form and make-up of those sectors that live within the tourist sphere. This is a transformation which may be just as important as that accompanying the first tourist boom in the Sixties.

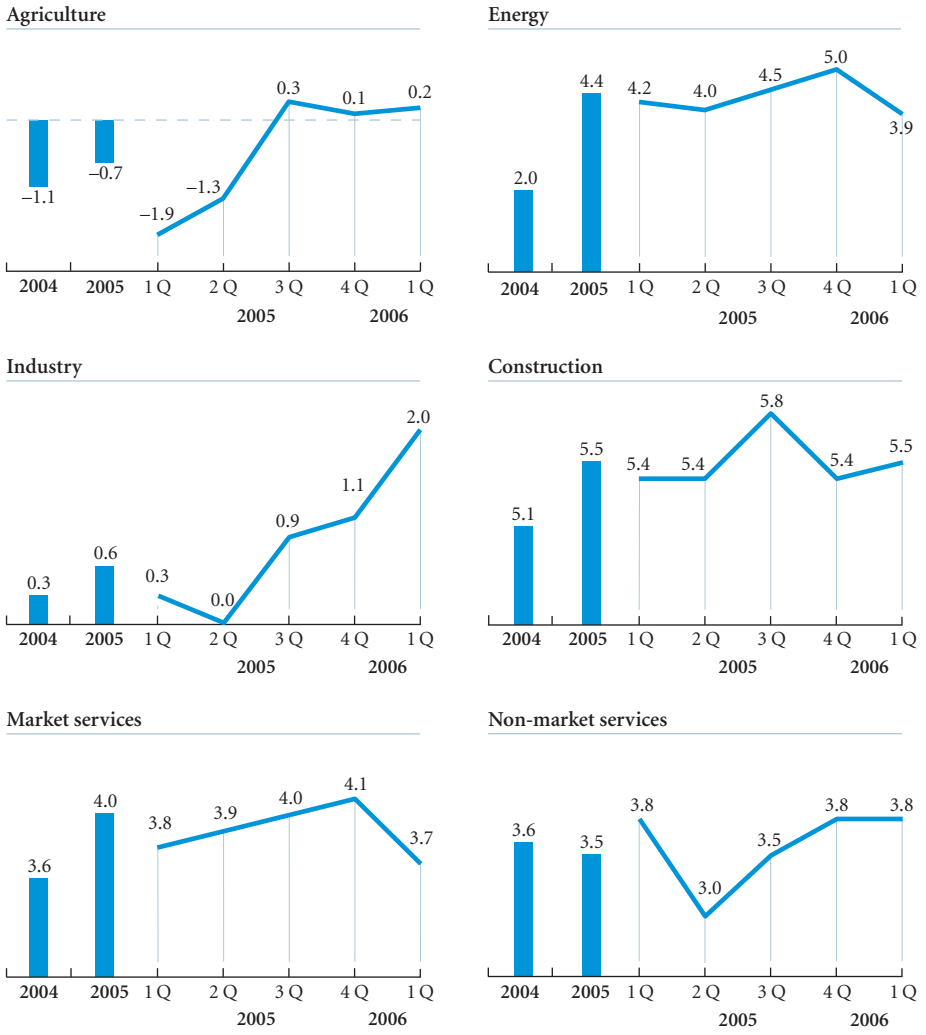
quarter of 2005, with a positive contribution coming from national demand (5 percentage points of GDP growth) and a negative contribution from the foreign sector (1.5 points), also identical. Private consumption maintained a very high growth rate (4.0% year-to-year) based mainly on the drive in spending on services which compensated for a less expansionist state of demand for goods, especially durables. As a result, passenger car registrations were down by nearly 1% in the first four months of the year whereas real growth of retail sales failed to reach 1% in the first quarter.

In any case, final consumption (both public and private) together contributed 3.1 percentage points to GDP growth, thus reasserting itself as one of the main engines of economic growth. With regard to gross capital formation, we should point out the slowdown in growth of investment in capital goods (mainly in transportation equipment) and other products. On the other hand, investment in construction gathered new drive, thanks to renewed activity in residential building which, going against all expectations, raised its annual growth rate to 7.4%.

Consumption and construction confirmed as main engines of economic growth.

TREND IN SPAIN'S GDP BY SUPPLY SECTOR

Percentage year-to-year change (*)



NOTES: (*) Figures adjusted for seasonal and calendar effects.
SOURCE: National Institute of Statistics.

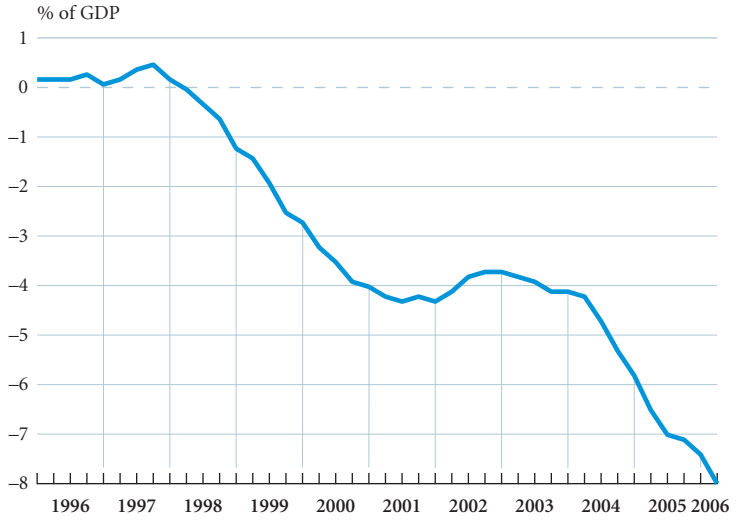
Negative balance in foreign trade pushes up current account deficit to levels never before seen.

The negative contribution of the foreign sector may be explained by the strong drive in imports which wiped out the benefits of a substantial increase in exports. Specifically, we should mention the good performance in exports of goods which were up by 12.7% year-to-year, in contrast to the poor result in exports of services brought about by the drop in tourist revenue inflows.

The increase in the trade deficit, along with the negative trend in other transactions (transfers, subsidies and property income), has pushed up the current account deficit to 10.6% of the GDP, according to figures for National Accounting. This has never been seen before. As we have stated on other occasions, without the protective umbrella of the euro, Spain's economy would already have suffered a sharp

CURRENT ACCOUNT DEFICIT OUT OF CONTROL

Cumulative current account deficit for 12 months



SOURCE: INE and internal figures.

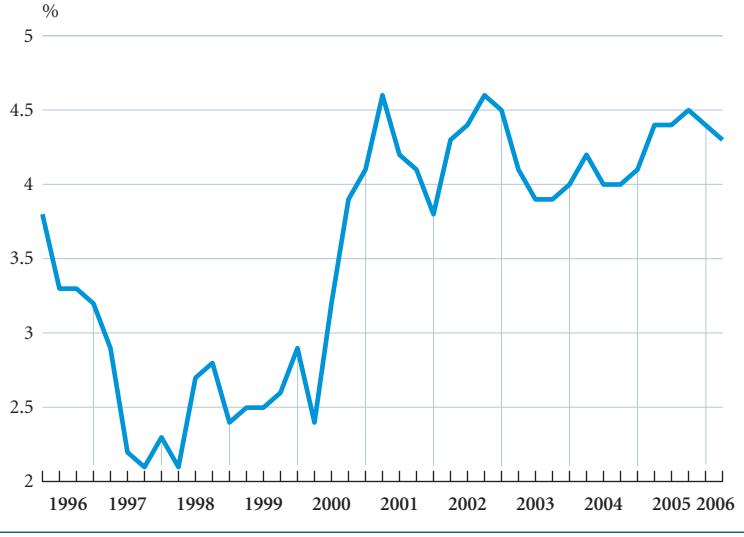
drop. Fortunately, Spain's integration in the Euro Area converts that deficit into a simple regional matter although, of course, everything has a limit.

On the supply side, the most positive factor is the recovery of industrial activity. Gross value added in that sector was up by 2% year-to-year in the first quarter helped by the good performance in foreign sales. Finally, the services branches are holding to a high level (although tending to ease growth slightly) while construction, in line with

On supply side, most positive factor is recovery of industrial activity.

GDP DEFLATOR REFLECTS INFLATIONARY PRESSURES IN SPAIN'S ECONOMY

Year-to-year change in GDP deflator



SOURCE: INE and internal figures.

