

I. Analysis of the situation of the City of Madrid

1. Economic environment

The recovery continues of the two economies which have remained lethargic in recent years, Europe and Japan, with an increasing resurgence of internal demand and of private consumption in particular. In the United States, the signs of downturn could become more intense in the second half of the year, as a result of the combined effect of the rise in interest rates and the downturn in the labour and real estate markets. It is to be anticipated that the central banks will continue to raise interest rates, with a small adjustment by the CEB (up to 3.25% at the end of the year from the present rate of 2.75%) and also by the Federal Reserve (up to 5.50% from the present 5.25%).

Growth in Spain remains robust, boosted by private consumption, but the risks continue to increase. Inflation reached 4.1% in May (making the differential with the EMU 1.6 percentage points), while the current account deficit was at a record high (7.9% of GDP). Another negative aspect is the balance of services, which also worsened (although it remains in surplus). Given the rise in the prices of crude in April and May, it is reasonable to expect a further worsening in the Spanish foreign trade position in the months ahead.

Madrid's economy continued to behave excellently in the first quarter of the year, as shown by the data for growth and the labour market. The region grew by 4.2% year-on-year and its unemployment rate remained at 5.9%. The outlook for growth for the City of Madrid points to a 4.0% year-on-year rate in 2006.

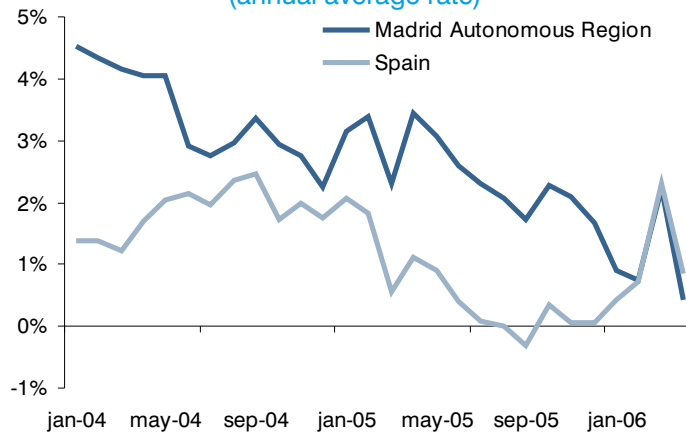
2. Production

INDUSTRY

Industrial activity in the Autonomous Region of Madrid was influenced by the Easter Week effect, meaning that the average annual Industrial Production Index (IPI) rate temporarily left its downward path of recent months and recorded an upturn in March, when a rate of 2.2% was achieved. This same effect led to an abrupt decline of 0.4% in April. However, industrial GAV increased by three tenths of a point to 0.6% in the first quarter of 2006.

Despite the persistence of negative year-on-year rates, the fall in the number of Social Security accounts in industry in the City of Madrid continued to ease. However, this was not the case with contribution accounts, which continued to decline by 2.5%.

Industrial Production Index (annual average rate)



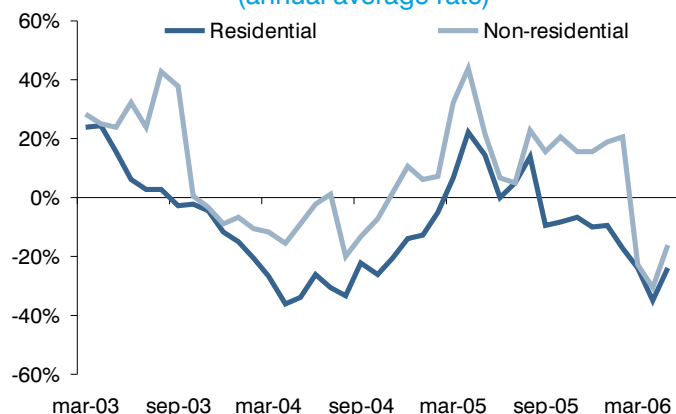
Source: National Institute of Statistics

CONSTRUCTION AND THE PROPERTY MARKET

Employment in the construction sector in the City of Madrid continued to grow at rates much higher than those in other business sectors. In March 2006, the number of workers registered with the Social Security system increased by 15.3%.

