

Consumption Outlook

Spain

First Half 2012
Economic Analysis

- **Growth in Spain and Europe is lagging** behind that of the global economy.
 - **Weak fundamentals mean that consumption**, especially of durable goods, is expected to decline.
 - **Because of lingering financial stress, high default rates, and, in particular, the expectation of weak demand**, consumer credit is not likely to rise in the short term.
 - **Worsening household expectations** accounts for most of the fall in demand for consumer credit during the current crisis.
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Index

1. Summary.....	3
2. Growth outlook for the Spanish economy.....	5
3. Durable goods.....	10
4. Consumer finance.....	19
Box 1. Effects of deleveraging on household consumption.....	21
Box 2. Drivers of demand for consumer credit.....	24
5. Analysis of the economic situation of retail trade based on BBVA's Business Tendency Survey: effects of the new consumer credit contract law.....	26

Closing date: 25 de May 2012

1. Summary

The outlook for global growth has changed little in recent months, but the intensification of the European crisis means that risk is tilted to the downside. Consequently, emerging countries can be expected to regain their positive growth differentials vis-à-vis developed countries, and should account for 80% of global growth in 2012 (3.6%) and 2013 (4.0%). The upturn in Japan and the moderate growth in the United States stand in contrast with sluggish demand in the European Monetary Union. In the latter, progress in dealing with the issue of the sustainability of Greek debt, in building a credible firewall around countries that are solvent but beset by liquidity problems and in strengthening fiscal unity have not been sufficiently decisive or continue to be mired down because of uncertainties on how to execute the needed measures. Because of the complacency of European governments and questions on the effectiveness of the steps taken, the positive effect of the injection of liquidity by the European Central Bank (ECB) on risk premiums wore off in the first few months of 2012.

Against this backdrop of uneven growth, uncertainty and a worsening economic situation in Europe, the Spanish economy went into recession, contracting 0.3% in the fourth quarter of 2011 and the first quarter of 2012. Despite the continued decline in employment, household consumption was flat between January and March of this year after shrinking in 4Q11 (-1.0% qoq). The less unfavourable performance of disposable income (resulting from the positive trend in the wage component) and the likely fall in savings offset the deterioration of the non-wage component (resulting, inter alia, from higher fiscal pressure) and of the remaining drivers of consumption, mainly, financial wealth.

Demand for durable goods continued to fall in 1Q12, but at a slightly slower pace than in 4Q11, contributing to a slowdown in the deterioration of consumption at the beginning of the year. In particular, seasonally and working day adjusted data (SWDA) show that the number of car registrations increased by 5.5% qoq from January to March of this year after falling in the second half of 2011. Rent-a-car company fleet renewals account for the recent spike in registrations, given that private channel sales remain weak. Indeed, the end of Easter Week caused registrations by car-hire companies to plummet in April, contributing, along with stubbornly weak demand from private parties and companies, to a 14.7% mom decline (SWDA) in sales last month. BBVA Research's forecasts point to a quarterly decline of nearly 9.5% (SWDA) between April and June, and thus estimate about 750,000 car registrations for all of 2012.

One of the consequences of lower car purchases is the ageing of the vehicle fleet during the current recession. Available data indicate that the percentage of cars less than 5 years old fell from 29.1% in 2006 to 16.6% at the end of 2011. By contrast, the share of automobiles between 8 and 14 years old rose by 10 points and that of cars more than 20 years old by 2 points. Because of these changes, the age of the Spanish fleet has converged with the average age of automobiles in neighbouring economies. Likewise, higher demand for used vehicles (UV) meant that sales of second-hand cars was twice that of new cars, bringing the used vehicle/new vehicle ratio into line with that found in Germany (1.8), Italy (2.1) or France (2.3).

Motorcycle and moped purchases continued to fall in the fourth quarter of 2011 and the first quarter of 2012. The reasons for sluggish demand for two-wheeled vehicles have to do with the weakness of the factors that determine this demand –mainly disposable income of potential buyers as a result of the worsening job market for young people– and increased risk aversion, which translates into delays in purchasing decisions and a reduction in current consumption of durable goods. In addition, changes to the Drivers' Regulations –in particular, the raising of the licence age for mopeds to 15 and the uncertainty regarding the A2 licence for motorcycles– have contributed to a contraction in sales of motorcycles and especially of mopeds. Given that registrations declined at a slower pace in 1Q12, and based on BBVA Research's forecasts for the rest of the year, the number of motorcycle registrations in 2012 might stand at about 100,000.

Nor did demand for furniture make a positive contribution to consumer spending in 4Q11 and 1Q12, as the sluggish recovery in this sector that began in the first half of last year wore off. Turnover in the furniture sector is closely tied to export volume and demand for housing. BBVA Research

estimates that—*ceteris paribus*—a 1% qoq fall in nominal exports leads to a 0.7% cumulative decline in turnover in the sector. By comparison, the cumulative effect of a similar reduction in nominal investment in housing is slightly less (0.6% qoq). The real estate adjustment is also having a negative impact on appliance purchases, leading to an acceleration in the restructuring process in the sector. According to data from the National Association of Major Household Appliance Manufacturers (ANFEL), the number of appliances sold decreased by 12.0% and revenue by 14.9% in the first four months of 2012, both in yoy terms, compared with declines of 11.2% and 14.4%, respectively, in 2011. Lastly, when seasonal and working day effects are factored in, domestic demand for ITC equipment and consumer electronics remained weak in late 2011 and early 2012. Retail sales of technology equipment fell by 2.5% (SWDA) from 4Q11 to 1Q12, while consumer electronics retail sales were 8.5% lower (SWDA), indicating that the downturn that began in the second half of 2010 and the first half of 2011 has worsened. Nonetheless, the outlook for the second and third quarters is favourable owing to the expected upturn in demand related to the holding of the European Football Championship in June and the Olympic Games in London in the first half of August.

Credit is a key determinant of demand for durable goods. Lingering financial stress, the restructuring of part of the Spanish banking system and weak domestic demand have constrained consumer financing. At the end of 1Q12, lending to households for consumption and other purposes—excluding housing—was down 15.3% yoy, bringing the outstanding balance to late 2004 levels. Household deleveraging—with lingering effects on spending (see Box 1)—has translated into a 3.9 pp drop in the ratio of consumer credit to GDP since 2007, causing Spanish household debt for consumer goods and services to fall below the European average. According to data from the BBVA Business Tendency Survey, the drop in consumer financing is primarily the result of an across-the-board slump in demand. The results of the consumer credit demand model, shown in Box 2, show that gloomier household expectations—reflecting in unemployment trends—account for about 80% of the decline in consumer credit during the current crisis.

The mid-term outlook is for consumer spending to shrink for the remainder of the year (by -2.0%) and the first half of next year (by -0.9%) as a result of the expected deterioration of its drivers. The expected destruction of jobs will cause the wage component of gross disposable household income to diminish. In addition, heightened fiscal pressure due to the need to meet public deficit targets will reduce the non-wage component despite a possible temporary upturn in total unemployment benefits. Net financial wealth will not recover until 2013, while real-estate wealth will continue to fall during the entire forecast horizon. Nevertheless, and despite the ongoing deleveraging process, the fall in the household savings rate to below levels seen in the preceding business cycle, the absence of demand-side inflationary pressure and continued low official interest rates will limit the contraction in private consumption over the next two years.

2. Growth outlook for the Spanish economy

Global growth will gradually recover, with widening differences among the main regions. Risk are, however, tilted to the downside

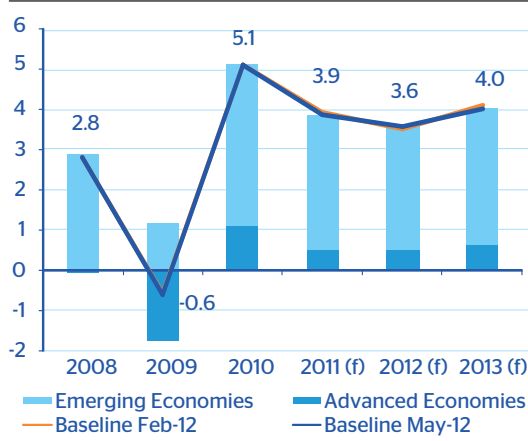
Following the gradual slowdown in 2011, the global economy is beginning to show signs of stronger growth. Global growth in the first quarter of 2012 is expected to be higher than in the previous quarter owing to the upturn in Asia (except China) and Latin America as well as steady—albeit modest—growth in the United States. In coming quarters, global economic is likely to continue to pick up, surpassing a quarterly rate of 1% by late 2012. This improvement will, however, remain uneven, with a growing divergence among the main economic regions. Growth in 2012 will be more evident in Asia given its recovery from the natural disasters in Thailand and Japan that undermined regional supply chains and the partial reversal of restrictive policies carried out since mid-2011. The United States will continue to post growth of about 0.6% qoq in 2012 and 2013—a level that is nonetheless significantly lower than that seen in previous recoveries. By contrast, the EMU economic activity will be stagnant owing to the cyclical downturn of the peripheral countries as a result of an aggressive fiscal consolidation and persistently high financial stress. We therefore expect global growth of 3.6% in 2012 and 4.0% in 2013, with emerging economies accounting for approximately 80% of this increase (see Chart 1). However, because this scenario is contingent upon on how the crisis in Europe plays out, risks continue to be tilted to the downside.

Against this backdrop, advanced economies will continue to implement lax monetary policies for a long period, in order to weather weak medium- and long-term growth. In emerging countries, central banks will have to weigh pressure from capital inflows and external uncertainty against inflationary risks (which are under pressure, in part, from oil prices) and strong domestic demand.

Europe needs a roadmap to overcome the crisis

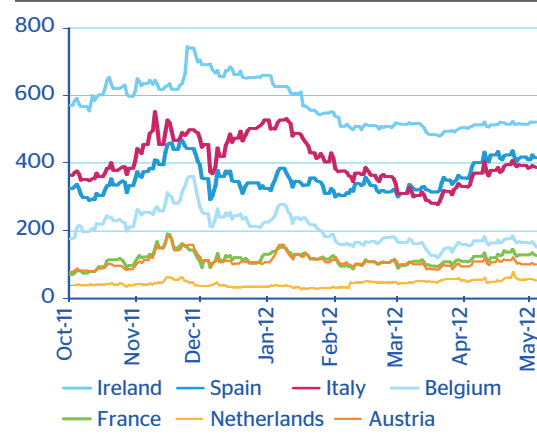
In recent months, some progress has been made in solving the European crisis, but numerous important issues remain pending. First, although Greece's sovereign debt has been restructured in the hands of private agents, there are lingering doubts on the long-term sustainability of the restructuring plan as a consequence, inter alia, of reform fatigue and the possibility of a deeper-than-expected recession. Second, progress has been made in building a firewall to isolate Greece, with the approval of the European Stabilisation Mechanism (ESM), which has the capacity to extend €500 billion in new lending, in addition to the € 200 billion already committed by the European Financial Stability Fund (EFSF). This has, however, been insufficient to quell market apprehension for at least four reasons: First, because Spain's and Italy's financing needs for the coming three years exceed that amount. Second, because of the presumption that ESM loans will rank ahead of current bondholders. Third, because it is not clear what portion of the US\$ 430 billion (approximately 330 billion euro) increase in International Monetary Fund (IMF) resources could be used to aid European countries. Lastly, because the European fiscal treaty, pending approval at the national level, requires governments to commit to structural deficits of no more than 0.5% of GDP. This is a significant move towards control of national budgets, but the possibility of bending the rules under "exceptional circumstances" could be interpreted as a relaxation of targets, making it more difficult for the ECB or the core countries of Europe to take more energetic action. In addition, there has been no progress towards a fiscal union. We are far from having a sufficiently clear roadmap indicating where Europe is headed.

Chart 1
Global GDP growth (%)



Source: BBVA Research

Chart 2
Sovereign risk premium in Europe
(spread vs. 10y German bond, bp)



Source: Datastream and BBVA Research

A worsening European crisis is the main risk to the global economy

One of the most important steps in the last four months was, clearly, the ECB's provision of long-term liquidity. This made it possible, at least through March, to significantly reduce European banks' liquidity risk, crack open the wholesale financial markets and narrow the sovereign spread of peripheral countries (see Chart 2). These positive effects proved temporary, however, given that the markets: (i) detected a certain complacency among policy-makers as risk premiums declined in the first quarter of 2012, and (ii) question many peripheral countries' ability to meet their debt targets while, at the same time, they are wary of the negative effects that meeting the targets will have on growth. Hence, risk premiums have once again shot up in Italy and Spain—in the latter case reaching levels seen during the period of greatest stress, November 2011.

The short-lived effect of long-term liquidity injections and the dilemma between consolidating fiscal accounts and restoring growth lead to two conclusions: First, that the ECB's actions can only address short-term difficulties, buying time while the underlying economic and institutional problems are dealt with. This means that the time for discussing possible exit strategies for the ECB has not yet arrived, and also that economic reforms should be accelerated at the same time as demand in the euro zone is restored to equilibrium through stimulus measures in the core countries. Second, that fiscal consolidation plans should be reviewed, with a focus on structural-deficit targets—in line with the spirit of the fiscal treaty- and with a more gradual approach to adjustment. In exchange for greater gradualism, member States should draw up comprehensive, explicit, detailed, multi-year consolidation plans. In this manner, sound public finance could be achieved without inflicting much harm on short-term growth. At the same time, this would make it possible to reap the long-term benefits of the structural reforms being implemented in the peripheral countries.

