

EXECUTIVE SUMMARY

1. Current situation of the City of Madrid

1.1. Economic environment and outlook

In 2012, significant steps have been taken toward European banking union, necessary if there is to be progress toward greater integration. However, the short-term difficulties in transferring the risk of the bank rescue to the European arena are prejudicial to Spain's interests. On the other hand, fiscal consolidation on the periphery of the euro and the global slowdown have caused the eurozone to fall into recession for the first time since 2009, and there is a risk that the situation will deteriorate further in the first part of 2013. With regard to economic activity in Spain, in the third quarter it was hampered by poor data on private consumption, and in the fourth quarter, with salaries already falling by 5.5% YoY, growth may have suffered even more. The same is forecast for public consumption, affected by the austerity measures.

Despite the 0.2% downturn in the third quarter, GDP growth in the Madrid Region was 1.4 points less negative than the Spanish average and four-tenths of a point less negative than the eurozone. However, in recent quarters the trend has deteriorated steadily reaching negative territory in the third quarter (a fall of 1.6 points compared to the fourth quarter of 2011). Similarly, 2012 was a poor year for the regional labour market, with a 3.3% decrease in Social Security enrolment, and, more acutely, an 11.4% increase in registered unemployment.

With regard to forecasts for 2013, the Spanish economy will continue to decline, and the GDP growth of 0.3% expected in 2014 will clearly be insufficient to achieve the recovery of employment and economic activity. In view of the problems holding back the economy, the city of Madrid is forecast to maintain a negative rate of GDP growth in 2013, with a decline of 0.9%, although this is 0.4 points less than in 2012 and points to possible growth of 0.5% in 2014, driven mainly by market services.

1.2. Production activities

INDUSTRY

At the end of 2012, the fall in the average annual rate of industrial production steepened, with a decline of 12.7% in November, nearly seven points more negative than the Spanish average. All industrial categories saw negative growth, particularly durable consumer and intermediate goods (down 18.7% and 18.1% respectively). The poor IPI data affected the Madrid region's gross value added (GVA), which recorded a YoY decline of 4.2% in the third quarter of 2012. The positive note is that the decline moderated by 2.3 points compared with the previous quarter.

The contraction in industry is also reflected in the Social Security enrolment data for the city of Madrid, with a YoY fall of 6% in the third quarter, five points worse than total enrolment.

CONSTRUCTION AND REAL ESTATE MARKET

Social Security enrolment in the construction sector fell 12% in the third quarter, much more than the 1% decline in total enrolment, i.e. 66.5% of the fall in enrolments in the city of Madrid was in construction.

The positive note was struck by the number of building licenses granted in the city of Madrid in the previous twelve months, which experienced a YoY increase of 32.7%. There was strong growth in free market housing, which helped to reduce the predominance of subsidized housing. Subsidized housing permits were centred on the Vicalvaro district, which accounted for no less than 94.7% of the licenses granted in the third quarter; free market housing was somewhat more distributed, with Retiro district leading with 38.3% of licenses. The increase in building licenses has brought a recovery in completion certificates (a 61% increase over the previous twelve months). However, the YoY decline of 20.8% in the designation of new land for non-residential construction reflects the lack of economic dynamism. By use, the most pronounced declines were in land for industrial and civic facilities (down 94.4% and 70.8% respectively), followed by the tertiary sector (down 11.5%), while the surface area for vehicle parking increased by 10.3%.

SERVICES

Financial system

During 2012, financial deterioration has increased, both in Madrid and in the country as a whole, motivated by the credit crunch and the stagnation of private savings. Thus, in the case of deposits, the YoY fall steepened to 4.2% in the third quarter, 1.2 points more than the previous quarter, meaning that the increase in savings achieved in 2011 has been reversed. The 0.9% downturn in credit also points to a negative trend. The situation is much more extreme in

mortgage financing, which suffered a fresh collapse in the third quarter, with a fall of 22.9% in the number of mortgages granted and an even more marked decrease in the amount advanced, 40.2%. On the other hand, the restructuring of the financial system continues its course with additional cutbacks in employment and branches. In this respect, the restructuring of Bankia and other banks taken into administration may accelerate the closure of commercial branches in the coming months.

The positive note is found in the Madrid Stock Exchange, which in the past few months has recovered much of the losses experienced earlier in the year. Between 2nd August and the end of the year, the market rose 27.9%, recovering 180 of the 228 points lost until then. The improvement in the Spain risk premium and the process of bank recapitalization, together with the return of foreign investors attracted by low prices, augurs well for the continuation of this revaluation in 2013.

