

Consumption Outlook

Second half 2012

Madrid, 13 December 2012

Key themes

- 1 Global growth will pick up gradually from the end of the year and throughout 2013 thanks to the monetary measures implemented by developed economies and the measures to support growth in emerging markets
- 2 The risk scenarios are less likely than three months ago, although the eurozone and the US are still facing significant challenges
- 3 Spain: is still expected to contract in 2012 and 2013. The fiscal measures implemented are bearing fruit but the recession is delaying meeting the target. Implementation of structural reforms is more necessary than ever before.
- 4 The change in Spanish household preferences is the main reason behind the variations in the consumption basket witnessed during the crisis
- 5 The increase in VAT and weaker drivers signal a decrease in consumption expenditure in 2013, especially on durable goods
- 6 Households will continue to deleverage, shaping the performance of consumer credit

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Global economy: gradual acceleration backed by economic policies

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Spain: the economy continues to adjust, fiscal efforts are bearing fruit and the agenda of reforms is more necessary than ever before

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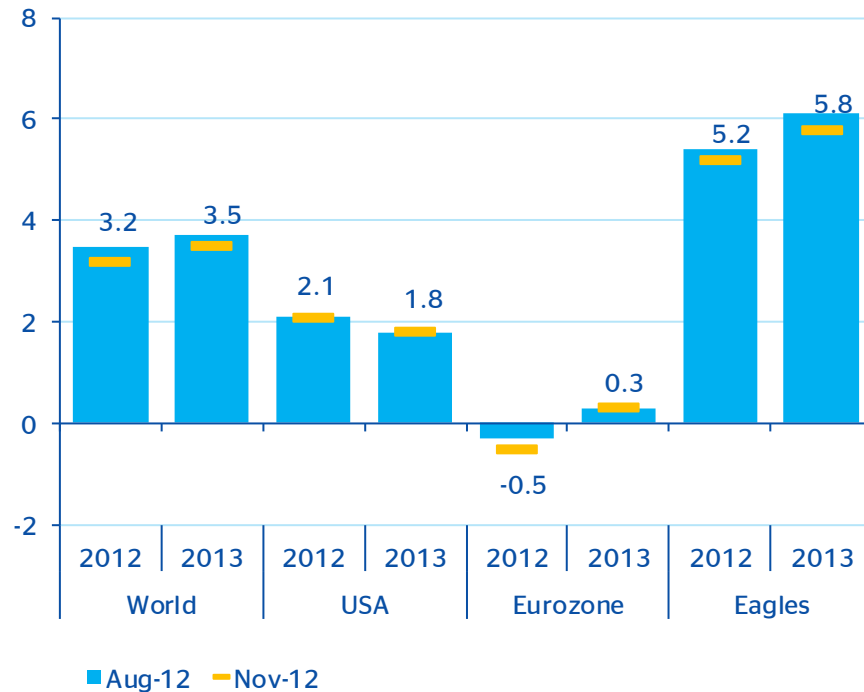
..... especially in demand for durable goods

Section 1

Growth remains heterogeneous

GDP growth by area (% yoy)

Source: BBVA Research



A three-speed world

Economic policy measures (pro-growth in emerging nations and monetary measures in developed economies) will boost global growth

Eurozone: slow, disparate and vulnerable recovery, with doubts as to the effects of fiscal consolidation on growth

Tail risk scenarios are currently less probable than they were three months ago...

... if the agreements are upheld and the proposed measures are applied, although there are still serious risks

Section 1

The European financial scenario has improved

Significant advances have been made over the past few months

Restructuring Greek debt and moving up the ESM timetable

Approval of the Treaty of Stability

Reforms in Portugal, Spain and Italy + growth plan through the EIB (1% of GDP)

The German Constitutional Court has backed the commitment to the ESM, which loses its preferred creditor status and will be able to directly recapitalise financial entities by establishing a single supervisor

ECB contingent intervention agreement (OMT): ECB acts as 'European-style' lender of last resort that will operate under fiscal conditionality

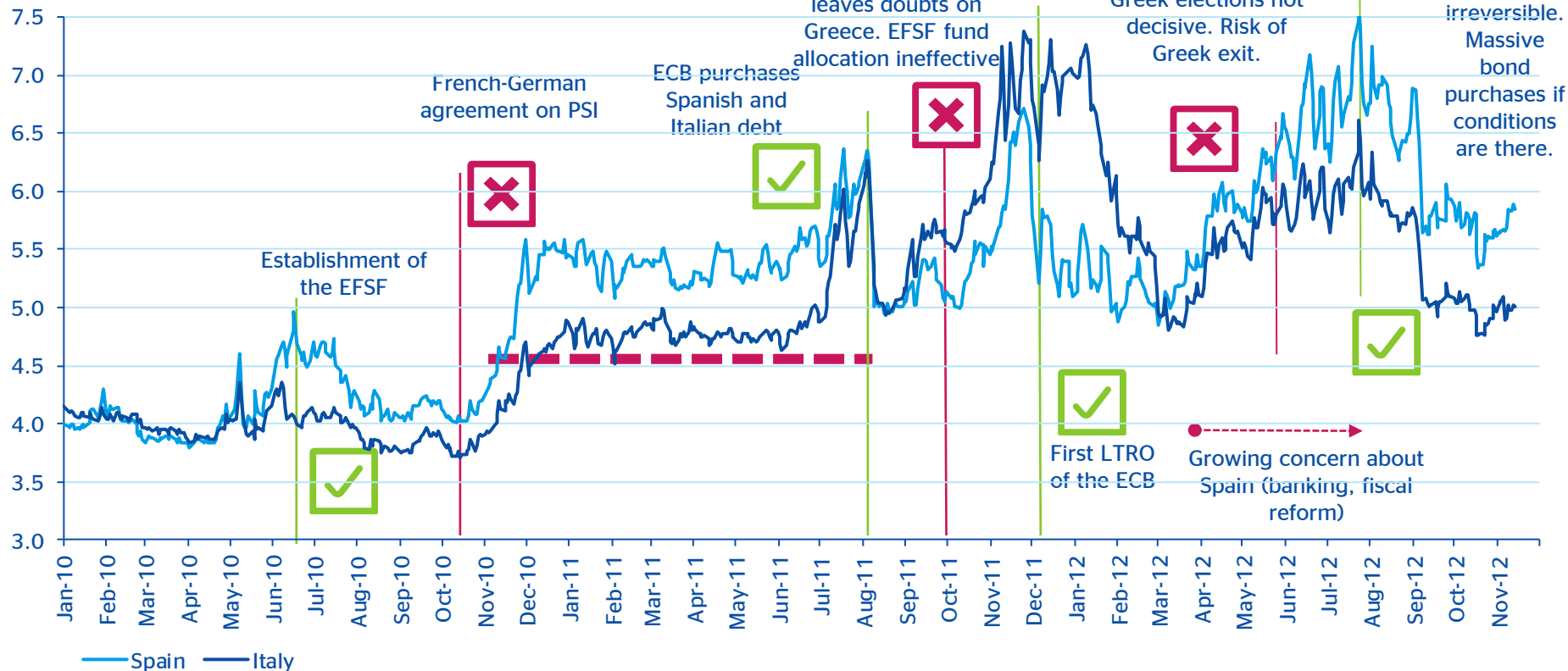
Section 1

Will Europe take advantage of this new window of opportunity?

The authorities have so far been a step behind events

Spain and Italy: 10Y bond yield (%)

Source: BBVA Research and Haver



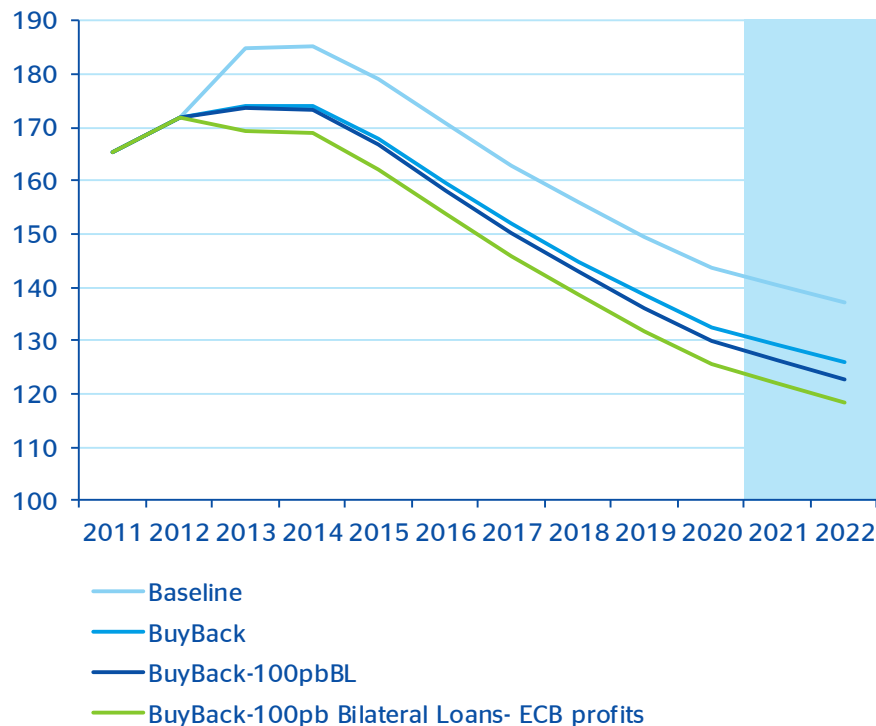
Section 1

Significant challenges still persist

1 Uncertainty over the sustainability of Greek debt

Greece: public debt (% GDP)

Source: BBVA Research and IMF



Results of the agreements on Greece

The next tranche of assistance has been approved and a raft of measures announced. These include lowering interest rates, a moratorium on the repayment of loans, the ECB writing off profits and the launch of a debt repurchase programme

Objective: reduce the debt ratio to 124% in 2020 and significantly below 110% in 2022 - pending approval by European parliament

The risk of imminent default has disappeared ...

... but uncertainty over the sustainability of long-term debt remains

Section 1

Significant challenges still persist

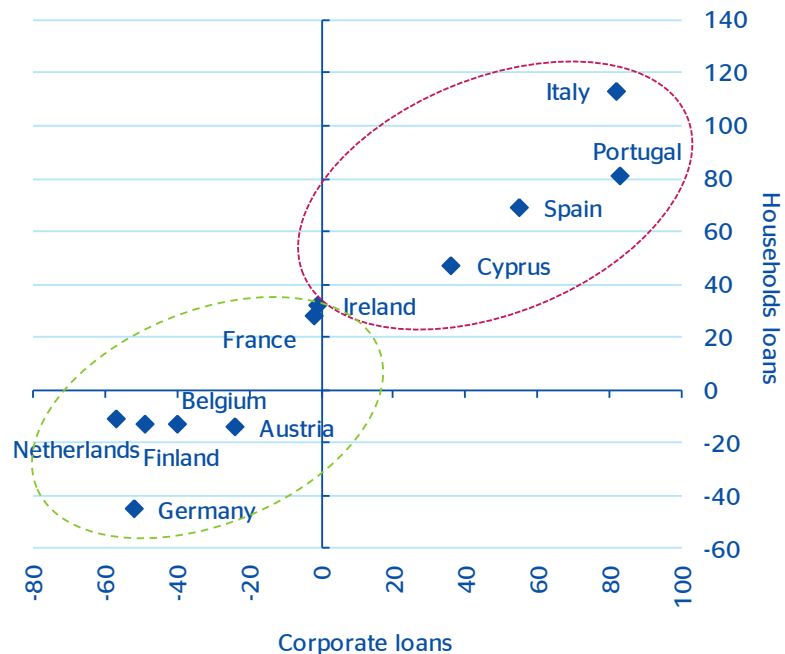
2 A fragmented European economy

Fragmented financial markets due to the existence of national regulations that need to be resolved after banking union

Change in the interest rate on new bank loans

(bp, December 2010 to July 2012)