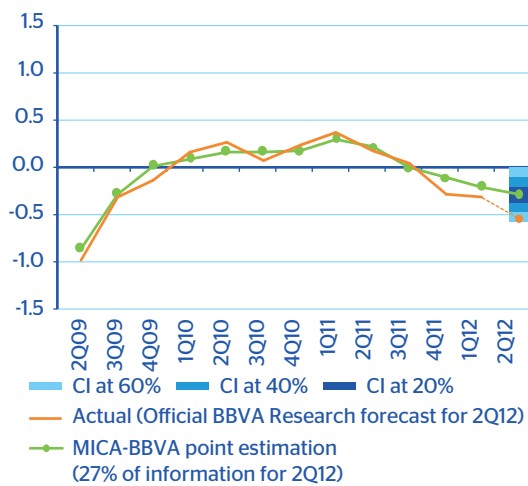
Our diagnosis of the Spanish economy remains unchanged even though some inherent doubts on economic policy have been cleared up

In recent months, the uncertainty undermining some of drivers of Spain's economic performance has subsided. In Europe, macroeconomic data make clear that the real economy has deteriorated somewhat less than expected. In addition, the prolonging of a loose monetary policy and of some unconventional liquidity measures carried out by the ECB, along with the gradual steps forward in governance, the restructuring of Greek debt and, lastly, the fiscal-consolidation efforts and the implementation of structural reforms in some member States helped temporarily mitigate, although

not completely eliminate, instability in sovereign-debt markets. Uncertainty on domestic economic policy has also waned, as a result of the adoption of measures to enhance confidence that the fiscal targets will be met, the passage of an ambitious labour reform and the announcement of a new financial-sector reform.

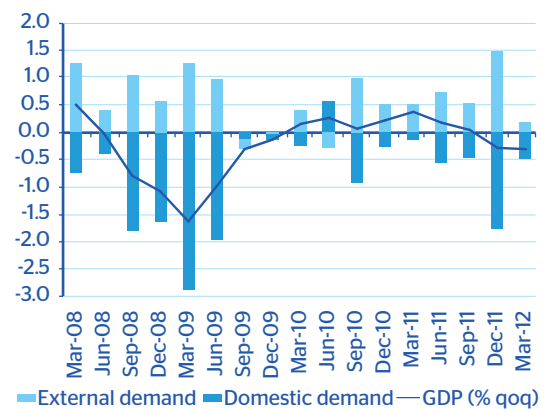
Nonetheless, our diagnosis on the precariousness of the fundamentals of the Spanish economy has not changed. Following the downturn in the previous quarter, the economy once again contracted in 1Q12, by 0.3%, which means that it has entered a technical recession. Hence, overall performance from January to March was in line with our expectations, which had given early warning that overall growth in the quarter would be negative and which are now raising red flags of an increased likelihood of a new downturn this quarter (see Chart 3). In addition, the breakdown of Quarterly Spanish National Accounts (QSNA) data 1Q12 confirmed, in line with our expectations, that, in terms of the components of growth, net external demand has risen and domestic demand has fallen, although this was less the case than in this quarter than in the previous one (see Chart 4).

Chart 3
Spain: GDP growth and forecasts using MICA-BBVA model (% qoq)



Source: BBVA Research based on INE data

Chart 4
Spain: contributions to quarterly GDP growth (%)



Source: BBVA Research based on INE data

Going forward, because of the worsening of the drivers of the Spanish economy, we expect that recession will continue through the end of the year and that the recovery, starting in 2013, will be slow, with positive, albeit moderate, GDP growth rates. However, we should reiterate that the risks are nonetheless tilted to the downside, and, given the Spanish economy's need for external financing, the current context points to a higher likelihood of risk scenarios.

In light of the external factors that have undermined Spain's economic performance, instability in European capital and sovereign debt markets will continue to exert pressure on cost of financing over the medium and long term, although in the short term the ECB's non-conventional measures and monetary policy can be expected to continue to act as a counterweight. In addition, the expectation of an European economic contraction will limit growth of foreign demand, even though this contraction will be somewhat less severe than forecast in late 2011 and global growth, along with a somewhat weaker euro, will prop the economy up.

Moreover, oil prices have recently risen, exerting additional pressure on growth and stoking inflation. Given the absence of inflationary pressure on internal demand in the EMU overall, higher imported inflation is not likely to be met with a contractionary monetary policy. Along with the short-lived nature of the shock, this will significantly limit the impact on economic growth in Spain. Although it is true that one underlying cause of the current episode is tight supply due to the partial cutback in crude imports from Iran, upward pressure is also being exerted on demand, both for precautionary reasons in light of heightened uncertainty and because emerging economies

are expected to experience high growth. Consequently, although the impact on inflation will be considerable, emerging-market growth will offset, at least partially, the negative effect on GDP¹.

Domestically, the main factor affecting our scenario is the continued correction of imbalances accumulated before and during the current economic crisis, and which, taken together, exert a significant drag on growth. Fiscal policy will remain contractionary, and it will not be possible to counter the effects of this policy with private domestic demand, that will continue to be burdened by deleveraging and weak fundamentals.

As the latest issue of Spain Economic Outlook², assumed it would, the Government announced discretionary measures regarding the deviation from the fiscal consolidation in 2011. In light of the macroeconomic scenario, this deviation will be corrected with a 3.6 pp reduction of the deficit to 5.3% of GDP this year. Although the announced measures suggest that a fiscal adjustment in the Public Administrations is feasible, that the State's targets are credible and that the most recent plans submitted by the autonomous communities include concrete measures, it is not clear that these measures are sufficient to reach the deficit target. The size of the deviation from the deficit target in 2011 and the possible impact of the business cycle on autonomous community accounts might make it necessary to introduce measures in addition to those already planned. Questions on the size of the fiscal consolidation in 2012, on how quickly it will be implemented and on the final cost of the financial-system reform have led to a negative differentiation of Spanish public debt. This limits the ability of economic-policy announcements to raise confidence, augmenting the negative economic impact of the fiscal adjustment. In addition, the announced budget measures focus—to a greater degree than we expected—on direct taxation and on investment spending, which will not help minimise the negative impact of the adjustment.

Nonetheless, certain domestic factors might have a positive influence on our scenario. First, regarding the short term, the central government implemented a payment programme for autonomous communities and local corporations, which will mobilise resources equivalent to approximately 2.5% of GDP. This liquidity-injection programme should have a positive impact on economic growth, although the full extent of the impact will depend on the percentage of obligations already priced in by creditors as well as its degree of liquidity³. Second, the labour-market reform approved in February⁴, if executed immediately and effectively, could restore the required balance between the adjustment of the extensive margin (employment) and the adjustment of the intensive margin (hours of work and pay) and reduce segmentation, although it will not prevent the economy from continuing to shed jobs⁵. The foundations are thus being laid for a more robust recovery in the medium term and, potentially, for stronger economic growth over the long term⁶.

In light of the aforementioned factors, we expect GDP in Spain to contract by about -1.3% for the year overall. In 2013, moderate growth of about 0.6% is expected (see Table 1). Despite the labour reform, expectations of an economic contraction will lead to further labour-market deterioration this year: jobs will continue to be lost in 2012 and the first half of 2013, and unemployment rates will rise to about 25%, despite the expected decrease in the active population.

1: For details on the structural VAR with sign restrictions from which the forecasts on the impact of the increase in oil price on the Spanish economy is derived, see Box 1 of Spain Economic Outlook for 2Q11: http://www.bbva.com/bbva/research/KETD/fbin/mult/1105_Situacionespana_tcm346-256519.pdf?ts=1742012.

2: See Box 2 of Spain Economic Outlook for 2Q12: http://www.bbva.com/bbva/research/KETD/fbin/mult/1205_Situacionespana_tcm346-326621.pdf?ts=2452012.

3: See Box 3 of Spain Economic Outlook for 2Q12.

4: Royal Decree-Law 3/2012, of 10 February, on urgent measures for labour-market reform: <http://www.boe.es/boe/dias/2012/02/11/pdfs/BOE-A-2012-2076.pdf>.

5: Because of the rigidities that make it difficult for companies and workers to change working conditions—in particular, the workday—the adjustment to the Spanish labour market between 2007 and 2009 focused on employment rather than on the number of hours worked. See the February 2012 issue of Spain Economic Outlook: http://www.bbva.com/bbva/research/KETD/fbin/mult/1202_Situacionespana_tcm346-286235.pdf?ts=1742012.

6: In the second quarter 2012 issue of Spain Economic Outlook, Box 4 contains an evaluation of the labour reform and suggestions on ways to improve it as well as complementary measures.

Regarding the composition of growth, the factors examined in our economic scenario for 2011-2013 point, on the balance, to further downward pressure on both external and above all domestic demand and imports. The expected deterioration of the drivers of private consumption point to lower spending during all of 2012 and the first half of 2013. Lower employment should translate into a decline in the wage component of gross disposable household income. In addition, heightened fiscal pressure due to the need to meet public deficit targets will reduce the non-wage component despite a possible temporary upturn in total unemployment benefits. Net financial wealth will not recover until 2013, while real-estate wealth will continue to fall during the entire forecast horizon. Nevertheless, the fall in the household savings rate to below levels recorded in the preceding business cycle, the absence of demand-side inflationary pressure and continued low official interest rates will limit the contraction in private consumption over the next two years.

Table 1

Spain: macroeconomic forecasts

(yoy %, unless otherwise indicated)	2008	2009	2010	2011	2012 (f)	2013 (f)
National Final Consumption Expenditure (FCE)	1.0	-2.3	0.6	-0.7	-3.6	-2.1
Private FCE	-0.6	-4.3	0.8	-0.1	-2.0	-0.9
Household FCE	-0.6	-4.4	0.7	-0.14	-2.0	-0.9
Public Administration FCE	5.9	3.8	0.2	-2.2	-8.0	-5.6
Gross capital formation	-4.2	-16.4	-6.0	-5.2	-7.5	-1.0
Gross fixed capital formation	-4.7	-16.5	-6.2	-5.1	-7.4	-1.0
Fixed material assets	-5.0	-17.1	-6.3	-5.4	-7.8	-1.2
Equipment, machinery and cultivated assets	-2.8	-22.0	5.3	1.5	-4.5	2.9
Equipment and machinery	-3.1	-22.6	5.5	1.6	-4.6	2.8
Construction	-5.7	-15.4	-10.1	-8.1	-9.2	-3.2
Housing	-9.1	-22.0	-9.8	-4.9	-6.6	-1.6
Other buildings and constructions	-1.6	-7.7	-10.4	-11.2	-11.8	-4.9
Intangible fixed assets	2.4	-3.9	-4.8	0.0	-2.3	2.4
Domestic demand (*)	-0.5	-6.5	-1.0	-1.8	-4.5	-1.8
Exports	-1.0	-10.2	13.5	9.1	4.0	8.9
Imports	-5.1	-16.9	8.9	-0.1	-6.2	1.6
Net trade balance (*)	1.4	2.8	0.9	2.5	3.1	2.4
GDP at mp	0.9	-3.7	-0.1	0.7	-1.3	0.6
Pro-memoria						
GDP w/o housing investment	2.3	-1.5	0.8	1.2	-0.9	0.7
GDP w/o construction	2.8	-0.8	2.0	2.3	0.0	1.1
Employment (LFS)	-0.5	-6.8	-2.3	-1.9	-4.6	-2.0
Unemployment rate (% active pop.)	11.3	18.0	20.1	21.6	24.6	24.8
Employment (FTE)	-0.2	-6.4	-2.6	-2.0	-4.3	-2.0

(*) Contribution to growth

Source: BBVA Research based on INE data

3. Durable goods

Although partial data suggested a worsening in Spain at the beginning of 2012 (see Table 2), household consumption was stagnate in the first quarter after having plummeted in the fourth quarter of 2011. The less unfavourable performance of disposable income (resulting from the positive trend in the wage component) and the likely fall in savings offset the deterioration of the non-wage component⁷ (resulting, inter alia, from higher fiscal pressure) and of the remaining drivers of consumption, mainly, financial wealth. The stagnation of consumer spending in the quarter was equivalent to a 0.6% decline in yoy terms, as had been forecast by BBVA's Synthetic Consumption Indicator (SCI) and its Model of Indicators Coincident with Consumption⁸ (MICC) (see Chart 5).

Table 2

Spain: consumer spending indicators (SWDA data)

% qoq	Availability of consumer goods	Car registrations		Domestic sales by large enterprises	Service sector turnover index	Retail commerce	Consumption NA
		Total	Private				
1Q10	-2.7	0.7	1.5	0.5	-0.2	1.6	-0.1
2Q10	3.4	1.6	3.7	2.0	2.3	-1.4	0.9
3Q10	-5.4	-32.1	-48.1	-6.0	-2.5	-2.0	-0.7
4Q10	-0.8	1.9	0.0	0.1	0.1	-0.3	0.7
1Q11	1.3	3.4	-1.8	-0.8	0.3	-2.1	-0.5
2Q11	-1.3	3.3	-0.4	-0.3	0.0	-1.1	0.2
3Q11	0.4	-7.8	-4.2	0.1	0.1	-1.3	0.2
4Q11	-1.0	-2.6	-2.7	-2.3	-2.9	-2.2	-1.0
1Q12	-3.8	5.5	-2.6	-0.3	-0.7	-0.9	0.0

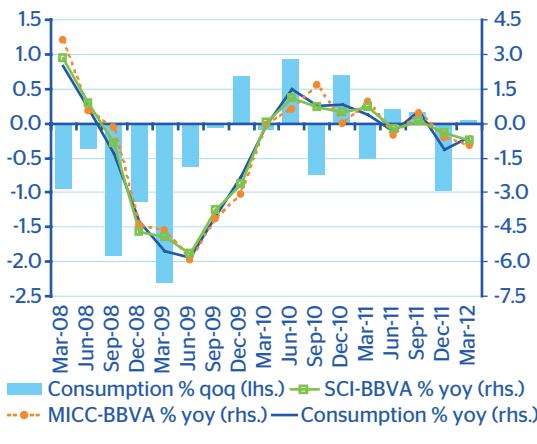
Source: BBVA Research based on MEH, ANFAC, AEAT and INE data

Unlike in 2010 and the first half of 2011, in 4Q11 the fall in external demand mirrored that of domestic demand. As shown in Chart 6, the disappointing performance of durable goods exports –down 11.9% qoq (SWDA) from September to December 2011 owing to the flagging European economy—accounts for much of the contraction in goods sales abroad. In first quarter of this year, external demand –primarily for goods— recovered slightly even though demand for durables once again declined, this time by 4.1% qoq (SWDA).

