

Consumption Outlook

Seville, 30 November 2011

Contents

Section 1

International environment: politics takes centre stage in the economic debate

Section 2

Spain economic outlook: slowdown, with risks on the downside

Section 3

Household consumption: fragile, due to the weakness of its drivers

Section 4

Demand for durable goods: nonexistent and unlikely to improve in the short term

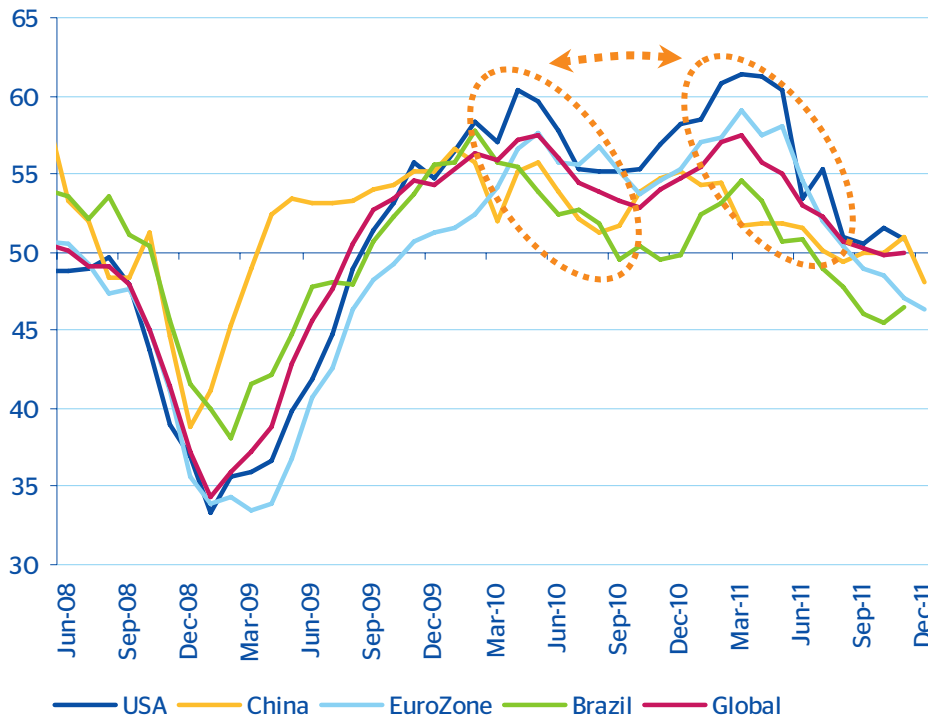
Section 1

Worse global outlook :

1. Disappointing macroeconomic data

Business expectations (PMI)*

* Levels above 50 indicate expansion
 Source: BBVA Research based on Bloomberg data