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

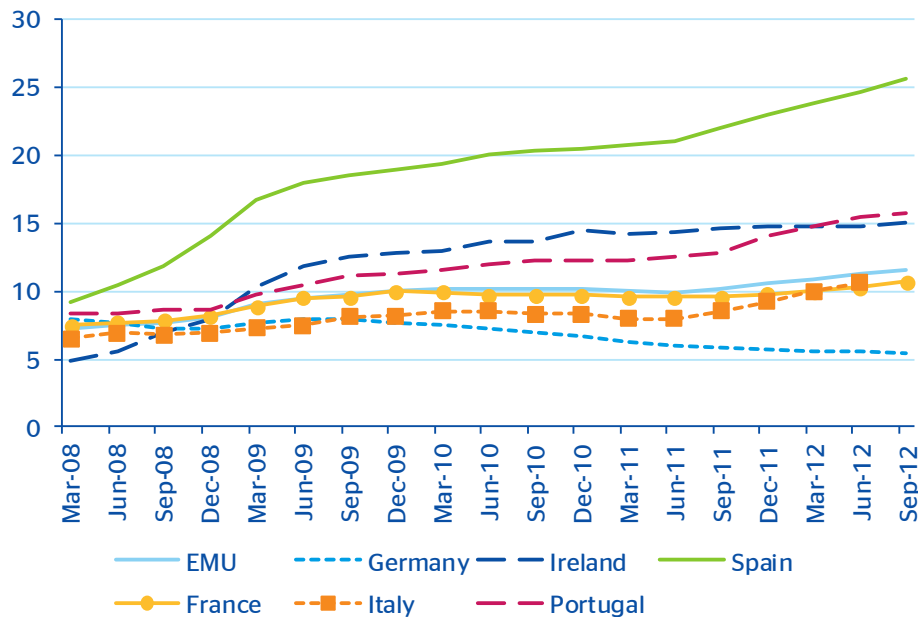


Real imbalances: the unemployment rate as a paradigm

Unemployment rate

(SWDA data, % of the active population)

Source: BBVA Research based on Eurostat data



Section 1

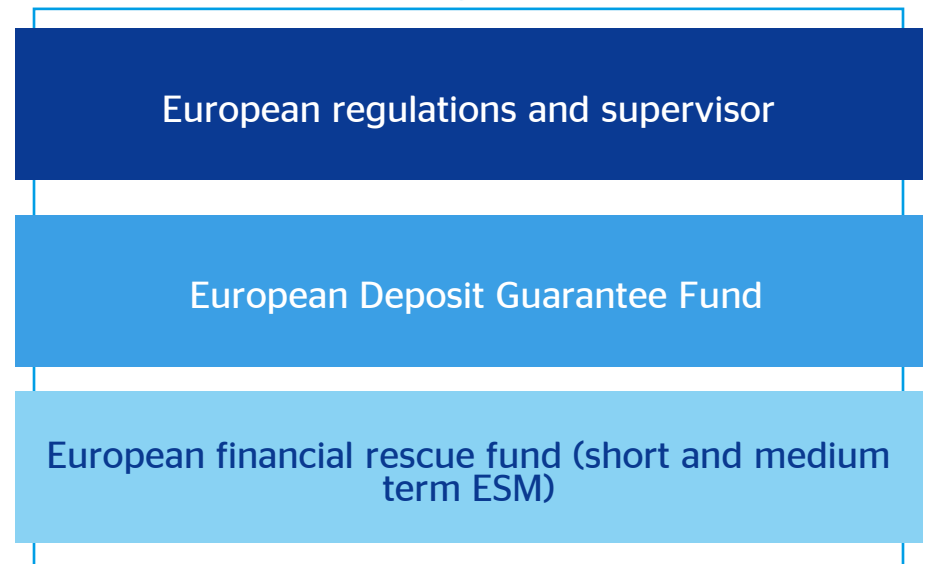
Significant challenges still persist

3 Need for greater fiscal and financial integration

From the Treaty on Stability to fiscal union



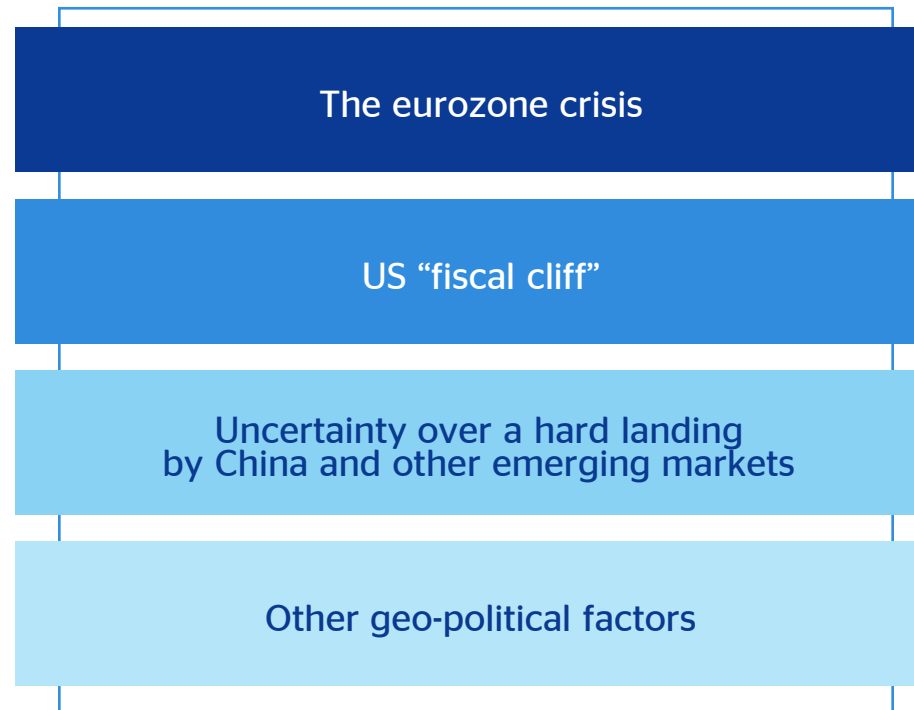
Banking union



Transfer of sovereignty

Section 1

Risk factors



The eurozone crisis is the most significant of all of these

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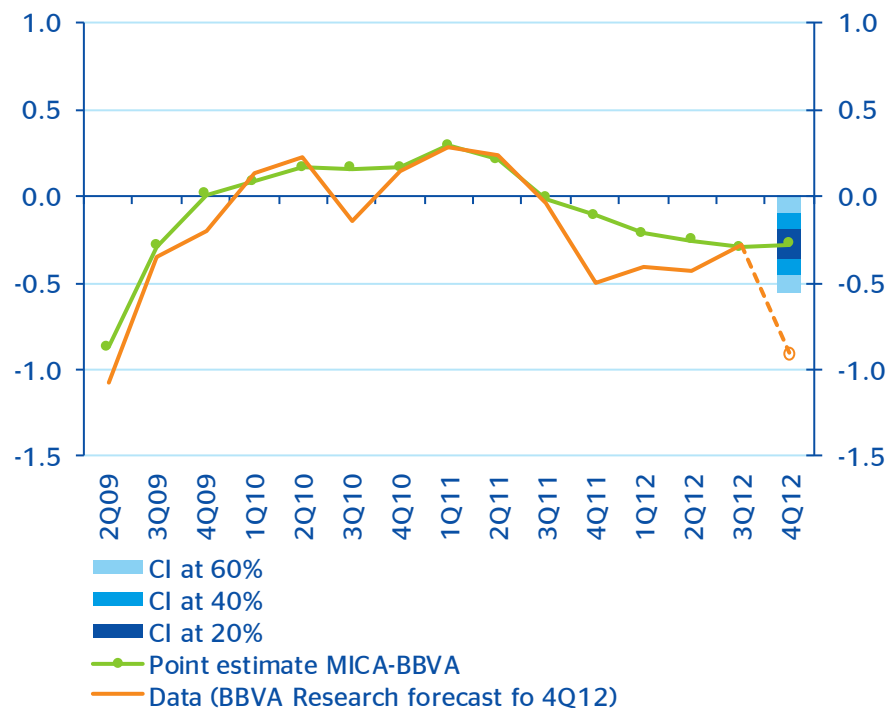
..... especially in demand for durable goods

Section 2

Spain, in recession

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

Source: BBVA Research
Current forecast: 7 December



The Spanish economy contracted in the first three quarters of this year ...

... and will also contract in the last quarter, although to a lesser extent than expected several months ago

Employment will continue to be hindered by the negative outlook for growth

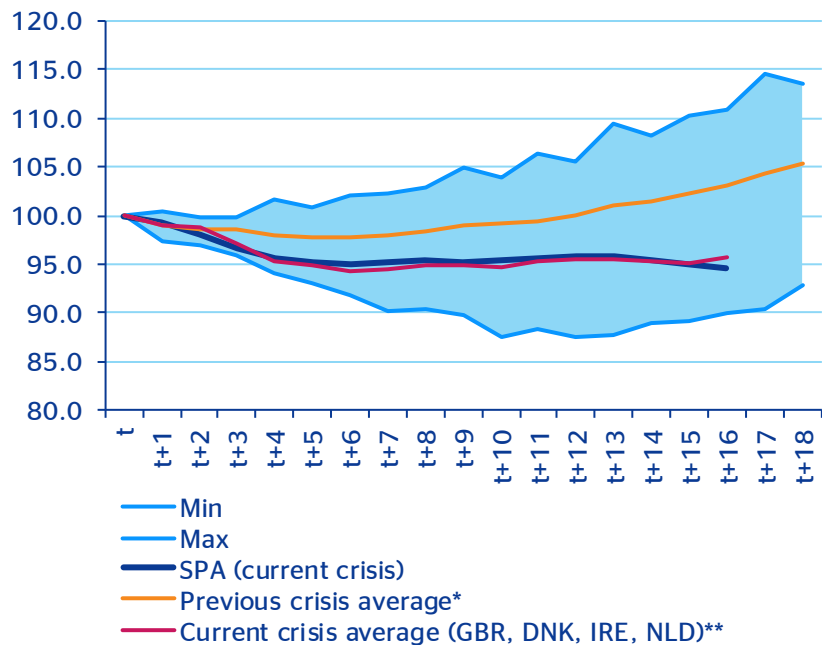
Section 2

Key factors

1 Adjustment of imbalances: real estate sector

Real GDP during property market crises (t=100)

Source: BBVA Research based on Haver data



The Spanish economy is correcting the imbalances built up in the previous expansion phase

The largest of these imbalances is found in the real estate sector

The downturn in activity in Spain (and in other European countries) seems to have been greater and recovery slower than on other occasions

Note: t is the period in which the price hit its peak
 * Refers to property market crises in the sample that have already concluded
 ** Refers to property market crises in the sample that are still ongoing

Section 2

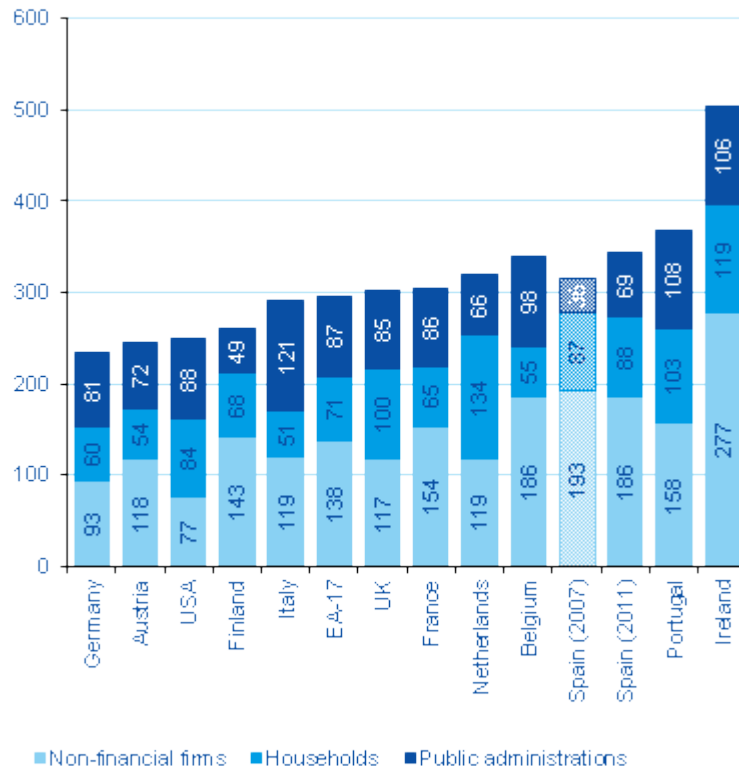
Key factors

2 Adjustment of imbalances: debt

Outstanding debt by business sector

(% of 2011 GDP, excluding the financial sector)

Source: BBVA Research based on Haver data



Excessive debt is a burden for the economy and hinders recovery

Deleveraging processes tend to be protracted (between 5 and 10 years)

Although the deleveraging process appears to have started in the private sector, the public sector continues to accumulate debt

