

ECONOMIC AND FINANCIAL SCENARIO

Economic activity continued to grow worldwide at a notable pace in 2005. Despite hurricanes Katrina and Rita, the US grew by 3.4% and remained the driver of world growth, backed by China and Japan, that saw an end to a 15 year bout of deflation.

Economic stagnation continued in Europe (with 1.3% growth). There were, however, signs of recovery towards the end of the year. Spain was one of the most dynamic economies in the area, posting growth of 3.4% in the year, but at the cost of major imbalances in its pattern of growth.

The robust performance of internal demand was fuelled by the strength of private consumption, the persistent investment in housing and the revival of investment in capital goods, which jumped by 9.5% in the year. The strength of economic performance was borne out by the creation of 894,000 new jobs and the drop in unemployment to 8.8%, the lowest in the last 25 years and the first time that it has fallen below the European average.

However, because of Spain's low productivity and price and growth differences with the Eurozone, the strength of internal demand has triggered a growing trade deficit. On the basis of November figures, Spain's financing needs have risen to 6.5% of GDP.



The Galician economy posted a similar performance to that of Spain as a whole although with a smaller imbalance in exports and slightly slower growth, driven by the robust performance of investment in construction and capital goods.

Within this financial scenario, the signs of recovery in the Eurozone in the last part of the year prompted the European Central Bank to raise rates in December for the first time since 2001 (from 2 to 2.25%). This movement drove market rates up with the Euribor climbing to 2.8%, its highest level since 2002.

The good macro-economic outlook, excellent corporate profits and low interest rates on long-term debt drove share prices up and stock markets ended another year with gains. In Spain the construction and banking industry drove the IBEX 35, which grew by 18% which was practically the same as in 2004.

Within this context, the financial sector in Spain continued to record robust growth fuelled by credit and in particular, mortgage activity. Within the savings bank sector, credit to private sectors of the economy was up 26% on 2004. This robust growth was compatible with the assurance of credit quality such that the bad debt rate fell to 0.69%.

The winning of balance sheet funds failed to equal the strong growth in credit. Deposits on the balance sheet grew by 17.3%, forcing entities to resort to issues as an alternative financing formula. This, in turn, triggered growth of 59.5% in issues.

The drive in credit filtered through to the income statement where all margins increased while the attributed consolidated surplus rose by 35.4% to over €6,000 million for the first time in the history of the savings bank sector.



CAIXA GALICIA GROUP IN 2005

STRATEGY

Within this context, the Caixa Galicia group sought to manage the balance sheet in order to reduce the negative impact on margins of rates that were still at all time lows in the first half of the year at the same time as it adapted its exposure to a scenario marked by gradual rate rises. In parallel with the above, the entity continued to drive a relationship-based banking model and the search for an organisation committed to sales and customer relations through a personalised top-quality service.

Some of the basic lines of action are summarised below:

A major boost to its marketing capacity through a matrix structure that includes new channels and favours segmented marketing action, focusing on the relationship with customers through actions such as the creation of customer files, the implementation of advanced sales support tools or the formation of a specialist SME assistance unit.

Focus on growing credits, loans and investments in those lines defined as preferential because of better risk adjusted returns: SMEs, home purchases and consumption, Growth that on the financing side entails an increase in time deposits, which is compatible with a sharp increase in the winning of off-balance sheet funds.

Restructuring of the corporate shareholding portfolio, adapting it to the framework contained in the new Circular 4/04, that changes the consolidation scope and therefore the return of these investments.

Intensifying the focus of technology and information systems on sales, the segmented exploitation of the customer base and the creation of value, following the progress in the last few years in improving efficiency and productivity.

Ensuring the robustness of growth and diversification as the basis of the Entity's sustained growth. Such robustness is built up by strengthening risk management tools and through a policy of prudence in the assumption and coverage of risks. Diversification through both the development of new lines and the expansion of the geographic scope and customer segments with which the entity works.

The results for the year bear out the positive impact of these actions on the Group. The volume of business grew by 28.9% to €45,306 million, Credits, loans and discounts were up 34.9% while the surplus attributed to the group amounted to €212.28 million, representing an increase of 96.9% on 2004.

These results are discussed in more detail below.