Public bidding processes are the main factor responsible for this positive behaviour by employment. Madrid continued to be a City committed to public investment, as despite the decrease in the accumulated volume of this variable in the Madrid Region, it remains at very acceptable levels. The increased importance of public bidding was most apparent in investment in civil works. The residential construction sector in the City of Madrid continued to display a tendency towards negative growth. In recent months, the non-residential segment has also undergone a moderate downturn. However, this segment continued to be the driving force behind the sector's progress.

Changes in the area of construction permits per land use (annual average rate)



Source: Madrid City Council Statistics Office - Municipal Town Planning Office

SERVICES

Financial system

We look again at the analysis given in previous editions of this Barometer, which described the evolution of employees in the financial sector in the City of Madrid and mortgage credit in our Region. The latter issue is of the utmost interest in a scenario with a toughening of the ECB's monetary policy.

The strength of the real estate market, as well as the City of Madrid's status as a strategic location in the expansion plans of many financial institutions, has continued to be an incentive for the opening of new bank branches. This was passed on to the labour market, with an increase in the number of social security accounts in the financial sector since the beginning of last year to 52,224 people in the first quarter of 2006.

Mortgage credit in the Autonomous Region of Madrid also maintained an upward trend, encouraged by the dynamism of the real estate market, although a change in the trend is anticipated in the months ahead as the rises in interest rates by the ECB, which placed the EURIBOR at 3.31% in May, 1.12 percentage points above the previous year, are passed on to the mortgage market.

The general trend in the main markets over the last two months has shown a decline in yields, which led to the Madrid Stock Exchange General Index once again being one of the most profitable in 2006, with a total yield up to June of 8.3%.

Tourism

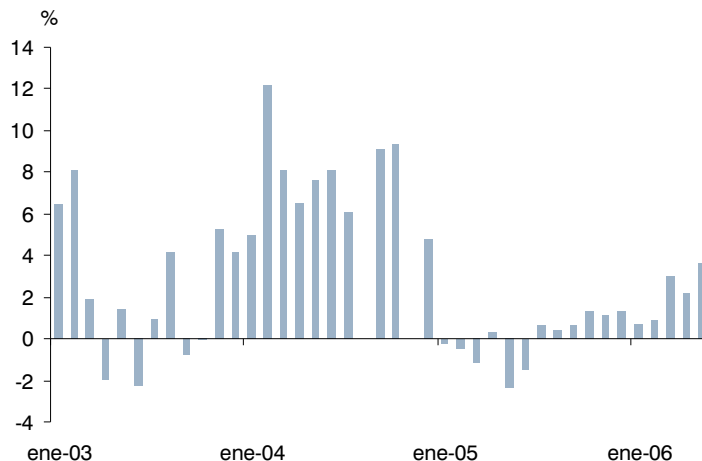
In the first five months of the year, a total 2,768,176 travellers stayed in hotels in the City of Madrid, with a total of 5,387,794 overnight stays. These data show a year-on-year increase of 8.2% in travellers and 5.6% in overnight stays. If this trend continues, the figure of 13 million overnight stays will be exceeded at the end of the year. Normally, the first five months of the year usually account for around 40% of the total overnight stays throughout the year. For this reason, it is anticipated that 2006 will be a good year for the Madrid tourism sector. The expansion of Barajas and the growth of intra-European tourism remains one of the key elements in the growth of our tourism sector.

Despite the year beginning with moderate figures for growth in the main variables of the sector, the data for April and May for the second quarter were exceptionally good. Partly as a consequence of Easter Week falling in April and the redirection of flows towards Spain, figures for hotel income have substantially increased. The rise in the Hotel Income Index was once again above 3.0% in April, and reached a year-on-year growth rate of 3.6% in May.