SUPPLY INDICATORS

Percentage change over same period year before

	2004	2005	2005				2006			
			1Q	2Q	3Q	4Q	January	February	March	April
Industry										
Electricity consumption (1)	4.1	2.8	4.8	2.7	1.5	1.9	3.2	3.6	1.6	4.2
Industrial production index (2)	1.6	0.7	0.3	0.1	0.7	1.6	3.5	2.7	1.7	...
Confidence indicator for industry (3)	–2.5	–4.9	–3.6	–7.0	–4.8	–4.0	–7.3	–6.0	–3.0	–5.0
Utilization of production capacity (4)	79.8	80.2	79.4	79.5	81.1	80.7	–	79.7	–	80.5
Imports of non-energy intermediate goods (5)	6.6	1.6	0.7	3.6	0.6	1.1	–0.8	12.6	18.4	...
Construction										
Cement consumption	3.7	7.4	1.3	13.7	7.9	6.2	13.8	12.6	20.7	–8.1
Confidence indicator for construction (3)	13.6	22.4	23.7	15.0	22.7	28.3	21.0	6.0	19.0	11.0
Housing (new construction approvals)	8.0	6.2	3.7	7.6	2.8	10.6	24.6	8.9	23.0	...
Government tendering	18.3	18.5	5.8	36.6	3.1	36.9	18.2	8.6	14.8	...
Services										
Retail sales	5.5	4.4	4.1	5.4	4.4	3.8	4.7	4.2	6.6	0.3
Foreign tourists	3.1	6.1	8.2	4.4	7.0	4.9	–0.1	2.0	0.0	17.7
Tourist revenue inflows	3.8	5.8	4.1	–3.9	13.9	4.9	–13.7	–2.5	...	...
Goods carried by rail (km-tonnes)	–3.5	–3.2	–14.3	–4.7	–2.3	11.0	6.0	6.0	12.2	…
Air passenger traffic	8.0	9.1	8.4	8.5	10.2	9.1	7.7	5.5	3.0	15.1
Motor vehicle diesel fuel consumption	7.2	4.9	2.7	7.5	4.9	4.2	9.7	5.2	...	...

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.

the trend in demand, comes out as the most dynamic sector with a contribution of 1.0 points to GDP growth.

Continuing upward trend in prices hurting competitiveness of Spain's economy.

The upward trend in prices is a blotch on Spain's economic picture. As we can see in the above graph, the year-to-year growth rate of the GDP deflator in recent months has stood very close to 4.5%, which by all means is an excessively high level. In its May report, the Organization for Economic Cooperation and Development (OECD) expressed its concern for the loss of competitiveness taking place in Spain's economy due to this excessive inflation. The international body insisted on its habitual recommendations: toughening fiscal policy (to raise the government surplus), fostering competition (particularly in the retail sector) and correcting the deficiencies in the collective bargaining system. The OECD also believes that, if the segmentation of the labour market were reduced, it would improve the present poor results in matters of productivity.

Labour market

Growth of employment stabilizes in first quarter

Spain's economy continued to generate employment at a very high rate in the first quarter of 2006, according to the Labour Force Survey, although somewhat lower than in previous quarters. In fact, estimated employment rose at a rate of 4.9%, four decimals lower than in the quarter before. In any case, estimates by National Accounting suggest a continuation of the current strong job creation.

Estimated employment still growing at very high rate.

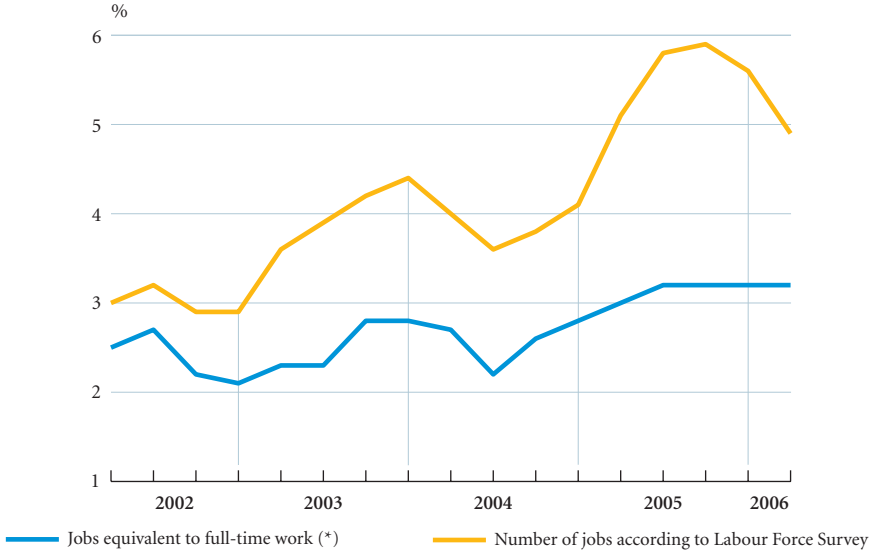
Apart from the drop in farm employment, figures from the Labour Force Survey for the first quarter indicate a continuation of the loss of strength in industrial employment which grew by 0.5% year-to-year in the first quarter and looks like running into the red as the year progresses. The delicate situation in some of the more traditional branches of manufacturing activity (clothing, leather, footwear and plastics) now being hurt by foreign competition and the difficulties noted by other sub-sectors more affected by relocation moves or the drop in foreign demand (paper and graphic arts, furniture and motor vehicles) would indicate an increase in this trend.

Worst result shows up in industry.

In addition, the moderation in employment in services, in principle attributable to seasonal factors, on examining figures from the Labour

HIGH JOB CREATION

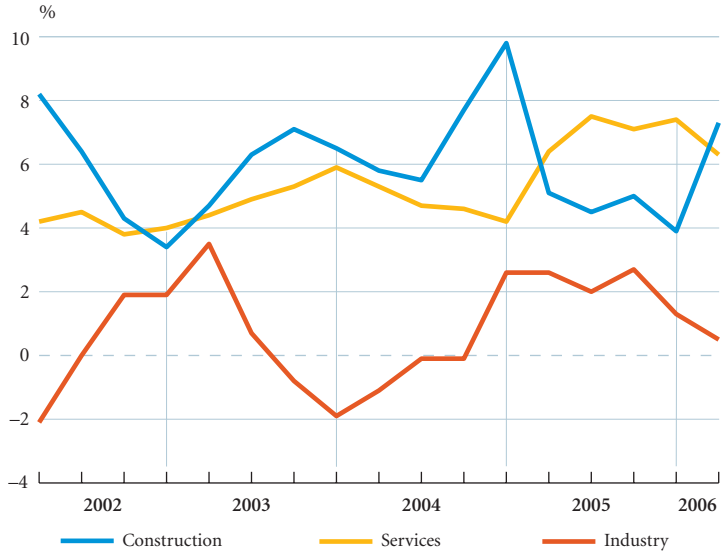
Year-to-year change in employment



NOTES: (*) Figures adjusted for seasonal and calendar differences.
SOURCE: INE and internal figures.

INCREASE IN CONSTRUCTION AND WEAKER SITUATION IN SERVICES

Year-to-year change in estimated employment by sector



SOURCE: INE and internal figures.

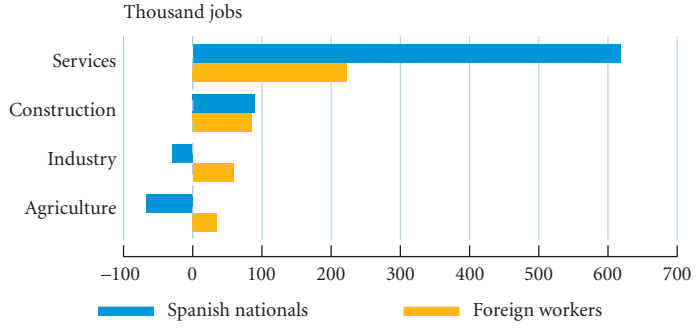
Some services showing slight moderation.

Force Survey in greater detail, seems to be due to other causes. In fact, the hotel and restaurant trade is the only branch of economic activity where employment moved ahead strongly in the first quarter, while slowdown was the norm in retail trade, the financial sector, education and some social services. The unexpected rise in employment in the hotel and restaurant trade (as much as 10.8% year-to-year) may be due to the bias arising from the process of giving regular work status to immigrants which began in February 2005.

The exception to this general picture of slowdown is still to be found in construction. In the first quarter, employment in this sector again rose sharply, going against forecasts of an expected cooling off in that sector.

IMMIGRATION KEY FACTOR IN NEW EMPLOYMENT

New employment created in one year as of first quarter of 2006



SOURCE: INE and internal figures.

