

Consumption Outlook

Madrid, 29 May 2012

Key themes

- 1 Europe decoupling** from the global economy growth **while the region continues to await a long-term plan** to boost economic activity and allow sovereign risk to be spread in exchange for structural reform and better coordination
- 2 Spain's GDP is still expected to contract** in 2012 (by 1.3%), before gradually recovering in 2013. However, **this outlook now appears less certain**
- 3** Building up confidence now depends on the design, execution, and communication of a **credible set of reforms**
- 4** Weaker drivers point to **declining consumption** in 2012 and the first half of 2013, especially for durable goods
- 5** Lingering financial stress and high default levels, and, in particular, the expectation of weak demand **do not point to an increase in consumer credit** in the short term
- 6 Worsening expectations** by households account for 80% of the fall in **demand for consumer credit** in the current crisis

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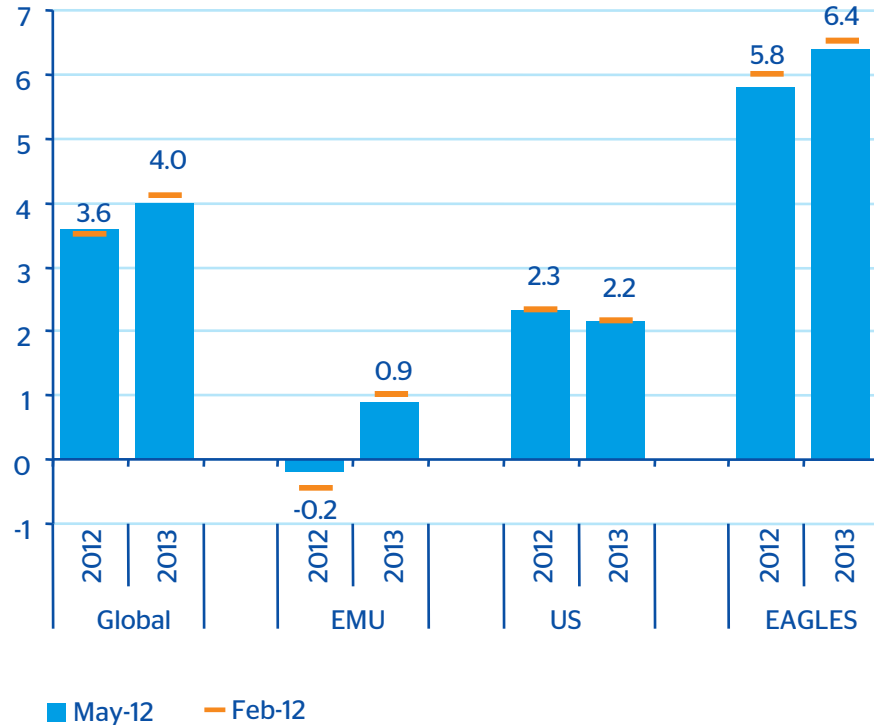
Demand for durable goods: is there any?

Section 1

Europe decoupling from global growth

GDP growth (% yoy)

Source: BBVA Research



The debt crisis continues, with Portugal under the spotlight and concerns about Spain

High levels of financial stress in Europe, with a risk of a tightening of credit

Stability Treaty: towards Maastricht 2.0
More emphasis on growth

Expansive, yet differing, monetary policies by the Fed, the Bank of Spain, and the ECB

A slow, disparate, and vulnerable recovery

Section 1

The European crisis continues

Significant progress...

Restructuring Greek debt and moving up the ESM

Provision of long-term liquidity by the ECB

Reforms in Portugal, Spain, and Italy

Approval of the Stability Treaty

ESM may indirectly contribute to capitalising financial institutions

... Although significant challenges remain

1. Uncertainty in Greece

2. Need for an effective firewall

3. Growth plan

4. A clear roadmap to "another" fiscal union

5. Need for greater financial integration

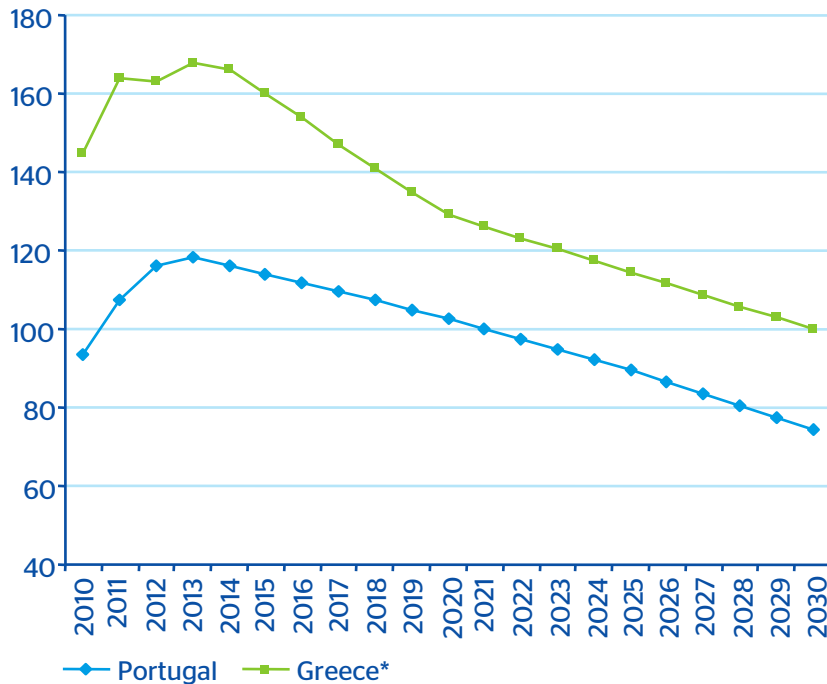
Insufficient progress → Risk continues to rise

Section 1

1. Uncertainty in Greece and Portugal

Greece and Portugal: public debt forecasts (% GDP)

Source: BBVA Research and IMF



* Scenario for Greece: assumes 95% of bondholders will participate in the haircut, 3% growth in 2015, and a primary surplus at 4.5% of GDP starting in 2014 (2.4% primary deficit in 2011)

Greece: ambitious targets, but uncertainty following elections, and a deep recession

Portugal: despite significant progress, there is no guaranteeing Greece's return to capital markets in 2013

The risk of setbacks remains high

Section 1

2. Need for an effective firewall

The debate centres on the amount of resources available, but it encompasses much more:

**New lending capacity: €500bn
(+ €200bn already committed by the EFSF)**

The EFSF can continue to lend through mid-2013, so as to enable the capitalisation of the ESM

**The increase in IMF funds
(€330bn)**

**What is more important is that the available funds be used efficiently:
they should not crowd out private demand**

Section 1

3. Agenda for growth

An agenda for growth that is compatible with fiscal adjustment

Clear roadmap for the future of EMU

Balance between growth and austerity:
reforms in exchange for a strategy focused on growth

Gradual fiscal adjustment with multi-year plans
Focus on structural deficits as called for in the Treaty

Short-term objectives: avoiding the risk of an austerity-recession
downward spiral and clearing up the uncertainty over the solvency of
sovereign debt

Section 1

4. Greater progress towards fiscal union

From the Stability Treaty...

Despite difficulties in estimating the volume, this places the right emphasis on structural adjustment...

...but also raises doubts about how and when to apply the "extraordinary circumstances" clause

Not ambitious enough to elicit an assertive move from the ECB hardliners and Germany?

...to fiscal union

Eurobonds: a good mechanism for *mutualising* risk

The "blue" and "red" bond proposal maintains a degree of market discipline

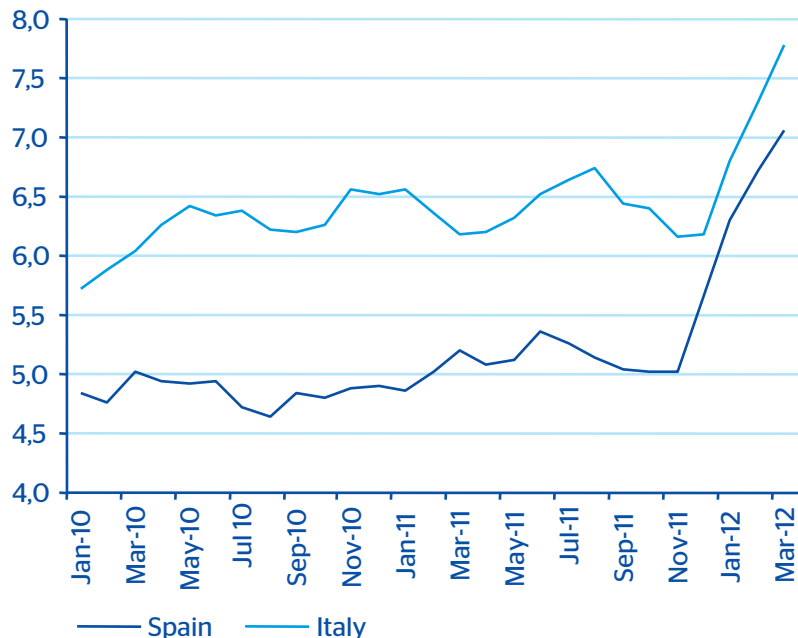
A union with temporary (rather than permanent) transfers would be sufficient

Section 1

5. Greater financial integration

Banking system: Euro-zone sovereign bondholdings (% of assets)

Source: BBVA Research based on ECB data



Objective: to eliminate interaction of sovereign risk and bank risk



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Main changes in the economic scenario in 2012

Main drivers of the macroeconomic scenario

Source: BBVA Research

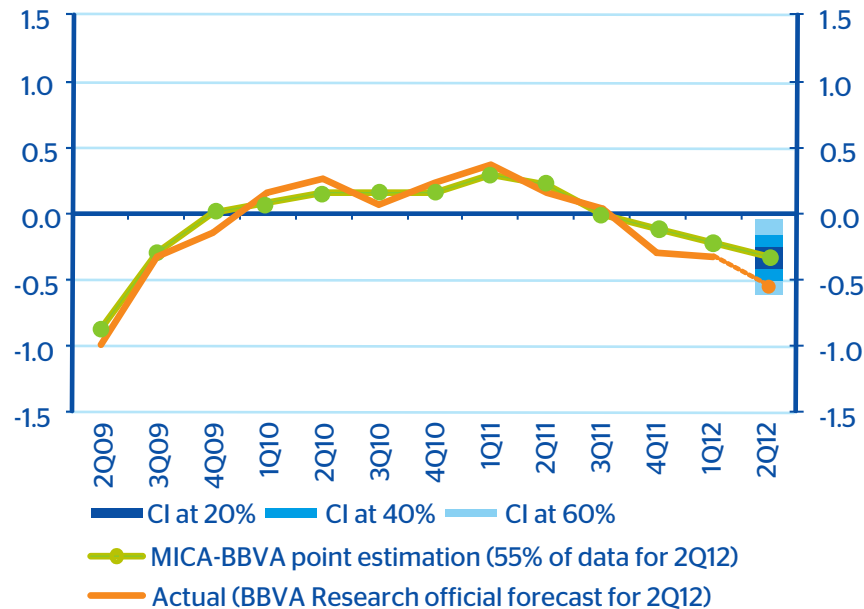


Section 2

1. Available data confirm the scenario

Spain: real GDP growth and forecasts based on MICA-BBVA model (% qoq)

Current forecast: 25 May
Source: BBVA Research



- The Spanish economy entered a technical recession in 1Q12...
- ...although the rate of slowdown did not worsen in comparison with 4Q11
- Published data indicate that 2Q12 growth is likely to have remained negative
- Employment continues to be hindered by the negative outlook for growth