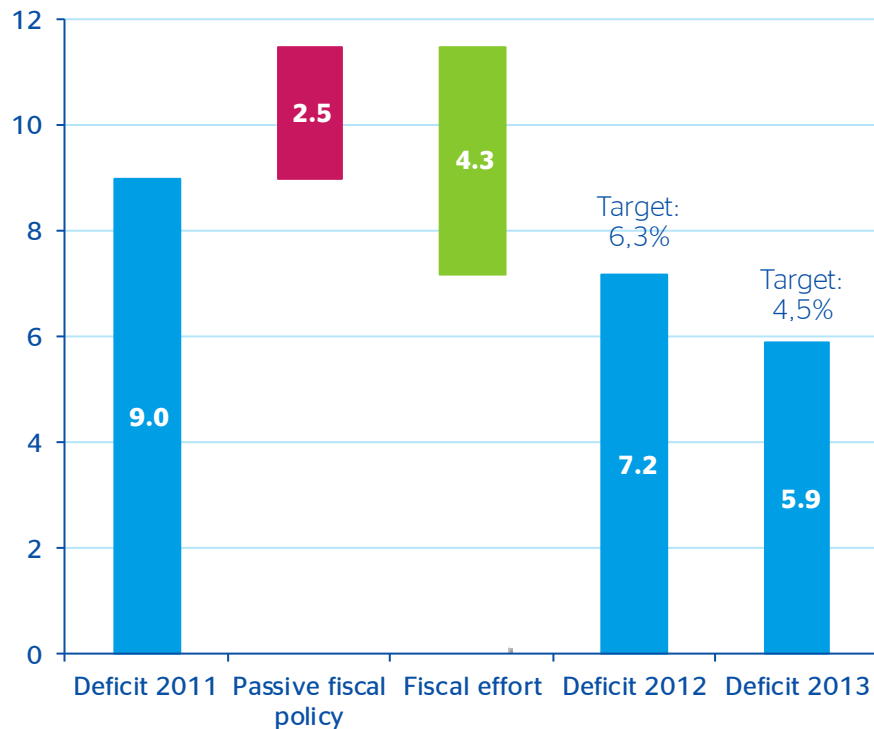
Section 2

Key factors

3 Adjustment of imbalances: substantial fiscal consolidation

Public administrations: breakdown of the public deficit excluding aid to the financial system (% GDP)

Source: BBVA Research, based on MINHAP data



Fiscal consolidation is working: the fiscal effort in 2012 will be over 4pp of GDP

The economic downturn is invariably delaying the achievement of the nominal target ...

... although at the current pace and a strict budget, a structural balance will be achieved in 2014

Overall, there are still major reforms to be undertaken, that would increase the efficiency of the public administrations

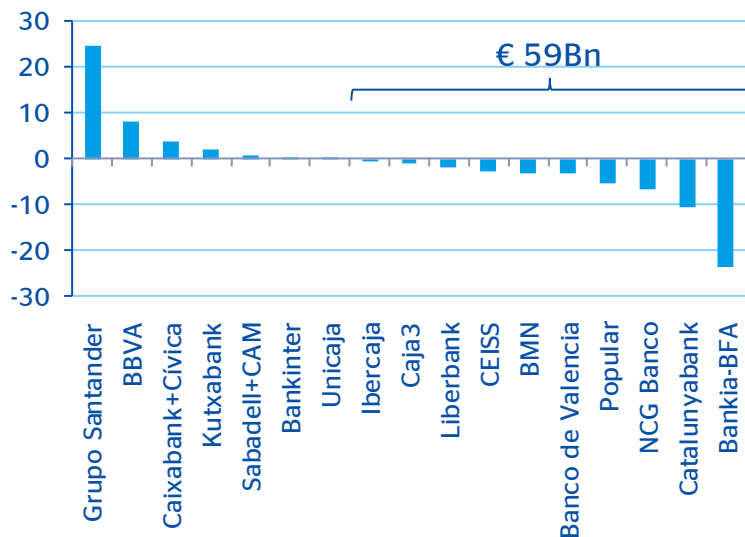
Section 2

Key factors

4 Adjustment of imbalances: Financial system restructuring

Capital requirements of financial institutions in the adverse scenario* (Eur Bn)

Source: Bank of Spain



A further step in bank restructuring

Recapitalisation plans will include EUR40bn in public aid

The system is not uniform: solvent institutions hold 70% of the assets

Process of transferring assets to Sareb, with discounts to attract private capital and no consolidation as public debt

* Does not include mergers under way or tax credits (EUR 54bn)

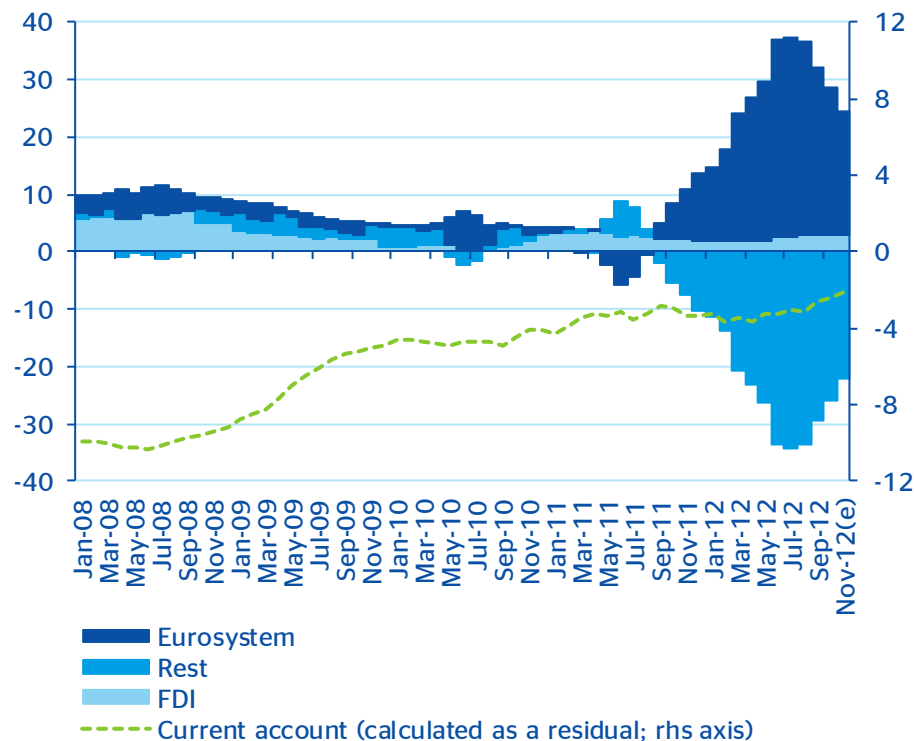
Section 2

Key factors

5 Lower risk premium and improved capital flows

Spain: balance of payments and capital flows

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



ECB announcements have contributed to:

- Preventing from a systemic risk event
- Ensuring the eurozone monetary policy functions correctly
- Reducing the upward pressure on the risk premium and capital flows in Spain
- Reducing risk aversion: partial reopening of the private debt markets

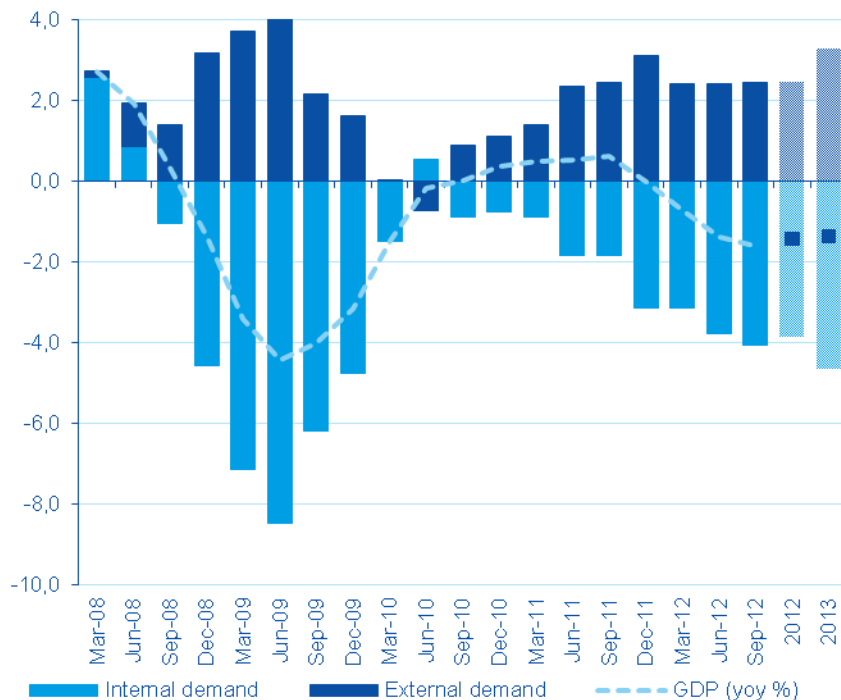
Section 2

Key factors

6 The solution lies in support from the external sector and structural reforms

Spain: breakdown of quarterly GDP growth (% yoy)

Source: BBVA Research based on INE data



- Reduce the risk of implementing fiscal policy (LEP)
- Mitigate the medium term risk affecting public finances (independent fiscal agency + pension reform)
- Increased competitiveness (professional services)
- A more dynamic labour market (ALMP)
- Regulatory changes (market unit)
- Encourage the growth of the SME segment (alternative financing)

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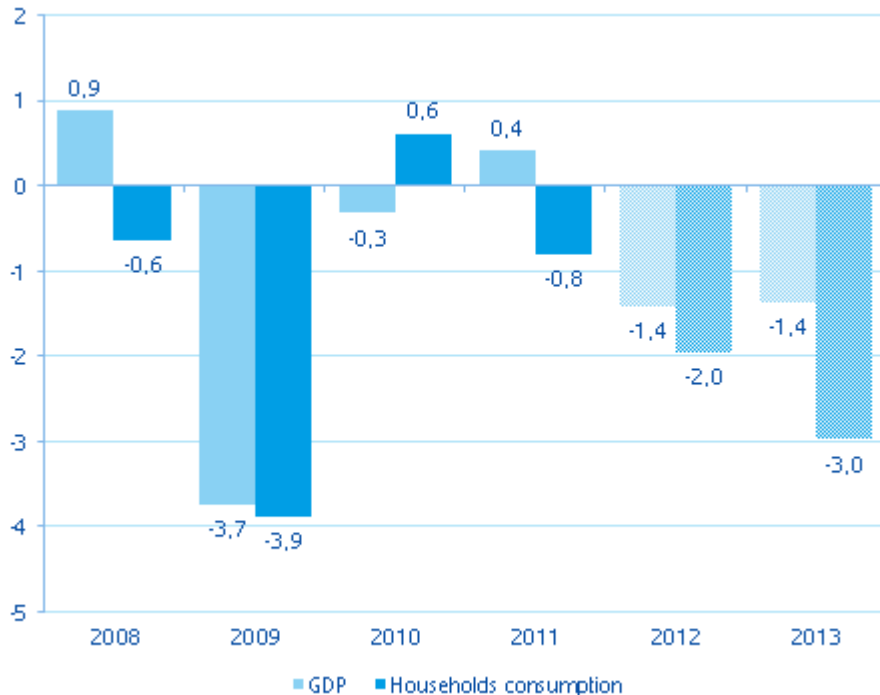
..... especially in demand for durable goods

Section 3

Household consumption

Spain: private consumption (%)

Source: BBVA Research based on INE data



Key drivers of consumption

Disposable income	<ol style="list-style-type: none"> 1. Job destruction and wage moderation 2. Public sector deleveraging
Propensity to save/consume	<ol style="list-style-type: none"> 3. Uncertainty 4. Liquidity pressure and return on savings
Possibility of borrowing	<ol style="list-style-type: none"> 5. Private sector deleveraging

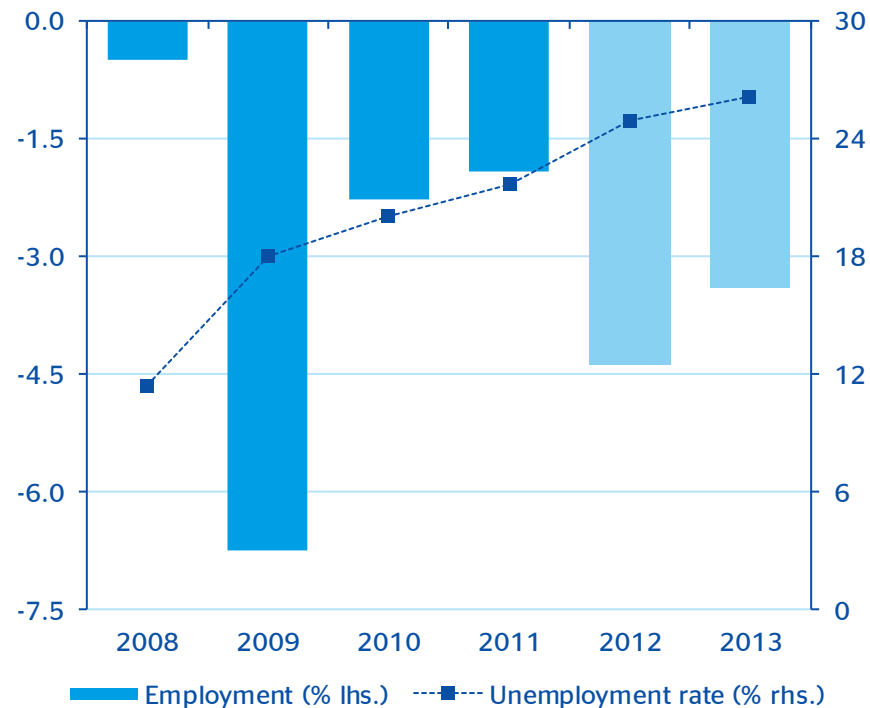
Section 3

Household consumption

1 Job destruction and wage moderation

Spain: employment growth and unemployment rate (%)

Source: BBVA Research based on INE data



Economic slowdown has caused greater job destruction

Labour-market reform could lead to a rebalancing of the extensive margin (workers employed) and the intensive margin (hours worked and wages) and reduce segmentation...