In any case, we should point out the sharp increase in employment in the past 12 months, amounting to 907,400 new jobs, with a job total of 19.4 million, according to the Labour Force Survey. Some 44.4% of new jobs created since the first quarter of 2005 (403,300) involved foreign workers. This figure includes jobs coming to the surface which were already existing in fact, given that employment among foreign workers shows a much higher growth rate of 21.3%, as against 3.7% recorded for employment among Spanish nationals, which is more indicative of the general trend in the labour market.

However sharp this increase may have been and without questioning the extraordinary strength of the process, the phenomenon of immigration is changing Spain's labour picture, particularly in certain sectors. Both in agriculture and industry, foreign workers are replacing Spaniards who, for some reason or another, are abandoning those sectors, as may be seen in the foregoing graph. In the past twelve months, employment of foreign workers in these two sectors has increased while among Spanish nationals employment has dropped. The situation in construction is different but new employment is practically divided in two halves between Spanish nationals and foreign workers. Finally, in services, a sector which accounts for the greatest volume of new jobs, Spanish nationals are in the majority but the proportion taken up by immigrant workers is very high at more than a quarter.

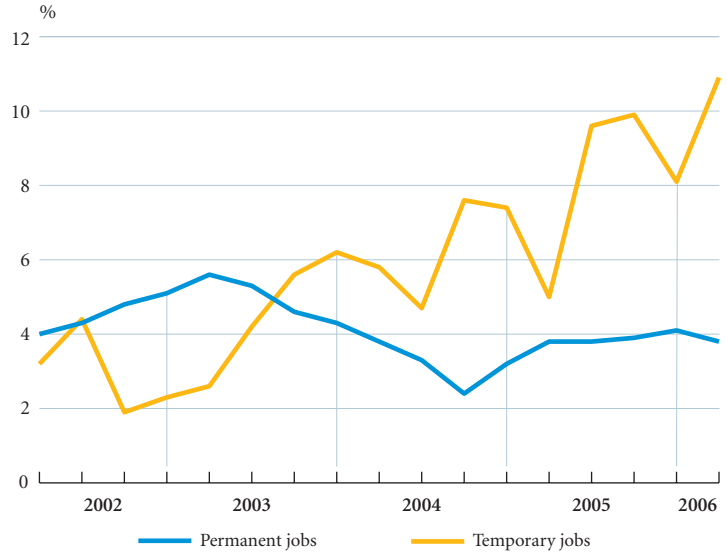
Construction, on the other hand, seems unstoppable.

Another relevant point showing up in the Labour Force Survey for the first quarter of 2006 was the strong growth of temporary work which now reaches 10.9% year-to-year, as against 3.8% recorded by permanent job holders. This means that 521,700 of the just over 900,000 jobs created in the past 12

Continued high level of temporary work brings government to adopt measures in favour of permanent hiring contracts.

SHARP RISE IN TEMPORARY EMPLOYMENT

Year-to-year change in wage employment according to type of hiring contract



SOURCE: INE and internal figures.

ESTIMATED EMPLOYMENT

First quarter 2006

	No. of employees (thousands)	Quarterly change		Annual change		% share
		Absolute	%	Absolute	%	
By sector						
Agriculture	984.8	–22.0	–2.2	–32.5	–3.2	5.1
Non-farm	18,415.3	107.9	0.6	940.0	5.4	94.9
Industry	*3,273.6*	*–14.9*	*–0.5*	*16.1*	*0.5*	*16.9*
Construction	*2,436.7*	*13.9*	*0.6*	*166.2*	*7.3*	*12.6*
Services	*12,705.0*	*108.8*	*0.9*	*757.6*	*6.3*	*65.5*
By type of employer						
Private sector	16,536.8	90.5	0.6	875.6	5.6	85.2
Public sector	2,863.3	–4.7	–0.2	31.8	1.1	14.8
By work situation						
Wage-earners	15,888.9	47.2	0.3	912.0	6.1	81.9
Permanent contract	*10,593.0*	*101.7*	*1.0*	*390.3*	*3.8*	*54.6*
Temporary contract	*5,295.9*	*–54.5*	*–1.0*	*521.7*	*10.9*	*27.3*
Non-wage-earners	*3,481.5*	35.3	1.0	–4.2	–0.1	17.9
Entrepreneurs with employees	*1,052.8*	*23.3*	*2.3*	*110.4*	*11.7*	*5.4*
Entrepreneurs without employees	*2,150.6*	*–1.0*	*0.0*	*–31.6*	*–1.4*	*11.1*
Family help	*278.1*	*13.0*	*4.9*	*–83.0*	*–23.0*	*1.4*
Other	29.7	3.2	12.3	–0.2	–0.7	0.2
By time worked						
Full-time	16,986.3	–12.7	–0.1	919.7	5.7	87.6
Part-time	2,413.9	98.6	4.3	–12.3	–0.5	12.4
By sex						
Males	11,575.6	26.0	0.2	412.7	3.7	59.7
Females	7,824.5	59.9	0.8	494.8	6.7	40.3
TOTAL	**19,400.1**	**85.9**	**0.4**	**907.5**	**4.9**	**100.0**

SOURCE: National Institute of Statistics and internal figures.

Unemployment rate stands at 9.1%, more than one point below one year ago.

months was of that nature. This shows the importance government moves to reduce temporary work (now accounting for 33.3% of wage employment) could have in the future. These moves involve measures to foster the changing of temporary hiring contracts into permanent contracts and making the firing process less costly.

In addition, registrations with Social Security, adjusted for the impact of the process of giving legal status to foreign workers, while still notably strong, are also showing a slightly more moderate profile that is much more coherent with the growth rate of the economy. In April, gross registrations grew by 5.6% which, if we discount the foreign workers given regular status (and who continued working), numbering 498,395 at the end of April, would amount to 2.8%.

The good performance in employment brought a 7.8% reduction in estimated

ESTIMATED UNEMPLOYMENT

First quarter 2006

	No. of unemployed	Quarterly change		Annual change		Share %	% of labour force
		Absolute	%	Absolute	%		
By sex							
Males	846.4	25.2	3.1	–94.6	–10.0	43.7	6.8
Females	1,089.4	69.3	6.8	–68.7	–5.9	56.3	12.2
By age							
Under 25 years	454.2	–2.1	–0.5	–77.4	–14.6	23.5	18.7
Other	1,481.6	96.6	7.0	–85.8	–5.5	76.5	7.8
By personal situation							
Long-term unemployment	530.7	–26.4	–4.7	–81.9	–13.4	27.4	–
Seeking first job	203.7	–16.6	–7.5	–53.4	–20.8	10.5	–
Other	1,201.4	137.5	12.9	–27.9	–2.3	62.1	–
TOTAL	**1,935.8**	**94.5**	**5.1**	**–163.2**	**–7.8**	**100.0**	**9.1**

SOURCE: National Institute of Statistics and internal figures.

LABOUR FORCE, EMPLOYMENT AND UNEMPLOYMENT BY AUTONOMOUS COMMUNITY

First quarter 2006

	In work force			Employed			Unemployed			Unemployment rate (%)
	Total (thousands)	Annual change	% annual change	Total (thousands)	Annual change	% annual change	Total (thousands)	Annual change	% annual change	
Andalusia	3,547.9	171.4	5.1	3,074.8	179.2	6.2	473.1	–7.8	–1.6	13.3
Aragon	599.0	2.6	0.4	561.3	1.5	0.3	37.7	1.0	2.9	6.3
Asturias	463.7	15.3	3.4	416.2	18.4	4.6	47.4	–3.1	–6.2	10.2
Balearic Islands	499.2	18.6	3.9	456.9	27.3	6.3	42.3	–8.7	–17.0	8.5
Canary Islands	983.2	42.7	4.5	865.7	45.7	5.6	117.5	–3.1	–2.5	12.0
Cantabria	264.9	9.3	3.6	245.9	15.2	6.6	19.0	–5.9	–23.6	7.2
Castile-Leon	1,122.8	19.5	1.8	1,020.0	28.3	2.9	102.8	–8.8	–7.9	9.2
Castile-La Mancha	861.0	49.0	6.0	779.3	45.1	6.1	81.7	3.9	5.0	9.5
Catalonia	3,619.5	138.5	4.0	3,365.8	161.0	5.0	253.7	–22.5	–8.1	7.0
Valencian Community	2,314.7	80.9	3.6	2,108.6	101.1	5.0	206.1	–20.2	–8.9	8.9
Extremadura	459.2	2.8	0.6	386.9	10.0	2.7	72.3	–7.2	–9.0	15.7
Galicia	1,269.3	21.0	1.7	1,142.5	30.2	2.7	126.8	–9.3	–6.8	10.0
Madrid Community	3,137.8	103.0	3.4	2,952.0	168.4	6.0	185.8	–65.4	–26.0	5.9
Murcia	638.4	33.5	5.5	589.3	39.1	7.1	49.1	–5.6	–10.2	7.7
Navarre	295.9	8.3	2.9	277.2	7.7	2.9	18.7	0.6	3.2	6.3
Basque Country	1,048.2	20.3	2.0	968.4	22.0	2.3	79.8	–1.7	–2.1	7.6
La Rioja	152.6	7.3	5.0	143.7	9.1	6.7	8.9	–1.7	–16.4	5.8
Ceuta and Melilla	58.6	0.2	0.3	45.5	–1.9	–4.0	13.1	2.1	19.1	22.4
TOTAL	**21,335.9**	**744.2**	**3.6**	**19,400.0**	**907.5**	**4.9**	**1,935.8**	**–163.2**	**–7.8**	**9.1**

SOURCE: National Institute of Statistics and internal figures.

unemployment putting the figure at 1,935,800 persons in the first quarter, in spite of the sustained increase in the rate of activity which, calculated as a relation between labour force and those 16 years or over, came to 58.0% in the first quarter of 2006.