7: Note that real wages per worker rose by 0.8% qoq in 1Q12 after shrinking by 0.3% qoq in 4Q11.

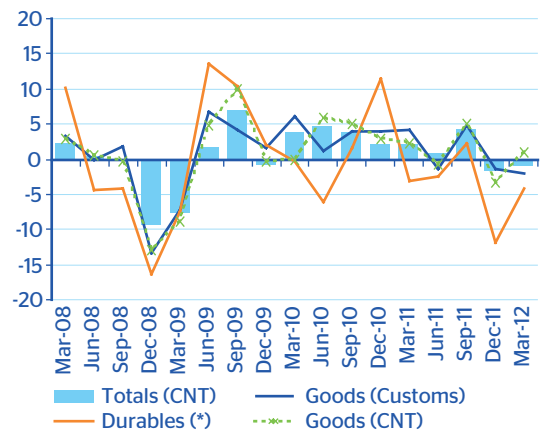
8: For more details on the MICA_BBVA model, see Box 1 in Consumption Outlook for 2H10: http://www.bbva.com/BBVAResearch/KETD/ketd/bin/esp/publi/espana/novedades/detalle/Nove346_195714.jsp?id=tcm:346-176089-64.

Chart 5
Spain: actual data and real time forecast of household consumption



Source: BBVA Research based on INE data

Chart 6
Spain: real exports (SWDA data, % qoq)



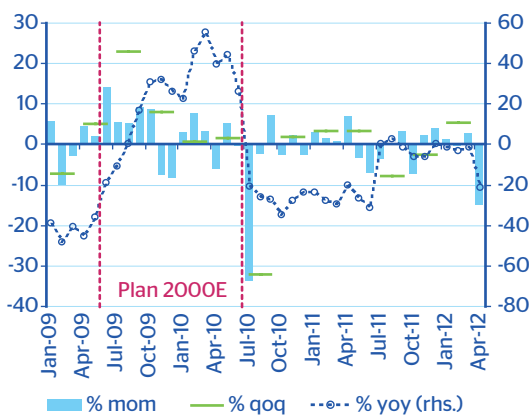
(*) Electrical appliances, consumer electronics, computer equipment, furniture, motorcycles and cars

Source: BBVA Research based on INE and Customs data

Demand for cars

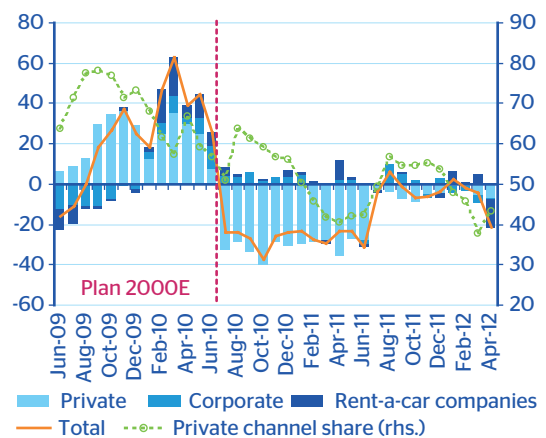
Following the 2H11 drop in the number of car registrations (7.8% qoq SWDA in 3Q11 and 2.6% qoq SWDA in 4Q11), sales increased by 5.5% qoq (SWDA) between January and March of 2012, driven by fleet renewals by car-hire companies (see Charts 7 and 8). When seasonal and working day effects are factored in, registrations by car-hire companies accounted for 21.4% of all car registrations in 1Q12, 4.5 pp above 4Q11. Indeed, the end of Easter Week caused registrations by rent-a-car companies to plummet in April. Together with persistently weak demand among private parties and companies –resulting from a deterioration of their fundamentals and greater uncertainty– this triggered a decline of 14.7% mom (SWDA) in sales last month. BBVA Research’s forecasts point to a quarterly decline of nearly 9.5% (SWDA) between April and June, and thus place the number of car registrations at about 750,000 for all of 2012.

Chart 7
Spain: car registrations (SWDA data)



Source: BBVA Research based on ANFAC and GANVAM data

Chart 8
Spain: contributions to yoy increase in car registrations (%)

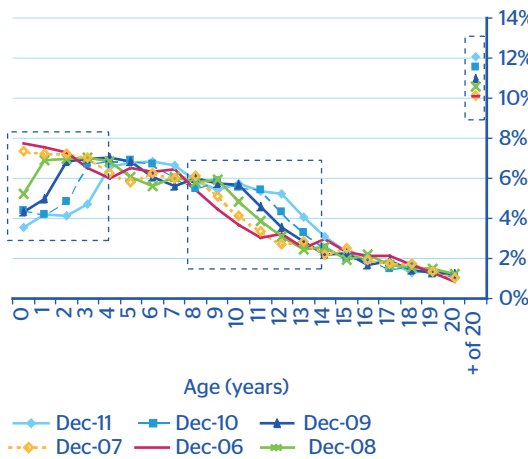


Source: BBVA Research based on ANFAC and GANVAM data

One of the consequences of lower car purchases is the ageing of the vehicle fleet during the current recession. As shown in Chart 9, the breakdown of the vehicle park by age has shifted to the right over the last five years. The percentage of cars less than 5 years old fell from 29.1% in 2006 to 16.6% in late 2011. By contrast, the share of cars between 8 and 14 years rose by 9.6 pp. Lastly, the number of cars more than 20 years old rose to nearly 2.7 million in 2011 (12.1% of the fleet), 563,000 more than in December 2006.

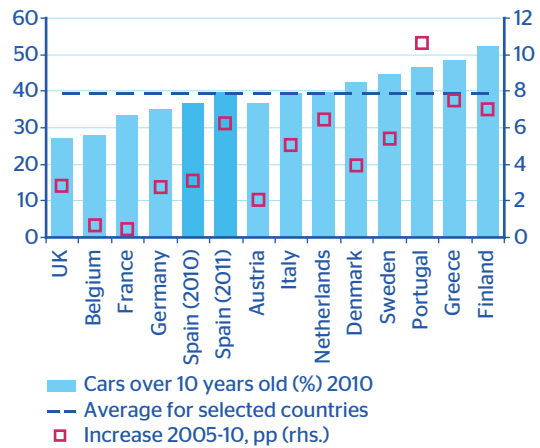
Does Spain have a comparatively old car fleet? The data shown in Chart 10 indicate that the percentage of cars more than 10 years old in Spain (39.6% in 2011) is in the average in comparison with the economies in our region. It is far above the 27.1% figure for the United Kingdom, a country with a relatively high fleet replacement rate, but it is also far below that of the Nordic countries (above 40%) –which have a mobility pattern characterised by a less intense use of the automobile– and Portugal (46.9%) or Greece (48.4%), whose economies have been bailed out and whose domestic demand is depressed.

Chart 9
Spain: breakdown of all cars by age (% of total)



Source: BBVA Research based on DGT data

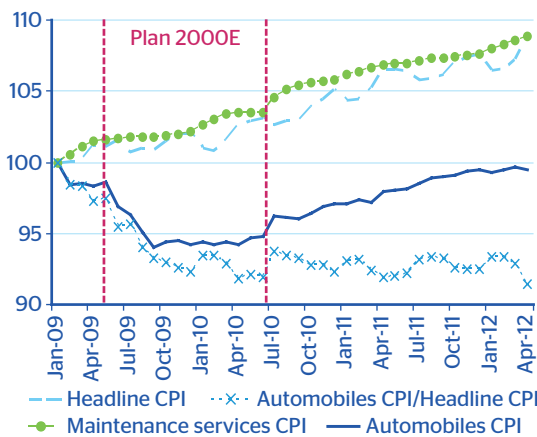
Chart 10
Cars more than 10 years old



Source: BBVA Research based on ANFAC, DGT, ACEA and OICA data

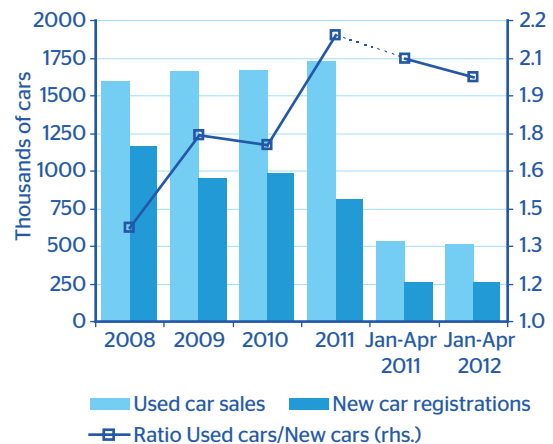
Because of persistently weak demand, the increase in car consumption prices was below headline inflation in the last half of the year; hence, as occurred under the “Plan 2000E”, in 2012 relative prices once again dropped: between September 2011 and April 2012, car prices rose by 0.5%, compared with headline inflation of 2.4% (see Chart 11).

Chart 11
Spain: car consumption prices (Jan-08=100)



Source: BBVA Research based on INE data

Chart 12
Car sales in Spain: NC vs. UC

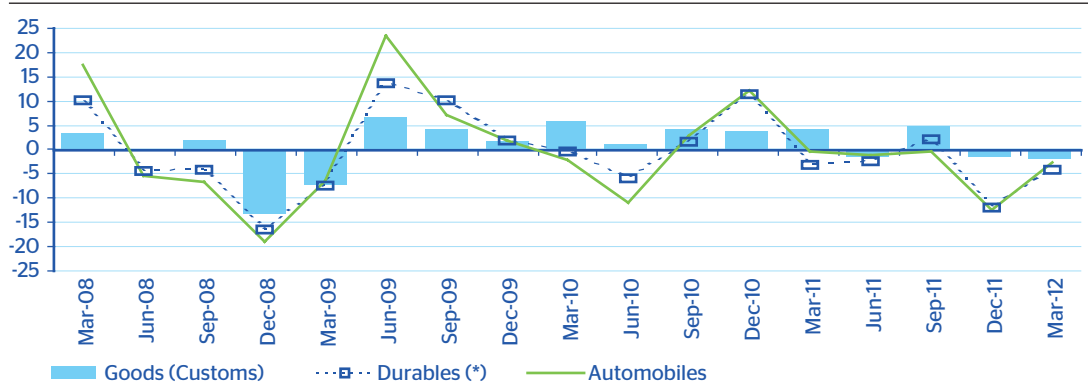


Source: BBVA Research based on IEA and GANVAM

Demand for used vehicles is one of the few bright spots in the Spanish car market (see Chart 12). In 2011 used car sales increased by 3.4% to above 1.7 million vehicles, with more than half (57.7%) of all transactions taking place between private parties⁹. New-car registrations fell 17.7% last year, causing the ratio of used cars to new cars to rise by 0.4 points, up to more than two used cars for one new car, similar to that found in Germany (1.8), Italy (2.1) and France (2.3). Even though, due to the decline in private channel sales, used-car transactions decreased by 3.7% yoy between January and April of 2012, the ratio of used cars to new cars remained steady at 2¹⁰.

External demand for cars has not offset the weakness of domestic demand, especially during the fourth quarter of 2011 in which car exports decreased by 12.5% qoq (SWDA), skewing figures for durable goods exports downward. Between January and March 2012, the slump in car sales abroad eased (-2.8% qoq SWDA), in line with the figure for total goods exports (see Chart 13).

Chart 13
Spain: real car exports (SWDA data, % qoq)



(*) Electrical appliances, consumer electronics, computer equipment, furniture, motorcycles and cars
Source: BBVA Research based on Customs data

Demand for motorcycles

Motorcycle and moped purchases fell at a faster pace in the second half of last year. As shown in Chart 14, the number of registrations of two-wheeled vehicles between September and December 2011 dropped 7.7% qoq (SWDA), returning to 2004 levels. The reasons for the decrease in registrations of two-wheeled vehicles have to do with the weakness of the drivers of demand for these vehicles –mainly disposable income of potential buyers as a result of the worsening job market for young people– and increased uncertainty, which translates into delays in purchasing decisions and a reduction in current consumption of durable goods. In addition, regulatory changes –in particular, the raising of the A2 license age for mopeds to 15 and the transposition of Directive 2006/126/EC nearly four years ahead of European requirements¹¹– has contributed to falling demand for motorcycles and above all mopeds. Given that the decline in registrations slowed to -5.4% (SWDA) in 1Q12, and based on BBVA Research's forecasts for the rest of the year, the number of motorcycle registrations in 2012 might stand at close to 100,000.

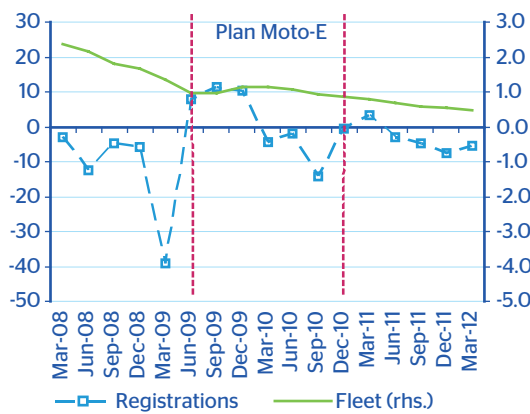
As with automobiles, the ongoing contraction in demand for two-wheeled vehicles –which helped bring down their relative prices by 0.6% from October 2011 to April 2012 (see Chart 15)– has been accompanied by an unfavourable trend in external demand. As shown in Chart 16, real exports of motorcycles and mopeds have plummeted by 33.1% qoq (SWDA) since September 2011 –a sharper decline than the overall reduction for the durable goods analysed– owing mainly to the contraction since 4Q11.

