CONSOLIDATED DIRECTORS' REPORT

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ECONOMIC AND FINANCIAL SCENARIO

2004 was an extraordinary year from the point of view of the world economy, production growing at the fastest rate (5%) since 1976. This robust performance was fuelled by the high rate of growth in the US (4.4% in the year as a whole, the highest since 1999), the remarkable growth which China continues to post and the recovery of the Japanese economy.

In **Spain**, production grew by 2.7% during the year, which was up by one decimal point on 2003. Internal demand continued to grow at a steady pace, driven by low interest rates and strong job creation: 461,300 new jobs, representing an increase of 2.5% compared with 2003. Particularly noteworthy was the recovery of capital goods investment following a weak performance in the past two years and, on a negative note, the sharp rise in the trade deficit. Inflation rose by six decimal points to 3.2% at the year end due to soaring energy prices.

Within this context, the **Galician economy** posted a positive growth differential with respect to Spain as a whole. GDP grew by 3%, exceeding the Spanish average by four decimal points, fuelled by three drivers: the growth in tourism within the framework of the Xacobeo Holy Year 2004, the persistent strength of both residential and infrastructure construction and the reduced negative contribution of overseas trade thanks to the improvement in exports. The solid performance of the economy filtered through to the labour market, where Galicia was one of the most prominent autonomous regions creating 37,400 jobs.

On the financial front, the weak economic outlook for the Eurozone kept European **interest rates** at historically low levels in 2004 while Euribor at 1 year fell to less than 2% in March. After March, rates rose slightly and steadied at around 2.3% in the second half of the year. As regards longer term rates, the return on European government securities fell to an all time low towards the end of the year.

European **stock markets** registered another year of growth, although more moderate than in 2003. The Ibex 35 rose by 17% registering the strongest performance of the leading European Indexes. In the US, the conviction that the last minor growth cycle had peaked led to even more modest gains (Dow Jones +3.3%). Finally, the currency market was one of the main points of interest in the year as the euro climbed to an all time high with respect to the dollar (1.36 USD/EUR) in December.

In the **financial sector**, the tendency was consistent with that of the past few years: strong credit growth and a more modest increase in customer funds secured through deposits, which was offset by the rise in the volume of issues. Similarly, the robust growth in inflows into investment funds at the start of the year slowed. The marked rise in credit was parallel to the slump in the securities portfolio that rose by only 1.4% as compared with 12.4% in 2003.

In terms of results, the low interest rate scenario precluded significant increases in net interest income. Nonetheless, the solid performance of commissions and gains on financial transactions enabled the savings bank sector to grow the surplus before tax by 5.76%.

THE CAIXA GALICIA GROUP IN 2004

STRATEGY

Within this framework, Caixa Galicia's short-term strategy focused on managing the balance sheet, within a scenario characterised by interest rates at record lows, and anticipating the impact of the application of International Accounting Standards in 2005.

From a longer term perspective, measures were adopted aimed at enhancing the branch network's business capacity through a matrix structure, enabling a more proactive, segmented and accommodating customer approach. This approach takes into account the parameters of efficiency and robustness that have characterised the entity's growth. We set out below some of the basic lines of action:

- Reducing the relative weight of the **fixed-income securities portfolio**, bringing it into line with a scenario characterised by all time low interest rates which are expected to climb slowly. The current low profitability rates have advised against renewal at maturity, helping to reduce exposure to expected rate hikes and the increased volatility of their contribution to results under IAS.

- Sustaining the high levels of growth of **customer loans** as a way of mitigating the impact of the fall in interest rates on net interest income. This line has focused on diversified growth where the traditional position with families has been supplemented by a growing presence in corporate financing.

- For **customer funds** the focus was on fixed-term deposits, as a way of reducing the exposure of financing costs to expected rate rises. The reduced use of the interbank market also forms part of this strategy.