Unless otherwise stated, the percentages indicated below represent the year-on-year variation at December 2005 while the amounts relate to the balance at that same date.

a)- Investment

Customer loans amounted to €19,358 million following an increase of 34.9%. Particularly noteworthy was the solid performance of SME financing which grew by 66% and mortgage lending which rose by 40%.

The robust performance of lending activity was compatible with the on-going quality of the portfolio, where the bad debt rate fell to 0.27%, one of the lowest in the Spanish financial system, coverage standing at 696%.

The impact of the securities portfolio on balance sheet growth was limited, with an overall increase of 21.6% to €11,043 million. Particularly noteworthy was the restructuring of the variable income portfolio, as is explained in the Corporación section, which ended the year with a market value of €1,821k, up 71.5% on 2004.

b)- Winning of funds

Customer funds managed amount to €25,948 million, representing growth of 24.8%. On-balance sheet funds grew by 25.4%, driven largely by the winning of time deposits which increased by 42%, while off-balance sheet funds managed rose by 21.7% to €4,212 million, with 22.9% growth in investment funds.

Once again the winning of funds through issues played a leading role, debentures and subordinated debt financing increasing by 141.9%. Noteworthy was the issue of Subordinated debentures aimed at the retail public amounting to €210 million which was covered in full.

c)- Services

Revenues from the provision of services grew by 8.6% driven by the solid performance of the main lines of business (investment funds, cards, insurance, guarantees), since charges continued to be lower than those applied in the sector as a whole.

Besides the aforementioned performance of off-balance sheet balances, noteworthy was the increase in other major lines such as the growth in cards amounting to 124,530 units, the formalisation of 93,000 new insurance contracts (40% up on 2004), or the rise of 43.6% in the guarantee balance.



d-) Results

The performance of the basic business financials filtered through to the development of revenues as follows:

Net interest revenue grew by 11.4%, to €434.8 million. Particularly noteworthy was the 28% jump in revenues generated by customer credit.

Revenues from the provision of services grew by 8.6%, which pushed the base margin (the reflection of the entity's capacity to generate recurring revenues) to €517.6 million, representing growth of 10.9%.

In addition to the performance of revenues from typical financial activities, the solid performance of the investee portfolio, in terms of both its contribution, owing to consolidation under the equity method, and through gains on financial transactions, pushed net ordinary revenue to €686.5 million, up 37.9% on 2004.

Progress in efficiency meant that this growth in net ordinary revenues extended to net operating revenue which rose by 83% to €334.56 million. The efficiency ratio (GEMO) stood at 51.3%, which represents an improvement of 12 percentage points, while productivity by employee grew by 20% and remains at €500,000 over and above the sector rate.

The development of the income statement has enabled appropriations to the provision for bad debts to almost triple, despite the low default level, and has made it possible to charge the pre-retirement of 97 employees to results. This has not had a negative impact on the surplus before taxes which amounts to €251.76 million, 72.8% up on 2004.

Following the mandatory payment of taxes, the net surplus attributed to the Group amounts to €212.28 million, up 96.9% on 2004.

These results enable the appropriation to Welfare Projects for 2006 to be increased to €57.8 million and to appropriate €154.45 million to reserves such that the equity balance has increased by 23% to €2,519 million.

Other information

The Caixa Galicia network comprised 752 operational offices at the year end, of which 36% were located outside Galicia (7 in Portugal and 1 in Switzerland) and 6 are representation offices distributed throughout Europe and Latin America. There are 913 ATMs and 24,249 PoS terminals.

The Entity's virtual banking service had 395,330 customers at the year end, representing growth of 18% compared with 2004. The number of transactions managed stood at 25.71 million, with an annual increase of 12.0%, which contributed decisively to the fact that 53% of transactions are completed through channels other than branches.



The number of employees of the Group stood at 4,597 at 31 December 2005.

Corporación Caixa Galicia

Corporación Caixa Galicia is the focal point of the group's diversification policy and the basic driver of the region's economic and business development.

In 2005 Corporación Caixa Galicia recorded its best results ever and posted a surplus after tax of €128.45 million, up 19% on the previous year. Moreover, a new corporate identity was launched (CXG) and the business divisions were restructured into nine units.

The Group of Companies includes companies in complementary sectors such as insurance, information technologies, real estate, services to companies and tourism. In 2005 the surplus before tax amounted to €15.9 million, up 50.2% on 2004.