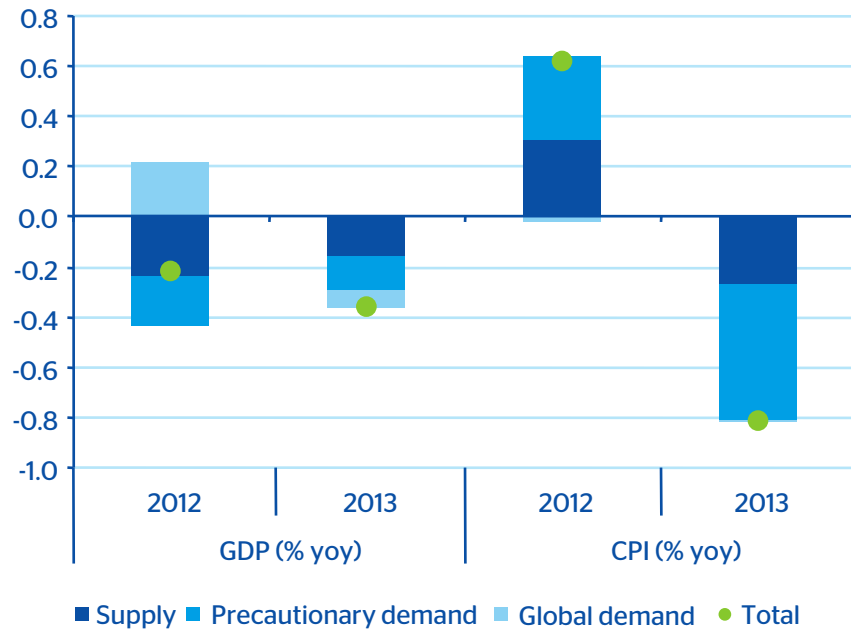
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2. Hike in oil prices

Spain: impact of recent oil price recovery on business activity and prices

(deviation from previous scenario)

Source: BBVA Research



Negative, but limited, impact

Rise in oil prices result of both supply-side and demand-side factors

Will have a temporary effect on long-term trends

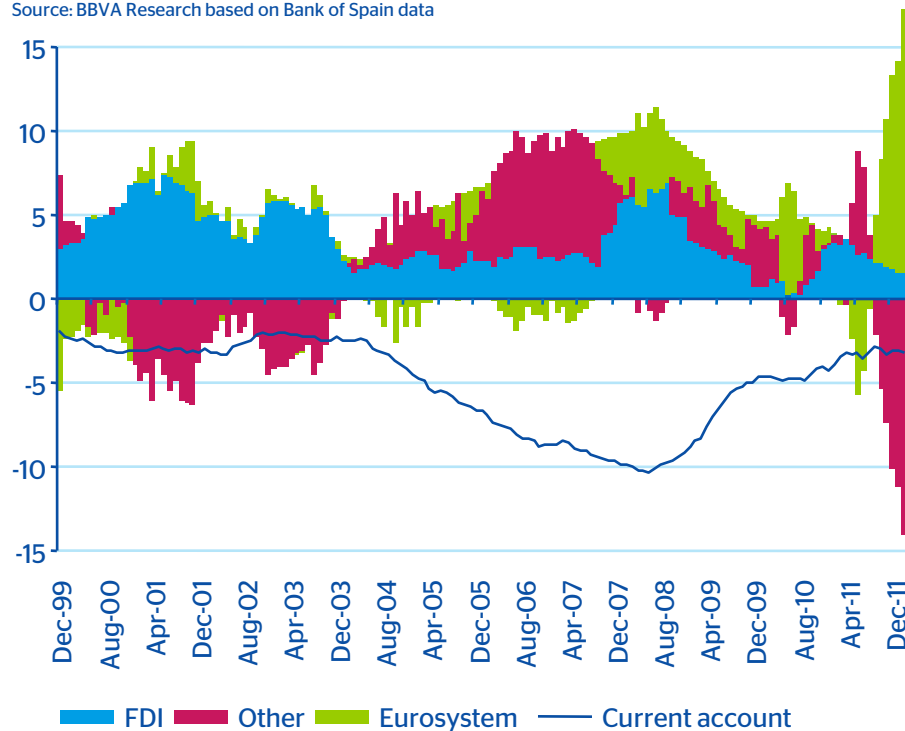
No contractive reaction expected in monetary policy

Section 2

3. Increased financial stress

Spain: balance of payments and capital flows

(Cumulative 12-month, % of GDP)
Source: BBVA Research based on Bank of Spain data



It is liquidity, not solvency

FDI and other capital flows entering the country were financing the current account deficit before the onset of the financial crisis

Starting in 2007, other capital inflows (bonds, loans, etc.) turned highly volatile...

... which makes the economy dependent on flows through the Eurosystem

In light of the lack of liquidity, the main risk lies in self-fulfilling expectations

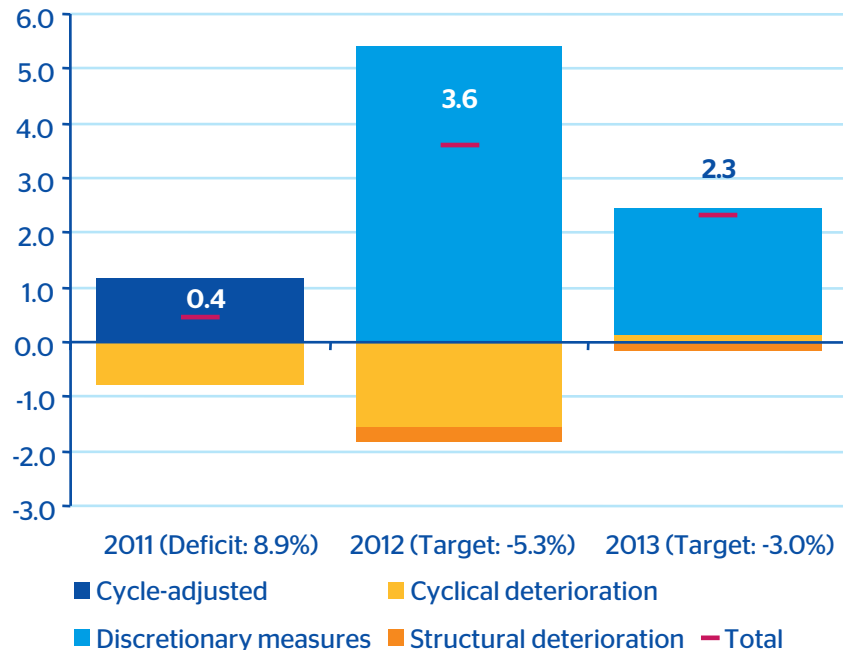
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4. Unprecedented fiscal adjustment due to the deviation in 2011

Spain: adjustment in Public Administration deficits

(% of GDP)

Source: BBVA Research



Fiscal adjustment measures equivalent to 5.1% of GDP are required in to reach the -5.3% target for 2012

The 2012-2015 Stability and Growth Programme contains measures that make meeting of the central government target perfectly feasible...

... with the focus very much on the Autonomous Communities

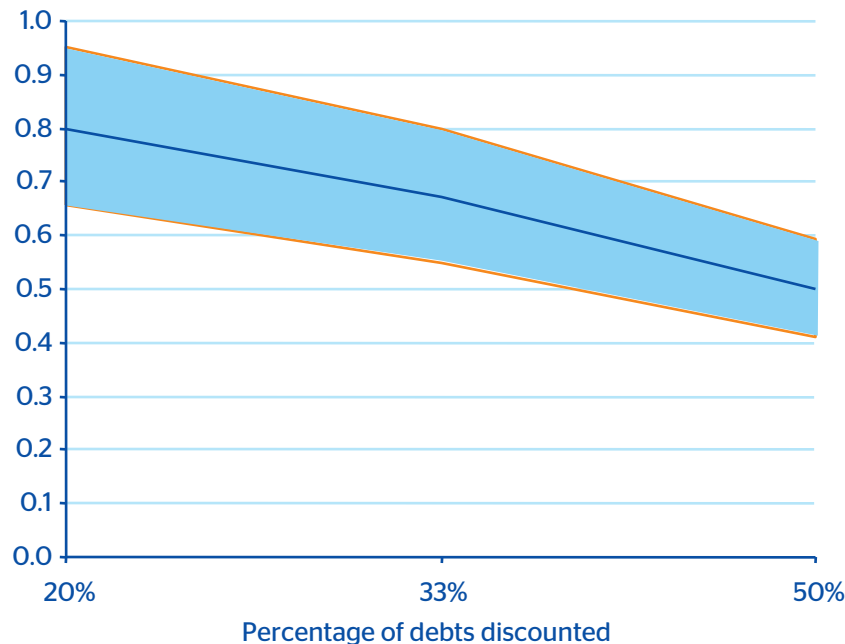
Additional manoeuvring room: as-yet-unspecified measures of the Autonomous Communities, or privatisations

Section 2

5. Supplier payment programme

The impact on 2012 GDP of the Government's programme to settle administrations' unpaid supplier invoices* (pp of GDP)

* Max and Min depend on agents' level of liquidity restriction
 Source: BBVA Research based on MINHAP data



Important liquidity injection

The Government is to inject the equivalent of 2.5% of GDP (€27bn) to pay off local and regional governments' debts with suppliers

The impact on growth could be significant, given that these companies are currently experiencing liquidity restrictions

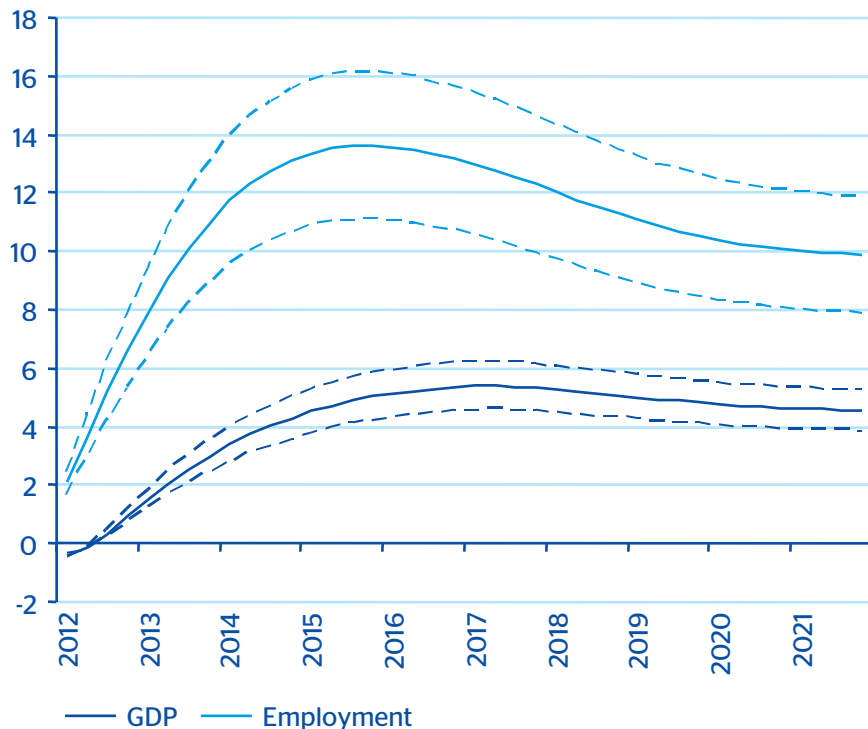
The final impact will depend to a large extent on current uncertainty

Section 2

6. Labour Reform

Spain: response to labour reform

(% deviation from trend)
Source: BBVA Research



The challenge: from adjustment to growth

Short-term objective: to prevent further job losses → change in working hours + labour flexibility and better-organised production

To stimulate growth where it is weak and to take advantage of it in more buoyant sectors

A redistribution of production drivers towards the more dynamic companies and sectors (export sector)