- The obtainment of **commissions** continued to be promoted through off-balance products (with a specific focus on insurance) and services such as payment means or securities brokering.

- The entity's commitment to **technology** was strengthened as a basic pillar for improving **efficiency** and productivity, optimising processing and favouring the migration of routine operations. At the same time, its customer orientation will give rise to a quality service and increase the sales network's capacity.

- Ensuring solid growth, which made high lending levels compatible with a fall in non-performing loan exposure. At the same time, work continued on the development of risk management tools (consistent with Basel II guidelines) and the increase in capitalisation levels.

The development of this strategic focus pushed business to almost €35,000 million, which is up 14,6% on the previous year, while the surplus attributed to the group amounted to €170.9 million. These results are discussed in greater detail below.

Unless otherwise, stated, the percentages set out below relate to the year-on-year variation at December 2004 and the amounts refer to the balance at that same date.

a) Investment

Customer loans rose by 18.6% to €14,356 million, driven by the robust performance of mortgage loans which grew by 20.4% and the segments defined as strategic: 1) Corporate financing grew by 20.8%, consolidating the market share won in the last five years. 2) Consumer credit almost doubled the amount granted in 2003. Prudent risk management resulted in a delinquency rate of 0.25% and coverage of 840% of doubtful balances. The Bad Debt Statistical Coverage Fund was fully covered.

Investment in the securities portfolio was readjusted in the light of the low yields obtained, which meant that maturities during the year were not renewed, and in anticipation of the imminent entry into force of the new International Accounting Standards (IAS), that change the criteria for consolidating investees. The balance of the fixed- income securities portfolio dropped by 15.4% while the balance of the equity securities portfolio slumped by 17.1%.

b) Customer funds

Customer funds managed grew by 11.9% to €20,461 million. Borrowings rose by 8.9% while the winning of long-term funds (through deposits, issues or temporary assignments of assets) was particularly noteworthy with growth of 11.8%, which will enable the impact of all time low interest rates to be passed on to financial costs. In this respect, there were fixed income securities issues – one involving Eurobonds and another junior bonds - amounting to €220 million, which have been fully subscribed.

Off-balance sheet products grew by 31.0%. Particularly noteworthy were insurance and pension plans where the overall balance rose by 98% as compared with 2003.

c) Services

For the lines generating commissions, in addition to the growth in off-balance sheet products indicated above, noteworthy in 2004 was the rise in credit cards in terms of both the number of units issued and the balances utilised by our customers. The number of credit cards climbed to 334,654 units in circulation, up 22.3% on December 2003, while the utilised balance jumped by 22.6% to €59 million

Also noteworthy was the growth in securities related activities. In addition to the increase in customers' stock market trading management (14%), the entity strengthened its participation as a placer or underwriter of public offerings (four operations) channelling over 11,000 purchase orders that generated commission income of €2.5 million.

d) Results

The financial highlights are as follows:

- Net interest income fall by 1.6% because of the difficulty in transferring the strong performance of the business to the income statement for two reasons: 1) the fall in interest rates to historical lows. 2) The aforementioned fall in the government securities portfolio, which reduced financial income by €78.4 million with respect to 2003.

- The sharp growth in off-balance products and the strong performance in services such as cards, securities or insurance resulted in an increase of 14.8% in net commission income.

- The contribution of gains on financial transactions has fallen substantially with respect to 2003 because of two factors: the atypical results generated in 2003 which amounted to €16 million (€9 million more than in 2002) and the fact that the current development of rates is not conducive to the realisation of capital gains on the debt market.

- The entity continued to grow efficiently as is borne out by the rise in productivity of 10.1%. Despite the opening of 26 new branches, administration overheads rose by 2.5% in real terms (5.7% in nominal terms) Moreover, the 17.1% rise in depreciation and write-offs evidences the entity's technological efforts.