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

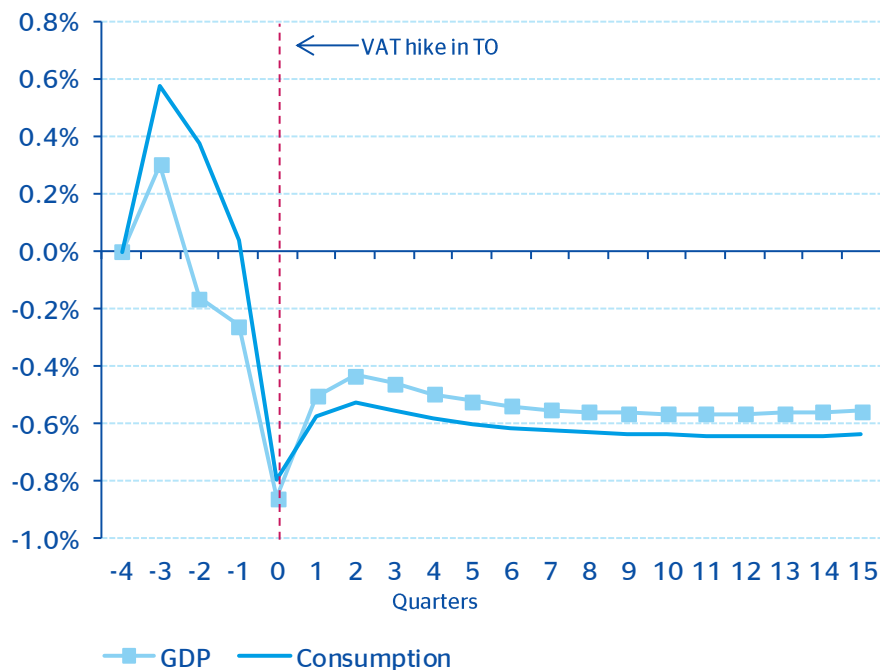
Section 3

Household consumption

2 Consequences of public sector deleveraging

Spain: response to a 2pp VAT hike (% deviation from trend)

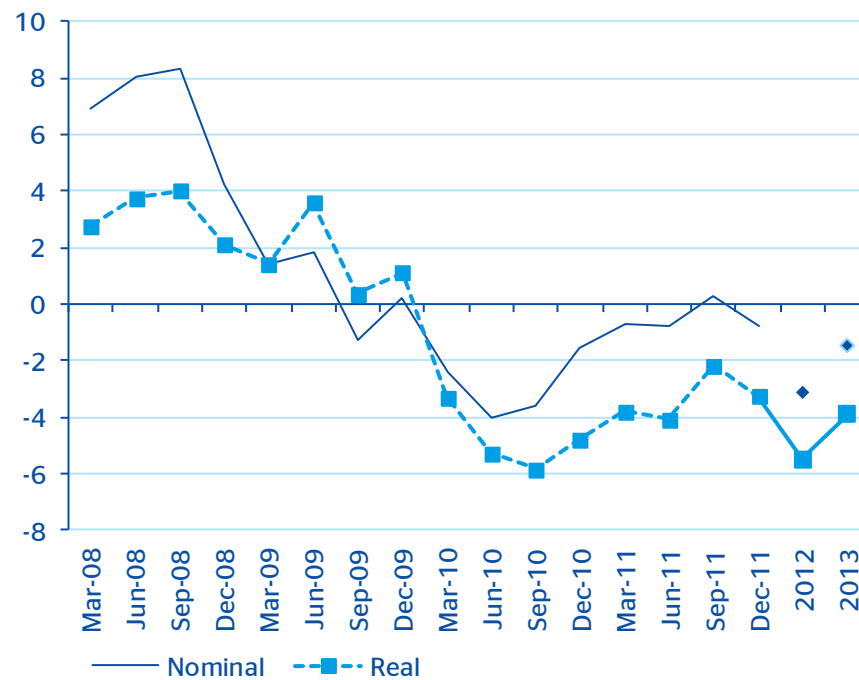
Source: BBVA Research. REMS simulations



Deterioration of labour market + fiscal consolidation

Spain: gross disposable household income (% yoy)

Source: BBVA Research based on INE data



Declining disposable income over the entire forecast period



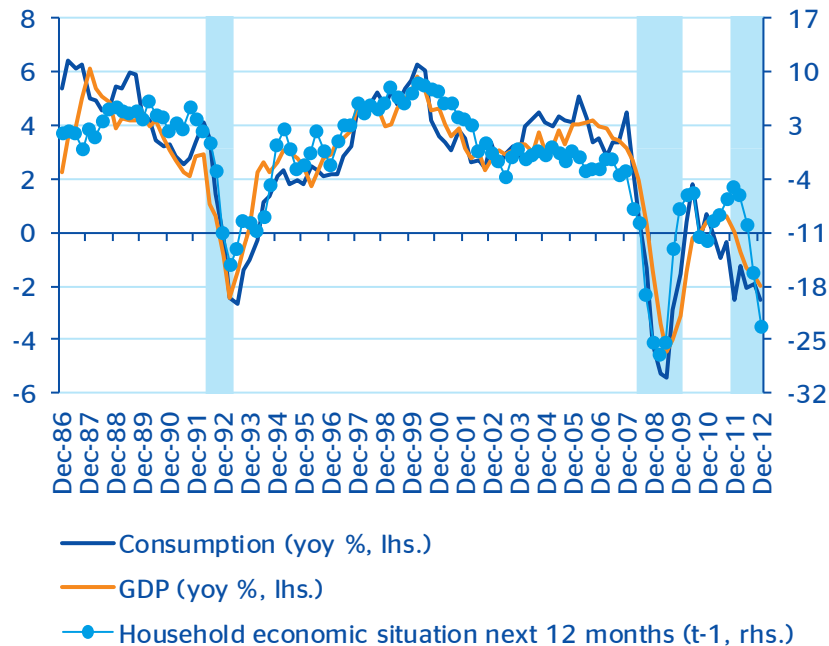
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Household consumption

3 Increased uncertainty

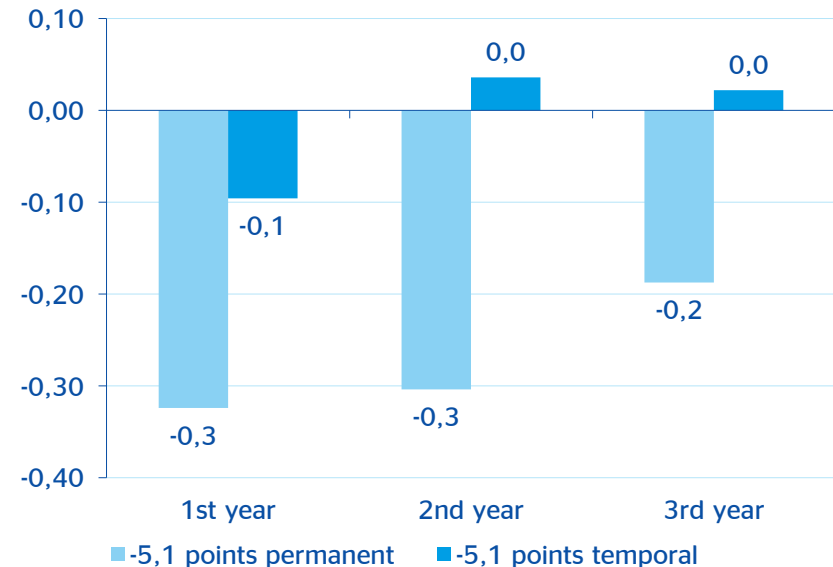
Spain: household consumption, GDP and confidence indicator (t-1) (%)

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



* The used confidence indicator is households perception about their future economic situation.

Uncertainty is expected to remain high



Purchases are being postponed

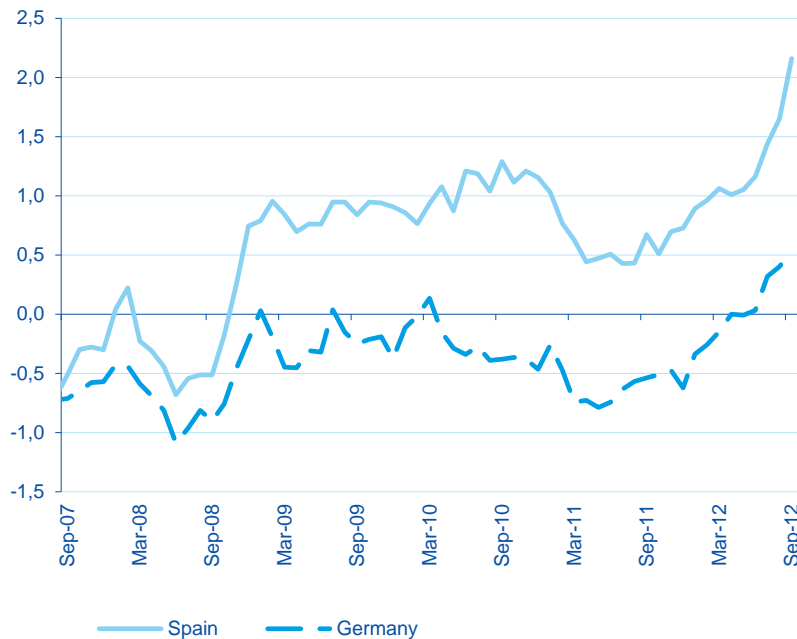
Section 3

Household consumption

4 Liquidity pressures and return on savings

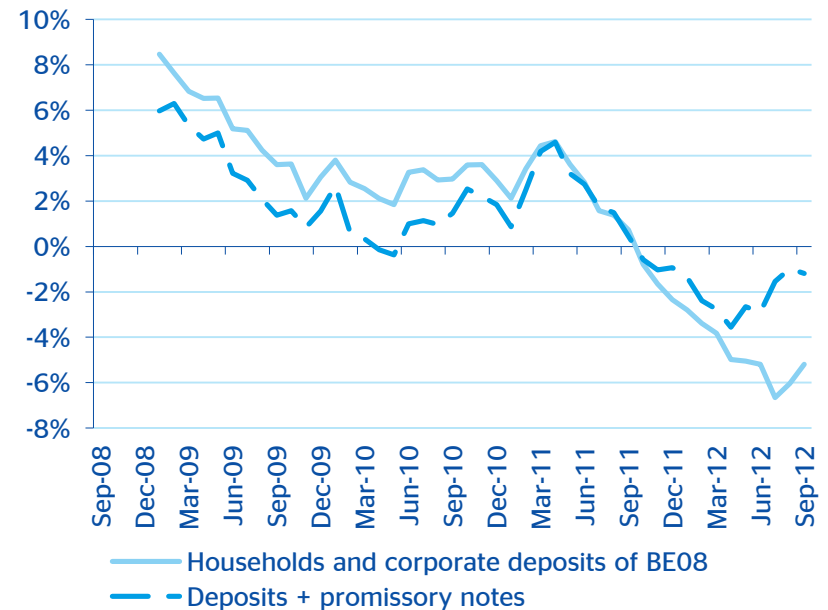
Spread between rates offered on term deposits and 12m Euribor (pp)