The Strategic Portfolio comprises shareholdings in companies that offer a favourable outlook in terms of profitability with a beneficial effect on the economic environment through the stimulation of key sectors. With a portfolio valued at €1,688 million (€585 million in latent capital gains), Corporación Caixa Galicia is present in strategic sectors through companies such as Ence, Pescanova, Unión Fenosa, Reganosa or Ebro Puleva.

During the year and within the framework of the changes introduced by Circular 4/04 to the treatment of these shareholdings, the portfolio has been restructured. The most noteworthy movements were the exit from Banco Pastor and Iberia and the reduction in the shareholding in ENCE, while the shareholdings in Reganosa, Pescanova and Unión Fenosa were increased.

With respect to Joint Ventures, the Corporación's first bet was Inverimentos Ibéricos, a joint venture with the Portuguese Group Amorim, to channel the entry of companies in that country. Its initial action has been the acquisition of a 10% holding in Galp. In this way, the Group is committed to economic integration with Portugal, uniting markets that are essential for the positioning and drive of the business fabric in both countries.

The Development Portfolio, Venture Capital and Welfare Projects have channelled investments to projects with either a strong innovative component or a clear social vocation.

In this respect, Gescaixa Galicia, the group's venture capitalist, continued its investment drive and grew the portfolio to €60.2 million, with noteworthy positions in sectors such as renewable energies and audiovisual, biotechnology or information technology sectors.



Real Estate Development received its final boost in 2005 through the formation of CXG Desarrollos Inmobiliarios in order to bring together interests in real estate development. Towards the end of the year its portfolio registered an accumulated investment of €30 million in projects distributed throughout Spain (Santiago, Sanxenxo, Oviedo, Barcelona, Madrid, Seville, etc.).

Welfare Projects and Corporate Responsibility

The expense effectively incurred by Welfare Projects of Caixa Galicia in 2005 amounted to €65 million with more than two and a half million beneficiaries through 4,121 activities carried out in more than 225 municipalities. In 2005 the Entity was the third Spanish savings bank in terms of the total amount appropriated to Welfare Projects.

By way of an overview of the main actions carried out in 2005, concerning social services, there was decisive progress on the dependence and support plan for the elderly following the completion of the Centre for the elderly in Vigo and the acquisition of an interest in Residencia Remanso in A Coruña.

With respect to production sector support, noteworthy is the commitment to Instituto Tecnológico Empresarial Caixa Galicia to improve the competitiveness of our production environment through entrepreneur training. Six masters degree programmes were offered together with several training activities aimed at managers in which 750 entrepreneurs were involved.

On the cultural front, the two most noteworthy events were as follows: The completion in the key towns of unique spaces for meetings, creativity and cultural exchange, through the recovery of the former military government premises in Ferrol and the completion of the new A Coruña head office.

Caixa Galicia has driven the integration of the Galician Welfare in the main cultural circuits with exhibitions such as Tàpies, the Thyssen Collection or Frida Khalo (the latter with more than 120,000 visitors).

Within the context of Corporate Responsibility, Caixa Galicia has adopted a pioneering position in the sector as the first Spanish entity to join the United Nations World Pact and one of the first to prepare a report in accordance with GRI (Global Reporting Initiative) standards and which has been verified by an external auditor.

Within the framework of the 290 tasks included in the Corporate Responsibility Plan approved by the Board late 2004, the following actions in 2005 are particularly noteworthy: start-up of new initiatives with non-profit organisations such as the solidarity gallery, commitment to service quality through the creation of customer managers, enabling customers to select the language to use with the entity and arrange contracts and the work to develop web enabled services on Level A accessible mode, according to WCAG 1.0. The websites of Welfare Projects and the group in Portugal already meet this standard.



RESEARCH AND DEVELOPMENT ACTIVITIES

Technological innovation. In keeping with business basics, technological investment has concentrated on supporting marketing actions while addressing the improvement of efficiency and internal processes. Funds appropriated to this amounted to €51.4 million, totalling €206 million in the last five years,

Business drive. Investment focused on supporting the marketing actions of the sales force through the launch of new services with a strong innovative component such as loans at ATMs. In addition, tools such as the Commercial Orientation Company Rating File, contractor scoring and a data mining technological platform which supports Advanced Customer Management have been made available to the Commercial Network

Increase in efficiency. In order to improve time devoted to the arrangement of transactions, the Electronic File has been implemented throughout the Entity and the E-Notario platform has been started up for the management, processing and signature of the documentation relating to personal loans.

