

# I. Analysis of the situation of the City of Madrid

## 1. Economic environment

The degree to which European and US economic cycles are out of sync has sharpened in recent weeks. The ECB has raised benchmark rates to 3.5% with scope for additional hikes, underscored by recent economic indicators (particularly business confidence) which continue to point a propitious environment in 2007. In the US, the slowdown in the real estate market continues. However, private consumption has not yet suffered, buoyed by the strength of the labour market. The Fed has continued to leave rates unchanged at 5.25%. The market is discounting a first US rate cut in the second half of 2007.

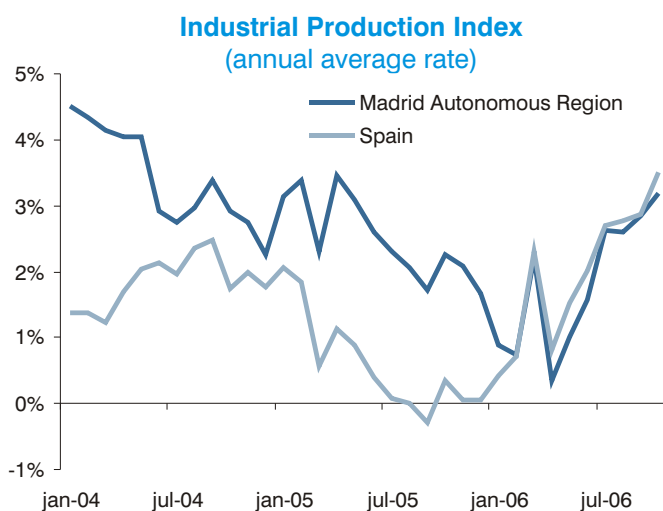
Meanwhile, Spanish growth continues to outpace the European average, with third quarter year-on-year growth of 3.8%. Corporate investment is the highlight, notably investment in capital goods, underscoring the Spanish economy's need to increase its productive capacity to absorb the growth in its workforce, largely the result of migratory flows.

The Madrid economy continues to outperform the overall Spanish economy and that of its European Union peers, as highlighted by growth and labour market figures. The regional economy (Madrid Autonomous Region) registered third quarter year-on-year growth of 4.2% in 2006. Looking to Madrid City, forecasts are for year-on-year growth of 3.4% in 2007.

## 2. Production

### INDUSTRY

Between August and October growth in the Industrial Production Index (IPI) for Madrid Autonomous Region continued to pick up pace, up from 2.6% year-on-year in August to 3.2% by October, in line with the overall national trend.



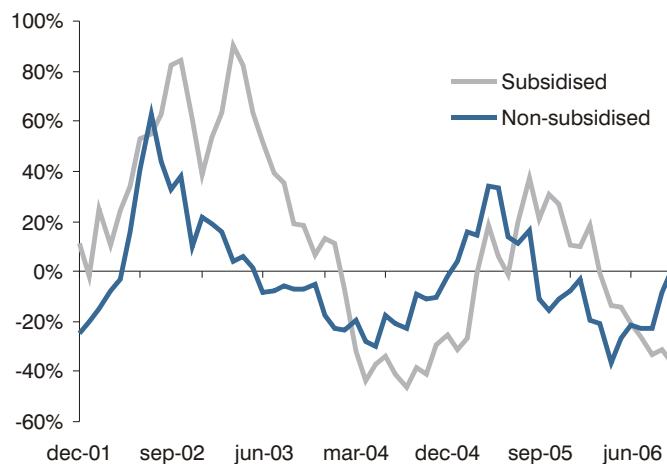
Source: National Institute of Statistics

In addition, regional accounting data from the Statistics Institute for Madrid Autonomous Region reveal an uptick in cyclical trend growth in industrial GVA from 2.5% in the second quarter of 2006 to 3.0% in the third quarter. In the labour market, the number of social security contributors from the manufacturing segment in Madrid City was flat in the third quarter of 2006 in the wake of five consecutive years of year-on-year drops.