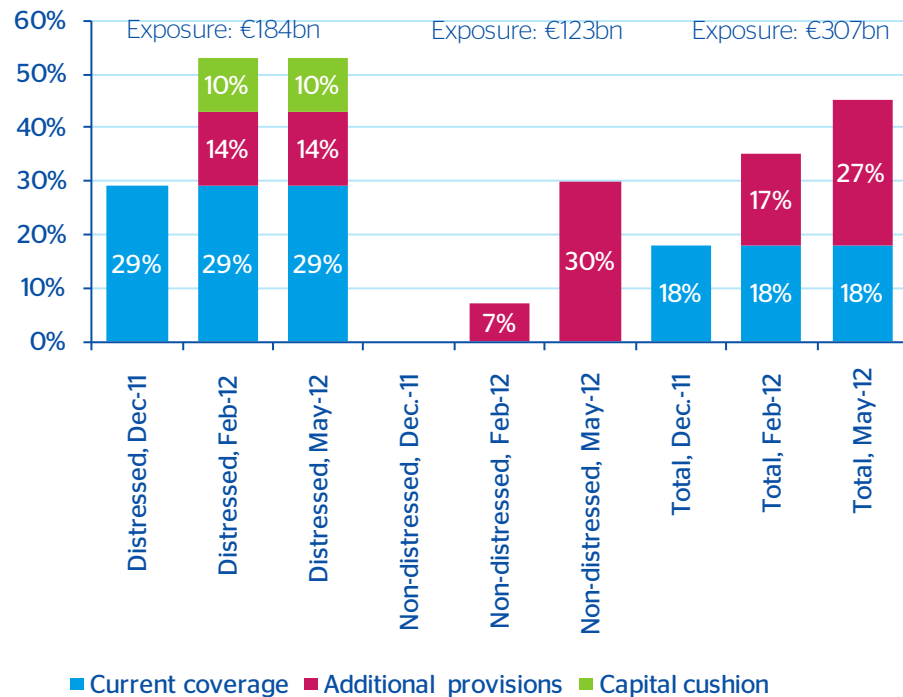
To eliminate barriers to internal growth via a more favourable regulatory framework

Section 2

6. Financial-System Reform

Real-estate assets: additional provisions and capital cushion

Source: BBVA Research based on MEC data



The new measures represent a step forward

- More realistic assumptions in real-estate valuations and larger writedowns
- The impact of the new requirements on shaping the sector will depend on how they are applied
- Taking prompt action in insolvent institutions and making the cost clear

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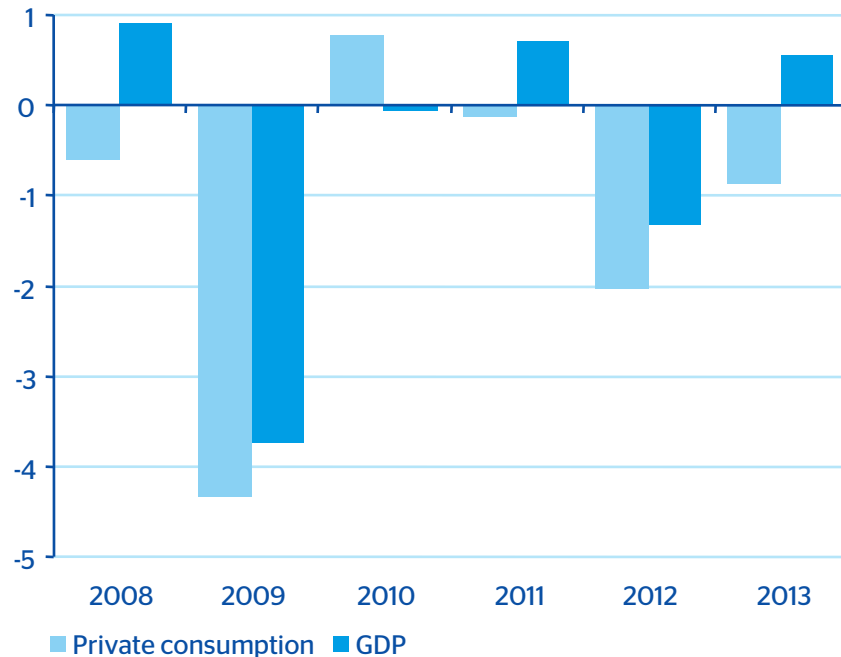
Demand for durable goods: is there any?

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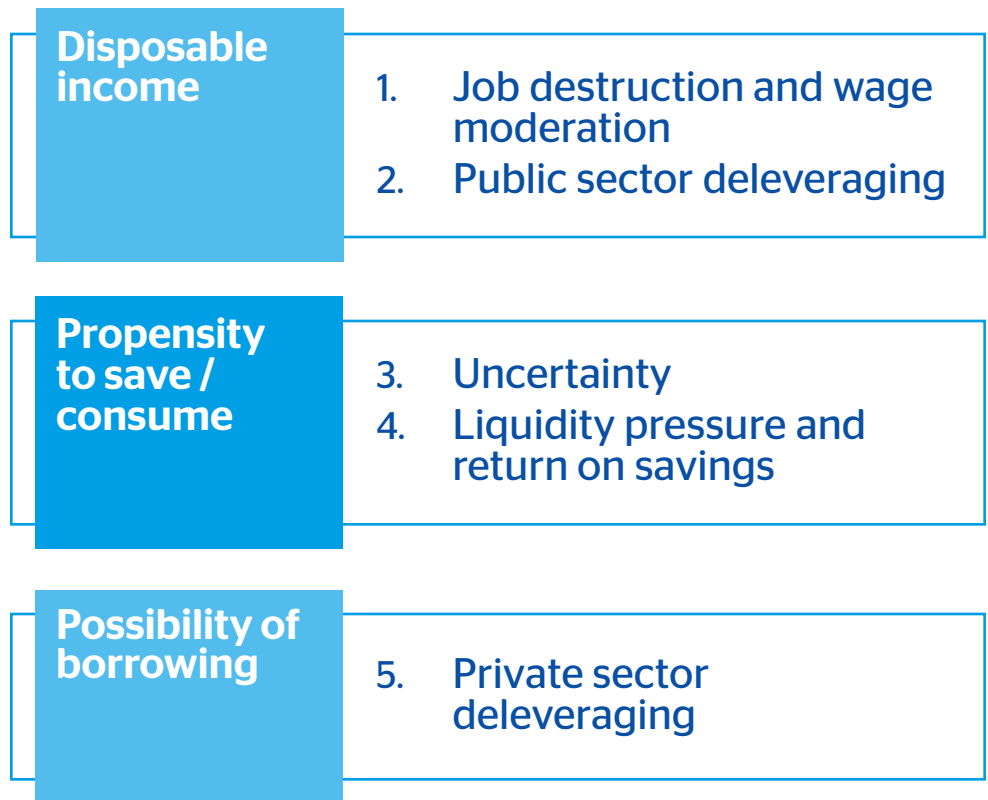
Household consumption

Spain: private consumption (%)

Source: BBVA Research based on INE data



Key drivers of consumption



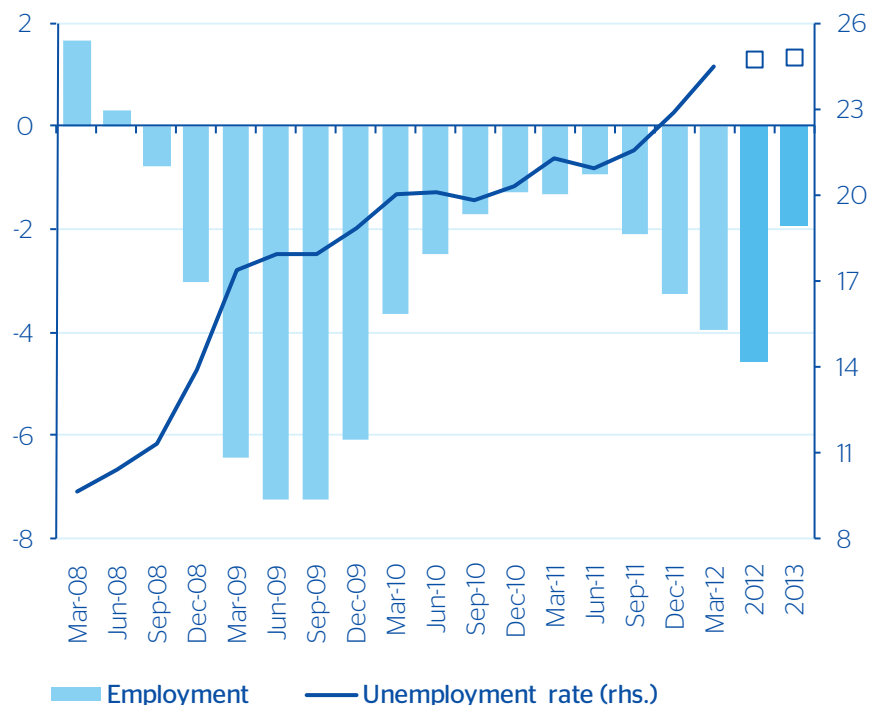
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Household consumption

1 Job destruction and wage moderation

Spain: employment and unemployment rates (%)

Source: BBVA Research based on INE data



The economic slowdown has caused greater job destruction

Labour-market reform might facilitate a rebalancing adjusting the extensive margin (employment) and the intensive margin (hours and wages) and reduce segmentation...

... but will not prevent the number of employed from continuing to decline in the short term

Section 3

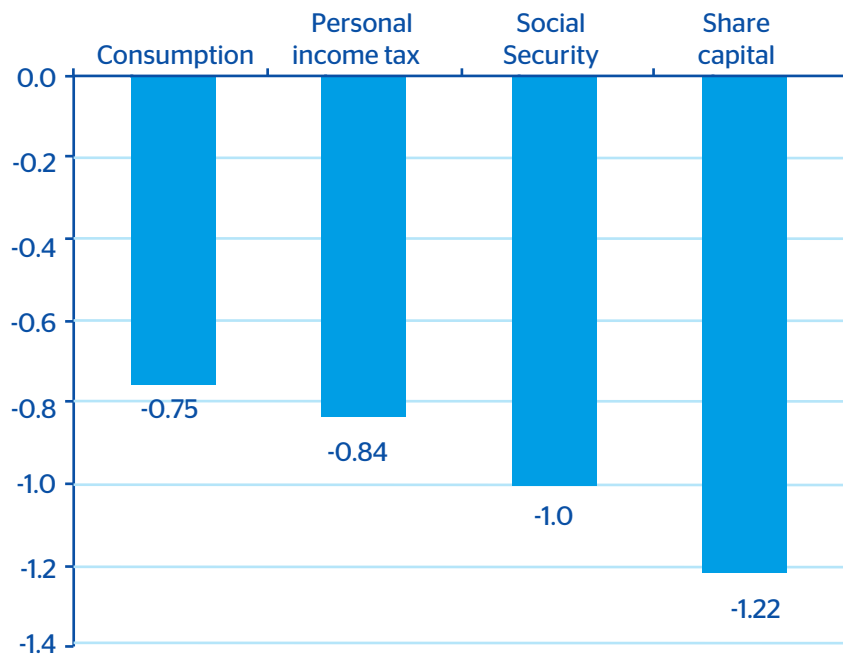
Household consumption

2 Public sector deleveraging

Spain: effect of higher tax rates on GDP

(Permanent increase, equivalent to 1% of GDP collected)

Source: BBVA Research. REMS simulations, effect after two years.