The unemployment rate stood at 9.1%, more than one point lower than in the same quarter last year. The differences between the indices for the male and female groups (6.8% and 12.2%, respectively) held at substantial levels. The unemployment rate for those under 25 years of age stood at 18.7%, three points less than in the first quarter of 2005.

Sharp growth of employment in La Rioja, Murcia, Cantabria, Castile-La Mancha and Madrid Community.

From a geographical point of view, the situation showed notable differences between autonomous communities. Those showing the biggest increase in employment were Andalusia, La Rioja, Murcia, Cantabria, Castile-La Mancha and Madrid Community, all with growth of estimated employment above 6%. At a lower level, at above 5%, came Canary Islands, Valencian Community and Catalonia. At the opposite extreme, Galicia, Extremadura, Castile-Leon and especially Aragon showed the lowest increases in employment.

Registered unemployment: favourable balance in first four months of year

Figures for unemployment supplied by the offices of Public Employment Services show a picture characterized by slight but sustained moderation in unemployment, that is to say, very similar to that in previous

REGISTERED UNEMPLOYMENT BY SECTOR, SEX AND AGE

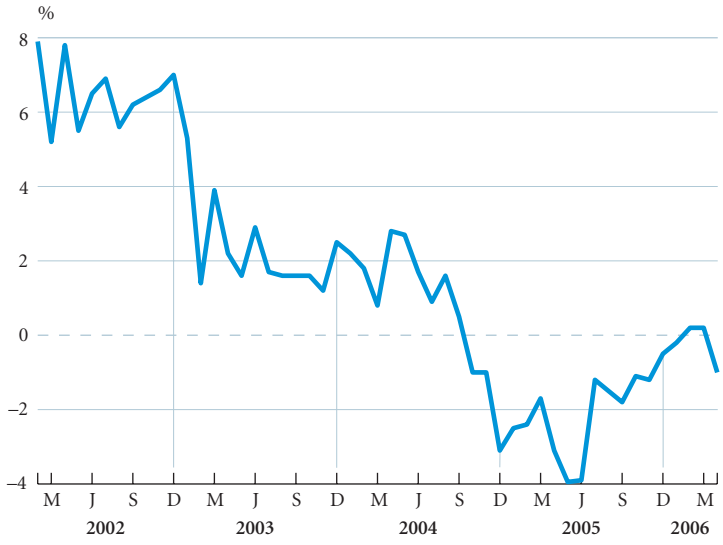
April 2006

	No. of unemployed	Change over December 2005		Change over same period year before		% share
		Absolute	%	Absolute	%	
By sector						
Agriculture	64,653	–574	–0.9	9,236	16.7	3.1
Industry	295,033	–6,286	–2.1	–8,970	–3.0	14.2
Construction	220,871	–24,229	–9.9	–15,390	–6.5	10.6
Services	1,265,554	–835	–0.1	–10,818	–0.8	61.0
First job	229,565	4,663	2.1	5,673	2.5	11.1
By sex						
Males	800,875	–51,088	–6.0	–32,037	–3.8	38.6
Females	1,274,801	23,827	1.9	11,768	0.9	61.4
By age						
Under 25 years	268,223	–7,672	–2.8	–2,647	–1.0	12.9
All other ages	1,807,453	–19,589	–1.1	–17,622	–1.0	87.1
TOTAL	**2,075,676**	**–27,261**	**–1.3**	**–20,269**	**–1.0**	**100.0**

SOURCE: Ministry of Labour and Social Affairs and internal figures.

REGISTERED UNEMPLOYMENT MODERATING

Year-to-year change in registered unemployment



SOURCE: Ministry of Labour and Social Affairs and internal figures.

months. In fact, the total number of those registered stood at 2,075,676 persons in April, 1.0% less than in the same month in 2005, according to the Public Employment Services Information System. Foreign workers unemployed rose to 141,939 representing a proportion of the total lower than in previous months at 6.8%.

In the first four months as a whole, unemployment dropped moderately but somewhat more sharply than last year, thus improving the situation in the various sectors. Only among those seeking a first job was there any appreciable increase in numbers, probably because of the momentum arising from the process of giving regular status to foreign workers.

Registered unemployment going down.

Prices

Tobacco and fresh foods salvage CPI in April

Substantial reduction in differential with Euro Area as energy prices tighten...

The inflation rate in April remained unchanged from the 3.9% recorded the month before, according to the consumer price index (CPI). This result made it possible to improve the differential with the Euro Area, if we take into account the increase in prices to 2.4% for the Twelve as a whole, according to the harmonized CPI.

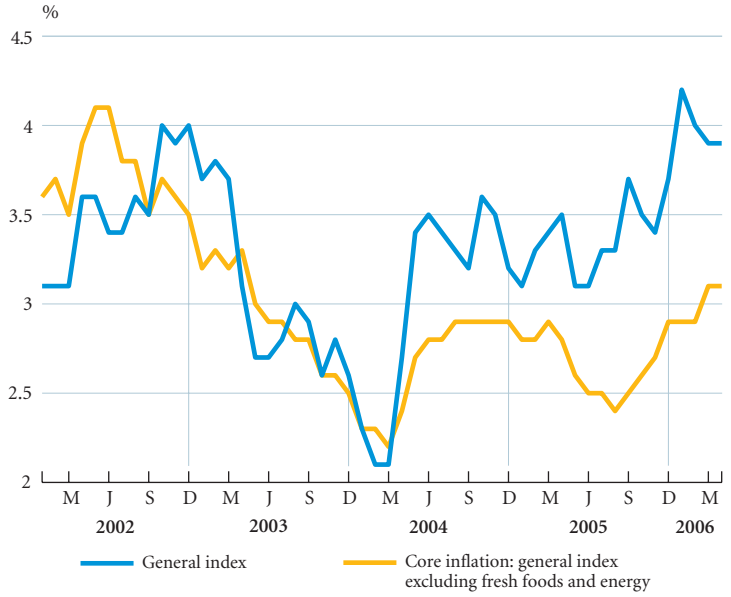
...due to tobacco and fresh foods.

The rise in the harmonized CPI for the Euro Area was based on prices for transport (due to the impact of fuels) and on the tourist component of the index, specifically, for hotels and restaurants. In Spain, the April index followed a notably parallel course, even with slightly greater increases but the final result was quite different in view of the fact that the increases were compensated by a sharp moderation in prices of fresh foods and tobacco. The price of cigarette packs, specifically, was affected by major swings which began as a result of the coming into force of the anti-tobacco law at the beginning of the year.

The rise in energy prices in April was quite sharp and even higher than in the same month in 2005, in spite of the fact that that was one of the months when fuel prices grew most. In addition, services prices grew by 4.1% year-to-year

CPI STABILIZES IN APRIL

Year-to-year change in CPI



SOURCE: National Institute of Statistics and internal figures.

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	0.7	0.3	3.9
April	1.4	1.6	3.5	1.4	1.8	3.9
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.

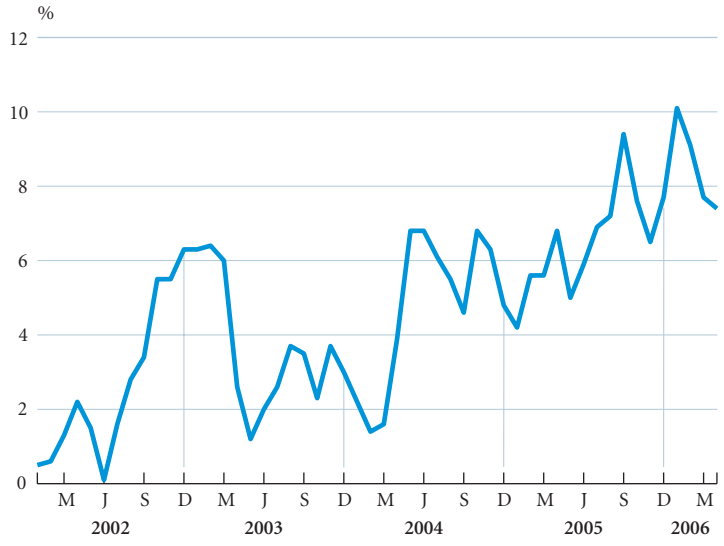
pushed up by tourist prices, a group in which the monthly rise was increased by the calendar effect of Easter Week which in 2006 came later falling in April.