## CONSTRUCTION AND THE PROPERTY MARKET

In the third quarter of 2006 the number of contributors to social security from the construction sector in Madrid City advanced by 8.9%, following four consecutive quarters of double digit growth. Growth in home building permits remains negative, although a turnaround appears to be underway. A shift in the trend in the residential construction segment began in April 2006, underpinned by the performance in permits for non-subsidised housing. While these permits grew once again in October 2006, permits for protected housing fell by 36.3% in the same period.

### Evolution of home building permits. Subsidised and non-subsidised housing (year-on-year rate)



Source: Madrid City Council Statistics Office Municipal Town Planning Office

## SERVICES

### Financial system

Lending activity and customer deposits continued to grow in Madrid Autonomous Region in the second quarter of 2006, in contrast to a slight slowdown at the national level. Banks remain the main beneficiaries of this trend posting deposit and lending growth in excess of 30% and 25%, respectively. The number of bank branches in the Madrid capital continued to grow, reaching 3,033.

On 15 December, 2006, the Madrid Stock Exchange hit a record high when the general index reached 1,583.14 points, equivalent to an annual return of 39.8%, over twice the return on almost all European indices. In October, average daily trading volume broke through the 5 billion euro

mark, 1.9 billion euros more than for the whole of 2005. In addition, the number of transactions and orders placed in October 2006 surpassed the former record set the previous May.

### Tourism

In the second half of 2006, tourism to the City of Madrid continued to perform well. Between January and November 2006, a total of 6.2 million visitors stayed at hotels in the City, representing growth of 4.9% over the same period of 2005. Specifically, in the three month period between September and November, 1.8 million visitors stayed in the City, equivalent to year-on-year growth of 2.2%.

The strong growth in the number of visitors to Madrid and the number of overnight stays has been driven by foreign tourism, a continuation of the trend seen in 2005, while Spanish tourism continues to weaken. Non-resident visitors and overnight stays in the first eleven months of the year grew 6.9% and 7.0%, respectively, compared to 3.3% and 2.1% for Spaniards.

The continued solid rate of growth in hotel accommodation has had the corresponding impact on employment across hotels in the City of Madrid. The figure revealed by the Hotel Occupancy Study carried out by the Spanish Statistics Institute put hotel personnel in November 2006 at 11,720, the highest figure recorded and equivalent to year-on-year growth of 6.1%. Between January and November, the number of employees rose 5.6% compared to the same 11-month period in 2005. This employment growth highlights business confidence within the hotel sector over the short to medium term.

### Transport

Passenger traffic at Madrid's Barajas airport rose 8.4% between December 2005 and November 2006, driven primarily by the strength in travellers from international destinations. Cargo traffic did not, however, fare as well, continuing the slowdown initiated in 2005, falling 4.6% over the same period. Employment growth in the third quarter - at 4.0% - was the highest in the last six years.

Mobility data reveal a slowdown in average urban daily traffic intensity (-3.1% year-on-year), a slowdown that was not accompanied by an increase in average speed levels, which fell 1.7% year-on-year through October 2006. During the first ten months of the year users of urban buses and the metro underground increased 3.5% in all, with growth in bus users outpacing (4.8%) underground users (2.5%). Regional train users also increased 1.4% in the third quarter of 2006 compared to the same period in 2005.