Tourism

Since the summer and, more markedly, from the autumn of 2012, a deterioration has been observed in the city of Madrid's tourism figures. The decline in tourism demand between September and November can be seen equally in the numbers of visitors and overnight stays (down 6% and 5.8% respectively). Indeed, between January and November, the city's tourism was down by almost 300,000 visitors and 701,000 overnight stays compared with the same period in 2011. The bulk of these losses are attributable to the poor results of foreign tourism.

Unlike the fall in demand for tourism, the behaviour of hotel capacity is more stable, although the current reduction in investment, together with the contraction of demand, limits their expectations for growth. With respect to employment in hotels and catering, the capacity to create employment shown by the sector in Madrid during 2011 has weakened in the course of 2012. On the other hand, the combination of weak tourism demand and an increase in hotel capacity has resulted in a decrease in revenue per room in the Madrid Region: November's 9.3% fall was the thirteenth consecutive monthly decline.

Transport

At the end of the year, the fall in Barajas air traffic steepened, with regard to both passengers and goods. The total number of passengers between January and November fell by 8.5% compared with the same period last year, which in absolute terms translates into approximately 4 million fewer passengers. Domestic passenger traffic continues to be most affected (down 14.8%), but international traffic (down 5.1%) is also affected, thus losing its cushioning role of earlier years. The growth of Spanish exports has not been reflected in an increase in freight traffic in Barajas (down 9.4%), because the bulk of trade flows are channelled into other less costly modes of transport.

In urban transport, the fall in travellers affects the EMT bus network and the Metro alike; both saw declines of around 4% between January and October, while local train services experienced a slight increase of 0.3%, largely due to a recovery in recent months.

1.3. Business dynamic

In the third quarter, the number of companies registered in the previous twelve months increased by 2.1%, but this was less than the growth in the number of closures (6.6%), slowing the net creation of companies in the city of Madrid. On the other hand, the new round of bank recapitalization has triggered strong growth in the average capitalization of Madrid's companies (in just one month, from June to July, the average market capitalization increased from €175,000 to €307,000).

The sharp increase in Social Security contribution accounts reflects the changes in the city's economic structure. In the third quarter, they hit a new record with 191,345 accounts, 28% more than a year before, prompted by the dynamism of the services sector (up 31.7%), which offset the drop in construction and industry (down 9.7% and 5.3% respectively). This growth in the tertiary sector has been favoured by the regularization of domestic workers, as well as self-employment and the outsourcing of services by businesses.

The end of 2012 saw a deterioration of the entrepreneurial confidence indicator for Madrid. It stood at -27.7, 2.8 points more negative than the previous quarter, though at the same level as at the beginning of the year. Accordingly, it can be said that, from a business point of view the economic situation is stagnating at negative levels. From the sectoral point of view, the most negative perceptions are found in construction, while in industry the assessment is considerably less negative. Likewise, in the fourth quarter the perception of the economic variables was more negative than at the beginning of the year, and, while still negative, once again the expectations of Madrid's businessmen for the first quarter of 2013 point to a somewhat less negative picture with regard to business variables (particularly employment and turnover).

1.4. Demand

At the end of 2012, the YoY fall in retail sales reflects a marked deterioration in levels of consumption. In November, the YoY fall in the Madrid Region stood at 6.4%, the lowest of the year and almost two points more negative than a year before. Similarly, in the case of the city of Madrid, the consumer confidence index stood at a record low (around 20 points). All these setbacks are detrimental to employment in the retail trade, which suffered a YoY contraction of 1.5% in November (almost a point more negative than in August, returning to the downward path seen at the beginning of the year).

The contraction of productive investment in the Madrid Region continues, although this trend has moderated in recent months. Thus, although the YoY fall in capital goods investment reached 10.6% in October, the lowest point in the year, the rate of decline has reduced significantly (by 1.8 points between July and October, compared to six points between April and July).

Like the rest of the country, one of the strengths of Madrid's economy is the positive trend in exports. In the twelve months to October 2012, the value of exports grew by 6.9%. The decline in imports is turning out to be decisive in reducing the region's negative trade balance. However, the increase in October is 15.6 points lower than in January, a symptom of the region's reduced capacity to continue boosting exports in a context of economic recession throughout the EU.

1.5. Prices and salaries

The YoY rate of inflation in the Madrid Region stood at 2.8% in November, 0.6 points less than in October, and it was expected to end the year at 2.5%, the same as in December 2011. The categories that have contributed most to the increase in prices have been 'tuition' and 'medicine'. In the current context of lower volatility and containment of energy prices, forecasts for the coming months suggest less inflationary pressure, and an overall rate of 2% is forecast for March and 1.4% for the end of 2013. The rise in prices may be due more to the rise in core inflation stemming from administrative decisions.