Source: BBVA Research based on INE and ECB data



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

Source: BBVA Research based on Bank of Spain data



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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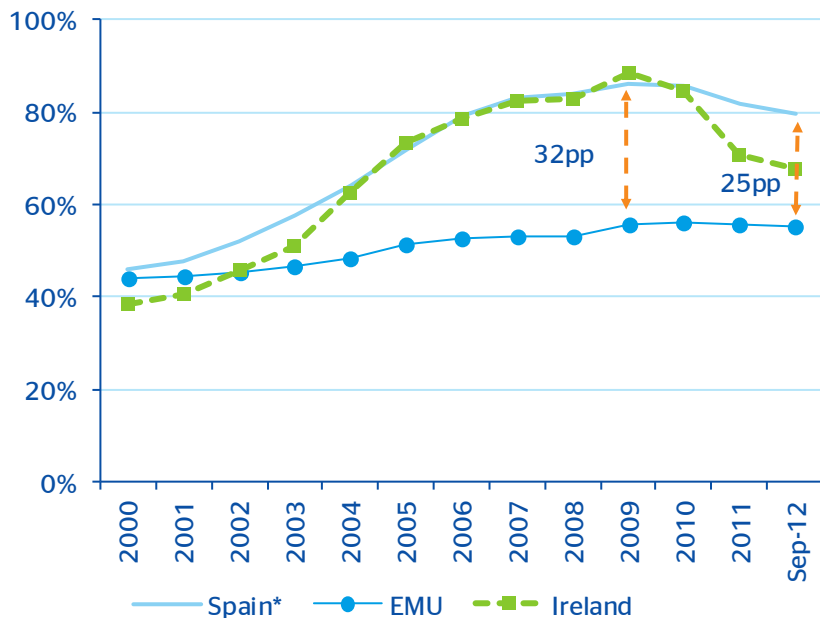
Household consumption

5 Household deleveraging

Household credit* (% of GDP)

(* Consumer and other + home loans; including securitisations)

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

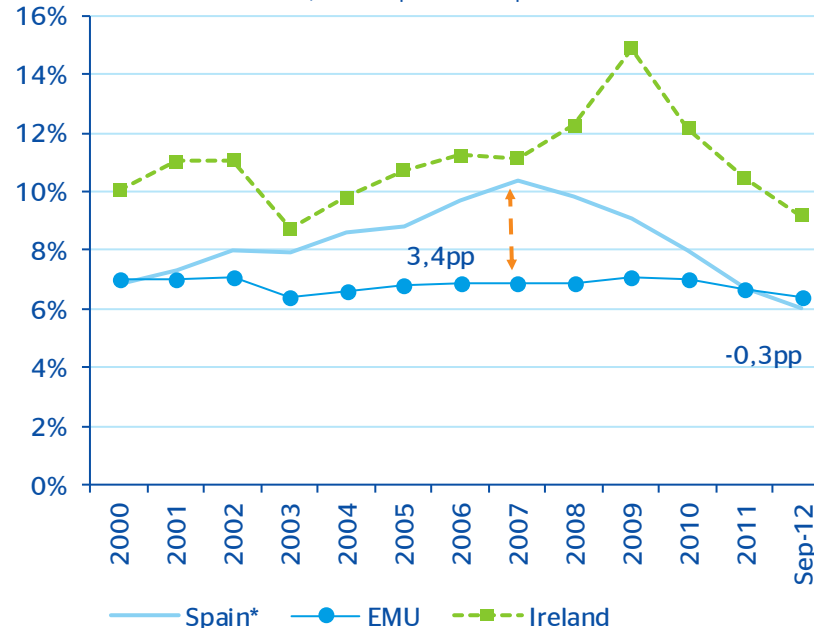


Household credit/GDP: far from converging with EMU levels

Consumer credit* (% of GDP)

(* Including securitisations)

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



Financial pressures + weakness of demand + high default levels do not herald a recovery in consumer credit in the short term

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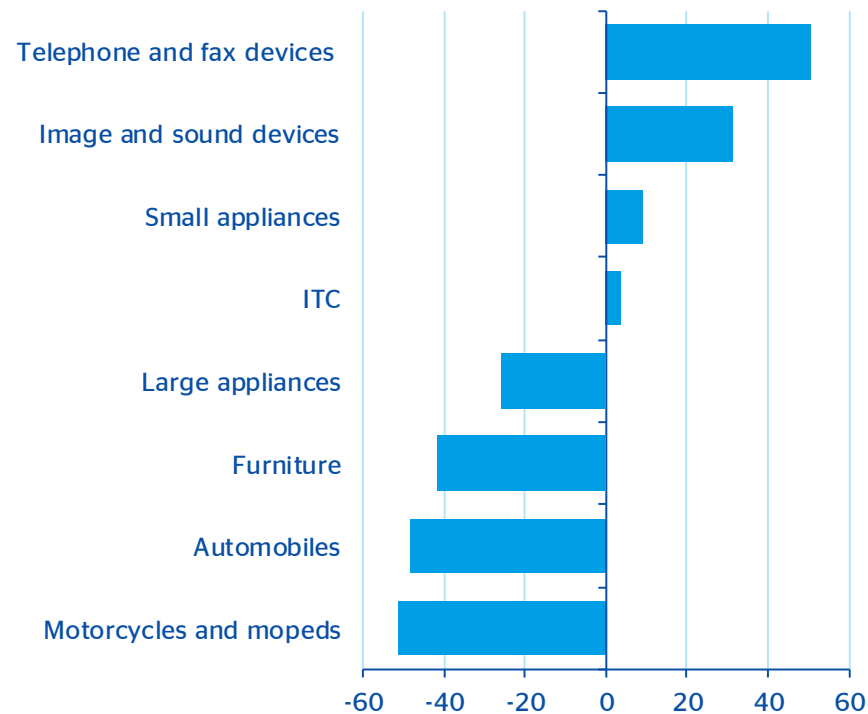
... especially in demand for durable goods

Section 4

Demand for durable goods

Spain: variation in real consumer spending on durable good between 2007 and 2011 (%)

Source: BBVA Research based on INE data (HBS)



Demand for durable goods has contracted most during the current crisis

- Tighter credit conditions,
- higher income elasticity,
- illiquid nature and
- the possibility of postponing purchases of these goods given the reigning uncertainty

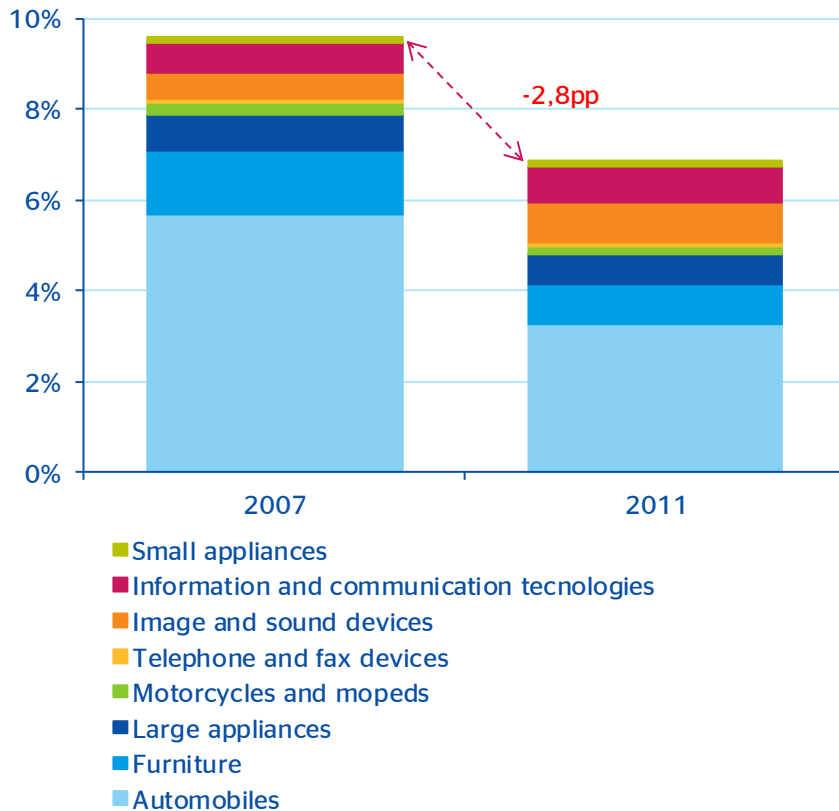
are some of the factors behind the fall in consumption of durable goods since 2007

Section 4

Demand for durable goods

Spain: durable goods as a share of household budgets (%)

(The ratio of the total expenditure on durable goods to the total expenditure of the household, real terms)
 Source: BBVA Research based on INE data (HBS)



Consequently, there has been a decrease in durable goods in real household expenditure

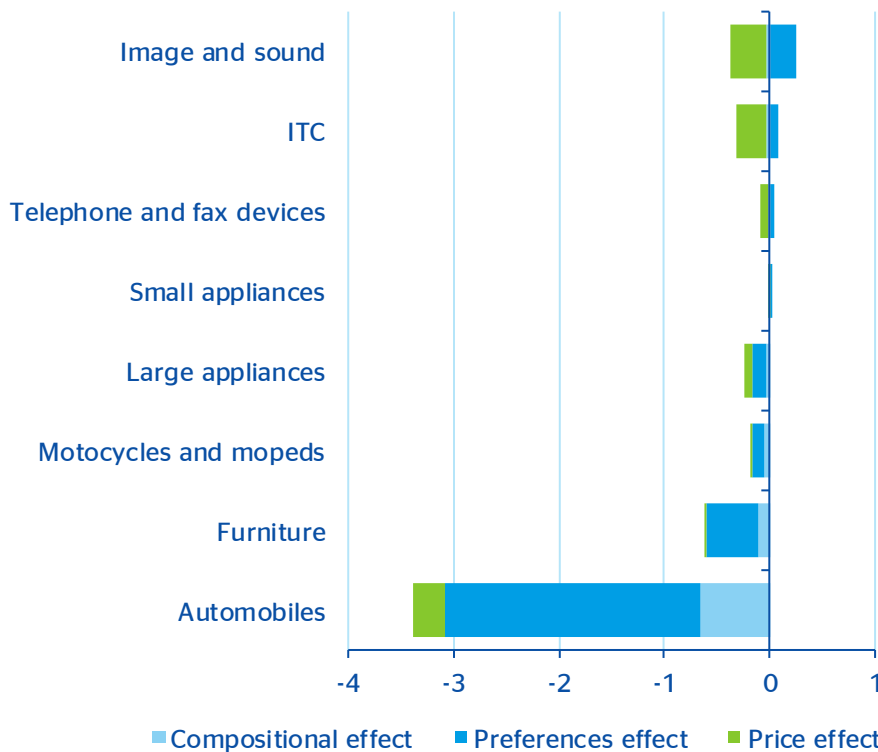
The rise in demand for brown line articles and small household appliances has not been sufficient to offset the drop in relative importance of two-wheeled vehicles, large household appliances, furniture, and above all, automobiles

Section 4

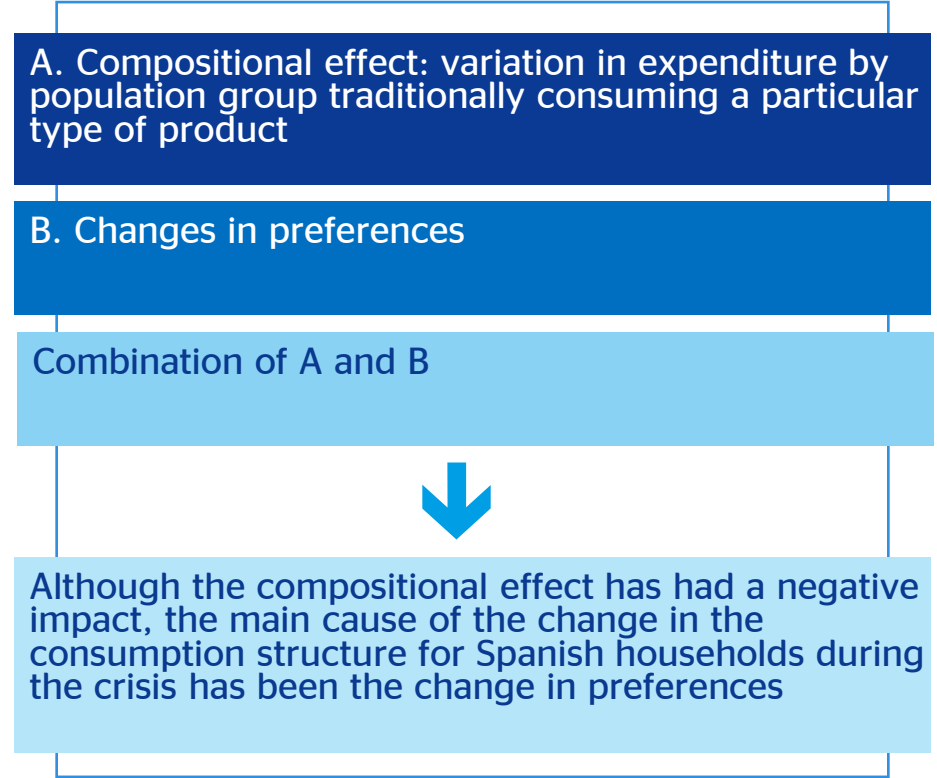
Demand for durable goods

Spain: breakdown of the change in budget share (real terms, 2007-11 pp)