In the period between January and May, the European market showed significant strength, with overnight stays from the main European countries increasing at a brisk pace. Stays from the United Kingdom grew by 20.1%, Germany by 15.2%, France by 9.2% and Italy by 7.7%. The number of overnight stays from Japan increased by 17.5%. The

favourable outlook for economic growth in what remains of 2006 and 2007 for Europe, Japan and the United States points to very positive expectations for growth in these markets in the second half of the year.

Evolution of the Hotel Price Index in Madrid Autonomous Region



Source: Hotel Price Index (HPI) - National Institute of Statistics

Transport

Activity at Madrid-Barajas airport has remained at significant levels during 2006. In the period between January and May of this year, passenger air traffic increased by 8.8% compared to the same period last year, encouraged by the volume of international flights, which increased by 11.3%.

In this context, employment in the transport area increased significantly for the third consecutive quarter, with a year-on-year rate of growth of 4.4% compared to the first quarter of 2005.

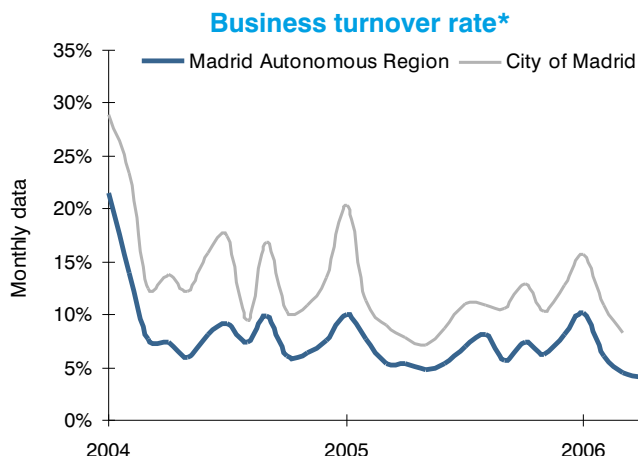
In the first quarter of 2006, a slight increase in passenger traffic was observed at the stations of the *Cercanías* suburban railway network in the City of Madrid, which is a recovery from the decline recorded in the last quarter of 2005. Furthermore, in the period January-April 2006, the number of users of public transport (bus and underground) increased by 2.3% compared to the same period last year.

3. Business Dynamic

In March 2006, the largest number of constitutions of new companies in recent years was reached, with a total of 1,916 companies. This figure gives an annual average of 1,385 companies, which is a growth of 10.7% compared to the figures for the same month in 2005. Although the figure for April will be slightly lower than that for March as a consequence of Easter falling in April this year, the data for May are anticipated to be very positive, consolidating the favourable business position of the City of Madrid in 2006.

The number of dissolution proceedings remained at low levels, with only 159 dissolution proceedings in March. There were 573 dissolutions during the first three months of the year, an increase of 5.3% compared to the same period in 2005.

The increase in the number of constitution proceedings, which was at a faster rate than the worsening in the number of dissolutions, has placed the business turnover rate at 8.3%, close to the lowest level in the last three years, which was 7.2% in May 2005. The favourable economic situation in the City of Madrid is having a direct effect on the creation of new companies and therefore on its business turnover rate.

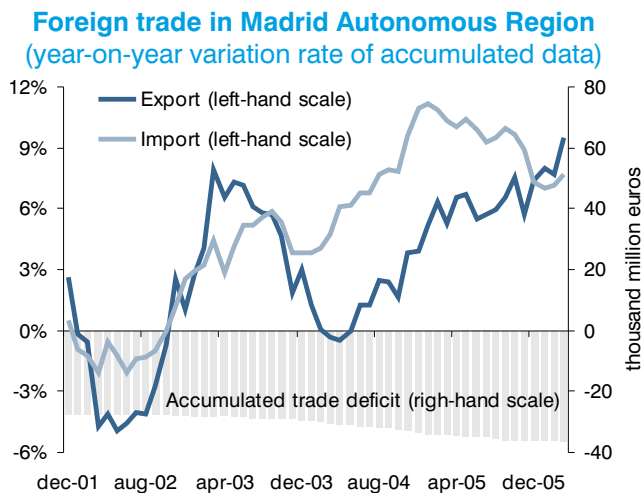


*Ratio of the number of companies dissolved to the number of those established
Source: Madrid City Council Statistics Office - Companies Register

4. Demand

The Madrid Consumer Confidence Index (MCCI) showed an upturn in May to 83.1 points, recording its highest level since the beginning of 2006. This improvement in consumer optimism was reflected in the positive evolution of purchases of consumer durables, which increased by nine percentage points in May compared to the same month last year. There was also an upturn in the growth of workers registered with the Social Security system in the wholesale trade sector, which has shown sustained growth since the middle of the third quarter of 2005.