Operations: In addition to continuing the migration of operational processes in order to optimise technological resources, Caixa Galicia has become the first financial institution to implement level 3 of the software and systems integrated capability maturity model under standard CMMI, the benchmark worldwide for software generation processes.

Financial innovation. Caixa Galicia consistently carries out research and development activities relating to new financial products in order to address the demands of an increasingly demanding and sophisticated public. In 2005 the most noteworthy innovations were as follow:

Investment funds, the launch of nine new products, of which the real estate fund AC Patrimonio Inmobiliario is particularly noteworthy, the entity being one of the few offering a fund with these characteristics.

Personal loans through ATMs, enabling a loan to be granted instantaneously through a channel to a pre-classified customer base. The use of this channel increased following the start-up late 2004 of the hal-cash service that combines ATMs and mobiles in order send cash.

Supplier payment service, offering companies the integrated management of payments to suppliers worldwide, in any currency and arranged in the manner of payment that the company chooses; thanks to its flexibility and versatility, the service is one of the most advanced on the market.



SIGNIFICANT EVENTS IN 2006

The Entity has implemented a new organisational chart commensurate with the matrix structure under which the commercial area is strengthened together with business design and development. Risk is also strengthened through the integration of all finance risk management in a single Assistant Management department that reports directly to General Management.

A new variable remuneration system has been implemented, the objectives of which are: to drive the taking on of marketing responsibilities, reward the sustained growth of results and involve the organisation's members in the success achieved, a system that links incentives to profitability objectives, business growth, customer relations and operational efficiency.

As part of the restructuring of the shareholding portfolio, the Entity sold its 5% shareholding in Transportes Azkar and invested €20 million in 20% of Cupire Padesa, the largest pizza company in Galicia, that will receive a sharp boost following this capital increase.

The new head office of Fundación Caixa Galicia has opened in A Coruña. This is the work of the prestigious architect Nicholas Grimshaw, where light and technology are the main players in a building that is called to become an architectural landmark in the North-east of Spain and a basic pillar of the Fundación's cultural creation and exchange.



OUTLOOK FOR 2006

According to IMF forecasts, world economic activity will continue to grow in 2006 at the same rate as in 2005. By country, growth will register some changes, with slower growth in the US offset by Japan and the Eurozone.

With respect to the Spanish economy, indicators point to the fact that growth peaked in 2005 and will tend to level off in 2006 to around 3.2%. The slowdown in internal demand will to some extent enable Spain's significant foreign trade imbalance to be restored, fuelling healthier growth.

Within this context, the weak recovery of EU States and the absence of excessive pressure on inflation will enable the European Central Bank to manage the tightening of its monetary policy, barring additional pressures on energy costs. Forecasts point to official rates climbing to around 3% by December. This will trigger a gentle rise in money market rates (Euribor at 1 year) in the first half of the year which will level off in the second half.

Within this framework, the basic drivers of the Entity's strategy will be as follows:

Promoting the expansion plan with the opening of 60 new offices, targeting the east coast of Spain, Andalusia and Catalonia as priorities, to which the opening of an International Banking Agency in Miami will be added.

Driving segment sales capabilities and relations with customers, making progress on the actions started up in 2005. In this connection, the SME division has been created to address the specific needs of this segment through 70 specialist managers; the subscriber platform has been consolidated by increasing the number of member establishments; customer loyalty and filing programmes have been promoted and a new specialist office network will be developed to address immigrant needs through the bank BEM – Galicia, where branches will act as agents of Caixa Galicia in this segment.

Sustaining high rates of growth in preferential investment and prioritising the winning of off-balance sheet funds since they offer a higher return in a scenario which is still marked by low interest rates. Investment will be financed through time deposits and issues.

Growing revenues from the provision of services by promoting those business lines generating customer value such as securities, payment means or insurance, which will offset the discontinuance of fees such as account maintenance and administration fees that do not relate to real value added services.

As a result of these lines of business, Caixa Galicia will end the year with turnover of €60,000 million, exceeding the consolidated surplus of €300 million, and 175,000 new customers.