9: For a detailed analysis of the drivers of used-car demand in Spain, see BBVA (2011): "Who buys a used car? Changes in the factors that determine vehicle choice during the crisis", Consumption Outlook 2H10, 14-21: http://www.bbva-research.com/KETD/fbin/mult/Situacion_Consumo_2S10_tcm346-248813.pdf?ts=15112011.

10: Because of the effects of the change in the Easter Week calendar on vehicle demand, it is difficult to make yoy comparisons.

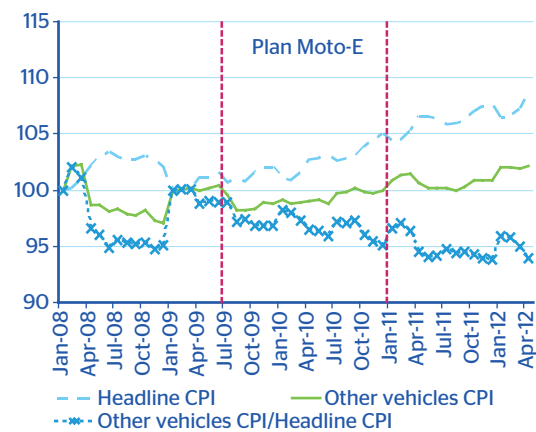
11: Spain was the first EU country to transpose Directive 2006/126/EC on drivers licences, through the passage in 2009 of Royal Decree 818/2009. For more details, see: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:403:0018:0060:ES:PDF,y> <http://www.boe.es/boe/dias/2009/06/08/pdfs/BOE-A-2009-9481.pdf>.

Chart 14
Spain: moped and motorcycle registrations (SWDA data, % qoq)



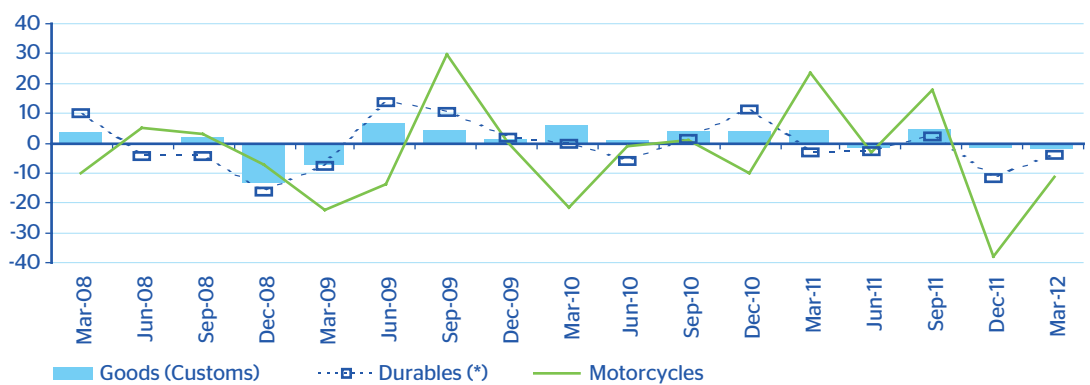
Source: BBVA Research based on Anesdor and Bank of Spain

Chart 15
Spain: consumption prices of mopeds and motorcycles (Jan-08=100)



Source: BBVA Research based on INE data

Chart 16
Spain: real exports of mopeds and motorcycles (SWDA data, % qoq)



(*) Electrical appliances, consumer electronics, computer equipment, furniture, motorcycles and cars
Source: BBVA Research based on Customs data

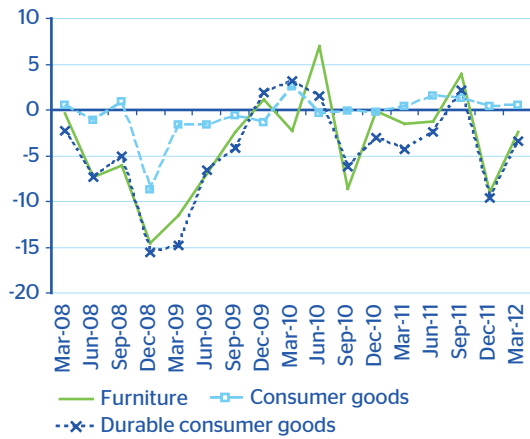
Furniture

Turnover in the furniture sector was 9.0% lower qoq (SWDA) in 4Q11, dropping an additional 2.4% qoq (SWDA) in 1Q12 and erasing the gain from the weak recovery that began in the first half of last year (see Chart 17). Two factors account for the performance of this sector: first, the negative trend in external demand, which, after rising 16.6% qoq (SWDA) in 3Q11, shrank by 18.6% between 4Q11 and 1Q12 as a result of economic downturn in Europe (see Chart 18); and second, the continued deterioration of investment in housing, which is the seed of consumer demand for furniture. Hence, residential investment declined at a faster rate, falling 4.3% qoq (SWDA) in 4Q11 and 5.8% qoq (SWDA) in 1Q12. As shown in Chart 19, furniture sector turnover is closely tied to exports and demand for housing. BBVA Research estimates that a 1% qoq fall in nominal furniture exports translates—*ceteris paribus*—into a 0.7% qoq cumulative fall in turnover in the sector. A 1% qoq reduction in nominal investment in housing has a slightly lower cumulative effect (0.6% qoq) on the furniture sector.¹²

12: Note that propensity to export in the furniture sector —understood as exports divided by gross added value in nominal terms— was 53.7% in 2010 compared with 29.5% for the economy overall.

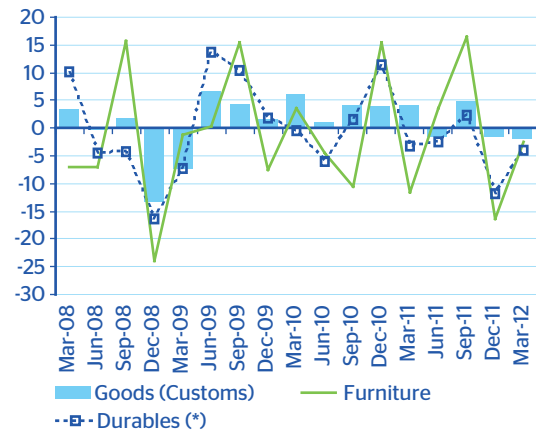
Despite sluggish demand, furniture prices continued to climb in 4Q11 and 1Q12 (by 0.8% from Oct-11 to Apr-12). However, since inflation increased 2.4% over the same period, relative prices for furniture fell 1.5%, as shown in Chart 20.

Chart 17
Spain: turnover (SWDA data, % qoq)



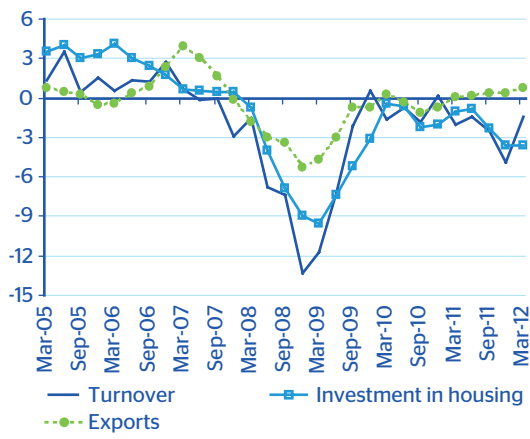
Source: BBVA Research based on INE data

Chart 18
Spain: real exports of furniture (SWDA data, % qoq)



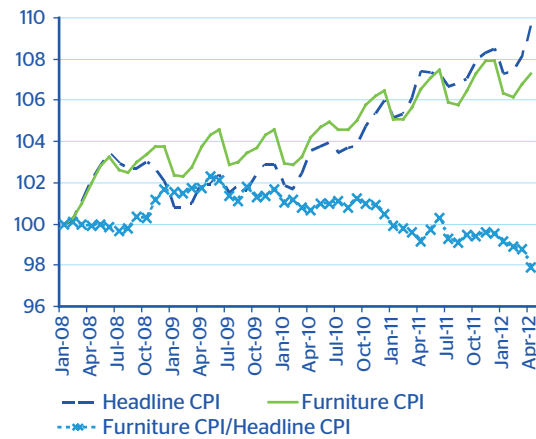
(*) Electrical appliances, consumer electronics, computer equipment, furniture, motorcycles and cars
Source: BBVA Research based on Customs data

Chart 19
Investment in housing, turnover and exports in the furniture sector (Nominal data,% qoq of the trend)



Source: BBVA Research based on INE and Customs data

Chart 20
Spain: furniture consumer prices (Jan-08=100)



Source: BBVA Research based on INE data

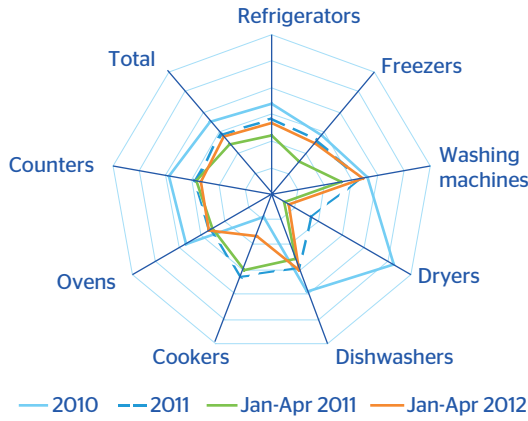
Major Household Appliances

The prolonged adjustment in the real-estate sector continues to have a negative effect on appliance purchases. According to data from the National Association of Major Household Appliance Manufacturers (ANFEL), the number of appliances sold decreased by 12.0% and revenue by 14.9% in the first four months of 2012, both in yoy terms, compared with declines of 11.2% and 14.4%, respectively, in 2011. Sales for all appliance families were lower through April, although the fall in washing machines (5.7%) and dishwashers (10.2%) was lower than the average for major household appliances overall (see Chart 21).

Sluggish consumption of major household appliances has translated into a general drop in prices. As shown in Chart 22, the CPI for electrical appliances slipped 0.4% between Oct-11 and Apr-12 (2.7% in real terms) and would have fallen even more had it not been for higher customer services prices. Repair services prices rose 2.3% in the last seven months.

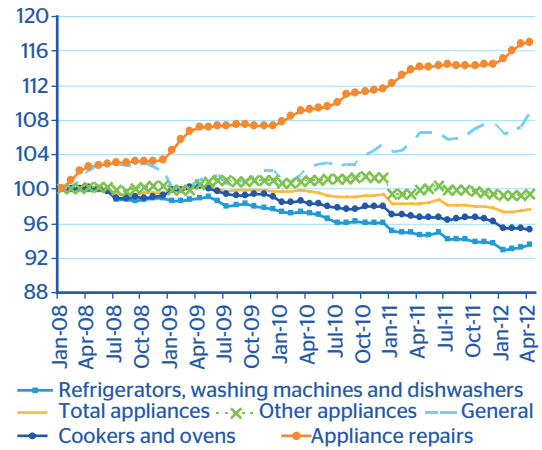
As with domestic demand, external demand for appliances contracted in the last half of the year, and more sharply than average demand for the durable goods examined herein. As shown in Chart 23, real exports of major household appliances were down 15.1% qoq (SWDA) in 4Q11 and 17.8% qoq (SWDA) in 1Q12, twice the decline for durable goods overall.

Chart 21
Spain: sales of electrical appliances per family (% yoy of the number of appliances)



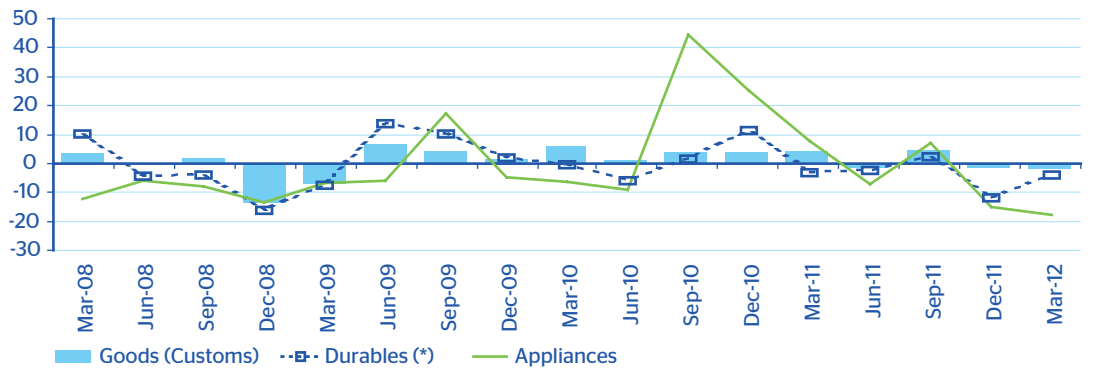
Source: BBVA Research based on ANFEL data

Chart 22
Spain: appliance consumer prices (Jan-08=100)



Source: BBVA Research based on INE data

Chart 23
Spain: real appliances exports (SWDA data, % qoq)



(*) Electrical appliances, consumer electronics, computer equipment, furniture, motorcycles and cars
Source: BBVA Research based on Customs

Brown line

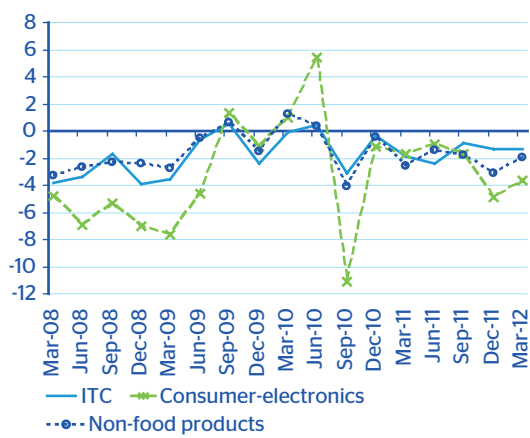
When seasonal effects are factored in, domestic demand for ITC equipment and consumer electronics continued in a slump in late 2011 and early 2012. As shown in Chart 24, retail sales of technology equipment fell by 2.5% (SWDA) from 4Q11 to 1Q12 –less than the decline in non-food products overall (5.1%)– while consumer electronics retail sales were 8.5% lower (SWDA), indicating that the downturn that began in the second half of 2010 and the first half of 2011 has worsened. The outlook for the second and third quarters is favourable owing to the expected upturn in demand for brown line items related to the holding of the European Football Championship in June and the Olympic Games in London from 27 July to 12 August¹³.