Source: BBVA Research based on INE data (HBS)



What causes changes in real relative consumption of a good? Three factors:



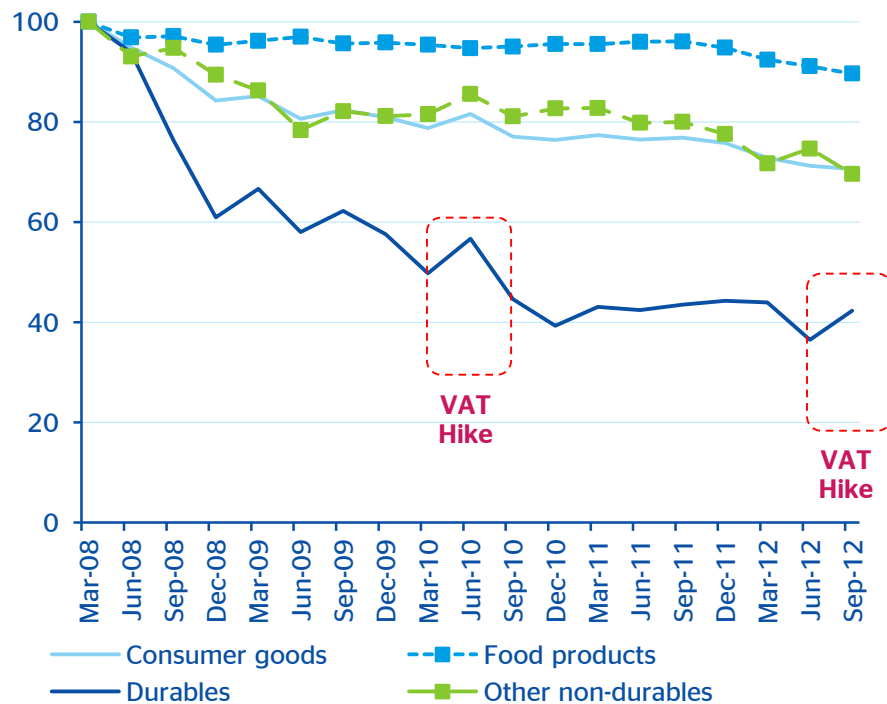
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Demand for durable goods

Spain: consumer goods expenditure

(SWDA data, quarterly averages, Jan-08 = 100)

Source: BBVA Research based on Ministry of Economy data



3Q12: a temporary improvement

Domestic demand for durable goods was the main reason for the easing of the slowdown in consumption in 3Q12

Purchases brought forward in response to VAT changes are responsible for the increase in demand for durable goods ...

..., which is expected to be temporary, as in 2Q10

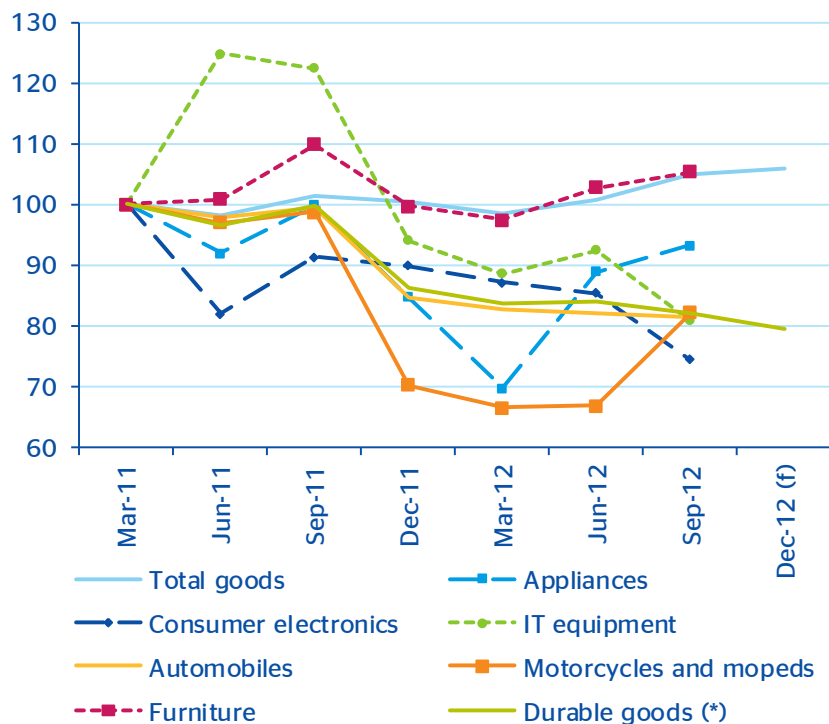
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Demand for durable goods

Spain: real exports of goods

(SWDA data; 1Q09 = 100)

Source: BBVA Research based on Ministry of Economy data



In contrast to the figure for total goods, external demand for durable goods dropped in 3Q12 ...

..., and available indicators for 4Q12 do not signal any change in this trend

Electrical appliances, two-wheeled vehicles and furniture: better relative performance

Brown line products: higher-than-average decline

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Demand for durable goods

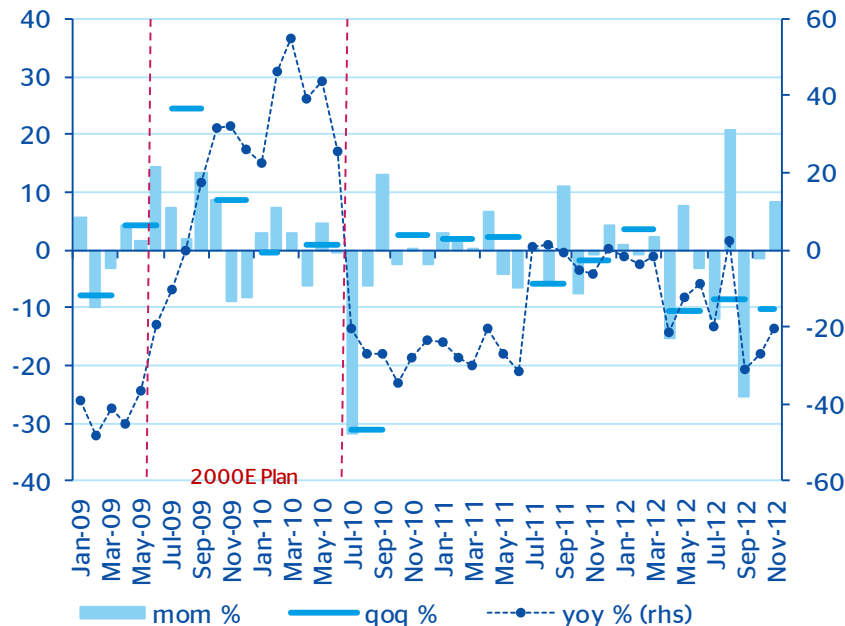
a Cars: the VAT hike has impacted recent sales performance...

The volatility witnessed over the past few months can be attributed to purchases brought forward by private consumers triggered by the VAT hike in September 2012

Spain: car registrations

(SWDA data)

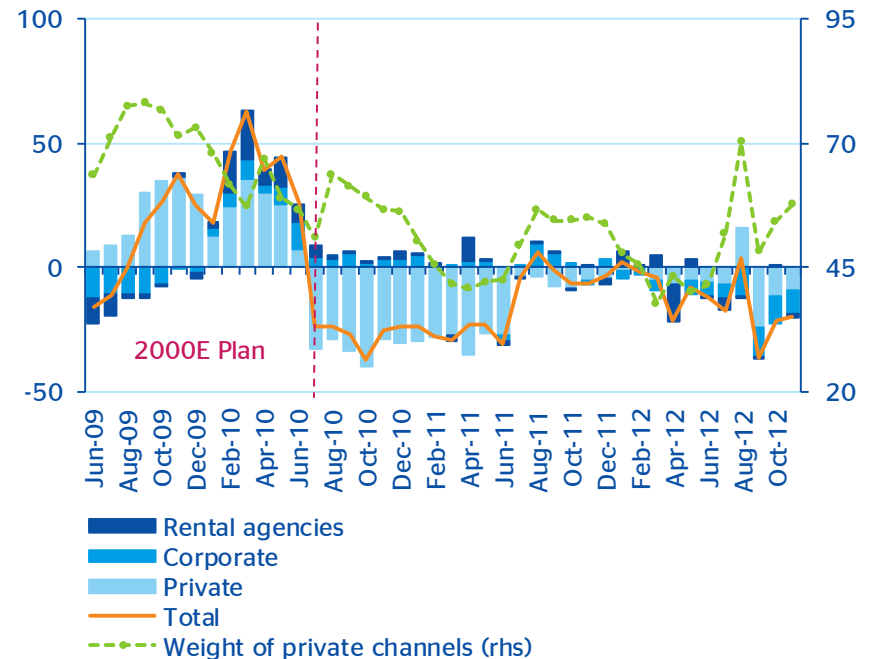
Source: BBVA Research based on ANFAC and Ganvam data



Spain: car registrations by sales channel

(contribution to % yoy)

Source: BBVA Research based on ANFAC and Ganvam data



Section 4

Demand for durable goods

a Cars: ...and the PIVE incentive plan will have an effect over the next few months

The PIVE incentive plan is expected to have a temporary positive impact on car registrations, particularly private vehicles. As in previous incentive programmes, the medium term impact will be minimal

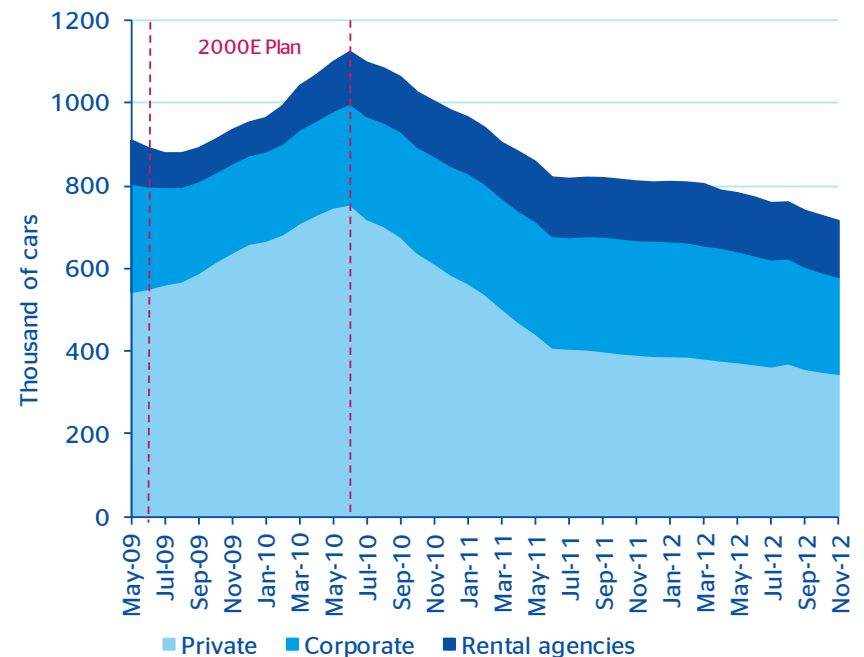
PIVE incentive plan

Source: BBVA Research, using IDAE data

Beneficiaries	Individuals, self-employed, microbusinesses, SMEs (<250 employees, revenue < EUR 50mn)
Eligible vehicles	New (or nearly-new <1 year) vehicles Categories: M1 (class A and B) and N1 (<160 gr of CO2/km) Price: ≤ EUR25,000 before tax (except for pure electric vehicles, and chargeable hybrids with extended autonomy)
Scrap vehicles	Age ≥ 12 years (M1) and up to 10 years (N1), registered in Spain
Minimum subsidy	EUR1,000 IDAE + EUR1,000 manufacturer or importer
Duration	from 1/10/12 (15/10 to activate reserves) to 31/3/2013 or as long as stocks last
Budgetary allowance	EUR75 mn (75 thousand vehicles)