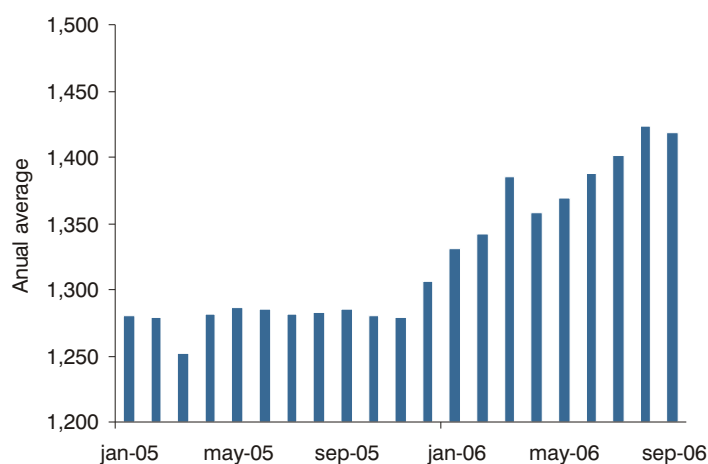
### 3. Business Dynamic

In the wake of creation of new companies in the City of Madrid in excess of 1,600 in the months of May and June, this indicator cooled somewhat in the third quarter, although still well in excess of 2005 levels, with average annual company incorporations of over 1,400. The quarter-on-

quarter slowdown was evident in both limited liability companies and PLCs. Nonetheless, the average for the third quarter of 2006 was 12.2% higher than for the third quarter of 2005.

The Business Confidence Index for the City of Madrid strengthened for the second consecutive quarter in the four quarter of 2006, with buoyant turnover continuing to boost profits, offsetting lethargic price increases. Annual results suggest that 2006 will have been an excellent year for business activity and point to a fairly promising outlook for 2007. The rate of increase in the key economic indicators in the corporate segment are expected to slow somewhat in the first quarter, although they are expected to be higher than those recorded in the second quarter of 2006, when they hit bottom.

### Evolution of constitutions of new companies in the City of Madrid



Source: Madrid City Council Statistics Office - Company Registration Office

## 4. Demand

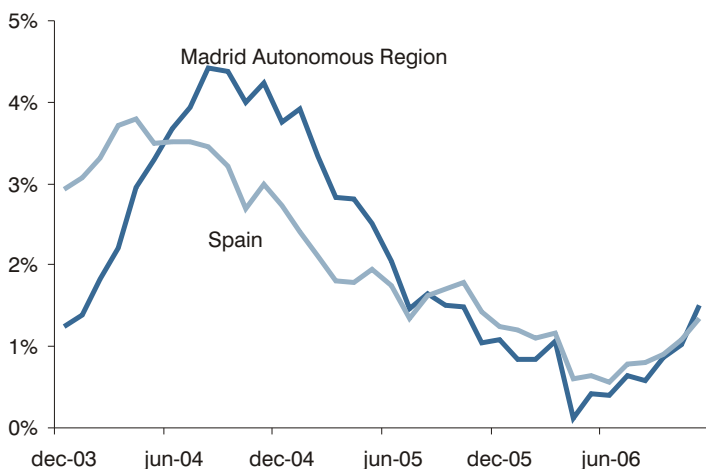
Retail sales in Madrid Autonomous Region, as measured by the retail index in constant prices, grew at their highest year-on-year rate in the month of November - at 5.2%.

The Madrid Consumer Confidence Index (ICCM, for its initials in Spanish) stood at 85.9 points in November 2006. This figure is a 10-point improvement over the 75.9 level recorded in November 2005. From this level, the ICCM has been improving on a sustained basis, heading towards the 100 point benchmark, last hit in 2001.

In terms of social security contributors in the wholesale segment, the region's performance was very much in line with national trends, slowing to 2.7% in November.

Finally, Madrid Autonomous Region's trade deficit rose by 5.7% on a trailing twelve-month basis. The deterioration in the trade balance continued in line with that witnessed in the months of August and September.