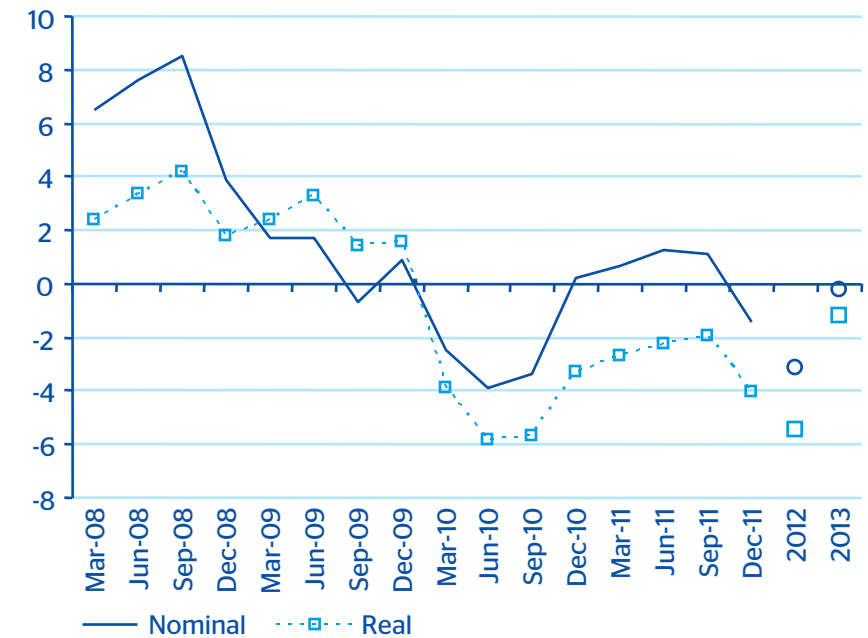


Deterioration of labour market + fiscal consolidation



Spain: gross disposable household income (%)

Source: BBVA Research based on INE data



Declining disposable income over the entire forecast period

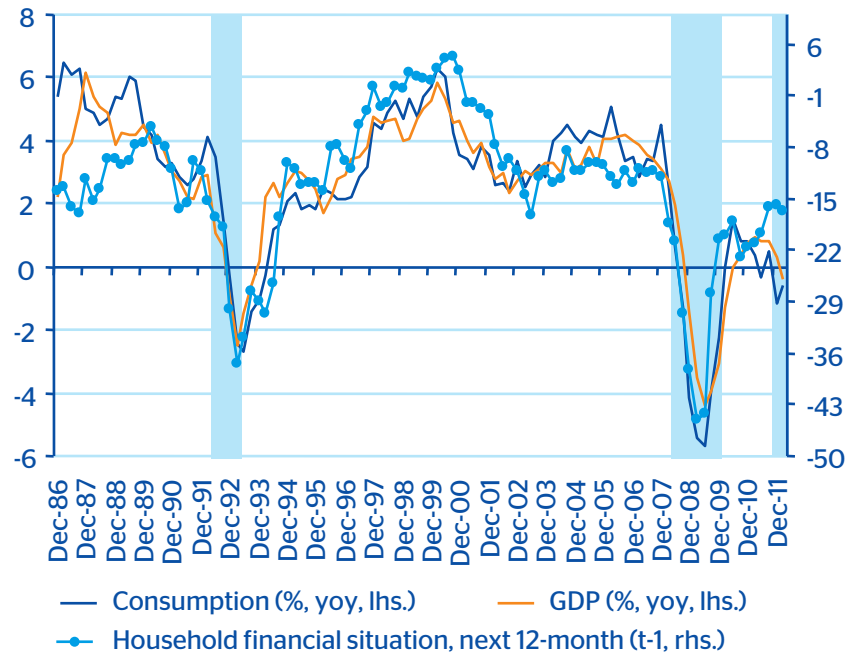
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Household consumption

3 Increased uncertainty

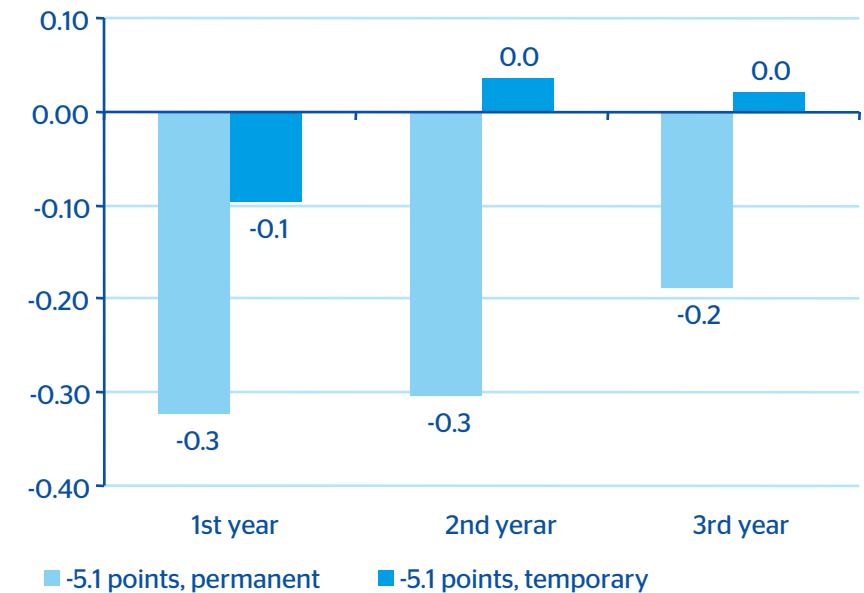
Spain: household consumption, GDP and confidence indicator (t-1) (%)

Source: BBVA Research based on INE and EC data



Spain: impact of decrease in confidence on growth in consumer spending* (%)

Source: BBVA Research based on INE data



*Confidence indicator used is households' perception of their future economic situation

Uncertainty is expected to remain high



Purchases are being postponed

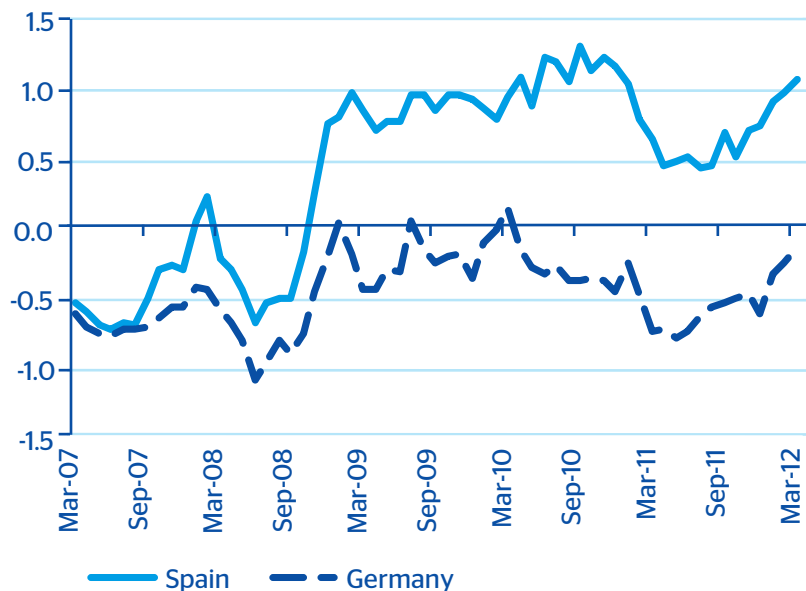
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Household consumption

4 Liquidity pressures and return on savings

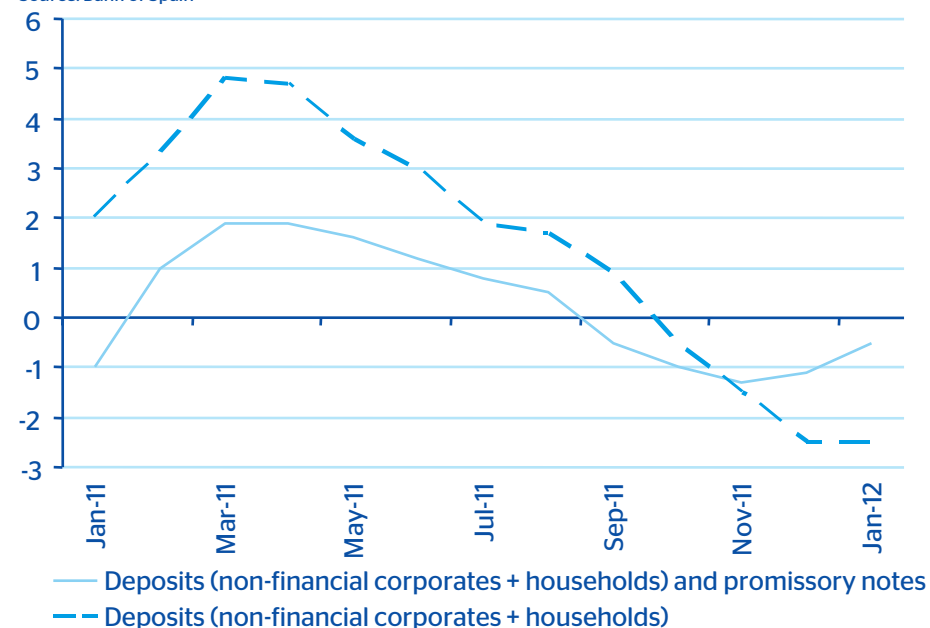
Spread between rates offered on term deposits and 12m Euribor (pp)

Source: BBVA Research based on INE and ECB data



Spain: promissory notes and deposits by non-financial corporates and households (% yoy)

Source: Bank of Spain



Liquidity pressures



Higher remuneration from private-party liabilities (first deposits and, later, promissory notes)



Encourages savings to the detriment of consumption

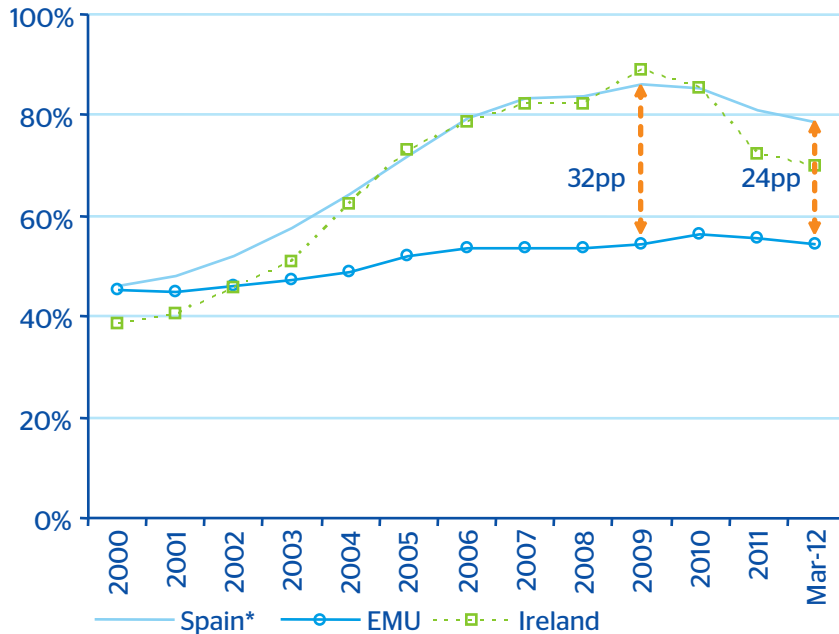
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5 Private sector deleveraging (I)

Household credit* (% GDP)

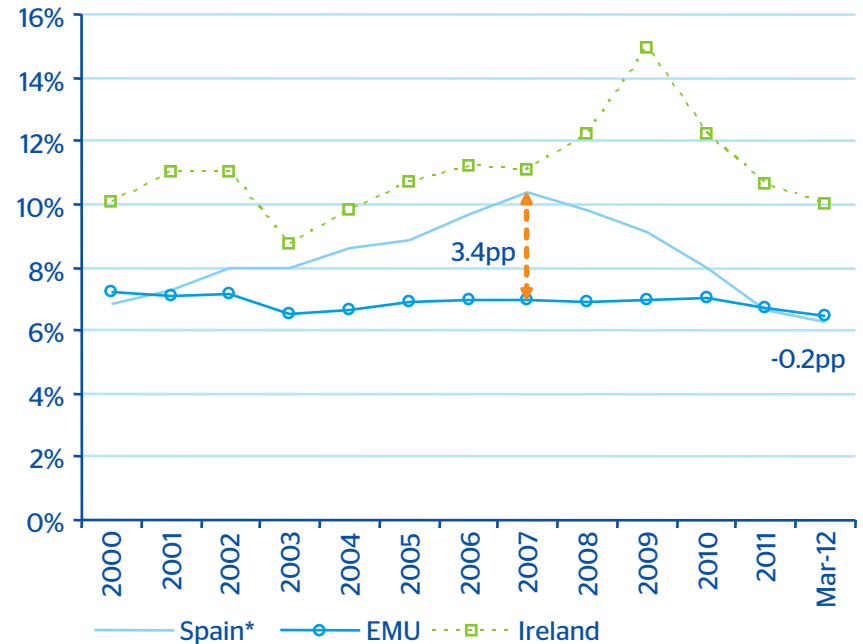
(* Consumer and other + housing, including securitisations)
Source: BBVA Research based on INE, Bank of Spain and European Commission data



Household credit: far from converging with the EMU (24 GDP points)

Consumer credit (% GDP)

(* Including securitisations)
Source: BBVA Research based on INE, Bank of Spain and European Commission data