Spain: car registrations (12 M moving sum)

Source: BBVA Research based on ANFAC and Ganvam data



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Demand for durable goods

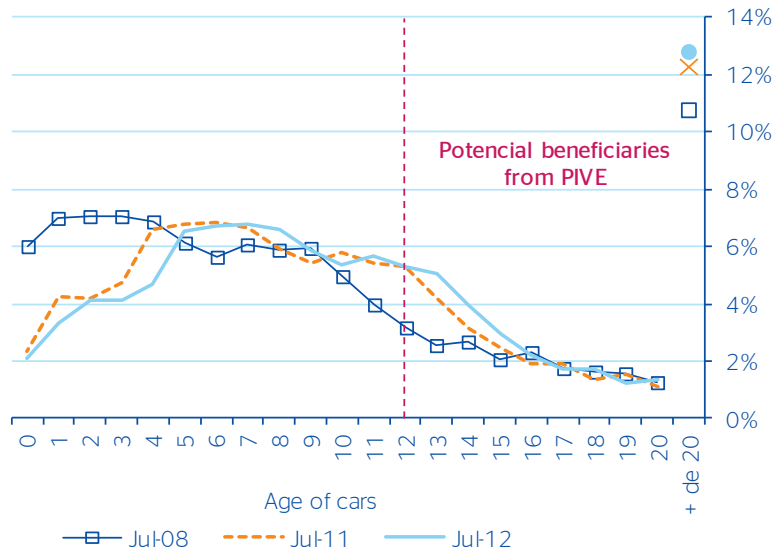
a Cars: ... slightly modernising cars in circulation and boosting used-car sales

The breakdown of total vehicles by age continues to shift to the right

PIVE incentive plan is fuelling demand for nearly-new vehicles and vehicles for low salary earners
Used cars/New cars = 2.0 Jan-Sep 12

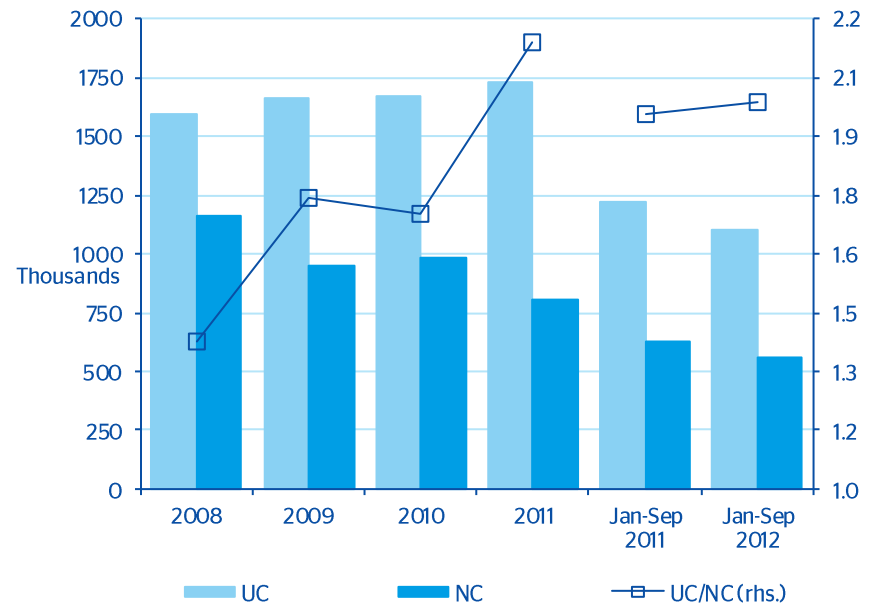
Spain: breakdown of all cars by age (% of total)

Source: BBVA Research, using DGT data



Spain: used vs. new vehicles

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



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Demand for durable goods

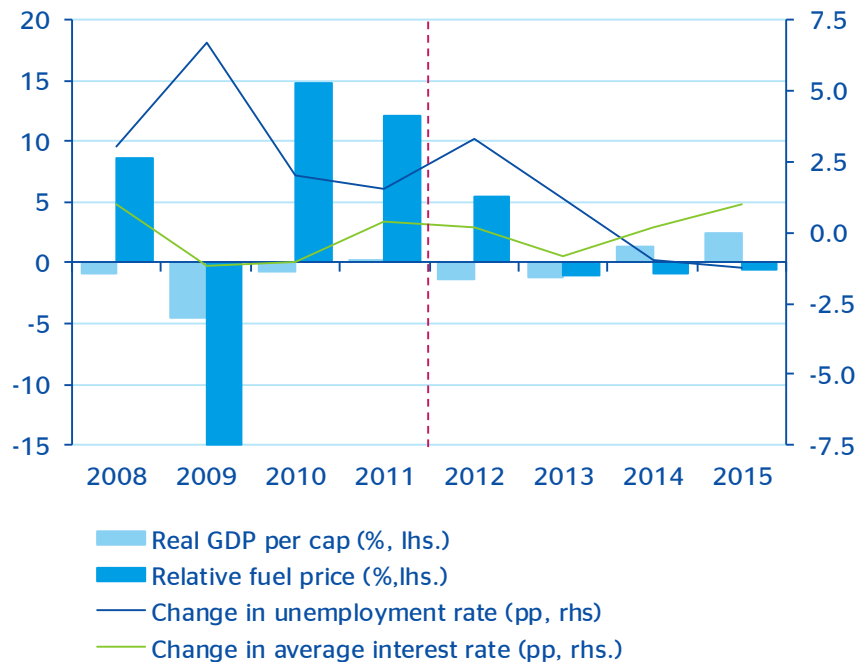
a Cars: outlook

Drivers of car registrations: complex scenario →

Approximately 700 thousand cars in 2012; uncertainty in 2013

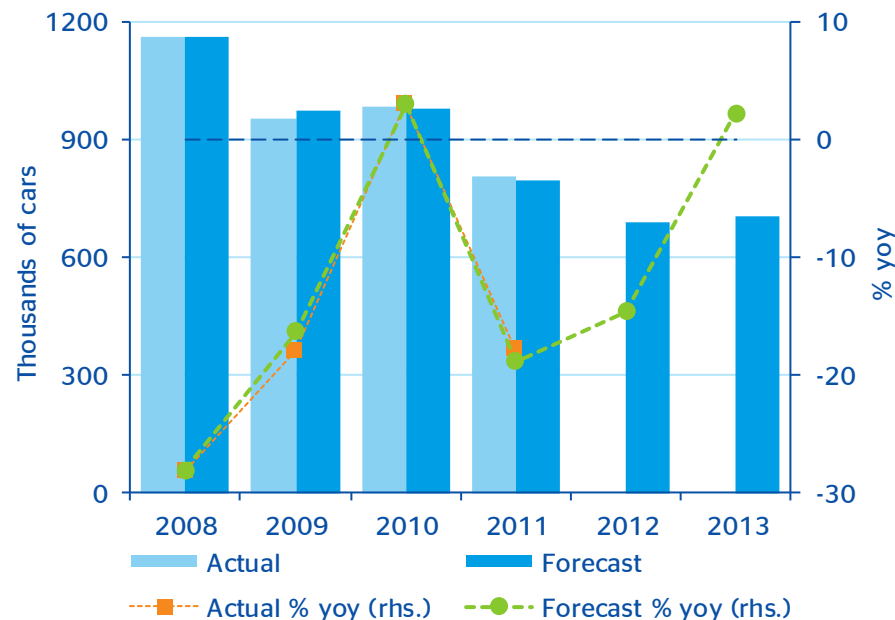
Spain: forecast performance car registrations drivers

Source: BBVA Research based on INE, MEC and BoS data



Spain: car registrations (Annual total and % change)

Source: BBVA Research and ANFAC



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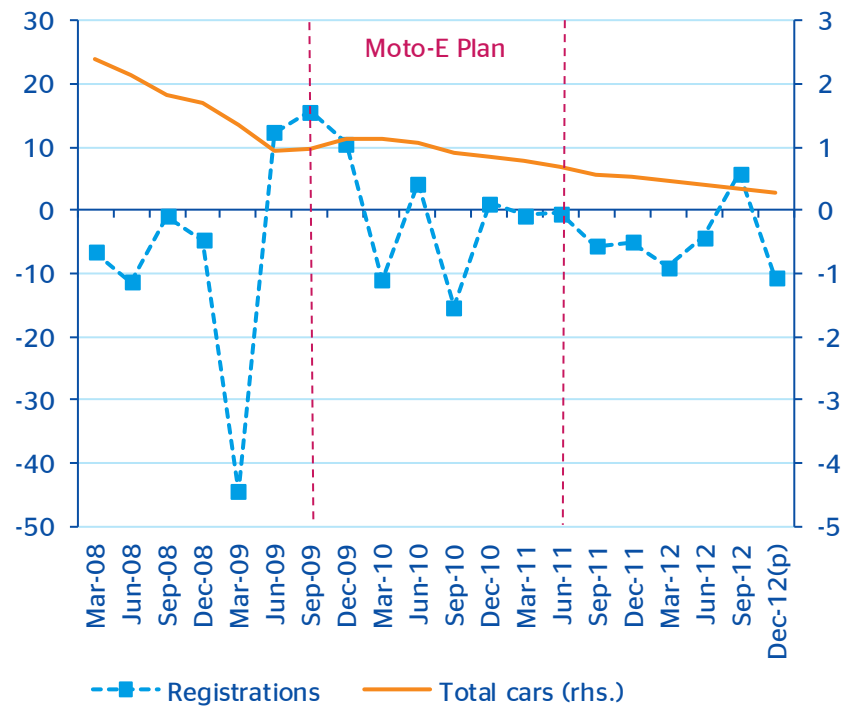
Demand for durable goods

b Two-wheeled vehicles: deviation in 3Q12 due to purchases brought forward

Spain: registrations of mopeds and motorcycles (SWDA

data, % qoq)

Source: BBVA Research based on Anesdor and BoS data



After two years of uninterrupted decline, the purchases brought forward as a result of the projected VAT hike explained the increase in motorcycle registrations in 3Q12

Figures for September and October confirmed that the pick up in demand was transitory



About 100,000 units are forecast to be registered in 2012. No change in this trend is expected next year

Section 4

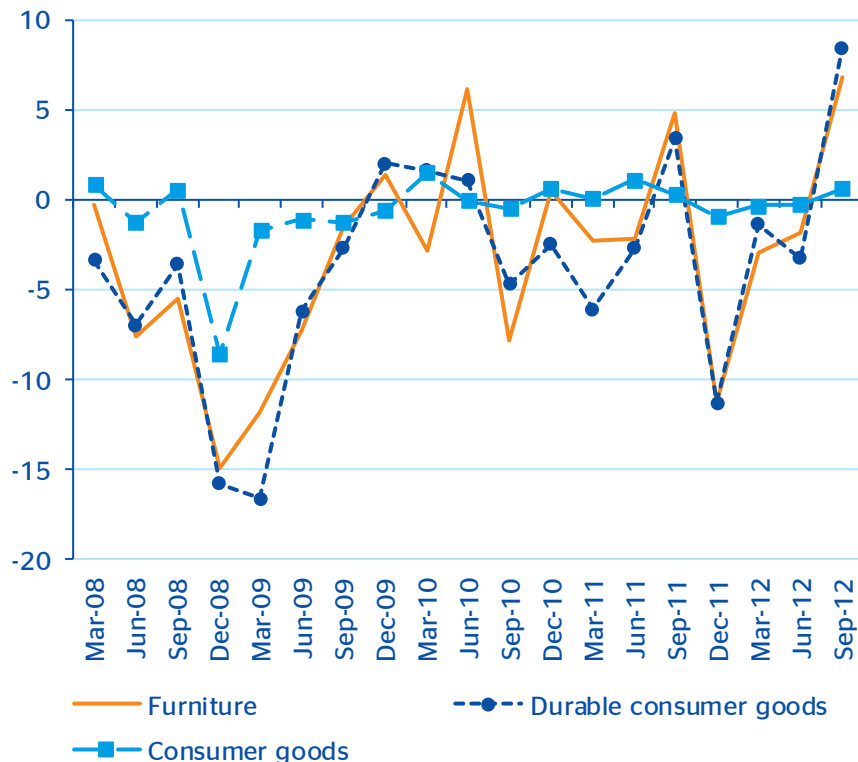
Demand for durable goods

c Furniture: improvement in line with the average for durable goods

Spain: furniture sector turnover

(SWDA Data, % qoq)