13: Data from the Multisectoral Association of Electronics, Information and Communication Technologies, and Digital Content Companies (AMETIC) indicate that the number of television sets sold soared by 38.1% and revenue by 19.5% overall in 2010 due to the "analogue switch-off" and the holding of the World Cup in South Africa from the second week of June to the second week of July.

Sluggish consumption has contributed to a reduction in prices in a sector with lingering deflation as a result of technological progress. As shown in Chart 25, prices for all consumer electronics products and IT equipment –except telephone equipment¹⁴– fell in the last six months, in both nominal and real terms.

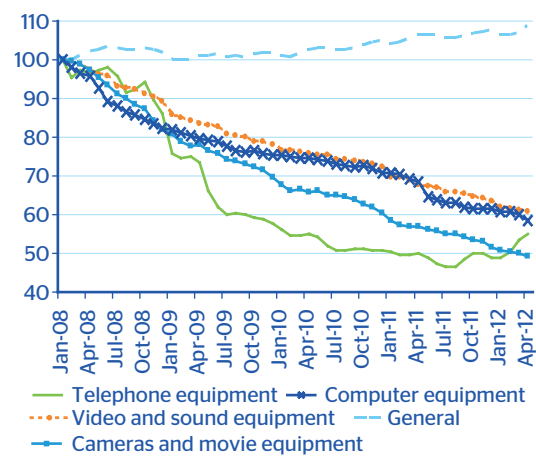
The trend in external demand, by product type, was the opposite that of domestic demand. Whereas real exports of computer equipment fell by 26.4% (SWDA) in the last half of the year –16.4 pp more than the average for the durable goods examined herein– sales of consumer electronics goods abroad rose slightly in the fourth quarter of last year before declining 6.3% qoq (SWDA) in the first quarter of this year.

Chart 24
Spain: real retail sales of brown line items (SWDA data, % qoq)



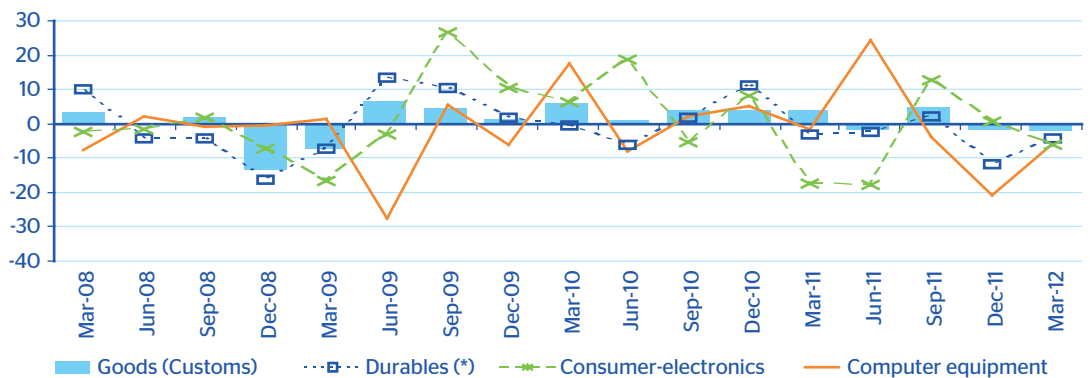
Source: BBVA Research based on Eurostat data

Chart 25
Spain: consumer prices for brown line items (Jan-08=100)



Source: BBVA Research based on INE data

Chart 26
Spain: real exports of brown line items (SWDA data, % qoq)



(*) Electrical appliances, consumer electronics, computer equipment, furniture, motorcycles and cars
Source: BBVA based on Customs

The persistent deterioration in demand for major household appliances and brown line items as well as growing financing difficulties have continued to spur the restructuring of the sector. As shown in Table 3, in recent months numerous retailers of electrical appliances, ITC equipment and consumer electronics have continued to adjust their cost structures by reducing their workforce (through layoffs) and shutting down or merging operations. These efforts have reduced the fragmentation that characterises the sector in Spain.

14: Prices for telephone equipment have risen 13.4% since January 2012. It is likely that this increase is partially due to the ending of discounts on mobile-handset purchases announced by some leading telephone operators.

Table 3

Restructuring in the major appliances and brown products sectors (2009-2011)

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 stores
Fibertel	D	(-) Voluntary bankruptcy
Media Markt	D	(+) Opening of stores
Ecomputer	D	(+) Opening of stores
Worten	D	(+) Opening of stores (+ partial absorption of 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	(+) Merger
Topcom Iberia	D	(+) Merger
Infinity System	M, D	(-) Temporary workforce reduction
Sanyo	M	(-) Plant closure
Electronic Devices Manufacturer	M	(-) Liquidation
Engel Axil	M	(-) Voluntary bankruptcy
BSH	M	(-) Workforce reduction
Sharp	M	(-) Temporary workforce reduction
Daewoo	M	(-) Workforce reduction following extinction of company
Daewoo	M	(-) Sale of plant
Di4	M	(-) Voluntary bankruptcy
Rimax innovation	M, D	(-) Liquidation
NPG	M	(+) Expansion
Conceptronic	M	(+) Merger
Digital Data Communications	M	(+) Merger

* D: distributing company; M: manufacturing company

Shaded cells: changes since previous Consumption Outlook issue

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

4. Consumer finance

Weak domestic demand, the duration of the international financial crisis and the restructuring of the Spanish financial system are the reasons for the unfavourable trend in consumer credit. At the end of the first quarter of 2012, household credit not for house purchase (consumer loans and other) was 15.3% below the figure for the same period the previous year.

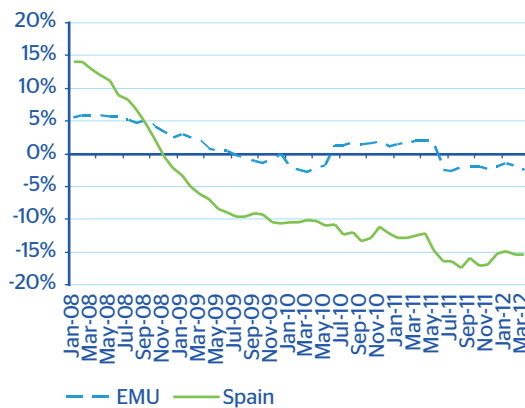
Trends in consumer credit: lower debt level than the euro zone

Because of the prolonged economic downturn, consumer credit continues the downward slide that began in 2008. In March 2012, lending to households for consumption and other purposes –excluding housing– was down 15.3% yoy, making this the twenty-ninth consecutive month in which it had declined by more than 10% yoy. Consequently, the outstanding balance is similar to that of late 2004 (see Chart 27).

The process of debt deleveraging, by which households have reduced the amount of their consumer credits, has translated into a 3.9 pp fall in the ratio of credit to GDP since 2007. Spanish household debt for consumer goods and services has not only converged with that of the EMU, but by late 2011 it had fallen below the European average. In addition to this drop in debt ratios, financing costs have edged down, bringing households' debt burden for consumer loans down from about 9% of gross disposable income in 2007 to 6% in early 2012. In coming years, the prolonging of the deleveraging process and lower interest rates are expected to reduce further the debt burden of this lending (see Chart 28).

Chart 27

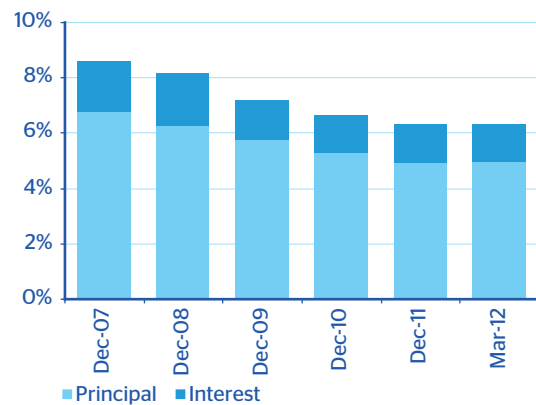
Outstanding balance of consumer credit (% yoy)



* Consumer credit includes securitisations
Source: Research based on Bank of Spain and ECB

Chart 28

Spain: households' debt burden for consumer loans (% of GDHI)



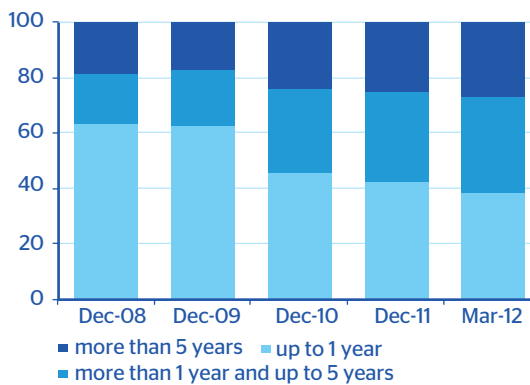
Source: BBVA Research based on Bank of Spain and INE data

New consumer loan transactions are distributed nearly evenly among the various loan terms. Whereas before the crisis new transactions were concentrated in the shortest terms (financing for less than one year), in 2010 and 2011 the share of these loans decreased in favour of longer-dated loans. This continues to hold true now, according to the most recent available data. Of all loans signed in March, 38% were for terms of less than one year, 35% for one to five years, and 27% for more than five years. Therefore, short-term loans, such as credit card financing, now account for a smaller share of the total (see Chart 29).

According to the Bank Lending Survey, recent trends in consumer credit in Spain are more the result of low demand than of tight supply. As shown in Chart 30, demand for consumer credit fell more at a quicker pace in the second half of last year, whereas supply increased. Therefore, while supply may have been constrained by tighter lending conditions for financial institutions in the

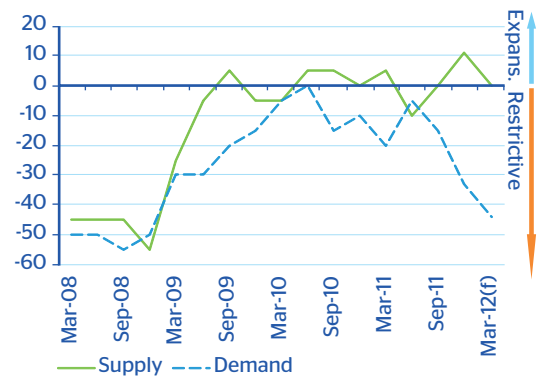
capital markets, the high remuneration of household liabilities (initially deposits and later notes) and the entry into force of new provisions on lending for construction activities and real estate development, weak demand is what has exerted downward pressure on consumer financing¹⁵.

Chart 29
Spain: distribution by term of new consumer credit transactions (%)



Source: BBVA Research based on Bank of Spain

Chart 30
Spain: Bank Lending Survey (consumer loans and others, balance of responses)



Source: BBVA Research based on Bank of Spain

Consumer loans by purpose

Given the lack of banking statistics on consumer loans by purpose, we must turn to data from the National Association of Financial Institutions (Asnef), which gathers information from specialised credit institutions. Consumer lending extended by this institutions contracted by 2.0% last year, including a 3.7% yoy decrease in 4Q11. The average loan in 2011 was for €2,950, 1.5% higher than in 2010. In terms of individual components, the 15.7% increase in personal loans in 2011 was insufficient to offset the reduction in credit for consumer goods (8.6%) and the stagnation of revolving loans (-1.1%). In 1Q12, the decline in consumer credit tapered slowed to -0.7% yoy. The positive performance of revolving credit cards (13.4% yoy) and personal loans (14.7% yoy) nearly offset the fall in consumer-goods financing (-13.5% yoy) and revolving credit (-10.0% yoy).

Automobile financing shrank by 2.2% in 2011. The rise in loans for used automobiles, both to businesses (20.9%) and households (7.2%), and in loans to businesses for new automobiles (16.0%), did not offset the sharp decline in financing for commercial vehicles (-57.0%), for new vehicle purchases by households (-7.5%) and for other vehicles (-0.6%). The average amount lent increased by 1.9% to €13,110 in 2011, on the strength of financing of new automobiles and commercial vehicles. In 1Q12, lending for vehicle purchases dropped once again, by 2.2% yoy, despite higher lending to buy for new cars (8.2% yoy) and commercial vehicles (16.1% yoy).

The situation in consumer financing has not changed significantly since the last issue of this publication. The decline in consumer credit is expected to continue in coming months, as part of the deleveraging process Spanish households is going through.

¹⁵: See Box 2 for a detailed analysis of the drivers of demand for consumer credit in Spain.

Box 1. Effects of deleveraging on household consumption

During the current economic crisis, indebtedness of Spanish households and companies has gradually corrected downward, favouring savings against consumption and investment. This deleveraging process is naturally reflected in simultaneous shifts in credit supply and demand towards a new equilibrium. This box examines the role that these shifts have played, and will continue to play, in household consumption.