Consumer credit: deleveraging well underway

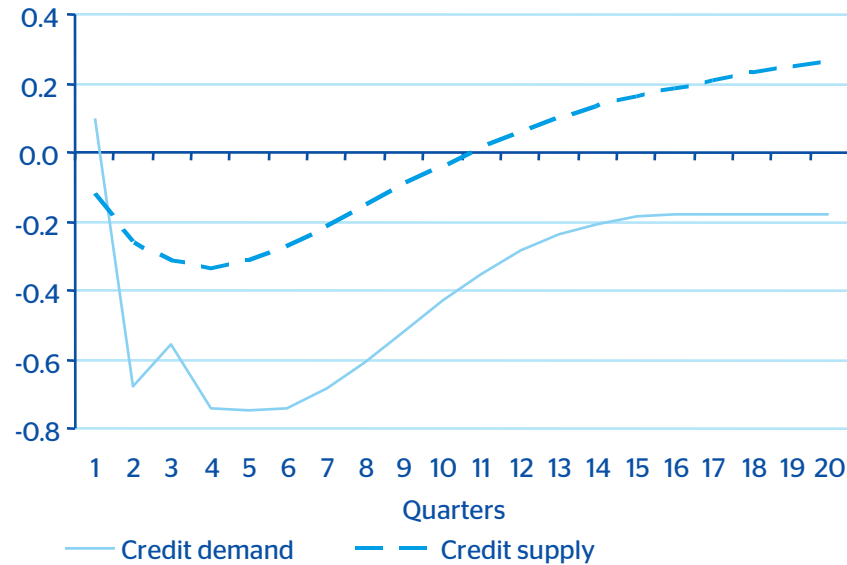
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5 Private sector deleveraging (II)

Spain: response of consumption to a negative stimulus from lending, by type of shock

(Deviation in annual growth from core scenario, pp)
 The stimulus has tapered off at 1 pp of credit in the first quarter of the year.
 Source: BBVA Research



The deleveraging process will be long

Will continue to have a considerable impact on consumption ...

... Deeper and longer-lasting if it results from lower demand for credit

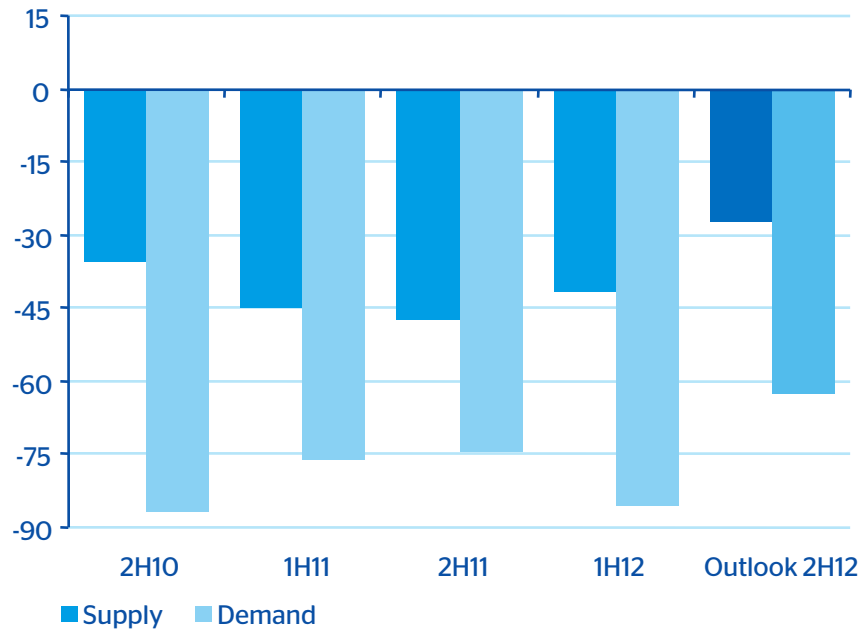
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Household consumption

5 Private sector deleveraging (III)

BBVA Business Trend Survey: perception of credit supply and demand

Balance of answers: (<0 indicates a worsening)
Source: BBVA Research



Results of BBVA BTS

Supply and demand for credit have fallen (more than expected) over the last quarter:

- Slack consumption and weak fundamentals have affected demand for credit, with a higher rate of contraction in 1H12

- Slight relaxation of lending conditions, although insufficient to avoid a contraction in supply

Outlook for 2H12: somewhat more favourable from the standpoint of supply of than demand for credit

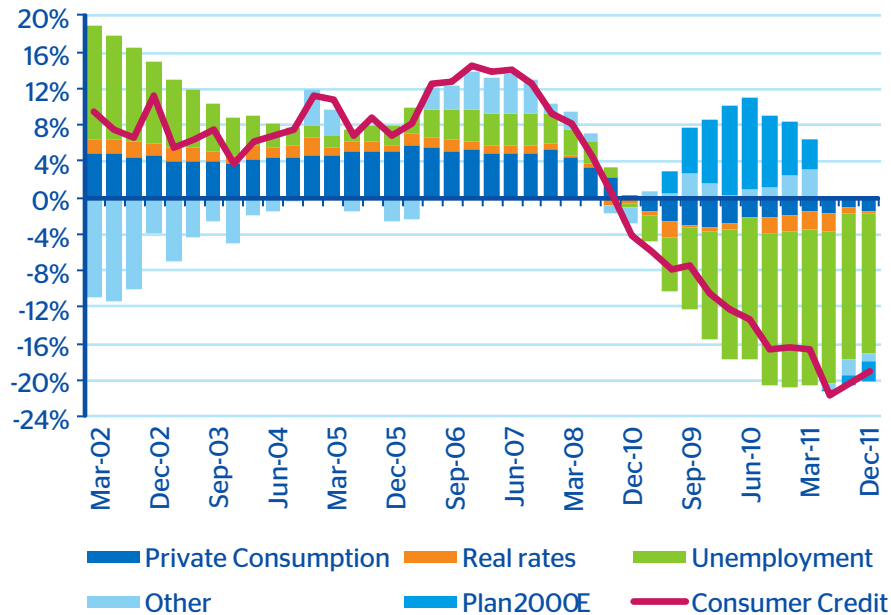
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Household consumption

5 Private sector deleveraging (IV)

Spain: contributions to yoy growth in consumer credit (%)

(%)
Source: BBVA Research



What are the reasons for the slowdown in demand?

∇ 1% in consumer spending → ∇ 1.4% in demand for consumer credit in the long term (*ceteris paribus*)

+100bp in interest rates on loans → ∇ 3.6% in demand for consumer credit

+1pp in unemployment rates → ∇ 4.6% in demand for consumer credit



Worsening expectations of households - reflected in rising unemployment rate- account for about 80% of the decline in consumer credit during the current crisis

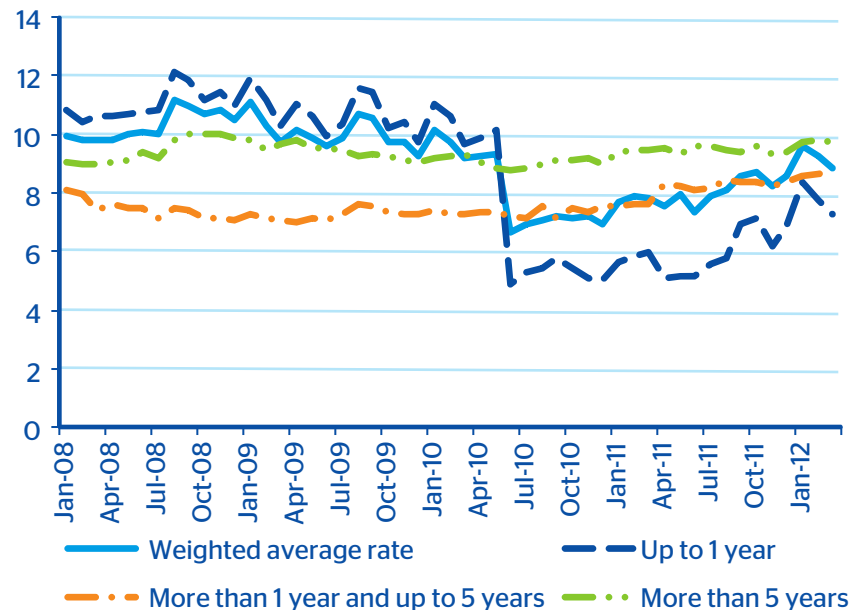
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5 Private sector deleveraging (V)

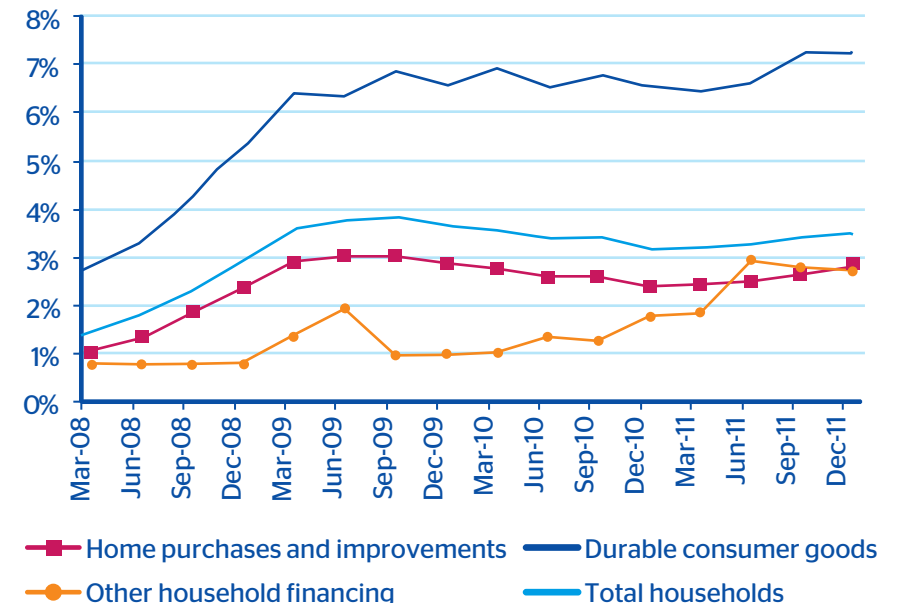
Spain: interest rates on new consumer loans (%)

Through May 10, one-year interest rate and the weighted average rate include credit card transactions
Source: BBVA Research based on Bank of Spain data



Spain: household default rate (%)

Source: BBVA Research based on Bank of Spain data



Lingering financial pressures + expectation of weak demand + continued high default rates do not point to a recovery in consumer credit in the short term

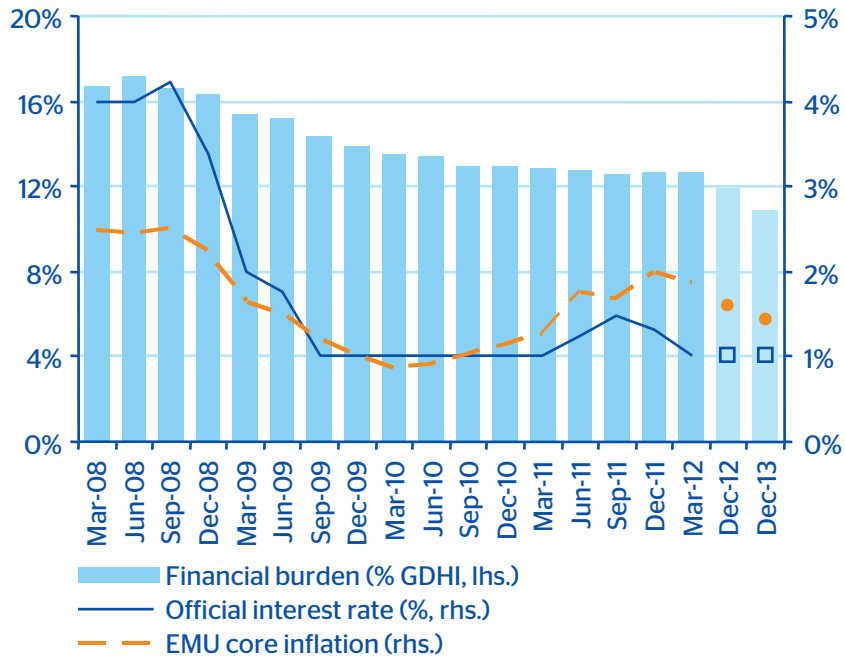
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5 Private sector deleveraging (VI)

Spain: financial burden of households, official rates and core inflation (%)

Source: BBVA Research based on INE, ECB and Eurostat data



Fragile economic situation + lack of demand-side inflation pressures will keep interest rates at historical lows ...