- The declining need for bad debt provisions, because of the fall in delinquency, the total coverage of the Insolvency Statistical Coverage Fund (one of the first Spanish entities to attain it) and the strong performance of the net contribution of investees have offset the slump in revenue from extraordinary activities. In this way, the surplus attributed to the group amounts to €170.93 million, up 2.5% on 2003.

These results allowed the amount appropriated to community projects to be increased to €55.4 million and €121.6 million to be appropriated to reserves pushing the equity balance to €1,932 million, up 14.5%.

Other information

The Caixa Galicia network comprised 735 branches at the year end, 36% of which are outside Galicia (seven in Portugal) and seven are representative offices located in Europe and Latin America. The number of ATMs amounted to 874 and the number of PoS terminals stood at 21,223.

Moreover, at the year end, the entity's electronic banking service had a total of 335,120 customers, up 23.8% on 2003. The number of operations managed amounted to €34.1 million, representing an annual increase of 52.68%.

The number of employees involved in ordinary activities stood at 4,248 on 31 December 2004.

Corporación Caixa Galicia

The Corporación Caixa Galicia Group posted a consolidated surplus after tax of €97.69 million, 13.4% up on the previous year, enabling it to consolidate its position as the driver of the Caixa Galicia Group's income diversification strategy.

In order to ensure that investment activity is strengthened in the future, capital was increased by €100 million this year.

The Corporación is divided into two main areas:

The **Operations Area** which encompasses subsidiaries that take on new lines of business complementary to the financial activity: insurance, information technologies, real estate, services to companies and tourism. The year 2004 as a whole was characterised by the growth in results in all operations areas, with the overall pre-tax surplus amounting to €14.21 million, 40.4% up on 2003.

For real estate, and as a result of its policy of entering into strategic alliances to increase its size and bid for large projects, Corporación Caixa Galicia set up, together with other leading financial entities and developers, several companies aimed at strengthening the presence of the real estate sector in its investment portfolio. These alliances have given rise to *Boreal Desarrollo Inmobiliario* (which represented an investment of €2.4 million), *Jocai XXI* (€1.6 million) and *Lazora* (€10 million).

Finally, noteworthy was the operations restructuring undertaken in the Group of Companies, centralising central and administrative services in a single company in order to drive commercial activities and improve efficiency.

The **Corporate area** encompasses two activities:

Venture capital investment is managed by Gescaixa Galicia. Last year it made investments amounting to €18.6 million, pushing the accumulated total since the start-up of business to €30.1 million. Consistent with the tendency in the sector, where, in the past few years, the amount of transactions has grown, *Gescaixa* carried out two major operations during the year: the acquisition of a 7.8% holding in *Filmax* and a 4.42% holding in *Veralia*.

The portfolio of direct shareholdings in companies is managed with a view to both combining favourable profitability prospects and a beneficial effect on the financial landscape by driving strategic sectors. At the end of 2004 the portfolio's market value amounted to €1,100 million, with latent capital gains of €274.29 million.

The most significant transactions in the year were the following:

- An increase in the stake in Sacyr-Vallehermoso, one of the leading construction groups in Spain, to 2.84%, which entailed a disbursement of €48.9 million. The generation of synergies with the construction group was strengthened following the exchange of the 10% stake that Corporación had in ENA (Empresa Nacional Autopistas) for 8.62% of Itinere Infraestructuras, the subsidiary of Sacyr-Vallehermoso that holds an extensive and growing portfolio of concessions in Spain and Latin America, including 70% of ENA itself.

- Banco Etcheverría: early in the year a purchase option was exercised over an additional 7.6% of the bank's capital for €2.7 million, which pushed the holding owned to 44.7% of capital.

- Banco Pastor: the Corporación participated in the capital increase effected in October and subscribed all the shares that related to its holding, leading to a disbursement of €21.4 million.