These sharp increases, which definitely would have put the CPI rate above 4%, were largely nullified by the moderation of fresh food prices, which

Most unstable components of index set course of inflation.

CPI AT MERCY OF ITS MOST UNSTABLE COMPONENTS

Year-to-year change in fresh foods and energy components of CPI



SOURCE: National Institute of Statistics and internal figures.

CONSUMER PRICE INDEX BY COMPONENT GROUP

April

	Indices (*)	% monthly change		% change over previous December		% annual change	
		2005	2006	2005	2006	2005	2006
By type of spending							
Food and non-alcoholic beverages	120.5	0.7	0.2	1.6	0.9	3.5	3.5
Alcoholic beverages and tobacco	122.6	3.2	0.3	3.5	0.6	8.6	2.2
Clothing and footwear	119.2	9.3	9.3	–1.0	–1.1	1.6	1.3
Housing	122.1	1.4	1.1	3.1	4.3	5.4	7.2
Household equipment	110.5	0.6	0.7	0.6	1.1	2.0	2.7
Health	107.2	0.5	0.4	0.1	0.7	0.9	1.3
Transport	121.7	1.2	1.5	3.8	4.3	6.3	6.7
Communications	91.1	–0.1	–0.2	–0.9	–0.4	–2.1	–1.2
Recreation and culture	103.4	–0.9	1.0	–1.0	–0.6	–1.3	1.1
Education	121.6	0.0	0.1	0.5	0.3	4.2	3.9
Hotels, cafés and restaurants	124.1	0.4	0.9	2.2	2.6	4.0	4.8
Other	118.1	0.3	0.3	2.6	2.7	3.1	3.4
By group							
Processed foods	119.4	0.9	0.3	1.9	2.0	4.3	3.9
Unprocessed foods	123.3	1.1	–0.1	1.7	–1.4	3.8	2.1
Non-food products	117.0	1.6	1.8	1.6	2.1	3.2	4.0
Industrial goods	113.7	2.9	2.9	1.2	2.0	3.0	4.0
Energy products	*127.6*	*2.6*	*3.1*	*5.8*	*8.0*	*9.6*	*12.2*
Fuels and oils	*134.7*	*3.6*	*4.1*	*7.3*	*9.3*	*12.5*	*15.0*
Industrial goods excluding energy products	*109.4*	*3.0*	*2.8*	*–0.2*	*0.1*	*1.0*	*1.4*
Services	120.8	0.2	0.7	2.0	2.1	3.5	4.1
Underlying inflation (**)	116.3	1.3	1.4	1.2	1.4	2.8	3.1
GENERAL INDEX	**117.9**	**1.4**	**1.4**	**1.6**	**1.8**	**3.5**	**3.9**

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

Immediate prospects uncertain because of difficulty in establishing course ahead for energy and fresh food prices.

were contained at 2.1% year-to-year (more than three points below the level at the beginning of the year). Mutton, produce and, especially, the sharp drop in poultry were key elements in this containment. On the other hand, tobacco and the slight moderation in non-energy industrial goods also played the same compensating role even neutralizing the potential rise in underlying inflation which remained stable at 3.1% year-to-year.

Keeping the above in mind, the prospects for the CPI fall within uncertain coordinates, particularly with regard to energy prices and unprocessed food prices which, furthermore, are the components which have the biggest effect on swings in the index. Prices for oil by-products have kept rising in recent years to levels unimaginable only a little while ago and it does not seem as if they are going to go down significantly. The weakness of the dollar, however, could help to improve the situation.

Producer prices of consumer goods moderating

Industrial prices at origin held practically stable in April, within high growth levels of 5.7% year-to-year. This result is a consequence of the sharp rise in energy prices (15.4%) and to a lesser extent of progressive increases noted in prices of other intermediate goods which grew by a rate of more than 5% year-to-year in April. On the other hand, there was greater containment of prices of capital goods and consumer goods, although in the latter case there exist differences among the various product groups.

In addition, the cumulative year-to-year growth of import prices moved up to 6.1% in the first quarter. Non-energy import prices grew by only 1.9%, basically because of intermediate goods and capital goods. On the other hand, in consumer goods we note a drop in prices arising from food products. Finally, farm products showed notable containment in February. The average increase in the first two months of the year held at a modest 2.4%, nearly eight points less than in the same period the year before.

Prices of imported consumer goods beginning to drop.

INFLATION INDICATORS

Percentage change over same period year before

	Farm prices	Producer price index					Import prices				GDP deflactor (*)
		General index	Consumer goods	Capital goods	Intermediate goods	Energy goods	Total	Consumer goods	Capital goods	Intermediate goods	
2005											
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	4.0	6.3	3.5	2.1	3.6	20.6	5.6	–6.5	–5.1	15.2	–
February	0.7	6.3	3.6	2.1	3.9	20.1	6.6	2.5	3.2	9.2	4.3
March	...	5.8	3.3	2.0	4.5	16.4	6.0	2.7	7.5	7.2	–
April	...	5.7	2.8	2.2	5.1	15.4	...	...	...	...	...

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

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

Foreign sector

Trade deficit keeps growing despite recovery in exports

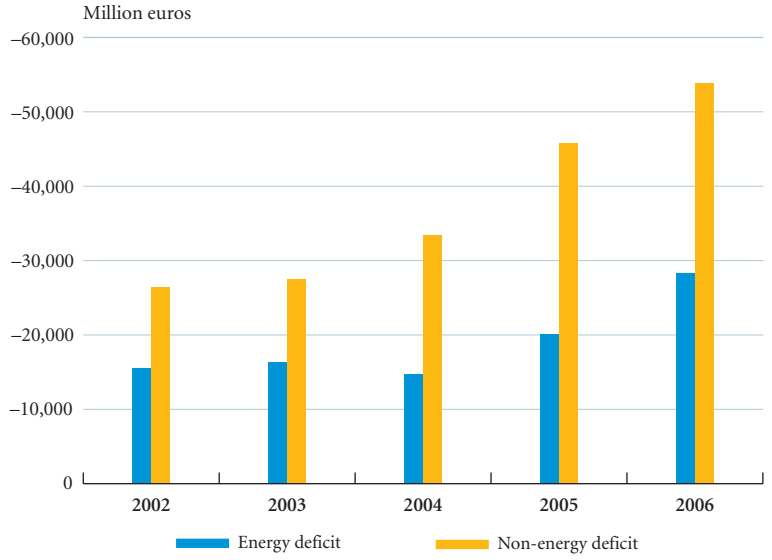
Trade with abroad recovers in first quarter.

Foreign trade in goods showed sharp growth in March of around 20% nominal, with higher growth in imports. This sharp increase may be somewhat upwardly biased by the calendar effect of Easter Week. Nevertheless, figures for national accounting for the first quarter (corrected for seasonal and calendar effects) suggest that this rise could be somewhat more substantial. Both exports and imports of goods have shown a quite notable rise increasing growth in both cases to around 12.5% by volume, that is to say, a rate very much higher than in previous quarters.

The rise in imports, affected by the impact of higher-cost oil (now at 354 euros a ton, 53.3% above the average in the first quarter of 2005), is also due to the quantity factor in the non-energy field. In the first quarter, according to Customs Department figures, that is to say, not seasonally adjusted, growth of non-energy imports came to 13.7% real or 22.1% if we look only at non-food consumer goods. Among these goods, the avalanche is more than notable in the case of consumer electronics, car parts, clothing and footwear. Naturally, the strength of domestic demand and

TRADE DEFICIT NOT ONLY A MATTER OF OIL

Cumulative balance for 12 months ending March



SOURCE: Customs Department and internal figures.