... reducing the financial burden of households and making resources available for consumption

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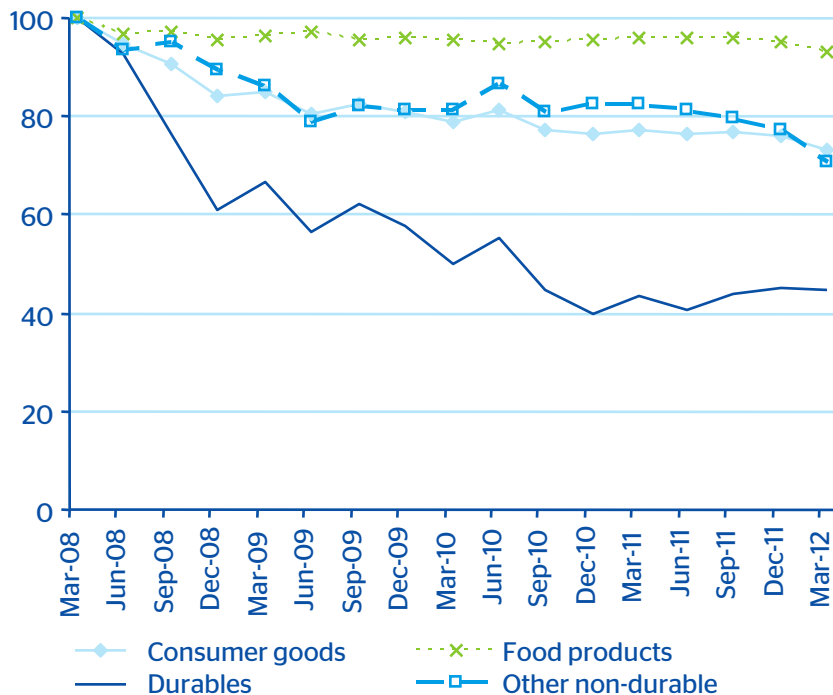
Demand for durable goods: is there any?

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Demand for durable goods

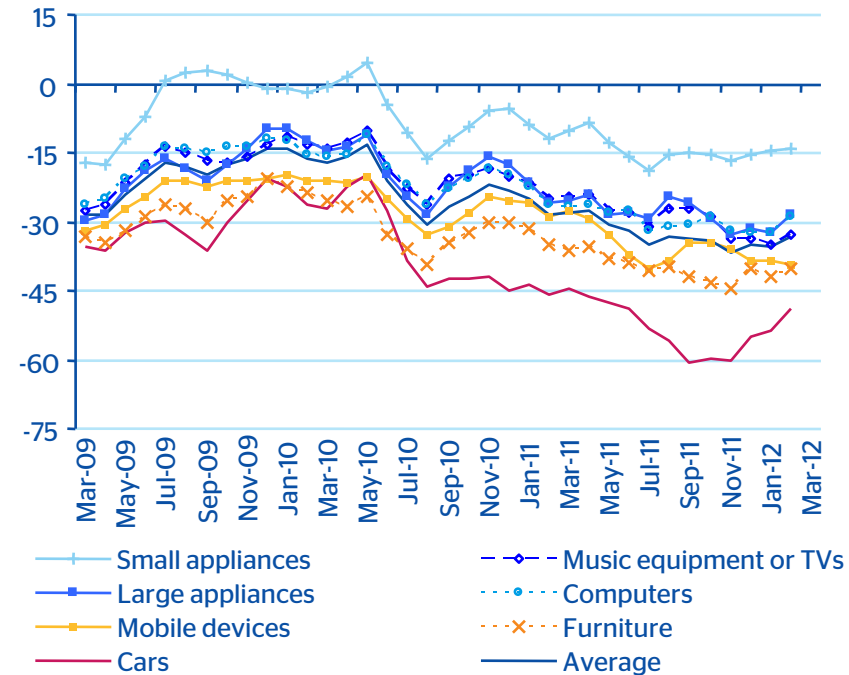
Spain: consumer goods availability

(SWDA data, quarterly averages, Jan-08 = 100)
Source: BBVA Research based on MEC data



Spain: perception of purchase timing

(Difference of percentages between positive and negative responses, MM3)
Source: BBVA Research, based on Millward Brown data



Domestic demand for durables remains weak ... Did it hit bottom in 2011?

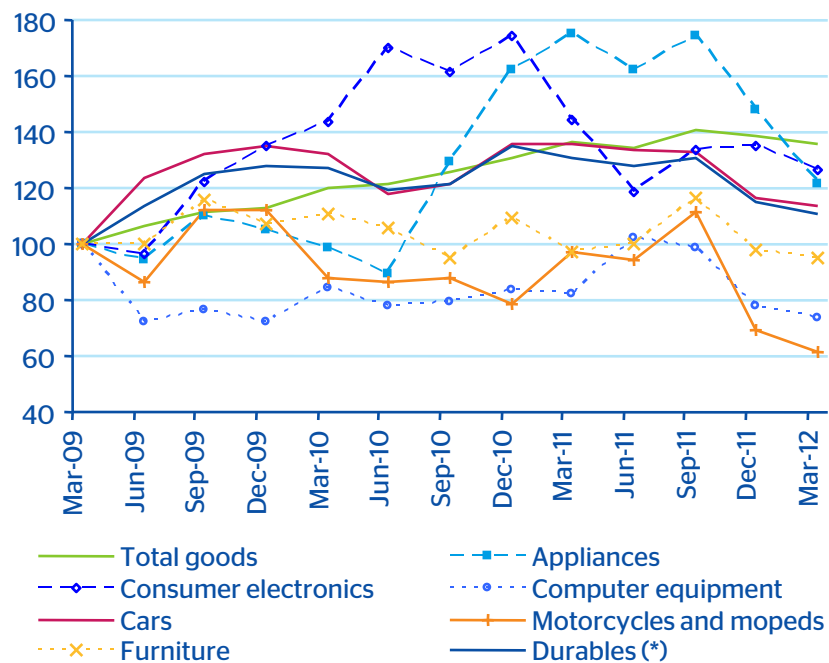
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Demand for durable goods

Spain: real exports of goods

(SWDA data; 1Q09 = 100)

Source: BBVA Research based on MEC data



Unlike in 1H11, foreign demand for durable goods has not offset sluggish domestic demand in 4Q11 and 1Q12

Consumer electronics, furniture and automobiles: better relative performance

Two-wheeled vehicles and electrical appliances: higher-than-average decline

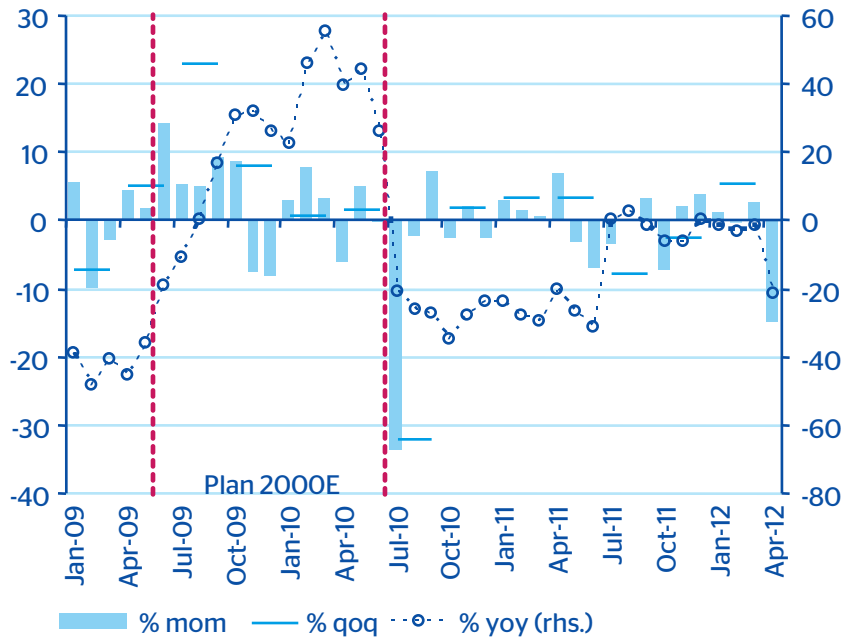
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Demand for durable goods

a Cars: changing composition of sales by channel ...

Spain: car registrations

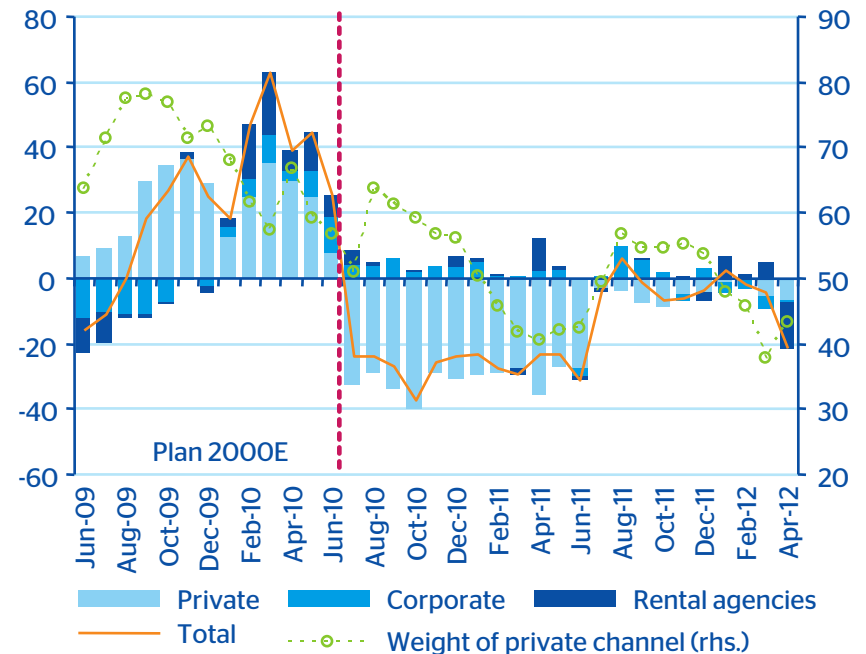
(SWDA data)
Source: BBVA Research based on ANFAC and Ganvam data



NCs rose in 1Q12 (+5.5% qoq SWDA) against a backdrop of falling prices ...
... but then plummeted again in April: -14.7% mom

Spain: car registrations by sales channel

(contribution to % yoy)
Source: BBVA Research based on ANFAC and Ganvam data



Rental companies are primarily responsible for recent fluctuations in sales (fleet renewals)

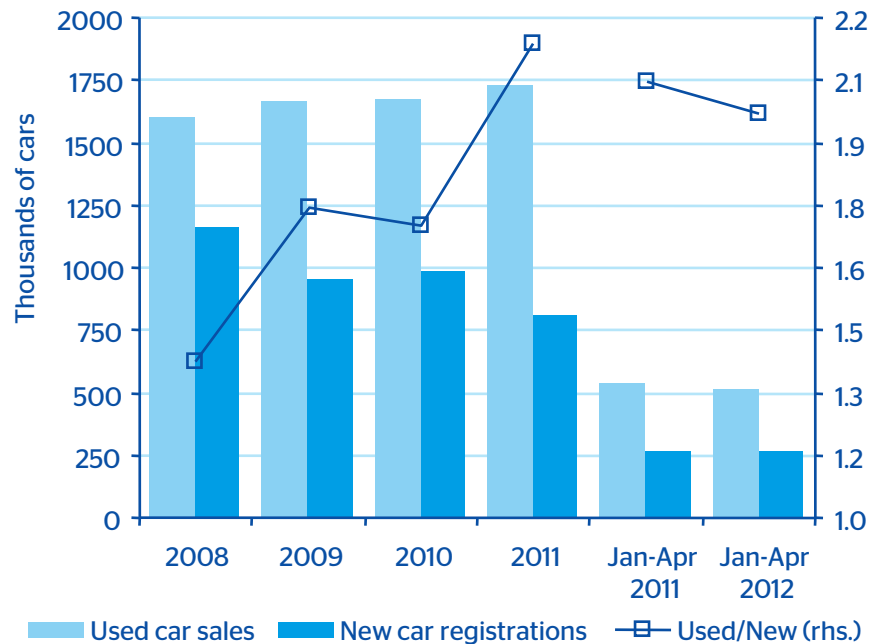
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Demand for durable goods

a Cars: ... and by tpe

Spain: Used vs. new cars

Source: BBVA Research based on ANFAC, IEA and Ganvam data



Demand for used vehicles continued to rise: 3.4% en 2011 (57.7% between private parties)

Slight correction in 1C12: -3.7% yoy

↓

used/new = 2.1 in 2011 (2.0 in 1C12) ...