Scant growth in 2Q11

Drop in confidence indicators and expectations in 3Q11

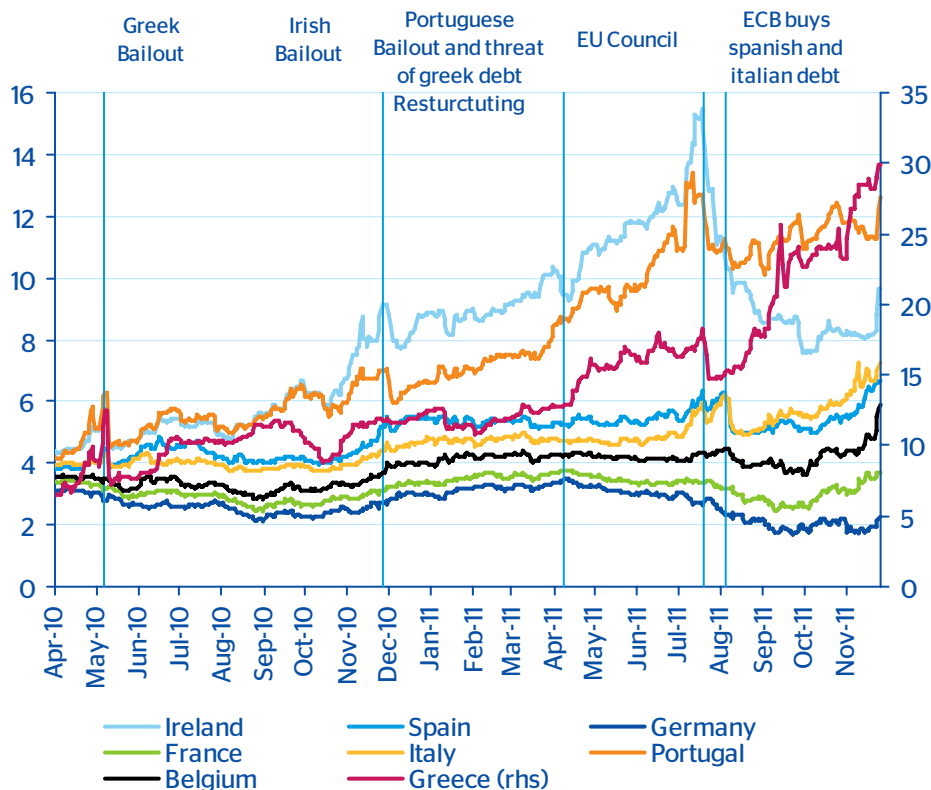
Budding impact on emerging economies

Section 1

Worse global outlook: 2. The debt crisis turns global

10-year bond yields

Source: BBVA Research based on Bloomberg data



The debt crisis is spreading to Italy and threatens other countries...

...becoming a global risk factor...

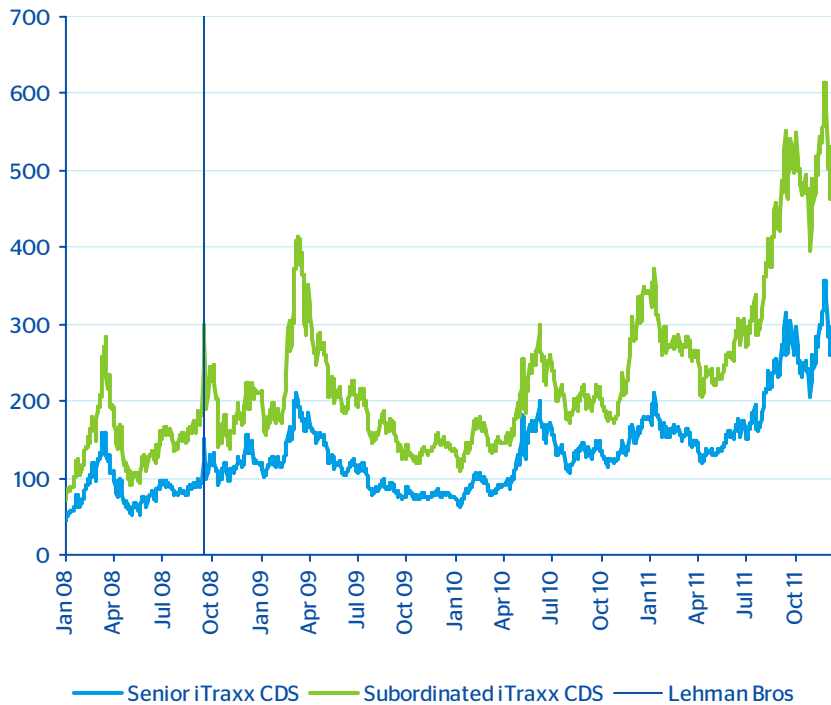
...and explaining nearly three quarters of the dispersion in risk premiums

Section 1

Worse global outlook: 3. Feedback with banking risk

Credit market: Itraxx CDS (bp)