Source: BBVA Research based on INE data



Two underlying reasons:

VAT hike in September 2012

Slowdown in the pace of deterioration of housing investment due to the elimination of fiscal incentives for the acquisition of property in January 2013 (tax incentives for purchases made and super-reduced VAT rate)



The furniture sector could become more dynamic in the last few months of 2012 and weaken sharply from the second quarter of 2013

Section 4

Demand for durable goods

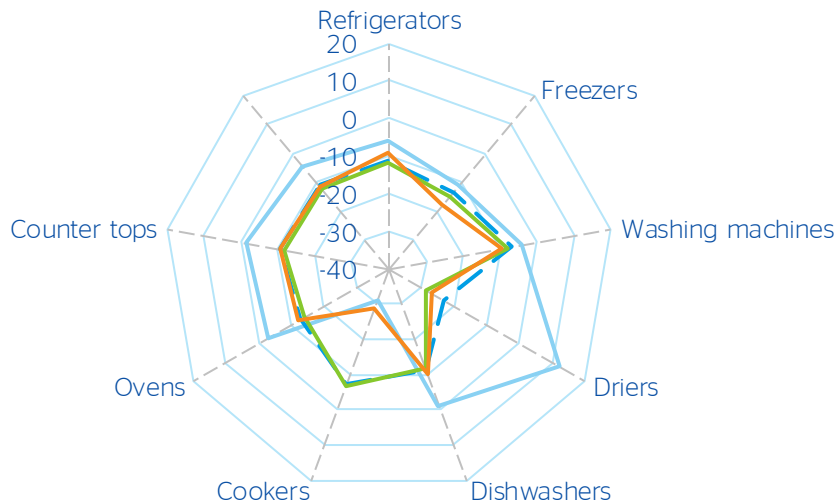
d Major household appliances: falling consumption, rising post-sales

Turnover Jan-Oct 2012: -12,5% yoy
 Fridges, washing machines, dishwashers and counter tops: smaller relative decline

Prices generally lower, even after the VAT hike, except for repair services

Spain: sales of appliances by product family

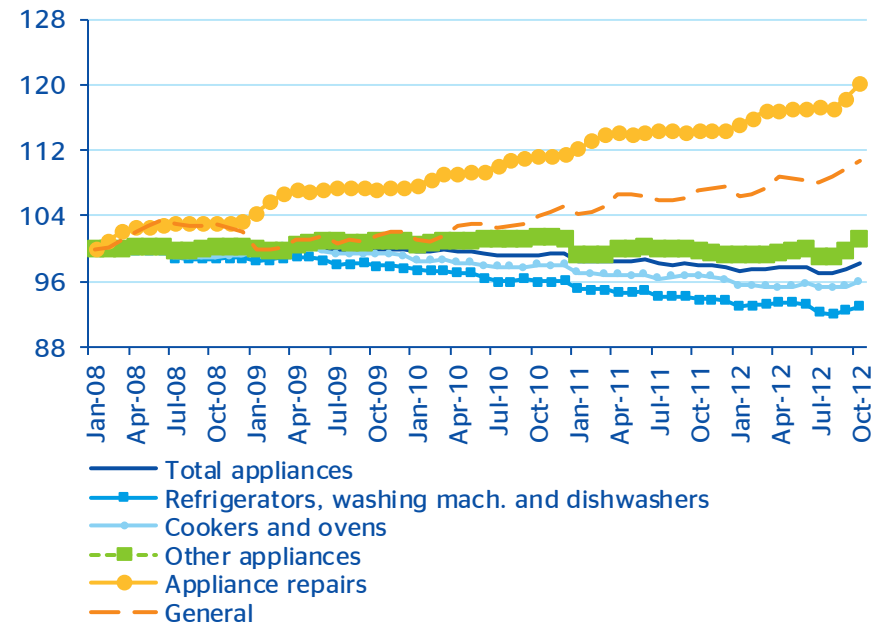
(% yoy of units)
 Source: BBVA Research based on ANFEL data



— 2010 — 2011 — Jan-Oct 2011 — Jan-Oct 2012

Spain: consumer prices for household appliances

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



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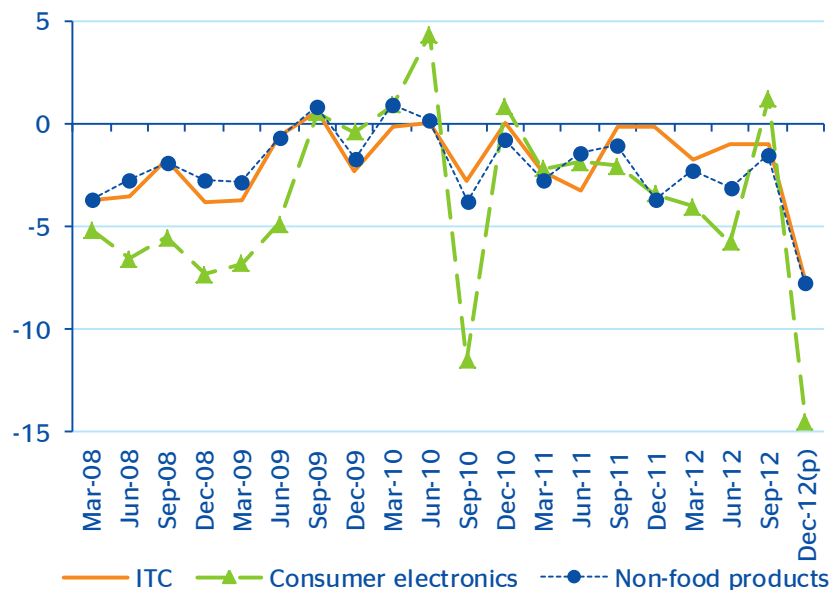
Demand for durable goods

e Brown line products: temporary recovery in consumer electronics; decline in ICT equipment

Figures for September and October 2012 confirmed that brown line products have been affected by the VAT hike even though it has barely been passed on to final prices
 Persistent deflation is helping to increase the penetration rate

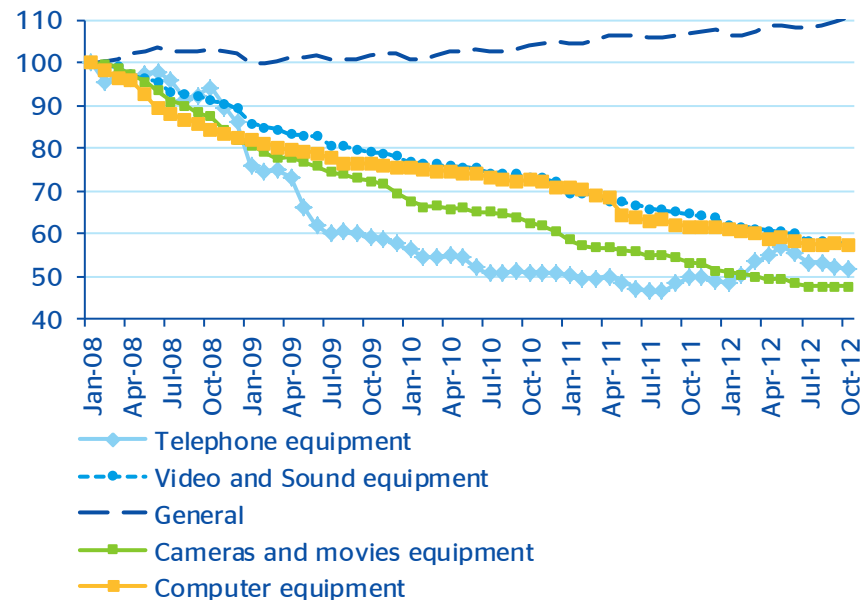
Spain: real retail sales of brown line items (SWDA data, % qoq)

Source: BBVA Research based on Eurostat data



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

Source: BBVA Research based on INE data



Key themes

- 1 Global growth will pick up gradually from the end of the year and throughout 2013 thanks to the monetary measures implemented by developed economies and the measures to support growth in emerging markets
- 2 The risk scenarios are less likely than three months ago, although the eurozone and the US are still facing significant challenges
- 3 Spain: is still expected to contract in 2012 and 2013. The fiscal measures implemented are bearing fruit but the recession is delaying meeting the target. Implementation of structural reforms is more necessary than ever before
- 4 The change in Spanish household preferences is the main reason behind the variations in the consumption basket witnessed during the crisis
- 5 The increase in VAT and weaker drivers signal a decrease in consumption expenditure in 2013, especially on durable goods
- 6 Households will continue to deleverage, shaping the performance of consumer credit

Consumption Outlook

Second half 2012

Madrid, 13 December 2012

Appendix

Forecasts

Spain and Europe: macroeconomic forecasts

Source: INE, Bank of Spain, Eurostat and BBVA Research forecasts

(Growth rates (yoy))	2009		2010		2011		2012 (f)		2013 (f)	
	Spain	EMU	Spain	EMU	Spain	EMU	Spain	EMU	Spain	EMU
Household FCE	-3,9	-0,9	0,6	0,9	-0,8	0,1	-2,1	-1,0	-2,9	0,0
Public sector FCE	3,7	2,6	1,5	0,7	-0,5	-0,1	-3,6	-0,1	-6,9	-0,5
Gross fixed capital formation	-18,0	-12,7	-6,2	-0,3	-5,3	1,6	-9,7	-3,6	-7,5	-0,6
Equipment, machinery and cultivated assets	-23,9	-18,7	2,6	6,3	2,3	4,2	-7,6	-5,3	-3,7	-0,8
Equipment and machinery	-24,5	-18,8	3,0	6,4	2,4	4,3	-7,7	-5,3	-3,8	-0,8
Construction	-16,6	-9,9	-9,8	-4,4	-9,0	-0,2	-11,8	-3,4	-10,0	-1,4
Housing	-23,1	-12,5	-10,1	-2,9	-6,7	0,9	-6,8	-1,9	-8,4	0,4
Other buildings and other constructions	-9,1	-7,0	-9,6	-5,9	-11,0	-1,4	-16,3	-5,1	-11,7	-3,3
Change in inventories (*)	0,0	-0,9	0,1	0,6	-0,1	0,1	0,0	-0,5	0,0	0,0
Domestic demand (*)	-6,6	-3,6	-0,6	1,2	-1,9	0,5	-4,0	-1,8	-4,7	-0,3
Exports	-10,0	-12,4	11,3	11,0	7,6	6,4	3,8	3,1	8,2	3,2
Imports	-17,2	-11,0	9,2	9,4	-0,9	4,2	-4,7	0,1	-1,8	2,2
Net trade balance (*)	2,9	-0,8	0,3	0,7	2,3	1,0	2,6	1,3	3,3	0,5
GDP mp	-3,7	-4,3	-0,3	1,9	0,4	1,5	-1,4	-0,5	-1,4	0,3
Pro-memoria										
GDP w/o housing investment	0,5	-3,8	0,5	2,2	1,0	1,5	-1,0	-0,4	-0,9	0,3
GDP w/o construction	1,6	-3,6	1,6	2,7	2,1	1,7	0,3	-0,2	-0,2	0,4
Employment (LFS)	-2,3	-1,8	-2,3	-0,5	-1,9	0,5	-4,4	-0,8	-3,4	-0,3
Unemployment rate (% of active pop.))	20,1	9,6	20,1	10,1	21,6	10,2	25,0	11,4	26,1	11,8
Current account balance (% of GDP)	-4,5	0,1	-4,5	-0,1	-3,5	0,0	-1,4	1,2	-0,5	1,2
Public debt (% of GDP) (**)	61,3	79,6	61,3	85,5	69,1	87,3	85,2	89,5	96,2	90,4
Public sector balance (**)	-9,7	-6,3	-9,7	-6,2	-9,0	-4,1	-7,2	-3,2	-5,9	-2,3
CPI (average for period))	1,8	0,3	1,8	1,6	3,2	2,7	2,5	2,5	2,3	1,8
CPI (end of period)	3,0	0,4	3,0	2,0	2,4	2,9	3,5	2,4	1,3	1,6

(*) contributions to growth

(**) excluding aid to the banking sector in Spain