**Retail sales in constant prices**  
(annual average rate)



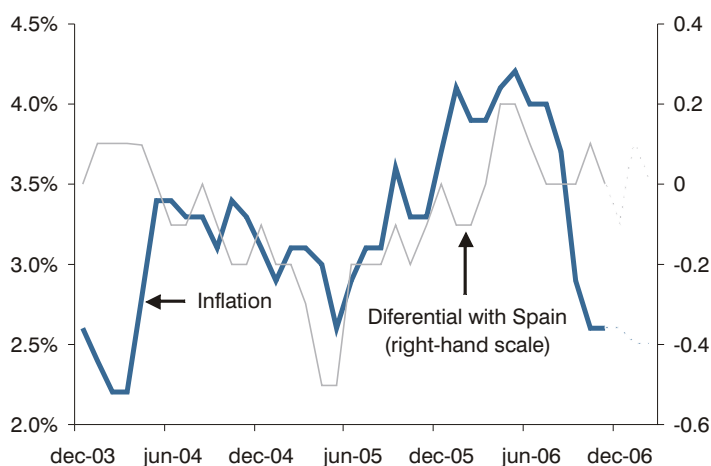
Source: National Institute of Statistics

**5. Prices and salaries**

Although the December 2006 figure has yet to be released, the latter part of the year was marked by a dramatic slowdown in consumer price inflation in Madrid Autonomous Region, with regional CPI falling from 3.7% year-on-year in August to 2.6% by November.

The December figure is forecast at 2.7%, which would put the average inflation figure for the full-year at 3.5%. The performance by inflation in Madrid Autonomous Region is in line with the overall national trend.

**CPI in Madrid Autonomous Region**  
(year-on-year rate)



Discontinuous line corresponds to forecasts  
Source: National Institute of Statistics, CAP and IFL

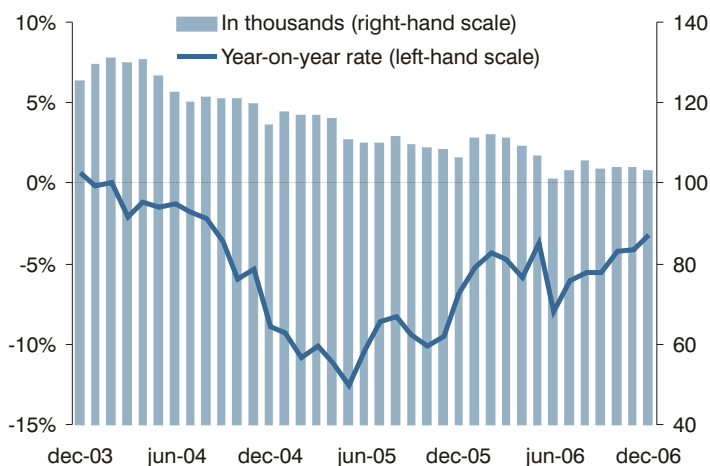
Industrial price growth also slowed significantly, with annual year-on-year growth through November at 2.5%, 1.1 percentage points below the national average. Although second hand housing prices increased slightly in the third quarter, growth remains well below the national average. New housing prices continued to grow in the City of Madrid, registering a year-on-year rate in excess of 16%. Finally, the third quarter was marked by a sharp increase in labour costs which was not mirrored with the same intensity at the national level.

## 6. Labour market

In third quarter of 2006 according to Active Population Survey data, the economically active population continued to grow at the same rate as the previous quarter at 3.7%, while the working population grew even faster at 4.3%, up from 4.1% in the second quarter of 2006, resulting in record highs in the City of Madrid in terms of both the active and gainfully occupied population. The strong performance by the labour market is also reflected in the drop in unemployment, which stood at 5.4% in the third quarter of 2006.

The slowdown in growth in the number of social security contributors continued, falling from 5.1% in the second quarter of 2006 to 4.3% in the third quarter, the result of the adjustment in the services and construction sectors as the impact of the foreign worker amnesty implemented in 2005 wanes. However, the overall number of contributors in the City of Madrid hit a new record at 1,886,449 people. Unemployment continued to fall at a slower rate in the last quarter of 2006, falling by 3.2% in December to 103,015. The average number of people unemployed in 2006 was 106,177 an average year-on-year drop of 5.1%.