Description of methodology

The financial market's intrinsic characteristics as a channel for liquidity in the real economy make it possible, unlike in other less complex markets, for the price and quantity of credit to react to factors in addition to the idiosyncratic decisions of the agents who operate in that market (credit supply and demand shocks). In Spain, these quantities and prices also respond to changes of monetary policy tone throughout the euro area (monetary policy shocks), shifts in

the cyclical and structural position of the domestic economy (aggregate supply and demand shocks) and changes in the degree of risk aversion by investors –both national and international– irrespective of trends in the fundamentals of the Spanish economy (risk aversion shock). Consequently, and given that it is well known that the aggregate data observed reflect not only supply or demand decisions by economic agents, an empirical problem arises with regard to the identification of these shocks and to the estimation of their possible impact on the real economy. Based on the methodology described by Faust (1998), Uhlig (1999 and 2005) and Canova and De Nicoló (2002), this Box shows the results of estimating a structural VAR with sign restrictions for the Spanish economy that makes it possible to solve the identification problem described above¹⁶. In the case we are examining, the sign restrictions imposed in the model are set out in the following table.

Table 4
Restrictions on the identification of structural shocks

	Variable	GDP	Productivity	Prices	Net indirect investments in Spain	ORS real credit	Differential rates on ORS lending	Default rate	Short-term real interest rate
<i>Shock</i>	Lag (L)								
(+)	L=0	0	0	0	0	0	0	0	-
	L=1	+		+					-
	L=2	+		+					-
(+)	L=0	+	+	-	0	0	0	0	0
	L=1	+	+	-					0
	L=2	+	+	-					
(+)	L=0	+	0	+	0	0	0	0	0
	L=1	+		+				-	0
	L=2	+		+				-	
(+)	L=0	0	0	0	+	0	0	0	0
	L=1				+				0
	L=2				+				
(+)	L=0	0	0	0	0	+	+	0	0
	L=1					+	+		0
	L=2					+	+		
(+)	L=0	0	0	0	0	+	-	0	0
	L=1					+	-		0
	L=2					+	-		

Note: to allow for a correct identification of structural shocks (sufficient conditions for identification), restrictions have been introduced that both characterize their necessary conditions (blue-highlighted) and guarantee their exclusion from the remaining shocks (grey-highlighted).

Source: BBVA Research

¹⁶: The methodology, introduced to identify monetary policy shocks, basically involves estimating a reduced-form VAR and then imposing sign restrictions on the impulse response functions in order to identify the structural shocks to be studied.

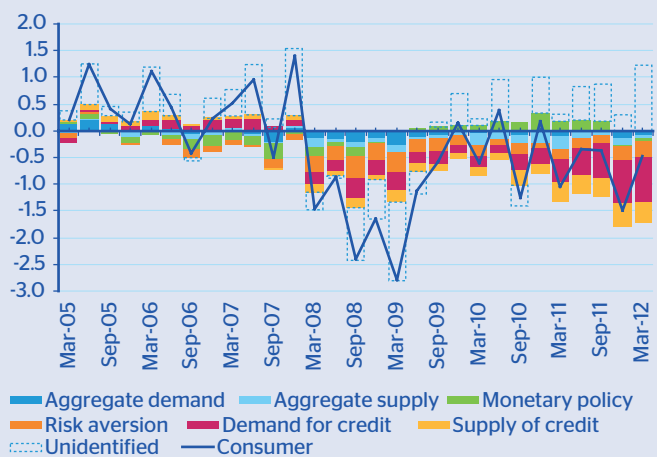
Apparent labour productivity is calculated based on the ratio of GDP to full-time equivalent employment, and net indirect investments in Spain are taken to be the difference between net inflows and outflows of capital, expressed as a percentage of GDP. The core CPI component has been used as a price indicator, and with it the amount of credit to ORSs (other resident sectors) has been deflated and the real short-term interest rate has been constructed, taking the 3M Euribor as a reference. The ORS lending rate spread is the difference between the synthetic nominal rate on these transactions and the 3M Euribor. In addition to the variables described above, the model includes the following macromagnitudes of the Spanish economy, on which no sign restrictions are imposed: household consumption, which is our variable of interest; consumer credit in real terms; the spread on consumer credit rates (the nominal rate on these transactions minus the rate on ORS lending transactions); and banks' capital as a percentage of banks' assets.

In greater detail, the restrictions shown in Table 4 imply that¹⁷: a) a monetary policy shock –positive from the perspective of Spain's domestic economy– lowers the short-term real interest rate and exerts upward pressure both on economic activity and on prices, with a one-quarter delay; b) a positive aggregate supply shock translates into an increase both in economic activity and in productivity as well as a fall in prices¹⁸; c) in response to a positive aggregate demand shock, both prices and the quantity of demand of goods and services rise, whereas the default rate does not increase¹⁹; d) a positive risk aversion shock raises the propensity of investors –both domestic and foreign– to make indirect investments in Spain, reducing the amount invested abroad²⁰; e) both positive credit supply and demand shocks exert upward pressure on the amount of available credit, although in the first case the spread on loan interest rates tends to rise, and in the second, it tends to fall.

Results and conclusions

Charts 31 and 32 summarise the main findings of these estimations. Beginning with what has occurred during the current economic crisis, Chart 31 shows the contributions from both identified and non-intensified shocks to the deviation observed in the growth of consumption to its mean. The results indicate that, once monetary policy has been stripped out, none of the other identified shocks has made a positive contribution to recent changes in consumption. Naturally, a significant proportion of consumption is not explained by the identified shocks and may stem, inter alia, from the tone of fiscal policy or from the economic effects of changes in oil prices or the real effective exchange rate. Even more importantly, we see that among the identified shocks, the contraction in demand for credit explains most of the decline in consumption by Spanish households. This finding suggests that the discretionary decisions of private agents are behind the financial deleveraging process and consequently that this process will be long and will continue to exert pressure on consumption, given what continues to be these agents' high level of indebtedness (in the case of families, about 123% of gross disposable income in 2011).

Chart 31
Spain: historical decomposition of the quarterly growth of consumption into structural and unidentified shocks (deviation from the mean in pp)



Source: BBVA Research

17: All other variables are assumed to not change initially.

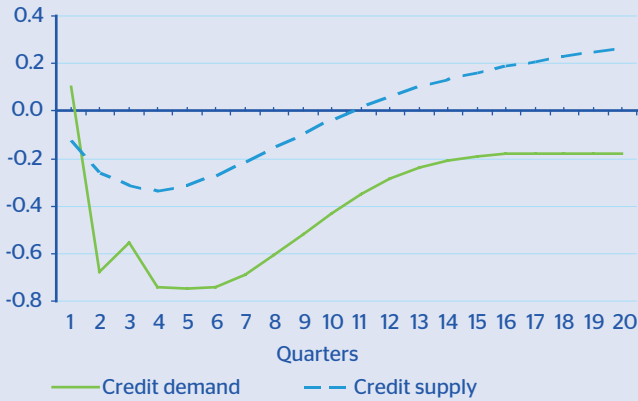
18: Rigidities in the Spanish labour market redound in a high procyclicality of employment, which, consequently, translates into the countercyclical behaviour of the apparent productivity of the labour factor. Although this result does not constrain the identification of the remaining shocks examined in this box—or the estimation of their impact on household consumption—it may lead to an underestimation of the impact of the aggregate supply shock on the Spanish economy.

19: The condition placed on the response of the default rate to an aggregate demand shock results from the need to differentiate this response from the response to a credit supply shock. Meeks (2009) and Tamási and Világi (2011) identify similar shocks—with effects on economic activity and prices of the same sign as those resulting from an aggregate demand shock—in which the default rate rises.

20: To identify this type of shocks, Tamási and Világi (2011) place restrictions on the response of monetary policy and the nominal effective exchange rate. These identification restrictions are not, however, suitable for the case of the Spanish economy given its integration into the EMU, where the ECB's unique mandate is to ensure price stability throughout the area.

Chart 32

Spain: response of consumption to a negative impulse from lending, by type of shock (deviation from qoq growth vis-à-vis the base scenario, in pp)



Note: the impulse has been normalized to 1 pp of credit.
Source: BBVA Research

Clearly, the findings described above, show the regularity, intensity and persistence of the shocks identified along with their impact on the long-term trends in real consumption, although they leave some important questions unanswered. For example, how would consumption be affected by a decline in credit, in the case of either a demand or a credit shock? Chart 32, simulating a 1.0 pp fall in real credit in the first quarter by type of shock, answers this question. For Spain, the results suggest that either a demand or a credit shock has a greater and longer-lasting impact on consumption than does a credit supply shock, the sign of which reverses in the medium term. This finding, along with the preceding one, confirms that the current deleveraging process will, inevitably, be long.

In sum, empirical evidence indicates that the deleveraging process in which both households and companies are immersed stems largely from their own discretionary decisions. The impact of these decisions on consumption is, consequently, proving significant, and this contractionary effect can be expected to be long-lasting. This result may, however, be reversed insofar as demand and supply shocks are not the only shocks with an effect on this component of aggregate demand. As shown in Chart 31, monetary policy along with other shocks not identified in this box have made a positive contribution to recent consumption trends. Likewise, supply or demand shocks that raise households' purchasing power could push up their spending for consumption.

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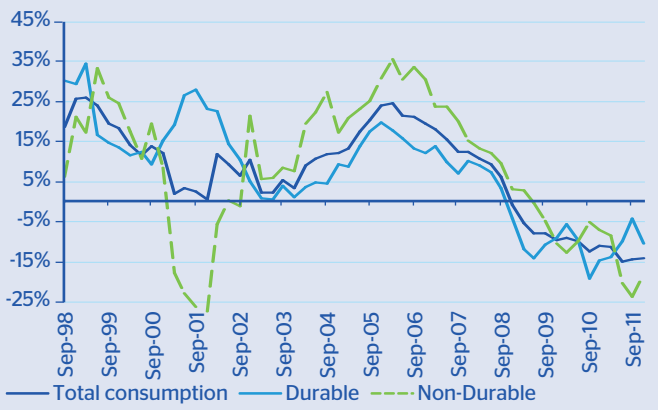
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Box 2. Drivers of demand for consumer credit

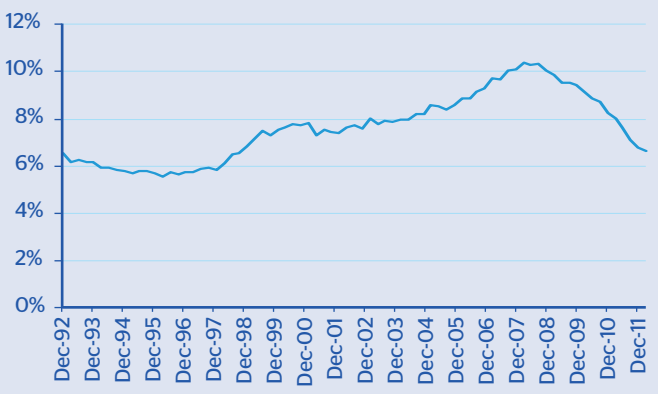
This box examines the factors that determine demand for consumer credit by Spanish households. The analysis uses a limited definition of consumer credit: lending by credit institutions to households for the acquisition of durable and non-durable goods and services. As noted in Section 4 and shown in Charts 33 and 34, households are quickly deleveraging for these items, from more than 10% of GDP in 2007 to 6.6% in late 2011.

Chart 33
Spain: credit to households for durable and non-durable goods and services (% yoy)



Source: BBVA Research based on Bank of Spain

Chart 34
Spain: credit to households for durable and non-durable goods and services (% of GDP)



Source: BBVA Research based on Bank of Spain

Household consumer credit depends primarily on three macroeconomic variables. First, there is a positive correlation with a country's income level and, therefore, aggregate private consumption. Second, there is an inverse correlation with the interest rate on a loan: the higher the interest rate, the lower the incentive for households to borrow, given the higher opportunity cost. Lastly, other factors, related to households' expectations regarding or household perception of the economic situation, directly affect demand for consumer credit. In a context of economic growth and job creation, households have a higher propensity to move purchases up through financing given their expectation that they will be able to repay their debts in the future.

To quantify the effects of each variable, real consumer credit has been modelled through an error correction model, taking real private consumption in national-accounting terms as an indicator of demand, interest rates on new credit transactions in real terms, as the price variable, and the unemployment rate as an indicator of household confidence and expectations. The model also takes into account government measures to provide incentives for durable-goods purchases, for example, "Plan 2000E", which stimulated automobile purchases from mid-2009 to mid-2010.

The results of the estimates indicate that consumption increases when aggregate private consumption rises, with a long-term elasticity of 1.4; it contracts by 3.6% for each 100 bp that lending interest rates rise; and it grows 4.6% for each additional percentage point decrease in the unemployment rate.