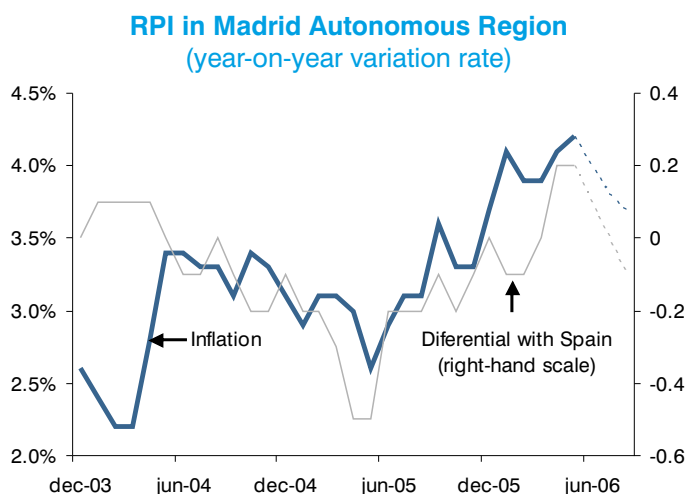
Finally, there was an improvement on the trade balance of the Autonomous Region of Madrid. The average quarterly rate of increase in the deficit was 6.6 percentage points below that recorded for the same period in the previous year. There were also sustained increases in exports from the Region, accompanied by a degree of moderation in the dynamism of imports.



Source: ICEX

5. Prices and salaries

The dynamic in the evolution of the prices of crude once again caused the resurgence of the scenario of inflation from late 2005, at least during the first half of 2006. In specific terms, the acceleration in the rise of prices led to a year-on-year variation of 4.2% in May. This new upturn has placed Madrid's inflation two tenths of a point above the Spanish average. Forecasts suggest a slight moderation in inflation over the next few months. For the first time this year, underlying inflation fell to 3.2% from 3.4% the previous month. As a result of the increase in energy prices, industrial prices continued their upward trend of the last year to reach a new high of 4.6%, although their positive differential compared to the Spanish average remains. House prices in the City continued to show year-on-year rates lower than those in the rest of the Region and Spain. Labour costs, with a year-on-year growth of 2.9% in the first quarter of the year, were five tenths of a point below the Spanish average.



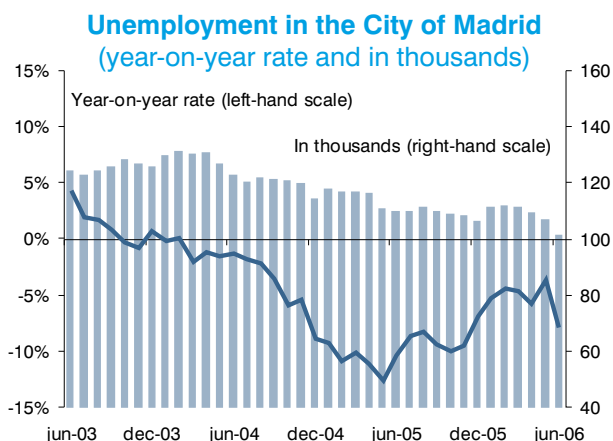
Discontinuous line corresponds to forecasts
Source: National Institute of Statistics

6. Labour market

According to data from the Active Population Survey, the working population in the City of Madrid increased by 4.8% year-on-year in the first quarter of 2006, which enabled the employment rate to increase to 60.1%. Growth was even more marked among the number of employed, who increased by 7.7% in the same period as a result of the improved behaviour in all business sectors, although the relative variation was especially intense in construction. All this led to a year-on-year decline of 2.6 percentage points in the unemployment rate, to 5.7%. It also led to an increase of five tenths of a point compared to the previous quarter.