### Unemployment in the City of Madrid (year-on-year rate and in thousands)



Source: Madrid City Council Statistics Office - INEM Employment Agency

## II. Sustainability

### Water management in the City of Madrid

Fully managed by Canal de Isabel II, the City of Madrid enjoys an efficient and complex water supply system which enables the delivery of very high quality water to a population of almost four million inhabitants.

The strategy employed in Madrid is demand-driven, introducing sliding rates depending on the level of consumption, predicated on consumer-targeted campaigns designed to increase awareness of the need to save water and the use of recycled water to irrigate public parks and gardens. Data show that water consumption fell in Madrid throughout 2006, highlighting the efficiency of this demand-driven approach which should be continued. In this manner, the City of Madrid is additionally fulfilling EC directives promoting the sustainability of water via the long term protection of available hydro resources.

In terms of quality, the city's waste water treatment system is cutting edge and enables the treatment of 100% of waste waters and their reincorporation into the rivers at very high levels of quality. Here too Madrid is meeting European directives, providing coverage, via the construction of new treatment plants, of 100% of the city's equivalent population.

All this puts Madrid at the forefront of European cities in relation to its water supply system, although these initiatives must be ongoing to ensure high quality water remains available to its citizens without damaging the river ecosystems from which it originates.

## III. Territorial balance in the City of Madrid

### Economic specialisation by district

Madrid has become a services city providing commercial, leisure and financial services as well as services to companies. The fact that Madrid is the economic centre of Spain is mirrored geographically within the city: economic entities and service providers are strongly concentrated in the central districts of the city, while industrial activity tends to be located in the city's southern and eastern districts.

Nonetheless, this concentration pattern has undergone modification in recent years, as witnessed by the relocation of industrial activity and other productive companies outside of the municipality of Madrid (towards satellite towns in greater Madrid), residential growth (urban renovations and developments) and the increasing significance of services in the economy.

## IV. Madrid as a business attraction pole

### “Plan Japón”

The first part of this section reviews direct foreign investment data, which grew very significantly at 12.3% year-on-year in the first nine months of 2006 to reach 2.29 billion euros. This puts Madrid top of the table in terms of Spanish regions receiving foreign investment, accounting for 36.3% of the total, ahead of Catalonia (29.9%) the next biggest regional recipient.

Next we review the so-called Japan Plan put in action by the Madrid town council in April 2005 with the goal of making Madrid the most sought after market in Japan for both investment and tourism, and to step up relations between Madrid and Japan, by promoting close collaboration between the institutions, business associations and citizens of Japan and Madrid. Many initiatives have been implemented since the program was launched almost two years ago, which have unfolded very satisfactorily. Japanese tourists choose Madrid ahead of all other Spanish destinations and it ranks very highly as a destination across all of Europe. This is no doubt the result of the significant efforts made to increase security and a series of initiatives developed to enhance the quality of service provided to them. One of the priorities set for 2007 is to promote close collaboration between the trade authorities and the Japanese investment boards in order to attract new investment flows from Japan to the City of Madrid.

## V. Monographic report

### Madrid as a competitive destination

Tourism to the City of Madrid is characterised by its significant cultural component one of the main draws for foreign visitors. The majority of Madrid's tourist attractions are concentrated in the city centre and are complemented by the cultural wealth, leisure activities and accommodation offer spread throughout the neighbouring districts which make up an area known for its shape as the central almond.

In terms of demand, the City of Madrid hosted 6.7 million tourists in 2006 which translated into over 13 million overnight stays, part of a growth trend underway since 2000. Specifically, over the past three years tourists are up by 40%, hotel places by 24% (especially in four- and five-star hotels) and hotel employment by 34%. Hotel occupancy is up 4 points over the same period.

The outlook for tourism is bright with the spotlight on opportunities in cultural and business-related tourism. The expansion of Madrid's Barajas airport and the infrastructure projects contemplated in the national infrastructure plan through 2020 will undoubtedly underpin a buoyant tourism sector in the coming years.