Community projects

In the course of 2004 Caixa Galicia invested €61.02 million in activities relating to its Community Projects, which represents an increase of 23.40% on 2003. Caixa Galicia's Community projects are organised in four functional areas where the most noteworthy actions were as follows:

Production sector support. Particularly noteworthy was the support of the Xacobeo 2004 Holy Year. In addition to promoting cultural values and exalting the value of the pilgrimage to Santiago, the effects of the Xacobeo Holy Year permeated the Galician tourism industry and economy. The launch of an innovative micro-credit program led to the processing of more than 200 applications and the preparation of 95 business projects.

Social Action and job creation. The first stage of the Residential Centre Plan ended with the start-up of the centre in Narón, which is the first of the four centres planned. The number of Non-Profit Organisations related to the Socialia program of Caixa Galicia for the non-profit and volunteer sector, in which the Internet portal (www.socialia.org) plays a major role, almost doubled to 784.

Cultural action. The main action was the recovery of Galicia's historical heritage and in particular, the restoration of the Lígneo Choir of the Santiago de Compostela Cathedral, a masterpiece of Renaissance art, in which more than €500,000 was invested. In addition to these actions, Community Projects developed a complex cultural programme in several arenas (painting, cinema, sculpture, photography, music, theatre) in order to contribute to a more culturally aware and freer society. More than 1,000 activities were organised in 2004 with over one million participants.

Investment plans. There is a multi-year investment plan to ensure that the main Galician towns have a permanent Community Project office, setting up the most important social-cultural centre network in Galicia. In 2004 the restoration work on the former Military Government building in Ferrol was completed and major progress was made on the Foundation's future headquarters in A Coruña, which will be operational early 2005.

With respect to Corporate Social Responsibility, Caixa Galicia was the first Entity in the sector to include management criteria. In 2004 it was the first Spanish savings bank to join the World Global Pact promoted by the United Nations and the first to draw up a corporate social responsibility report based on GRIs, internationally recognised standards for the validation of sustainability reports.

Reiterating its commitment towards society, the Board approved the start-up of a CSR plan with 290 specific tasks that will drive the Entity's relationship with its customers, employees, suppliers, directors and society in general, from an economic, social and environmental perspective.

RESEARCH & DEVELOPMENT ACTIVITIES

Technological innovation. In a manner consistent with strategic business aims, the entity's technological investment concentrated on supporting business actions while bearing in mind the necessary strengthening of the TIC structure which forms the backbone of the Entity's operation. The funds appropriated to this area amounted to €41.72 million, totalling €185.5 million in the past five years:

Business support. Investment focused on supporting the sales actions of our sales force through the launch of new highly innovative services such as the on-line insurance multi-rater, "on-broker Caixa Galicia", the investment fund utilities "Mi perfil" and "Mi gestor" or the Caixa Galicia Mobile range, that adds a new channel to our services platform by converting the customer's telephone into a broad functionality access channel.

Infrastructures. In addition to upgrading the IBM central host computer and increasing its capacity by 30.1% in order to support the increase in the branch network, the most important project was the server virtualisation project which Caixa Galicia was the first Spanish savings bank to undertake. This project has yielded excellent results and facilitated major cuts in costs, the migration of old operational systems, a reduction in new server installation times and the optimisation of hardware resources and space. Also noteworthy was the start-up of an international banking platform to support the operation of operational branches abroad (Geneva, Miami)

Financial innovation. Caixa Galicia consistently carries out research and development of new financial products in order to accommodate demands from an increasingly demanding and discerning public. In 2004 the most noteworthy innovations were as follows:

Wind bonds. In 2004 Caixa Galicia launched the first bond securitization issue for the retail market in Spain. This is a financial instrument that permits the exploitation of Galicia's wind energy potential to be financed, the benefits generated filtering through to the population as a whole.

The issue amounted to €26 million and was provisionally rated A1 by Moody's. The bonds are issued at 10 years with a return of 2.75% of a wind farm group's invoicing, with a minimum of Euribor at six months plus 0.25%.