In the field of industry, the Industrial Price Index for the Madrid Region reached 3% in November, 3.1 percentage points lower than at the beginning of the year, significantly reducing the difference with the Spanish average. With regard to housing prices, the city of Madrid suffered a fresh collapse in the third quarter of 2012, particularly in second-hand housing (down 15.2%) and somewhat less in new housing (14.9%).

Labour costs in the Madrid Region accelerated their downward trend in the third quarter, taking the YoY rise to 0.8% (2.7 points less than the first quarter) and pointing to a negative trend in the coming quarters.

1.6. Labour market

The economic crisis overshadows the outlook for Madrid's labour market. The fall in employment recorded in the EPA labour market survey moderated in the third quarter of 2011, with a fall of 1.6%, 2.8 percentage points less negative than the previous quarter; however, this is due to the increase in non-salaried and temporary salaried workers, while the more stable employment of those with permanent contracts declined. Had it not been for the increase in domestic staff regularized in the services sector, the poor third quarter data for Social Security enrolment, especially in construction and industry, would have been even worse, which reveals the absence of dynamism in the economy. Women and young people, who traditionally have the greatest difficulty in finding employment, are being driven out of the labour market by the worsening of the economic crisis.

In these circumstances, and given the weakness of the economic growth forecasts, expectations for a revival of the labour market in the city of Madrid are remote at the moment, and the trend is for the combination of job losses and increasing unemployment to continue in 2013. In this respect, the forecasts for the first quarter of 2013 indicate a 3.6% YoY decline in Social Security enrolment in the city of Madrid, 2.7 points more negative than in the first quarter of 2012. Similarly, the city's registered unemployment could exceed 265,000 in the first quarter of 2013, up 20,000 over the previous year.

2. Monographic report

RANKING OF EUROPEAN CITIES 2012¹

This issue of the Barometer presents, for the sixth consecutive year, the results of the ranking of the 25 European cities considered major metropolises, which include Madrid. The aim of this study is to analyse the city of Madrid's standing in terms of a series of key indicators and the changes occurring in the city, in comparison with trends in the other main European cities.

As in previous issues, the changes in European cities are analysed by studying their performance in four key areas: 1) Economy and labour market, 2) Transport and communications, 3) Knowledge society and 4) Quality of life, with an overall ranking calculated as the weighted sum of these.

Madrid is in 5th position in the 2012 Ranking of European Cities, down one place from the previous year, behind Berlin, London, Paris, and Frankfurt; the latter takes over fourth place after moving up four positions due to improvements in transport and communications. Madrid's fall is due to a slight deterioration in all areas.

In the area of Economy and market, Madrid achieved joint 3rd position in the ranking, along with Paris, behind only London and Berlin, with especially good performances in the categories of "Economic influence", "International events", "Retailing", "Availability of office space", "Metropolitan area", "Population in 2020", "Access to markets", "Labour qualifications" and "Labour costs", in all of which Madrid is among the top five. This position is a step backwards compared to 2011, due to the deterioration of two factors. On the one hand, labour market factors, due both to the fall in the rate of activity and to the rising unemployment rate. On the other hand, factors linked to economic influence, where Madrid, though it continues to occupy a leading position, fell two places with regard to 2011 to 5th position. This deterioration is attributable primarily to the sharp decline in financial sector employment, as a result of the current restructuring of the Spanish financial system and lower economic growth compared to other European capitals.

In the area of Transport and communications, Madrid held the 8th position in the ranking in 2012, behind Berlin, London, Frankfurt, Barcelona, Paris, Munich and Amsterdam, although it is among the five leading cities in terms of air passenger traffic, tourism and quality of internal communications. This eighth spot represents a fall of four places from the 2011 ranking and is due to the slowdown in both passenger arrivals at Madrid Barajas airport and the number of tourists staying in hotels, where Madrid is in 24th place with regard to variation in passenger numbers (down nine places from 2011) and 18th in the change in tourist hotel nights, a decline of nine positions

¹ Ana Ramos (Afi Consultores de las Administraciones Públicas)

from 9th in 2011. However, despite this slowdown, in terms of total volume of tourists Madrid rises one place, from 6th to 5th, ahead of Rome.

Madrid remains in the middle of the ranking with regard to the Knowledge Society, immediately behind Frankfurt and ahead of Amsterdam; it holds 5th and 10th place respectively with regard to the availability of technology and quality of telecommunications, but with worse results in investment in R&D (16th) and in research staff as a proportion of total employment (10th).

Finally, with regard to Quality of life, Madrid lies in 12th position, down two from 2011. Its best results are for "Quality of life for staff" (3rd position), 8th in "Liveability", 9th in "Air quality" and 18th in "Overall quality of life". The decline is due to the worse rating for "Liveability", where Madrid has slipped from 6th position to 8th, losing ground with regard to Stockholm, Hamburg, and Paris. It maintains its 18th position in the Quality of life ranking developed by Mercer.