FOREIGN TRADE

January-March 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	10,155	48.0	16.0	1,956	66.4	4.6	–8,199	19.3
Consumer goods	18,102	19.9	28.6	15,887	12.4	37.7	–2,215	87.8
Food	*3,154*	*10.2*	*5.0*	*5,167*	*4.1*	*12.2*	*2,013*	*163.8*
Non-foods	*14,948*	*21.8*	*23.6*	*10,720*	*15.1*	*25.4*	*–4,228*	*71.7*
Capital goods	6,455	12.6	10.2	4,205	47.2	10.0	–2,250	65.1
Non-energy intermediate goods	28,600	14.2	45.2	20,146	13.4	47.7	–8,454	70.4
By geographical area								
European Union (EU-15)	37,418	13.1	59.1	30,152	9.7	71.5	–7,266	80.6
Euro area	*31,350*	*12.0*	*49.5*	*23,958*	*8.3*	*56.8*	*–7,392*	*76.4*
Other countries	25,894	31.8	40.9	12,042	42.6	28.5	–13,852	46.5
Russia	*1,652*	*33.7*	*2.6*	*313*	*45.3*	*0.7*	*–1,339*	*18.9*
United States	*2,150*	*25.1*	*3.4*	*1,800*	*43.9*	*4.3*	*–349*	*83.8*
Japan	*1,454*	*–5.6*	*2.3*	*346*	*27.2*	*0.8*	*–1,108*	*23.8*
Latin America	*3,411*	*69.2*	*5.4*	*2,397*	*51.6*	*5.7*	*–1,014*	*70.3*
OPEC	*5,334*	*47.5*	*8.4*	*1,076*	*28.6*	*2.5*	*–4,259*	*20.2*
Rest	*11,893*	*24.9*	*18.8*	*6,110*	*42.4*	*14.5*	*–5,782*	*51.4*
TOTAL	**63,312**	**20.1**	**100.0**	**42,194**	**17.4**	**100.0**	**–21,117**	**66.6**

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

the substitution of domestic production by foreign products lies behind the major strength of purchases from abroad.

On the export side, there was also notable improvement. Real growth estimated by the Customs Department came to 12.7% in the quarter. On the one hand, this was thanks to the extraordinary strength in foreign sales of capital goods (41.1% more by volume) related to the export of ships which was without equal in 2005. In addition, this was thanks to the good situation in non-food consumer goods (14.5%) due to a rise in exports of cars, consumer electronics and clothing. In terms of markets, third countries were the cause of the rise in exports given that markets in the European Union, while improving, showed relatively weaker.

Imports up sharply, especially non-food consumer goods.

The sharp recovery in the flow of trade abroad did not involve substantial changes in the increase of the trade deficit from the situation in previous months. In the first quarter this had reached 21.12 billion euros, 25.7% higher than in the same period in 2005.

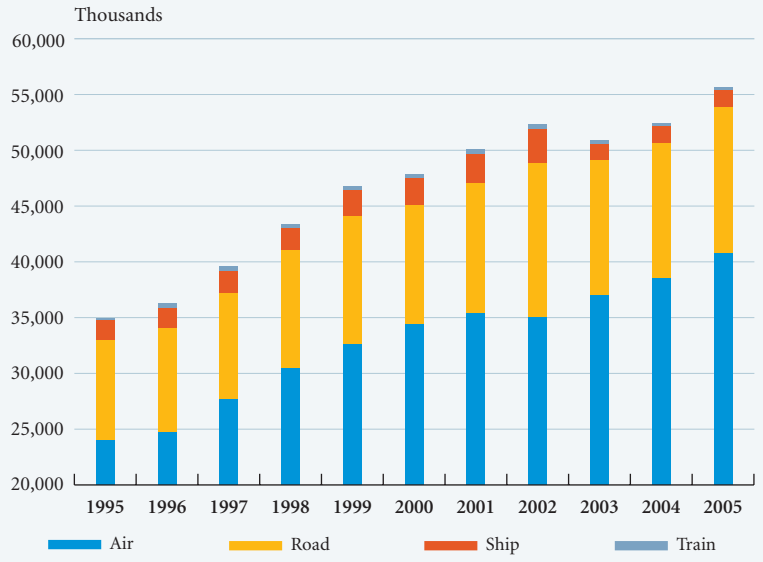
Exports also recovering thanks to positive state of third country markets.

The new tourist has arrived

In the past ten years, the number of tourists (visitors who spend at least one night in Spain, according to the official definition) rose at an average annual rate of nearly 5% going above 55 million in 2005. In absolute terms, this meant more than 20 million new tourists in ten years. This notable increase is the result of the trend to increased international mobility of persons fostered by the extraordinary increase in transport facilities, especially with the progressive liberalization of air transport. Indeed, more than 80% of the increase in tourism in Spain in those 10 years may be explained by the rise in that mode of transport. In 2005, some 73.2% of the 55.7 million tourists entering Spain's economy, that is to say, somewhat more than 40 million persons, came into the country by air.

AIRCRAFT ACTS AS ENGINE OF TOURIST GROWTH

Tourists according to mode of transport used



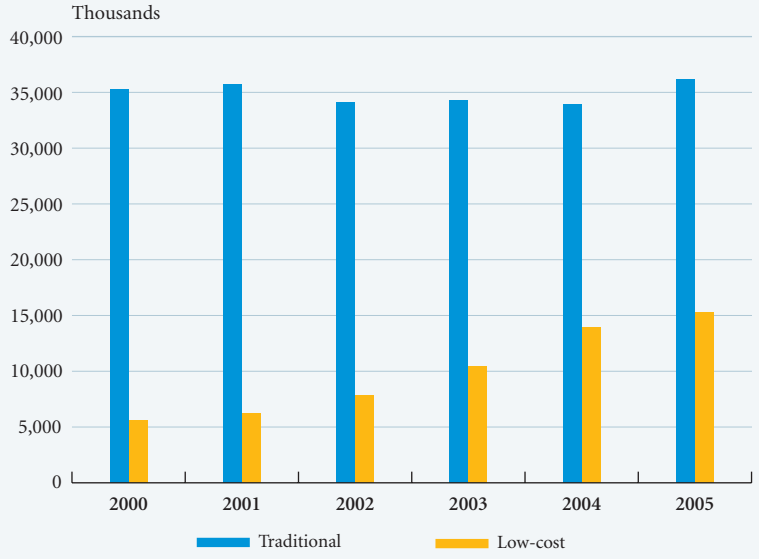
SOURCE: Bank of Spain and internal figures.

This quantitative growth was accompanied by a qualitative change which at times may go by unnoticed. One of the more substantial changes taking place in the tourist business is that brought about by low-cost air transport companies and the parallel use of Internet. The tourist boom by air finds its undoubted ally in the low-cost companies. In 2005, some 29.7% of passengers arriving in Spain (including Spaniards on return flights) did so using so-called low-cost companies, these being understood as those other than the traditional airline companies. In 2000, the market share of this segment was 13.7% involving the transport of somewhat more than 5.6 million persons, one third of those carried in 2005.

These figures also include charter flights, a category that has also been losing strength to the benefit of the new companies operating on low-price systems, without any linked tourist packages, involving tickets largely obtained through Internet or telephone service offices. In 2005, three companies (Easyjet, Ryanair and Air

RISE OF LOW-COST AIRLINE COMPANIES

Passengers arriving in Spain by air, by type of carrier



SOURCE: Ministry of Industry, Tourism and Commerce and internal figures.

Berlin), with more than 3 million passengers each, more or less equally dominated more than 60% of the whole low-cost market.

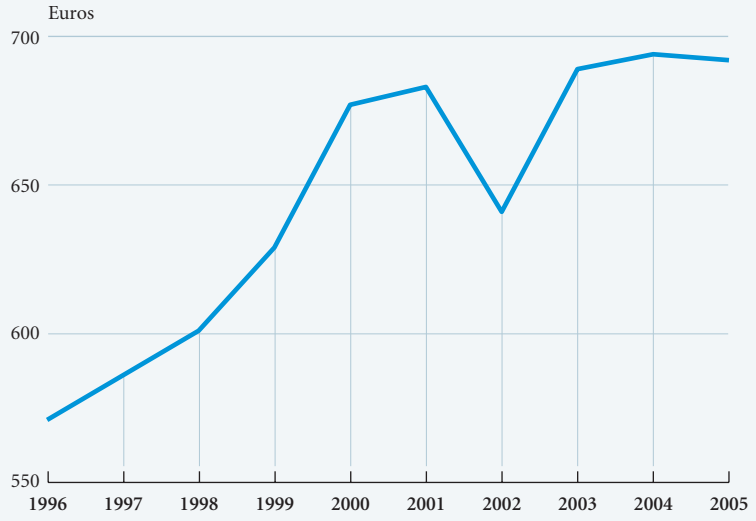
Spain's future tourism is going to increase mainly through this new mode. The profile of the new tourist is an individual who travels on his/her own account, with family or friends, not making use of pre-paid tourist packages (in 2005 some 61.5% did just that, 11.5% more than in the year before), usually for leisure purposes and expressing somewhat more diversified interests than «sun and beaches» (although this reason continues to be predominant). Furthermore, this tourist will be more and more independent of the traditional travel agencies with Internet being the means of getting information, making bookings and paying for tourist travel more and more used. In spite of its present dominant position, the hotel could lose relative importance as normal lodging in favour of use of one's own holiday home or rental accommodation or staying with friends (probably foreigners already established in the country).