Knowing the response of consumer credit, in real terms, to changes in macroeconomic variables, and given the trends of the latter, we can break down growth in consumer credit at each moment in time. As shown in Chart 35, from 2002 to early 2006, real consumer credit rose by an average of about 8% per annum. Thereafter, the rate of growth accelerated, rising to above 15% yoy in late 2006. In this period, all the fundamentals contributed positively, demand being the indicator with the greatest impact, as it made an average contribution of 5 pp. Because of strong growth in consumer spending during this expansionary phase of the

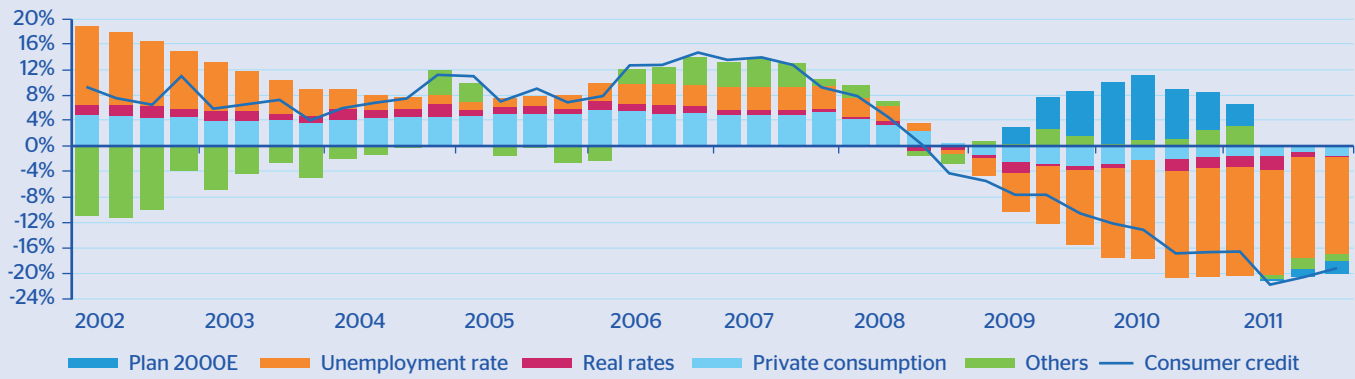
Spanish economy, there was positive growth in demand for credit; indeed, 3 pp of the growth in credit between 2006 and 2007 did not stem from economic fundamentals. Starting in 2007, real growth in consumer credit slowed, and in 2008 it turned negative. The dominant reason for the deterioration has been the higher unemployment rate, that is, the component consisting of household confidence and expectations, which fell by as much as 17 pp at its low point in 2011 and which at the end of last year accounted for -15.3 pp of the -19.1 pp decline in real credit. Measures focusing

on demand in the automobile sector, such as Plan 2000E (between May 2009 and May 2010), have had a positive effect on car purchases and financing, contributing as much as 10 pp to the yoy credit growth rate in the second quarter of 2010. The effect of these measures has, logically, worn off, and in 2011 their contribution turned negative²¹.

Clearly, trends in consumer credit are largely explained by higher consumption in the preceding expansionary phase and by the higher unemployment rate during the current crisis.

Chart 35

Spain: contributions to yoy growth in credit to households for durable and non-durable goods and services (%)



Source: BBVA Research

21: Note that the outstanding balance of consumer credit, that is, a stock variable, has been modelled. For this reason, the positive effects of the Plan 2000E can still be perceived in the second half of 2010, after the conclusion of the plan.

5. Analysis of the economic situation of retail trade based on BBVA's Business Tendency Survey: effects of the new consumer credit contract law²²

To round out our study on the economic situation of the retail trade sector in Spain and its interrelation with the supply and demand for credit, BBVA Research introduced its six-monthly Business Tendency Survey (BTS) in December 2010. The BTS is aimed at managers and directors of BBVA's Consumer Finance Department in Spain who sell consumer loans (brokers) in the sectors distributing goods—mainly durable goods—and retail services²³.

The BTS survey is divided into three sections. The first contains information on the location of those interviewed (autonomous community, province and sectors of collaborating companies); in the second section participants are asked about their assessment of the economic situation—current and forecast—for the sectors in which they operate and the economy as a whole. In the third section, those interviewed evaluate the present and future trends for the supply and demand for credit in their area of business²⁴. In addition, to analyse the effects of the entry into force of Law 16/2011, of 24 June, on consumer loan contracts, at the end of September of last year, an additional model was included in the BTS for the second half of 2011 asking respondents their opinions on the new regulation for customers and financial institutions.

Results of the BTS: reality worse than expectations

Chart 36 shows that respondents' perceptions on the economic situation in Spain have turned gloomier over the last two years. In the first half of 2012, the spread between the percentage of respondents indicating the economy had improved and the percentage indicating that it had worsened—normally used to gauge the economic situation²⁵—has narrowed by 83.5 points, 16.6 points less than in 2H10. Although economic performance has worsened in the four preceding six-month periods, BTS respondents expect the economic deterioration to ease up in the second half of the year. Hence, 47.5% of respondents feel that the economic situation will not deteriorate further in 2H12 whereas only 16.6% consider that it has not worsened in 1H12.

The evaluation of the current state of the Spanish economy and the outlook for it vary according to the sector of the respondent. As shown in Chart 37, the balance of responses varies from one region to the next²⁶. In the first half of 2012, responses to the BTS by residents of Madrid, the Canary Islands and the Northeast and South regions pointed to a worsening of the economic situation less severe than indicated by the national average. By contrast, respondents from the Central, East and Northeast regions pointed to a more severe worsening than that indicated by the national average. Expectations for 2H12 are improving in all Autonomous Communities, especially in Madrid and the Northeast and East regions.

22: We are grateful to the following people for participating in the surveys: the managers and directors of BBVA's Consumer Finance department, as well as for the collaboration of Antonio Marín, Ángel Morán, Ana Rubio, Macarena Ruesta and Pep Ruiz in designing the questionnaires and collating the data.

23: The activities studied are car and motorcycle sales and repairs; retail sales of ITC equipment; sales of hardware articles, paints and glass; household appliances; furniture; cosmetic and hygiene products; and other products which are not sold in specialist establishments. Other credit activities relating to granting loans to institutions not involved in money trading are also included (particularly consumer loans).

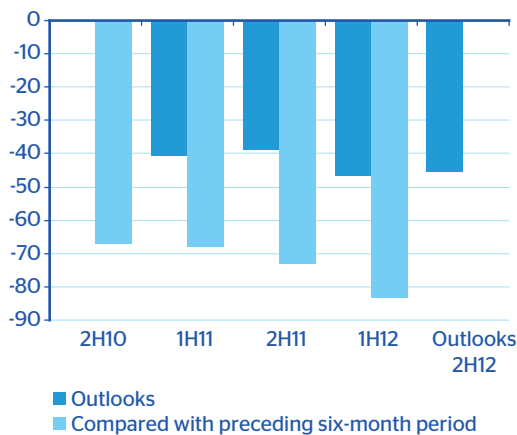
24: Bear in mind that the questions refer to the market as a whole and not to BBVA's policy.

25: Constructing a balance of responses based on the data of opinion polls is common practice. See, for example, the synthetic indicators formulated by the European Commission (http://ec.europa.eu/economy_finance/db_indicators/surveys/index_en.htm) and the Ministry of Industry, Tourism and Trade (<http://www.minetur.gob.es/es-ES/IndicadoresyEstadisticas/Industria/EncuestaCoyuntura/Paginas/EncuestaCoyuntura.aspx>), among others.

26: In order to preserve the confidentiality of the participants and to avoid problems of representativeness, aggregate results for the seven autonomous community groups which comprise level 1 Statistical Territorial Units (NUTS1) are listed. These are: Northwest (Galicia, Asturias and Cantabria); Northeast (Basque Country, Navarra, Rioja and Aragon); Madrid (Community of Madrid); Central region (Castile-León, Castile-La Mancha and Extremadura); East (Catalonia, Valencia and Balearic Islands); South (Andalusia, Murcia, Ceuta and Melilla); and Canary Islands (Canary Islands).

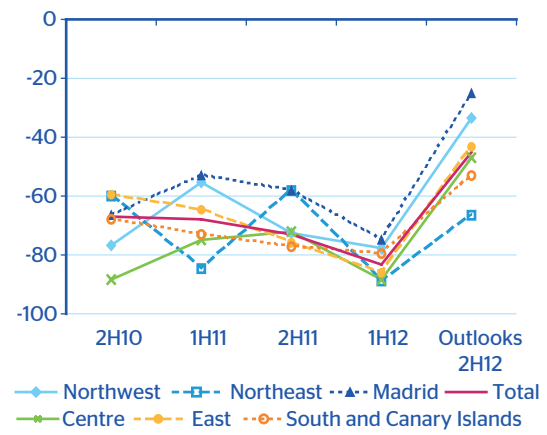
In line with the results for the economy overall, the perception on the economic situation held by all sectors of activity worsened between January and June 2012, and to a greater extent than forecast six months ago. Regarding the activities analysed, we should note that the perception has deteriorated to a lesser extent regarding the state of the motor-vehicle sector (including motorcycles). As shown in Chart 38, the spread between the percentage of responses pointing to an improvement in this sector and the percentage pointing to a deterioration was 9.5 points higher than the average for the remaining activities in 2H11, and stood at 15.5 points in 1H12. As with the Spanish economy, the situation for all sectors is expected to continue to worsen in 2H12, although at a significantly slower pace than last year.

Chart 36
Perception of the state of the Spanish economy: balance of responses (<0 indicates a worsening)



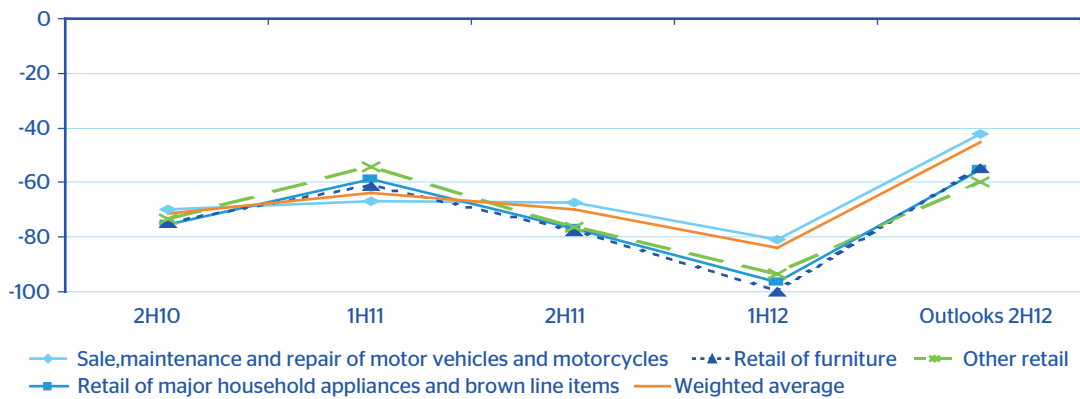
Source: BBVA Research (BTS)

Chart 37
Perception of the state of the Spanish economy in each region: balance of responses (<0 indicates a worsening)



Source: BBVA Research (BTS)

Chart 38
Perception of the economic situation of each sector: balance of responses (<0 indicates a worsening)

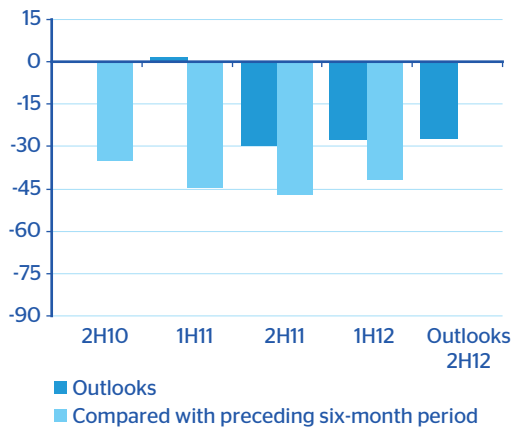


Source: BBVA Research (BTS)

Credit trends reflect a worsening of the economy as perceived by respondents, as a result of both of diminishing supply and of increasingly weak demand. BTS respondents consider that the supply of, and especially the demand for, credit have decreased over the last two years more than expected (see Charts 39 and 40). In particular, the percentage of respondents who feel that supply shrank between January and June of 2012 stood at 48.9%, 5.7 pp lower than in 2H11; by contrast, 87.1% of the survey respondents feel that demand shrank in 1H12, 7.9 pp higher than in the previous six-month period.

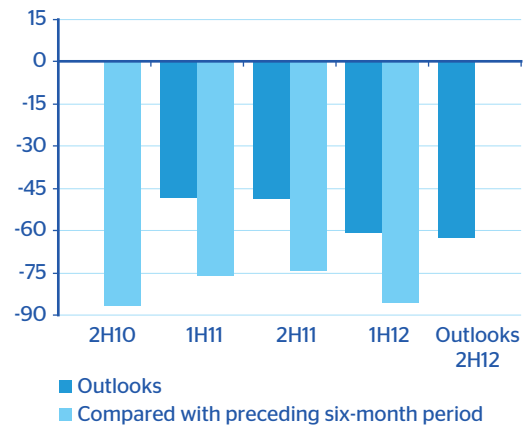
The outlook for 2H12 is somewhat more favourable in terms of the supply of credit. Only 38.1% of managers and directors at BBVA Consumer Finance believe that supply will contract, while 66.9% consider that demand for credit will continue decreasing, although at a lower rate than during the first part of the year.

Chart 39
**Perception of credit supply (%):
balance of responses (<0 indicates a worsening)**



Source: BBVA Research (BTS)

Chart 40
**Perception of demand for credit:
balance of responses (<0 indicates a worsening)**

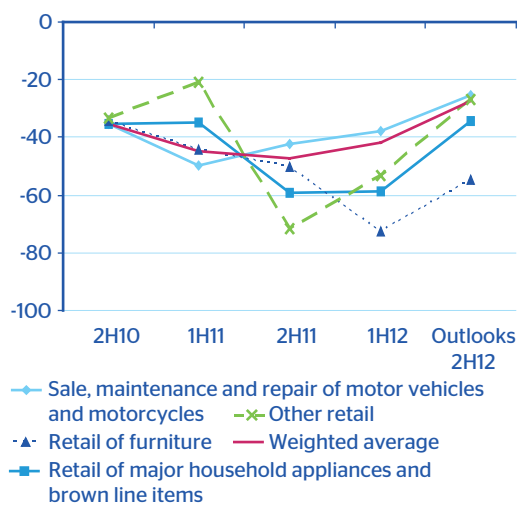


Source: BBVA Research (BTS)

The trend in loans by sector replicates the aggregate pattern, with a slowdown in the deterioration of supply and worsening of demand compared with 2H11, and with expectations not being met in either case. There are however certain differences (see Charts 41 and 42). In particular, we should note the significant contraction in the supply and demand for credit in the retail furniture sector –probably associated with the ongoing adjustment in the real estate sector– and the less unfavourable trends with credit in the car and motorcycle distribution sector.