There was strong demand for **guaranteed funds** in 2004. In keeping with this, the Entity launched four new products that registered a solid performance (€75 million captured). Three of these funds include as a novelty the opening of liquidity windows on interim dates when members may dispose of their position without a penalty.

Demand on the real estate market has remained strong although the increase in prices makes it difficult for some social groups to afford a home. In view of the situation, the Entity has launched five new mortgages that reduce this obstacle by adjusting the term, interest rate and review (fixed or variable) formula to the borrower's situation.

SIGNIFICANT EVENTS IN 2005

1. In order to ensure more flexible and accommodating sales actions and increase the contribution of value and service quality, in January 2005 the **"efficient file" project** was started up. The Entity's customers with homogenous profiles are distributed in files, the management of which is assigned to the CRM manager. As a result, 152,938 customers have been distributed in 1,039 files.

   "Efficient files" represent a major step towards a relations-based banking model, promoting business actions focused on the customer's specific needs while optimising the deployment of human resources gradually released from administrative tasks thanks to migration to remote customer services channels.

2. Galician financial legislation was the only legislation that laid down a minimum percentage **appropriation to Community projects**, which has penalised Galician savings banks under International Accounting Standards (IAS). The regional government has eliminated such provisions of the Financial Law and replaced them with an Agreement concluded with two of the regional savings banks in February 2005.

3. In February the entity sold half of its block of shares (9.95% of the bank's capital at the time of the sale) that it holds in **Banco Pastor**. Following this transaction, the entity has brought its investment strategy into line with new International Accounting Standards (IAS) and obtained a capital gain of €45 million.

4. 4. In the first quarter two new products were launched: **Hal Cash**, a revolutionary system for sending money using mobile telephony to the ATM network, and the Service for the Integrated Management of **Payments to Suppliers**.

OUTLOOK FOR 2005

World economic performance in 2005 will not be as strong as in 2004 although the economy will continue to grow at a considerable rate which the IMF puts at somewhere in the region of 4%. The reasons lie in the slowing of growth in the US and China and soaring energy prices.

Within this context, the Spanish economy will continue to register a significant growth differential with respect to the Eurozone. There will, however, be some changes as investment in capital goods will take over from household consumption and construction. GDP will increase by approximately 2.7% next year.

With respect to the impact of the development of the economy on the financial landscape, European interest rates will remain low for most of the year although they are expected to rise in the last part of the year as European economic recovery takes hold. In the longer term, yields should also tend to rise from the historical lows recorded at the start of the year

Within this scenario, the entity will basically focus its strategy on the following:

Increasing the network's contribution to results, leveraging the surplus of the branches that have joined the network in the last few years as part of the entity's expansion. This will offset the decrease in income from wholesale activities.

Driving the capacity to sell and generate customer value of our distribution structure. The branch network's work will be supplemented by a matrix structure through a CRM manager that will have a close relationship with customers. At the same time, the network will be strengthened through **35 new branches and** work will continue on changing the focus of the overseas network with the opening of operational branches in Geneva and Miami.

Business guidelines focus on growth in SME activity and the financing of consumption, where payment means and the continued drive of mortgage financing will be given priority. As regards securing business, insurance and pension plans will continue to play a key role while deposits will continue to grow on the balance sheet.

Progress will continue to be made with respect to **efficiency and productivity**, driven by the increase in the generation of income, the entity's technological deployment, the on-going improvement of processes and the containment of the number of employees, that will rose by 2.5% despite the increase in the network. The objective is to increase the percentage of operations qualifying for migration carried out outside the office to 56.6% .

Maintaining the strict parameters of **solvency** that the entity includes in its management that will be borne out by a delinquency rate that will continue at historical lows, the performance of new issues that, together with the appropriation to reserves, will push the solvency rate to over 12% and a major advance in the implementation of the advanced risk management systems provided by Basel II.

As a result of these lines of business Caixa Galicia will end the year with a volume of business of €40,000 million and a surplus before tax of more than €230 million.