... In line with Germany (1.8), Italy (2.1) or France (2.3)

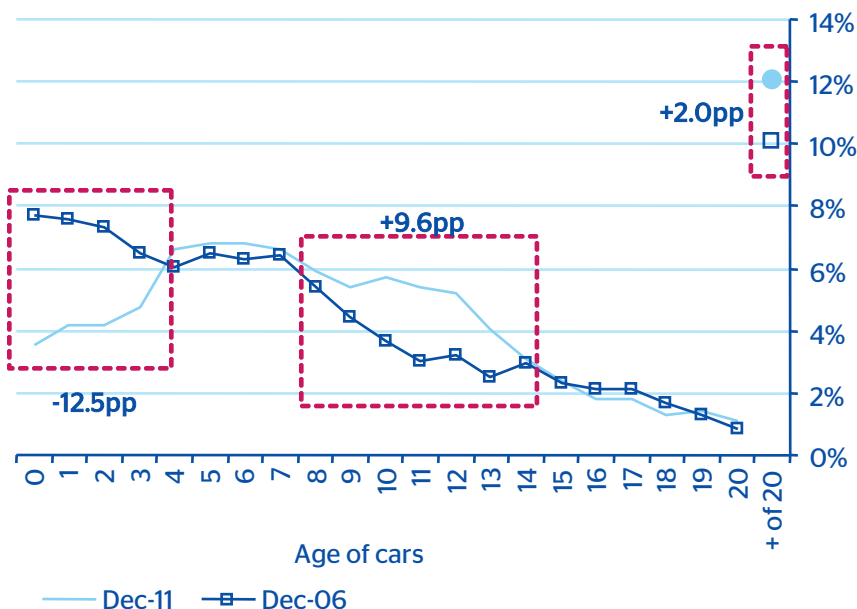
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a Cars: an ageing fleet... along with the rest of Europe

Spain: breakdown of all cars by age (% of total)

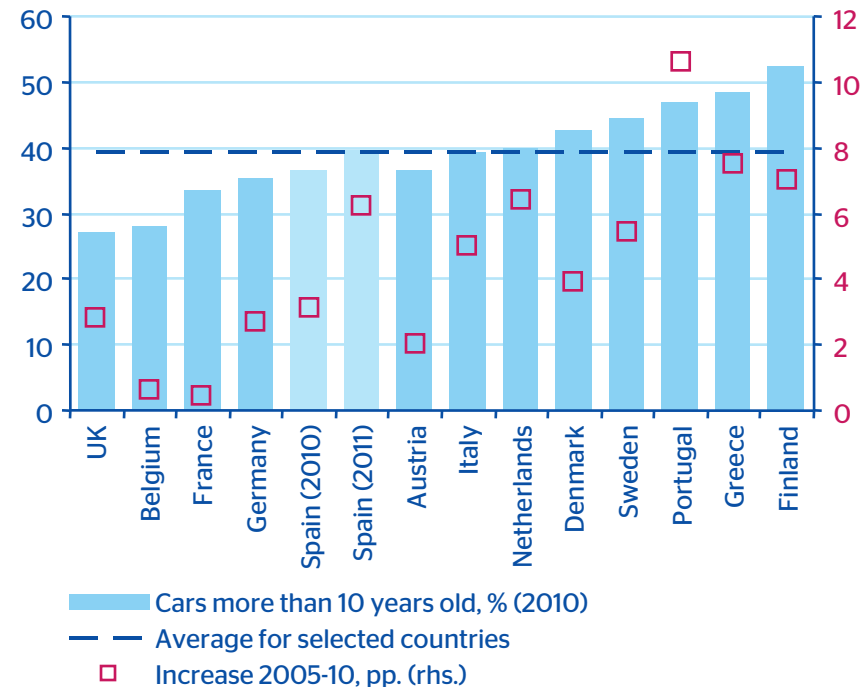
Source: BBVA Research, using DGT data



The breakdown of cars has shifted to the right

Cars more than 10 years old (% of total)

Source: BBVA Research based on ANFAC, IEA, ACEA and OICA



Convergence with Europe against this backdrop of overall ageing of the vehicle fleet

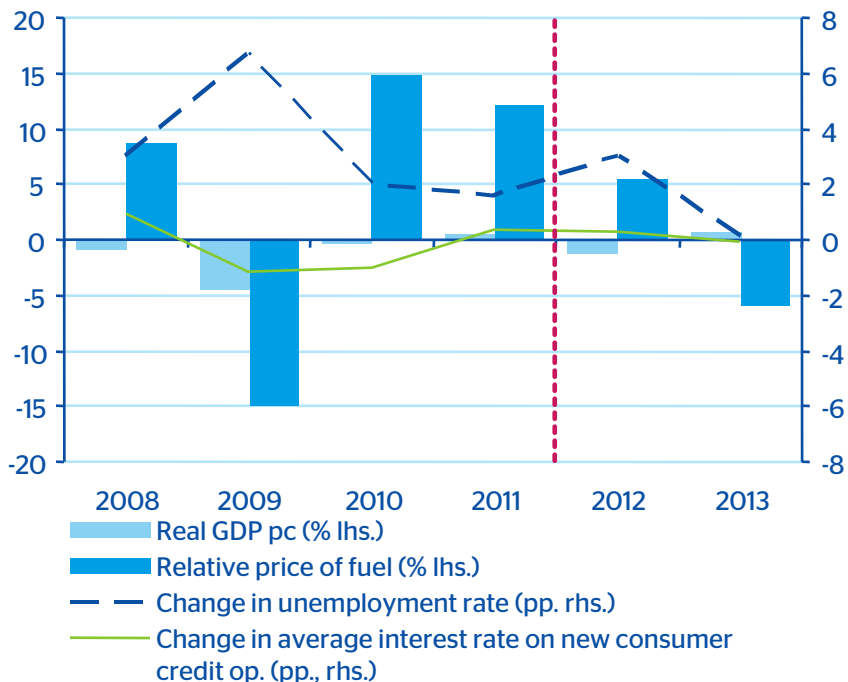
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a Cars: outlook

Spain: forecasts for drivers of car registrations

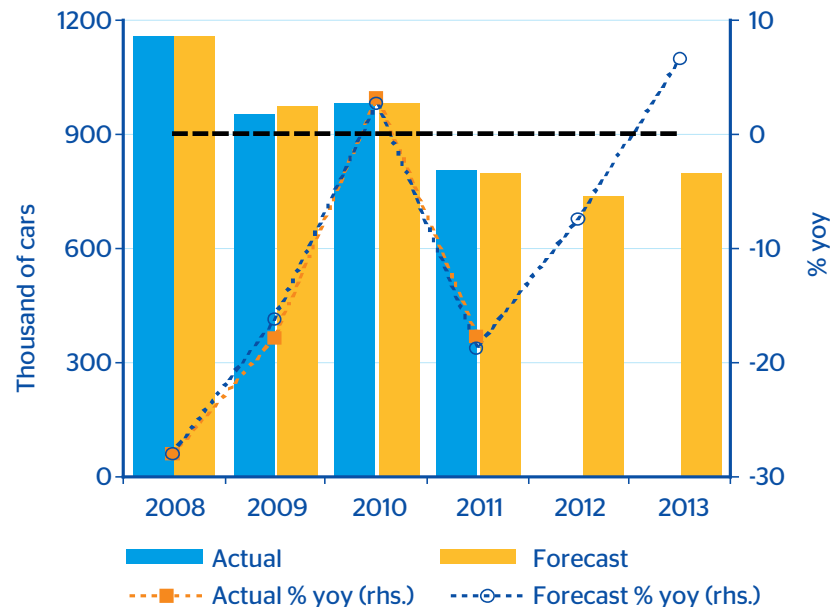
Source: BBVA Research based on INE, MEC and Bank of Spain data



Spain: car registrations

(Annual total and % change)

Source: BBVA Research and ANFAC



Drivers of car registrations: complex scenario



Some 750 thousand cars in 2012 and 800 thousand in 2013

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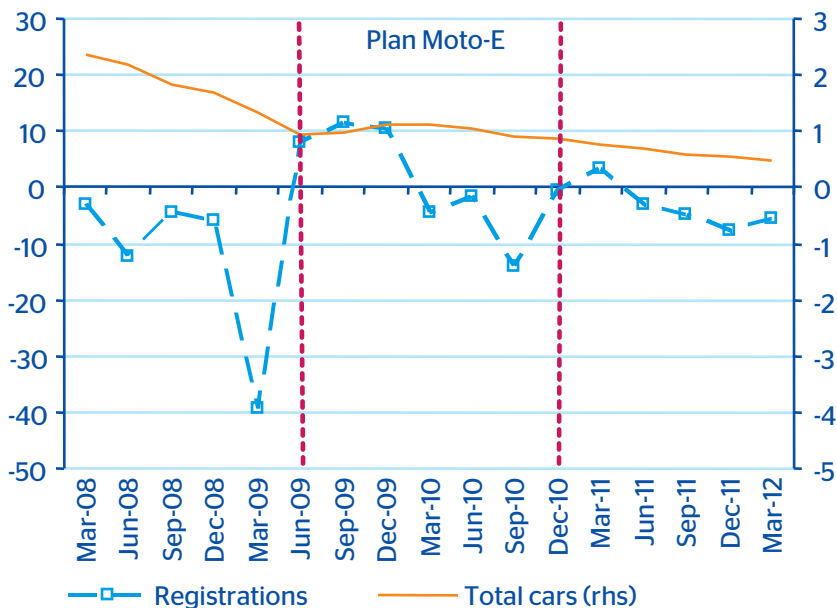
Demand for durable goods

b Two-wheeled vehicles: going downhill

Spain: registrations of mopeds and motorcycles

(SWDA data, % qoq)

Source: BBVA Research based on Anesdor and Bank of Spain data



What are the reason for lower demand?