During the January-March period, workers with Social Security accounts increased by 6.8% year-on-year. Growth was most marked in construction, with 15.3%, and services, with 6.8%. These rates continue to be affected by the legalisation process for foreign workers.

Recorded unemployment in the City of Madrid intensified its rate of year-on-year decline with 7.9% in June, giving a figure of 101,053 unemployed, the lowest figure in the entire series.



Source: Madrid City Council Statistics Office - INEM Employment Agency

II. Sustainability

Solid urban waste management model

The change of paradigm towards sustainable development has had a major effect on waste management in the most advanced cities. The City of Madrid has equipped itself with an advanced comprehensive solid urban waste management system.

The spectacular increase in household waste during the period between 1960 and 2005 in the City of Madrid was almost ten times higher than the increase in population in the same period. This increase in urban waste is compensated by an optimistic downward trend in the kg/inhabitant ratio.

Madrid City Council is the institution responsible for overall waste management of the solid urban waste generated in the City. This management aims to comply with the priorities established by European policy - to reduce, reuse, recycle and assess the value of urban waste.

Over time, urban waste management has evolved from mere collection and storage at a dump to today's selective collection systems, recycling treatments, composting and energy valuation. The *Valdemingómez* Complex was conceived as a sophisticated technological park for the comprehensive treatment of urban waste, where biogas is one of the most innovative and sustainable features in terms of compliance with the Kyoto Protocol.

III. Territorial balance in the City of Madrid

New "fringe belt" areas in the City

14 "fringe belt" districts have been identified due to their position outside the Central Area of the City. The population of these outlying districts is growing more than the City's average rate. Demographic forecasts must be corrected upwards if we consider the housing that has been planned or is being built in the new urban developments. The Urban Action Programmes and urban developments planned by Madrid City Council will entail a major change in town planning for the outlying districts of Madrid and the City as a whole.

As a response to intense and increasing demand, the construction of public subsidised housing, promoted by both the Council and the private sector, is a key objective of Madrid City Council.

The road network, as well as "making a city", plays an essential role in territorial cohesion, citizens' mobility and accessibility to business activities. The *Madrid Calle 30* scheme will have a very positive effect on internal communications and on the improvement of the quality of the urban environment in the outlying districts.

IV. Madrid as a business attraction pole

Research and innovation in the City of Madrid

In recent years, the City of Madrid's economy has experienced a period of significant growth, exceeding the average GDP per inhabitant and work productivity rates of the European Union.

In this section of Attraction Pole, we present an analysis of the current research and innovation situation in the City of Madrid, in the Spanish and international fields, focusing specifically on its booster effect and its business appeal capacity.

The concept of innovation must be understood in its most wide-ranging terms, as a factor in regional development and global positioning, and not merely as a determinant in economic growth. The endogenous development of quality production factors or their attraction towards the City of Madrid are key factors in the growth of Madrid's economy in the near future.

V. Monographic report

Madrid as a site for company headquarters

An analysis or assessment of the City of Madrid as a site for headquarters immediately raises various strategic questions. In what position is Madrid in Spanish and international terms to attract or retain company headquarters? How can Madrid increase its ability to attract major companies' decision-making centres?

The answer to these questions should take companies' global relocation processes into account. This mobility, while it is not particularly recent, has accelerated significantly in recent years, and is today a second stage in the process of internationalisation of the economy. However, decision-making centres and headquarters of large companies in particular have not been affected by these changes until more recently, as they are closely linked to a particular city due to their history, shareholders or the residence of the company directors. More recently, there have been two main factors which have considerably increased the mobility of business headquarters: The waves of mergers and takeovers in the main economies in the 1990s, and the increased mobility of financial capital and human capital thanks to new communication technologies and the development of transport infrastructures.

As a result, in the context of the high level of business mobility, the City of Madrid must continue working to maintain its current leadership as a preferred location for headquarters.