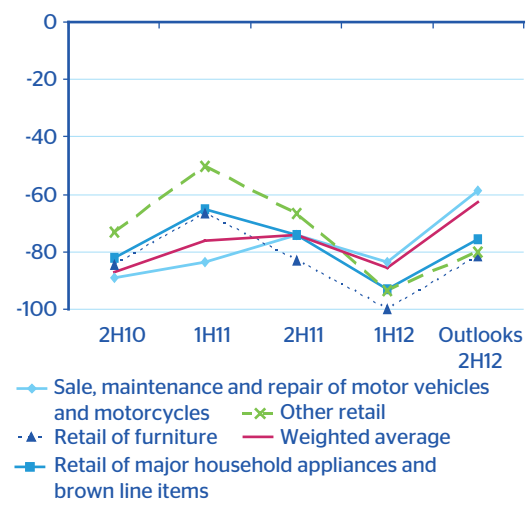
The expectations of BTS respondents for 1H12 suggest that credit will continue decreasing in all the activities studied, due to both supply and demand, albeit at a lower rate. This is also consistent with forecast trends for economic activity in each sector.

Chart 41
**Perception of credit supply in each sector:
balance of responses (<0 indicates a worsening)**



Source: BBVA Research (BTS)

Chart 42
**Perception of demand for credit in each sector:
balance of responses (<0 indicates a worsening)**



Source: BBVA Research (BTS)

Law on consumer credit contracts: little effect on supply, significant advantages for demand

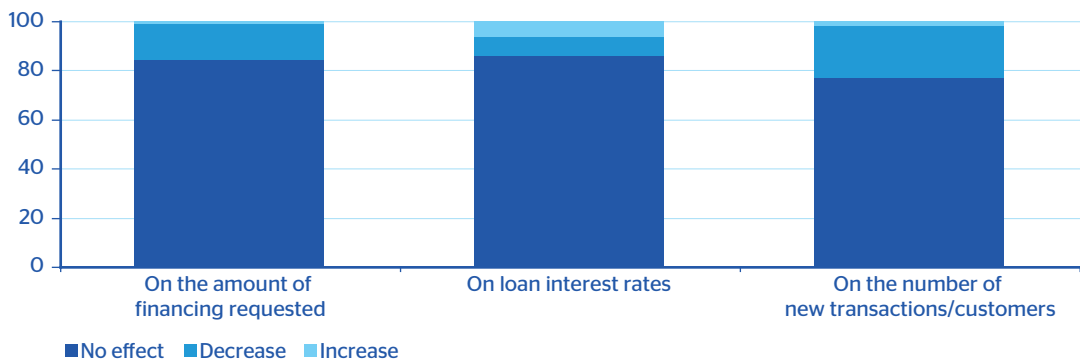
On 25 September 2011, the Law on Consumer Credit Contracts came into force after gaining passage in June of that year²⁷. The new law aims to adapt current European legislation to the evolution of financial practices and enhance consumer protection, harmonising consumer credit contracts and making them transparent.

To understand the possible effects of the new requirements for lenders and the broadening of borrowers' rights, an additional section was included in the BTS issue for the second half of 2011. The findings indicate that the new law has minimal consequences in financial institutions. Hence, 84.7% of the respondents stated that the legal change has had no effect on the amount of financing requested, while 86.5% consider that it has not affected interest rates on loans. The most important effect of the new law has been on the number of new transactions: 20.9% of the BTS respondents say that the obligation to evaluate borrowers' solvency on the basis of information provided by loan applicants as well as that contained in records on financial creditworthiness, among other sources, has caused a decline in the number of loans (see Chart 43).

Although credit institutions and intermediaries must now go to greater lengths when reporting and executing a transaction, the managers of BBVA's Consumer Finance department see certain advantages for lenders in the new law, especially in terms of the certainty stemming from improvements in how loan contracts are drafted and the possible increase in market share owing to the elimination of deceitful offers (see Chart 44).²⁸

Undoubtedly, the main beneficiaries of the changes introduced through Law 16/2011 are consumers, as shown in Chart 45. First, because the new law puts a cap on cancellation fees (83.4% of the respondents view this as an advantage); second, because it increases transparency during the contracting process (79.1%); and, third, because of the link between the good or service being financed (58.3%) and the increased ease with which parties can desist (57.1%). However, respondents do not have the perception that the regulatory changes have made it easier to obtain financing: for 77.3% of them, this aspect constitutes an advantage solely for borrowers.

Chart 43
Effects of the new consumer credit contract law (%)

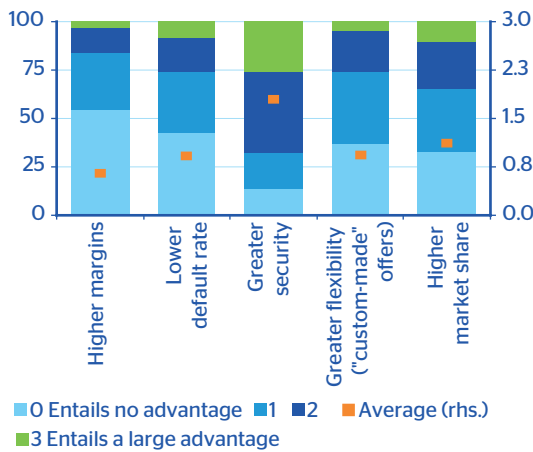


Source: BBVA Research (BTS)

27: Law 16/2011 is available at: <http://www.boe.es/boe/dias/2011/06/25/pdfs/BOE-A-2011-10970.pdf>. See Box 2 of the 1H11 issue of Consumption Outlook for a detailed analysis of the new credit contracts law: http://www.bbvaesearch.com/KETD/fbin/mult/1111_Situacionconsumo_tcm346-281278.pdf?ts=1652012.

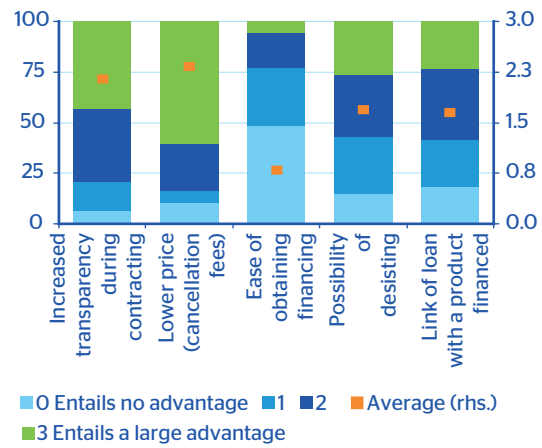
28: It is likely that the three months that elapsed between the entry into force of the new law and the preparation of the 2H11 were too short a period to evaluate to what extent the legal change will bring down the default rate.

Chart 44
Advantages of the new consumer credit contract law for lenders (%)



Source: BBVA Research (BTS)

Chart 45
Advantages of the new consumer credit contract law for borrowers (%)



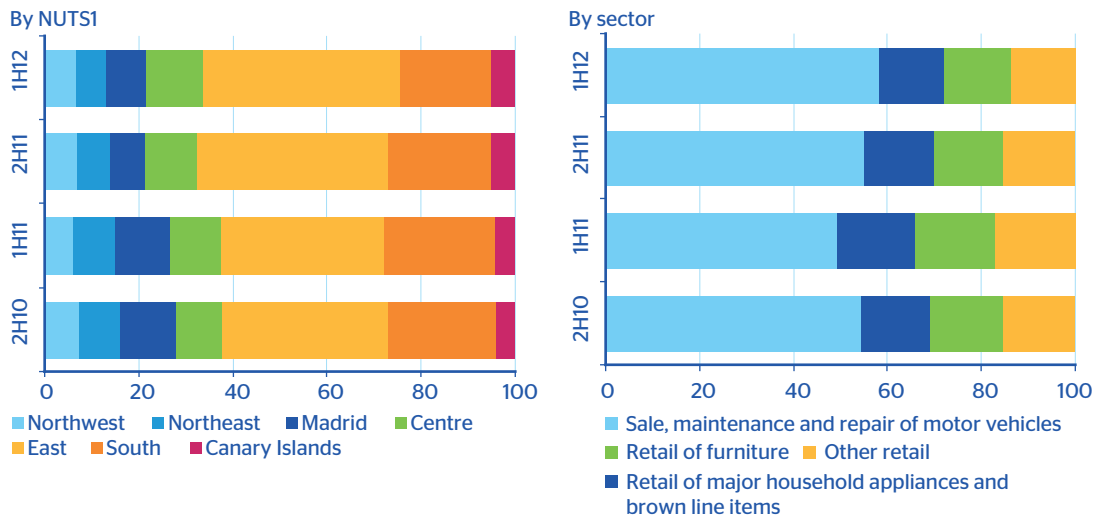
Source: BBVA Research (BTS)

In sum, the results of the BTS suggest that the economic situation of retail sectors worsened more than expected over the last year, especially in the case of activities most closely linked to the real estate sector such as sales of furniture, household, major appliances and brown line items. Slack consumption and weak fundamentals have affected demand for credit, with a higher rate of contraction in the first half 2012. At the same time, financing conditions eased somewhat, although not enough to prevent a contraction of the supply of consumer loans in all branches of retail activity, with furniture distribution being the branch that was hit the hardest. Despite its unquestionable advantages for borrowers, the new consumer credit contract law does not appear to have significantly affected financing.

The outlook for 2H12 points to a generalised slowdown in the deterioration of economic activity, largely based on a smaller decline in the supply and demand for credit. Nevertheless, reality has systematically worsening expectations over the last two years. Along with the lingering financial tension, this will serve to test compliance of these expectations.

Appendix

Table A1.
BBVA Business Tendency Survey. Breakdown (%)



NUTS1: Nomenclature of the level 1 Statistical Territorial Units. Northwest: Galicia, Asturias and Cantabria; Northeast: Basque Country, Navarra, Rioja and Aragon; Madrid; Central region: Castile and León, Castile-La Mancha and Extremadura; East: Catalonia, Valencia and Balearic Islands; South: Andalusia, Murcia, Ceuta and Melilla; Canary Islands.
Number of observations: 175 in 2H10, 147 in 1H11, 163 in 2H11 and 140 in 1H12.
Source: BBVA Research

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This report has been produced by the Sapin Unit:

Chief Economist for Developed Economies

Rafael Doménech
+34 91 537 36 72
r.domenech@bbva.com

España
Miguel Cardoso
+34 91 374 39 61
miguel.cardoso@bbva.com

Anabel Arador
+34 91 374 401 40 42
ana.arador@grupobbva.com

Joseba Barandiaran
+34 94 487 67 39
joseba.barandia@bbva.com

Mónica Correa
+34 91 374 64 01
monica.correa@bbva.com

Juan Ramón García
+34 91 374 33 39
juanramon.g@bbva.com

Ángel Gavilán
+34 91 374 52 62
angel.gavilan@bbva.com

Félix Lores
+34 91 374 01 82
felix.lores@bbva.com

Antonio Marín
+34 648 600 596
antonio.marin.campos@bbva.com

Myriam Montañez
+34 954 24 74 8
miriam.montanez@bbva.com

Virginia Pou
+34 91 537 77 23
virginia.pou@bbva.com

Leticia Riva
+34 91 374 62 66
leticia.riva@bbva.com

Pep Ruiz
+34 91 537 55 67
ruiz.aguirre@bbva.com

Camilo Andrés Ulloa
+34 91 537 84 73
camiloandres.ulloa@bbva.com

With the contribution of:

Economic Scenarios
Rodrigo Falbo
+34 91 5373977
rodrigo.falbo@bbva.com

Financial Systems
Jose Felix Izquierdo
+34 91 3744200
jfelix.izquierdo@bbva.com

Macarena Ruesta
+34 91 3743321
esperanza.ruesta@bbva.com

BBVA Research

Group Chief Economist Jorge Sicilia

Emerging Markets:

Alicia García-Herrero
alicia.garcia-herrero@bbva.com.hk

Cross-Country Emerging Markets Analysis

Álvaro Ortiz Vidal-Abarca
alvaro.ortiz@bbva.com

Asia
Stephen Schwartz
stephen.schwartz@bbva.com.hk

Latam Coordination
Juan Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Alejandro Puente
apuente@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Oswaldo López
oswaldo_lopez@bbva.com

Mexico
Adolfo Albo
a.albo@bbva.bancomer.com

Macroeconomic Analysis Mexico
Julián Cubero
juan.cubero@bbva.bancomer.com

Developed Economies:

Rafael Doménech
r.domenech@bbva.com

Spain
Miguel Cardoso
miguel.cardoso@bbva.com

Europe
Miguel Jiménez
mjimenezg@bbva.com

United States
Nathaniel Karp
nathaniel.karp@bbvacompass.com

Financial Systems & Regulation:

Santiago Fernández de Lis
sfernandezdelis@grupobbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Pensions
David Tuesta
david.tuesta@bbva.com

Regulation and Public Policy
María Abascal
maria.abascal@bbva.com

Global Areas:

Financial Scenarios
Sonsoles Castillo
s.castillo@bbva.com

Economic Scenarios
Juan Ruiz (I)
juan.ruiz@bbva.com

Innovation & Processes
Clara Barrabés
clara.barrabes@bbva.com

Market & Client Strategy:

Antonio Pulido
ant.pulido@grupobbva.com

Global Equity
Ana Munera
ana.munera@grupobbva.com

Global Credit
Javier Serna
javier.serna@bbvauk.com

Global Interest Rates, FX
and Commodities
Luis Enrique Rodríguez
luisen.rodriguez@grupobbva.com

Contact details:

BBVA Research
Paseo Castellana, 81 - 7th floor
28046 Madrid (Spain)
Tel. + 34 91 374 60 00 and + 34 91 537 70 00
Fax. +34 91 374 30 25
bbvaresearch@bbva.com
www.bbvaresearch.com