In addition, the new tourist is an individual travelling on a budget lower than that of the traditional tourist but who, in proportion, spends more at his/her destination than at point of origin (tourist package tours are now not as important), according to the Institute of Tourist Studies. Furthermore, lower spending per tourist may be explained by shorter stays.

The new tourist may be a person with stable connections (or at more regular intervals) with Spain, thanks to greater accessibility and, of course, the progressive consolidation of home ownership by foreigners in tourist areas. While it is true that surveys carried out by the Institute of Tourist Studies show that the tourist who stays in his/her own home or that of family or friends spends less than the tourist staying at a hotel, it may be that on this point there is some undervaluation of total spending because of the amount under headings such as

AVERAGE SPENDING PER TOURIST STABILIZING

Tourist spending per tourist



SOURCE: Bank of Spain, Ministry of Industry, Tourism and Commerce and internal figures.

maintenance, home goods, etc. For this reason, figures for tourist spending must be taken with some care, given the limitations of available statistical facilities. When it comes to measuring tourist spending, the difficulties increase if we take into account that some groups do not fit into conventional definitions. Under this category, we must include profiles that perhaps do not match the stereotype normally applied to the tourist, as in the case of those people who spend relatively long periods in Spain. This is a growing reality that does not fit into the traditional pattern and one which will continue to have more importance in the future.

Current account deficit continues to rise with steep drop in services balance.

Current account deficit again disappointing in February

The figure for the current account balance again worsened notably in February with the drop in various headings, mainly in transfers, services and goods, which meant holding to the trend in previous months. Looking at a shorter time-frame, the figures for the first two months also fail to raise much optimism. The cumulative deficit as of February (15.15 billion euros) was up 26.6% compared with the same period in 2005. By heading, the worst performance showed up in the services balance, seeing that the surplus dropped spectacularly because of the sharp rise in payments, especially in non-tourist services. The trade balance was worsened although not as sharply as in previous months. Finally, both the incomes balance and the transfers balance showed lower deficits, which partly made up for the poor results in the former headings.

The current account deficit was compensated, although only to a very small extent, thanks to the surplus in the capital balance amounting to 651 million euros in the early months of the year. In spite of this, net world borrowing of Spain's economy in this

BALANCE OF PAYMENTS

Cumulative figure for last 12 months in million euros

	February 2004	February 2005	% change
Current account balance			
Trade balance	–55,940	–71,576	28.0
Services			
Tourism	*26,392*	*25,627*	*–2.9*
Other services	*–4,433*	*–5,015*	*13.1*
Total	21,959	20,612	–6.1
Income	–13,738	–16,306	18.7
Transfers	–1,423	–2,544	78.8
Total	**–49,141**	**–69,813**	**42.1**
Capital account	**8,253**	**8,052**	**–2.4**
Financial balance			
Direct investment	–28,582	–37,076	29.7
Portfolio investment	84,293	73,248	–13.1
Other investment	2,670	32,766	–
Total	**58,381**	**68,938**	**18.1**
Errors and omissions	–388	–936	141.4
Change in assets of Bank of Spain	–17,105	–6,242	–63.5

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.

period stood at 14.5 billion euros, 27.3% more than in 2005.

In the financial sphere, direct foreign investment in Spain was down sharply in the first two months of 2006 as opposed to Spanish direct investment abroad which in the same period was up nearly 5 times thanks to the strength of investment in the corporate field. Similarly, real estate investment was also up sharply (72.7%) probably due to the need to diversify risk in assets held in other countries.

Direct foreign investment down while Spanish investment abroad up sharply.

Public sector

Government revenues continue strong growth

Tax revenue grows well above nominal growth of economy.

Central government non-financial revenue amounted to 55.46 billion euros in the first four months of 2006, some 12% more than in the same period in 2005. This figure does not include the 14.82 billion euros corresponding to the segments of tax collections for personal income tax and the greater part of indirect taxes ceded to the autonomous communities and local councils so that it is of little significance as an indicator of the revenue gathering capacity of the central government through general taxes. If the taxes ceded are included, collections came to 70.29 billion euros, which meant an increase of 11.1% compared with the year before.

The biggest increase came in direct taxes (13.6%) thanks to the good state of collections for corporate tax, pushed up by initial tax installment payments. The increase in collections for indirect taxes was somewhat lower at 10.7%, these being affected by an extraordinary drop in collections for value added tax (VAT) on import transactions, probably due to matters of accounting compatibility. Revenues for domestic transactions, on the other hand, were up by a very high rate (25.1%) which is also difficult to explain in homogeneous terms. Under special taxes, the tax on tobacco brought about a drop in collections in spite of an

CENTRAL GOVERNMENT BUDGETARY IMPLEMENTATION

April 2006

	Month		Cumulative for year	
	Million euros	% change over same month year before	Million euros	% change over same month year before
Non-financial revenue	**22,204**	**20.0**	**55,464**	**12.0**
Non-financial revenue adjusted (*)				
Personal income tax	7,968	13.0	24,728	11.1
Corporate tax	5,729	25.9	6,625	22.5
VAT	9,264	22.1	27,681	13.1
Special taxes	1,405	–4.9	5,773	0.3
Other	1,543	21.2	5,481	2.0
Total	**25,909**	**18.1**	**70,288**	**11.1**
Non-financial spending	**8,956**	**7.1**	**41,972**	**–1.0**
Treasury balance	**13,248**	**30.5**	**13,492**	**89.0**
Surplus (+) or deficit (–) (**)	***13,312***	***43.5***	***17,896***	***44.1***

NOTES: (*) Includes tax segments ceded to autonomous communities under financing system in operation as of 2002.
(**) In terms of National Accounting.
SOURCE: Ministry of Economy and Finance and internal figures.

increase in tax rates, which may be attributable to a drop in consumption. Collections for fuels were up moderately in view of a possible contraction in consumption and a shift in demand to diesel fuel, a fuel that carries a lower tax rate.

Central government non-financial spending was down by 1.0% to show a figure of 41.97 billion euros. This figure does not include the balancing-entry for revenues corresponding to those tax segments ceded to the autonomous communities. This reduction was aided by the sharp drop in interest payments and capital transactions seeing that the other headings, that is to say, personnel costs, purchases of goods and services and transfers, showed growth of between 5% and 7%.

The central government Treasury balance as of April, that is to say, the differences between non-financial revenue and spending, was positive in the amount of 13.49 billion euros and well above the same period last year. This large balance compensated for the notable increase in financial assets (12.22 billion euros in total), which, among other relevant headings, includes the current account at the Bank of Spain and various deposits in financial institutions for an amount of 10.21 billion euros.

Central government ends first four months of year with ample Treasury surplus.

Savings and financing

Interest rate for home-purchase in March still holds below inflation.

Financing granted to companies grows more than that going to households.

Rise in interest rates fails to halt loan demand

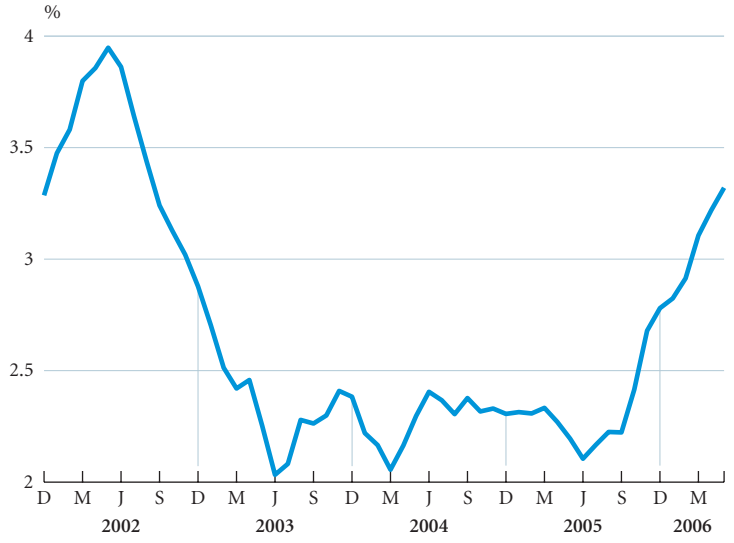
The restrictive turn in monetary policy begun by the European Central Bank last December continues to shift to bank interest rates. Average interest rates charged by credit institutions to companies and households have risen by 30 basis points from December to March. Nevertheless, the levels remain relatively low, both in nominal and real terms, that is to say, discounting the inflation rate. In general, bank interest rates stand only a few decimals above the inflation rate.