RENOVATION A PROMISING SECTOR IN MADRID¹

In the face of the economic crisis, and specifically the combination of the crisis in the construction sector and the problems of access to housing experienced by important segments of the population, two subjects have recurred in the political debate in recent years: rental as a mode of access to housing and renovation as a construction activity. With regard to the second of these, the key is to answer the following question: Can renovation meet the real estate needs of Madrid's population? And if so, how? The answer to this question allows us to deduce the potential size of the renovation sector in Madrid in the future, an especially relevant issue for a municipality which has undertaken the review of its overall planning.

Madrid has a significant stock of empty dwellings. Programs of urban recycling, regeneration and renovation could contribute to improve the attractiveness of this unused housing. However, although there is a history of renovation, to date it has been a secondary element with respect to housing, and for the most part, it has been concentrated in the central areas of the city. Few constructions built prior to 1979 have been renovated, but given the poor quality of construction during the postwar era, they are among those which could have the most positive effect on quality of life. With regard to the buildings suitable for renovation, there is a notable stock of dilapidated buildings in the Centre district with a particular concentration of structural problems, and specific conditions in three major areas: the districts bordering on the Centre, those which saw rapid growth in the postwar period and the newer outlying districts.

Renovation has an important impact in economic and employment terms, although it depends on the strategy finally adopted:

- A "slow initial development" scenario, which would be consistent with meeting the needs arising from new household formation, would suggest the renovation of 5,500 dwellings per year. The impact would be around €110 million euros annually (€1.1 billion in the period up to 2020), with the creation of 5,500 jobs in the same period.
- On the other hand, a "constant development" scenario, consistent with the European goal of reducing the energy consumption of existing buildings by 80% by 2050, would involve the renovation of 38,936 dwellings per year. The economic impact would be €778.7 million per year (€28.8 billion over the period to 2050), generating 144,632 jobs in total until that date.

Thus, renovation has potential as a strategy for meeting part of the future demand for housing and other uses in Madrid and a capacity to generate economic activity and employment, provided that the necessary conditions are met:

¹ José María Ezquiaga Domínguez (Doctor Arquitecto y Sociólogo), Javier Barros Guerton (Arquitecto), Gemma Peribañez Ayala (Arquitecto)

- Establishment of agreements with energy providers, enabling the funding of renovations to be linked with the billing of the households over the medium term, along the lines of those existing in the UK, drawing on the lessons provided by that program. The establishment of similar systems in non-residential markets is more complex.
- Establishment of economic incentives along the lines set out in the draft State Plan for the promotion of rental housing and urban renovation, regeneration and renewal over the 2013-2016 period.
- Financing facilities in view of the current limitation of mortgage credit to the housing stock in the hands of the banks.
- In the revision of the draft State Plan, adjustment in the territorial model of the balance between the goal of renovation and the size of the residential and building capacity in future developments of building land, which is generally preferred by large developers for its greater ease of management.
- It must be remembered that the Madrid property market has a metropolitan dimension, so the effectiveness of measures to promote renovation will be affected by initiatives in neighbouring municipalities.

Initiatives must take account of the specific conditions of the different urban areas, and, at least, those of the two large urban morphologies:

- In the case of the areas with a predominance of apartment blocks, the renovation of the building occurs in a more isolated way, as it is difficult to do it by large units simultaneously. Certain measures of high energy efficiency, such as insulation on the outside, affect the definition of the alignments and would require the urban planning to be adapted. Another priority is to accurately delimit the roles of the car and of public transportation in areas where the road network is often limited to a mere space for parking and movement, despite the absence of green areas.
- In areas where open blocks predominate, the possibilities of intervening to replace buildings may be higher in some cases, improving the conditions of sunlight and urban quality of the environment. The greater distance between built elements may allow the surface area of the dwellings to be extended (the experiences in France of architects such as Lacaton & Vassal are illustrative), as long as the impact of these measures is adequately controlled, in legal and technical terms and with regard to the urban landscape. The low functional diversity that these spaces tend to have, compared with city blocks, makes it necessary to consider also the possibility of configuring local centres of trade and services, to facilitate the provisioning of the population. Attention should focus on the quality of the urban spaces between housing blocks and, again, an appropriate allocation of road space between public and private transport.

Finally, the implementation of a logic of urban regeneration /urban recycling, focusing not only on building but on revitalizing the urban fabric as an alternative to the model of expansion on the periphery, which has prevailed during the past decade, would involve major redevelopment costs, with an even greater impact on the economy and employment for the municipality of Madrid, and with greater economic efficiency due to the leveraging of existing, consolidated, infrastructure which could require capacity improvements.