Deterioration of drivers (disposable income, unemployment—especially among young people—and risk aversion)

Regulatory changes: increase in the licence age for mopeds to 15 and the transposition of Directive 2006/126/CE almost four years ahead of European requirements



In 2012 some 100 thousand mopeds might be registered (125 thousand in 2011)

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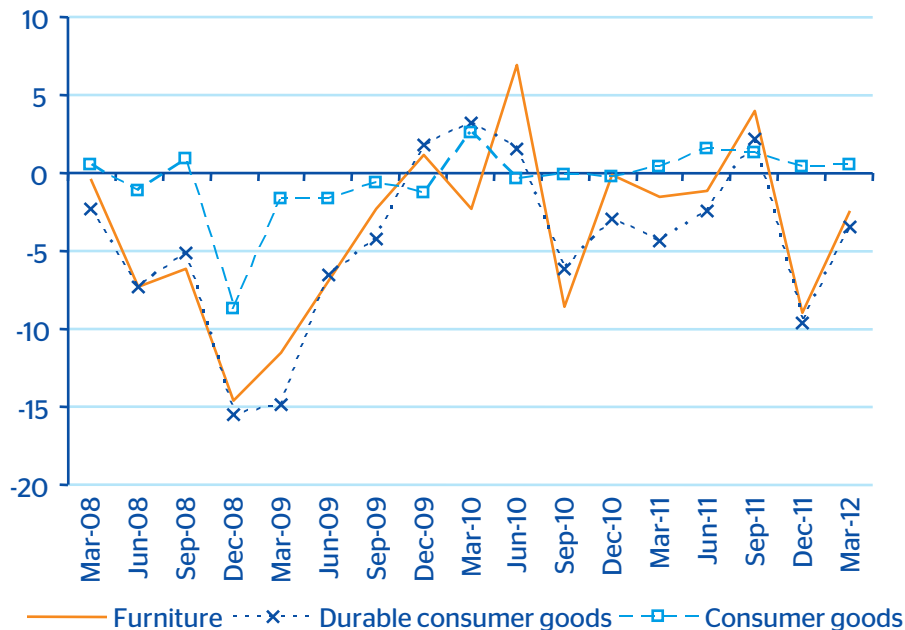
Demand for durable goods

c Furniture: drop in line with the average decline for durables

Spain: furniture sector turnover

(SWDA data, % qoq)

Source: BBVA Research based on INE data



Two underlying reasons:

Downside exports: -18.6% SWDA between 4Q11 and 1Q12

Perennial deterioration in investment in housing: -10.1% SWDA between 4Q11 and 1Q12

BBVA Research estimates:

- ∇ of 1% qoq in nominal furniture exports → ∇ approx. 0.7% qoq in turnover
- ∇ of 1% qoq in nominal investment in housing → ∇ decline in turnover 0.6% qoq, cumulative

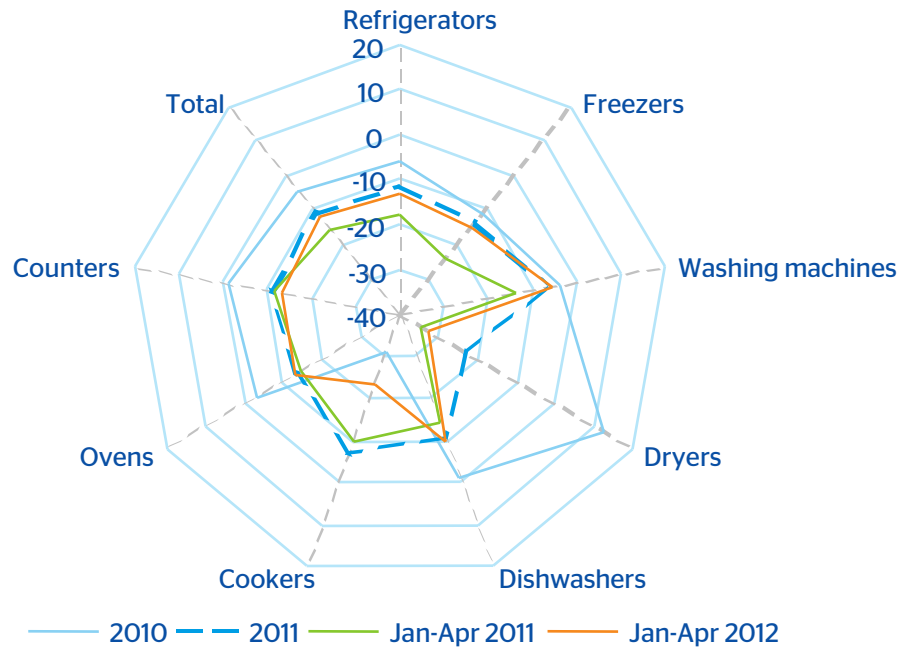
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Demand for durable goods

d Major household appliances: falling consumption, rising post-sale

Spain: sales of appliances by product family

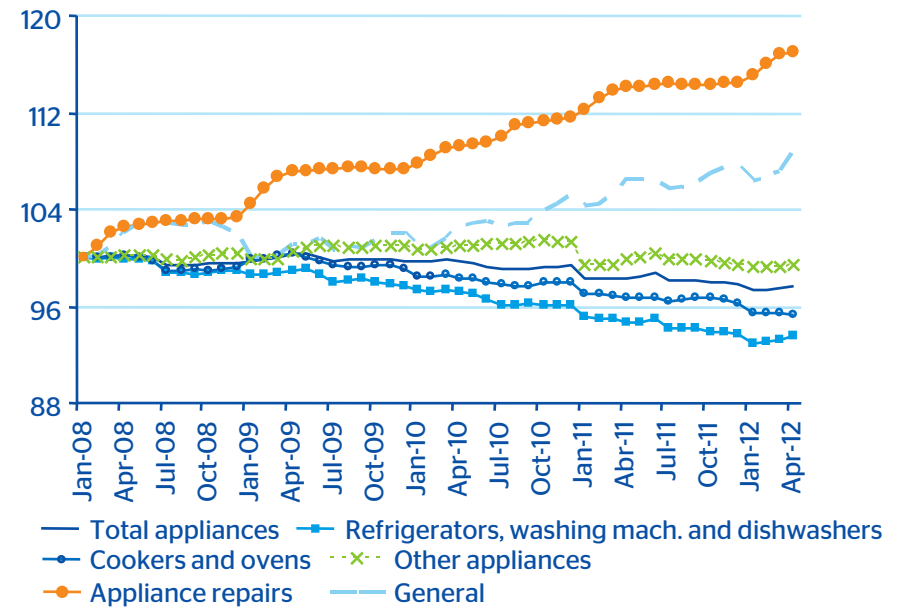
(% yoy of units)
Source: BBVA Research based on ANFEL data



Jan-Apr 2012: -12.0% yoy; turnover: -14.9% yoy
Washing machines and dishwashers: smaller relative decline

Spain: consumer prices for household appliances

(Jan-08 = 100)
Source: BBVA Research based on INE data



Generalised fall in prices, except for repair services (+17.0% since Jan-08)

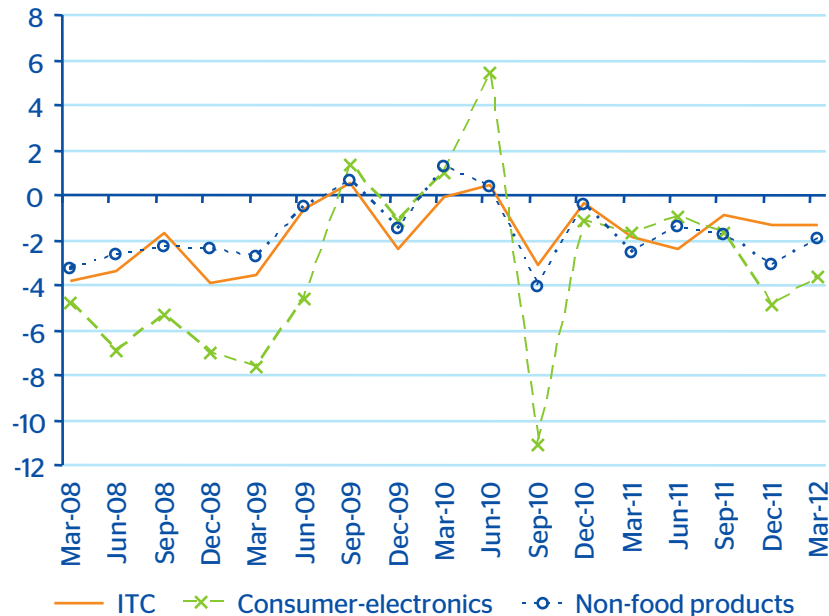
Section 4

Demand for durable goods

e Brown line products: a promising half year following a year to forget

Spain: real retail sales of brown line items

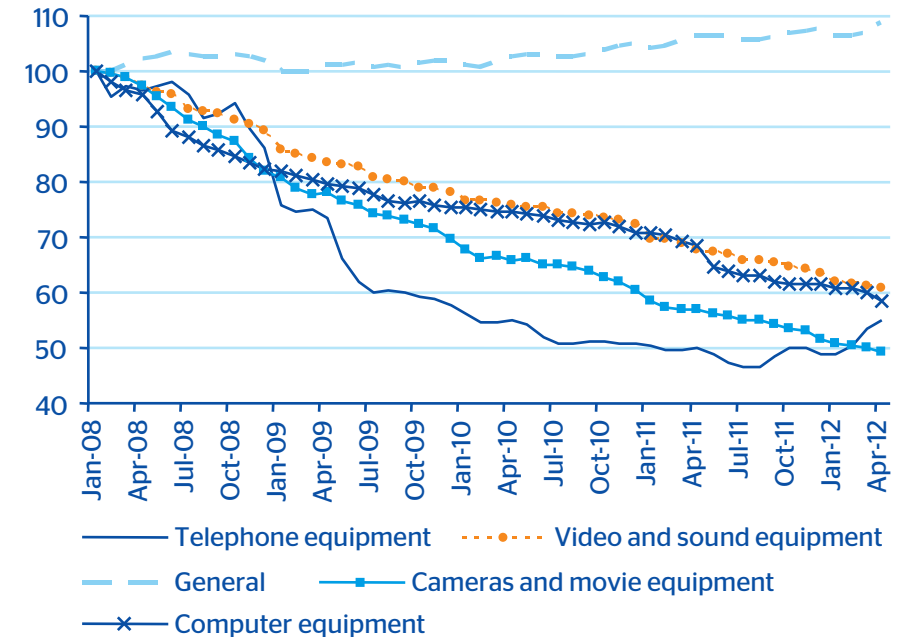
(SWDA data, % qoq)
Source: BBVA Research based on Eurostat data



4Q11 + 1Q12: consumer electronics -8.5% SWDA;
ITC -5.1% SWDA
Eurocup and Olympics: will increase sales in 2Q
and 3Q

Spain: consumer prices for brown line items

(Jan-08=100)
Source: BBVA Research based on INE data



Persistent deflation (except in telephony)
contributes to raise penetration rate

Key themes

- 1 Europe decoupling** from the global economy growth **while the region continues to await a long-term plan** to boost economic activity and allow sovereign risk to be spread in exchange for structural reform and better coordination
- 2 Spain's GDP is still expected to contract** in 2012 (by 1.3%), before gradually recovering in 2013. However, **this outlook now appears less certain**
- 3** Building up confidence now depends on the design, execution, and communication of a **credible set of reforms**
- 4** Weaker drivers point to **declining consumption** in 2012 and the first half of 2013, especially for durable goods
- 5** Lingering financial stress and high default levels, and, in particular, the expectation of weak demand **do not point to an increase in consumer credit** in the short term
- 6 Worsening expectations** by households account for 80% of the fall in **demand for consumer credit** in the current crisis

Consumption Outlook

Madrid, 29 May 2012

Appendix Appendix 1

Spain: restructuring processes in major appliances and brown products sectors (2009-12)

* D: distributing company; M: manufacturing company

Shaded cells: changes since publication of last Economic Outlook. Consumption

Source: BBVA Research based on Alimarket and European Monitoring Centre on Change data

Company	Type of company*	Type of restructuring
PC City	D	(-) Store closure and workforce reduction
Darty	D	(-) Store closure
Miró	D	(-) Store closure and workforce reduction
Unecsa	D	(-) Voluntary bankruptcy
Urende	D	(-) Store closure and workforce reduction
Urende	D	(-) Approval of closing of stores and workforce reduction
Unecsa	D	(-) Closing of stores
Fibertel	D	(-) Voluntary bankruptcy
Media Markt	D	(+) Opening of stores
Ecomputer	D	(+) Opening of stores
Worten	D	(+) Opening of stores (+ partial absorption PC City)
Fnac	D	(+) Opening of stores
Fnac	D	(+) Opening of stores
Worten	D	(+) Opening of stores
Apple	D	(+) Opening of stores
Electro merkat	D	(+) Opening of stores
Tristar Spain	D	
Topcom Iberia	D	(+) Merger

Company	Type of company*	Type of restructuring
Infinity System	F,D	(-) Temporary workforce reduction
Sanyo	F	(-) Plant closure
Electronic Devices Manufacturer	F	(-) Liquidation
Engel Axil	F	(-) Voluntary bankruptcy
BSH	F	(-) Workforce reduction
Sharp	F	(-) Temporary workforce reduction
Daewoo	F	(-) Workforce reduction following extinction of company
Daewoo	F	(-) Sale of plant
Di4	F	(-) Voluntary bankruptcy
Rimax innovation	F,D	(-) Liquidation
NPG	F	(+) Expansion
Conceptronic	F	
Digital Data Communications	F	(+) Merger