In March, the interest rate for home-purchase as estimated by the Bank of Spain even went slightly below the annual inflation rate. The interest rate for buying consumer durables and for other purposes stood at a higher rate (6.36%), some 51 basic points above the low in February 2005. The interest rate for loans and credits applied to companies, in spite of a slight increase in recent months, was in line with inflation, which meant a real interest rate of close to 0%.

In this context, it is not surprising that financing to the private sector continues to rise sharply given that, furthermore,

INTEREST RATES ON RISE

1-year Mibor (monthly averages)



NOTES: Figures go up to May 19.
SOURCE: Bank of Spain.

the economic climate remains generally favourable. As a result, financing to companies and households rose by 22.6% in the past 12 months as of March, the highest figure recorded for at least the last 10 years. While this figure may have been affected by the placing of Easter Week in the calendar (falling this year in April as opposed to 2005), the figures show that demand for loans is not faltering. Both companies and households are showing a lively appetite for new financing, although recently the increase in funding granted to companies has been higher with an annual change rate of 23.4% as against 21.7% for households.

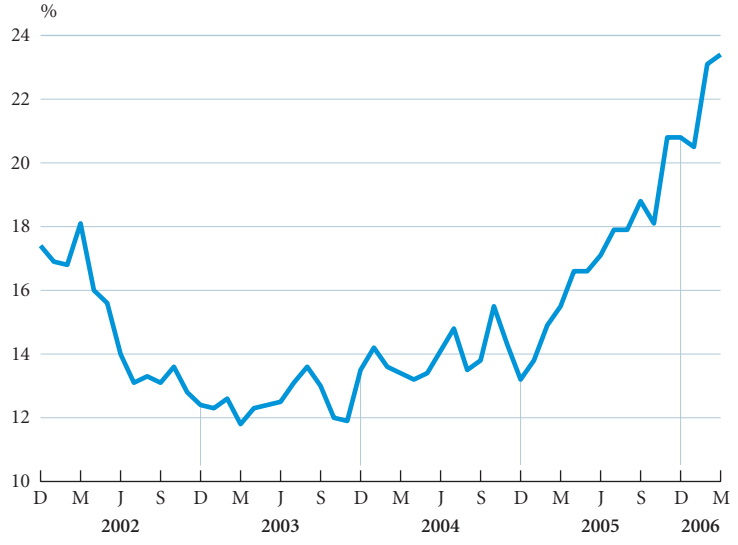
The greater part of funding going to households is made up of home mortgage loans which rose by 24.3% in March compared with the same month last year, scarcely two decimals less than in December. Demand for funding for home purchase has continued to be boosted by the growth of incomes, by favourable terms offered by financial institutions and certain socio-demographic changes. On the one hand, the large number of young people of an age to establish a family, the increase in single-parent households, the rise in immigration and demand for holiday homes has driven the growth of mortgage loans. Furthermore, financial institutions have eased borrowing terms in a situation of rising interest rates.

Favourable financing terms, along with growth of incomes and socio-demographic factors boost demand for mortgage loans.

Consumer credit also continues to show great strength. In the first quarter of 2006 the total figure for new loan and credit transactions involving households for the purchase of goods and services such as cars, appliances, furniture, clothing and travel came to 13.03 billion euros, a rise of 21.7% compared with the same period the year before. Loans for other purposes, such as securities, land, etc., showed a similar course with new transactions amounting to 16.42 billion euros, an annual increase of 19.5%.

FUNDING TO COMPANIES MARKS UP HIGHEST ANNUAL GROWTH RATE IN PAST DECADE

Year-to-year change in financing granted to non-financial companies



SOURCE: Bank of Spain.

Big increase in bank deposits

Deposits of all types record increases.

In the case of financial assets in the private sector, we also note that this continues to show major growth. Total deposits of resident companies and households are increasing at rates similar to those of loans, in fact, at double the rate of increase in the Euro Area as a whole. Deposits for a term of more than two years continue to show a sharp increase although changes in accounting criteria tend to boost the increase. On-demand and savings accounts rose by 12.6% during the past year, a lower rate given that they offer less of a yield.

Assets of investment funds up 13% in twelve months ending in April.

Another financial instrument in favour with savers is participations in investment funds. The assets of securities mutual funds rose by 9.25 billion euros in the first four months of the year going to a total of 255.11 billion euros, according to figures provided by Inverco, the sector organization. As a result, total assets of securities mutual funds rose by 13.1% in April compared with the same month the year before.

Net cumulative subscriptions in the first four months of the year amounted to 5.24 billion euros. The rest, accounting for the increase in assets, may be attributed to capital gains obtained due to the favourable performance of the stock markets.

In the January-April period the biggest net inflows of new money (discounting outflows) into securities mutual funds was concentrated in global funds, which present some risk but also offer higher prospects for gain. On the other hand, savers tended to move away from bond-based and money-market-based funds because of low yields.

Average annual yield reported by securities mutual funds in April was 6.0% but there were wide differences according to type of fund. Emerging country share-based funds thus obtained spectacular annual yields of 71.0%. At the other extreme, yields on long-term bond-based funds showed a slight loss of 0.10% because of capital losses represented by interest rate increases in the past 12 months.

DEPOSITS OF COMPANIES AND HOUSEHOLDS AT CREDIT INSTITUTIONS

March 2006

	Total	Change this year		Change over 12 months		% share
	Million euros	Million euros	%	Million euros	%	
On-demand savings (**)	397,247	1,057	0.3	44,420	12.6	41.6
Up to 2 years (*)	198,274	7,754	4.1	29,447	17.4	20.8
More than 2-year term (*)	269,327	28,720	11.9	126,502	88.6	28.2
Repos	70,709	–2,337	–3.2	–5,204	–6.9	7.4
Total (*)	**935,558**	**35,194**	**3.9**	**195,166**	**26.4**	**97.9**
Deposits in currencies other than euro	**19,663**	**4,024**	**25.7**	**13,440**	**216.0**	**2.1**
TOTAL (*)	**955,220**	**39,217**	**4.3**	**208,605**	**27.9**	**100.0**

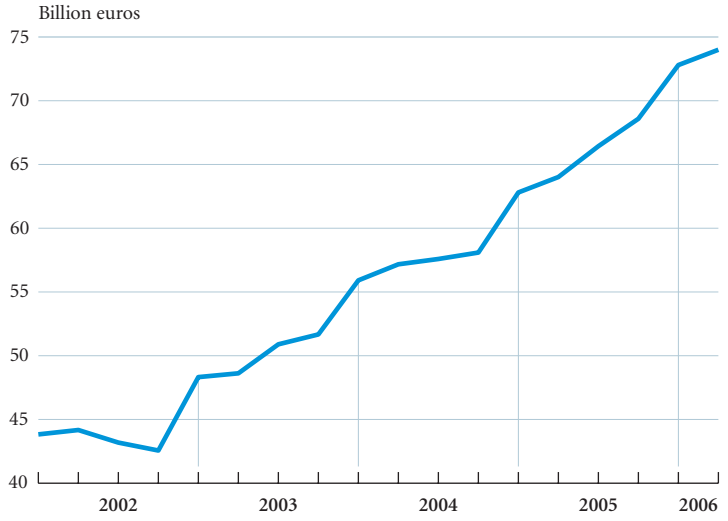
NOTES: (*) As a result of the coming into force of new regulations in application of the International Financial Reporting Rules, as of June 2005, increases in time-deposits as a cross-entry to entries on the assets side of securitizations that had been taken out of the balance sheet make comparison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

Another very significant financial asset is that made up of pension funds which ensure payments to complement government pensions. At the end of the first quarter the total assets of pension funds amounted to 74 billion euros, a notable increase of 15.6% in the past 12 months. By type of pension system, the assets of individual pension funds amounted to 44.27 billion euros, an annual increase of 17.4%. This system boasts the largest number of participants with a total of 7,765,295 persons. The company-based system increased in terms of assets going to 28.69 billion euros, 12.9% more than in March 2005. This system reports 1,570,960 participants. In turn, the associate system showed total assets of 1.04 billion euros, some 18.4% higher than at the end of the first quarter of last year. The number of participant accounts under this system was 86,207, considerably lower than other types.

Total pension fund assets up 16% in twelve months ending in March.

SUSTAINED INCREASE IN PENSION FUND ASSETS

Total pension fund assets



SOURCE: Inverco.

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