Source: BBVA Research based on Bloomberg data



The debt crisis increases concerns about banks' solvency

Higher finance costs affect activity

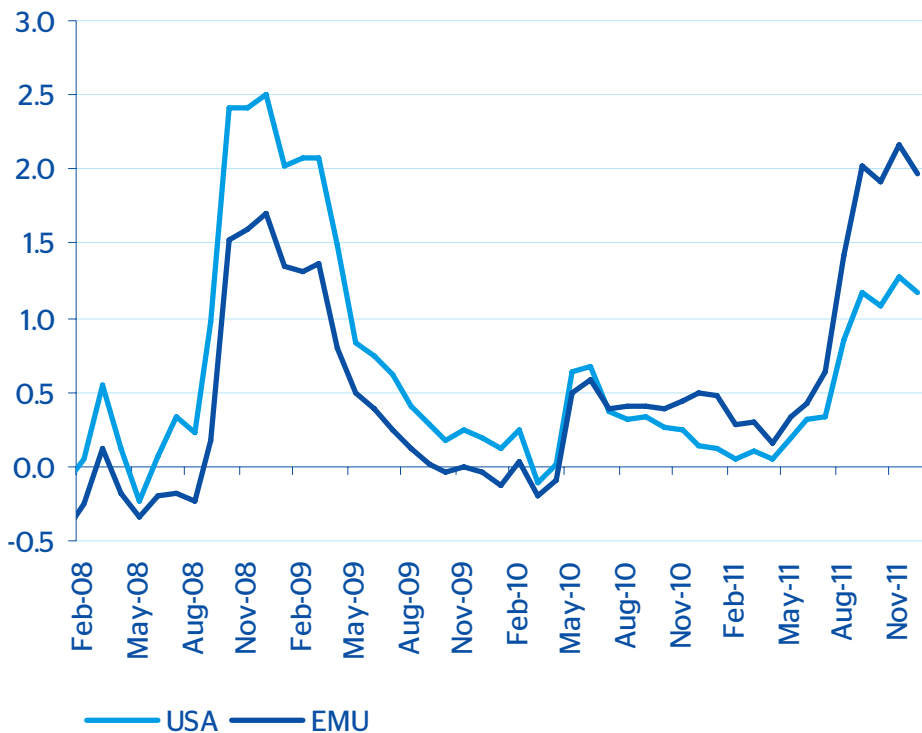
Recapitalisation of European banks to avoid a vicious circle

Section 1

Worse global outlook: 3. Feedback with banking risk

BBVA financial stress index (FSI)

Source: BBVA Research



Debt crisis + banking risk
= greater financial stress

If stress persists throughout 2012, growth in the EMU could contract 2.5pp (1.3 in the US)

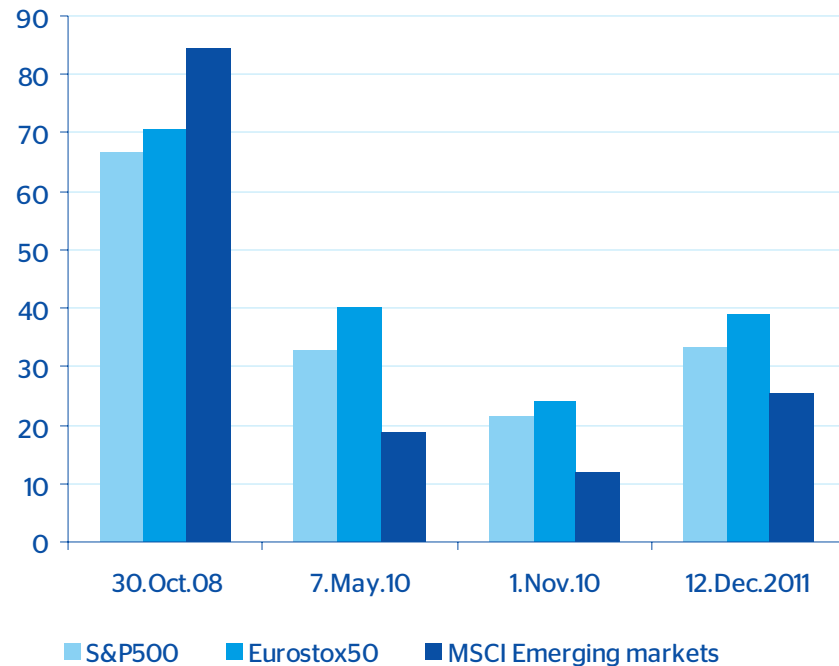
“Wait and see” is not an option given the scant room to manoeuvre through fiscal and monetary policy

Section 1

Worse global outlook: 4. Across-the-board uptick in risk

Implied stock market volatility

Source: BBVA Research based on Bloomberg data



Increase in volatility in debt and equity markets

Highest levels since autumn 2008

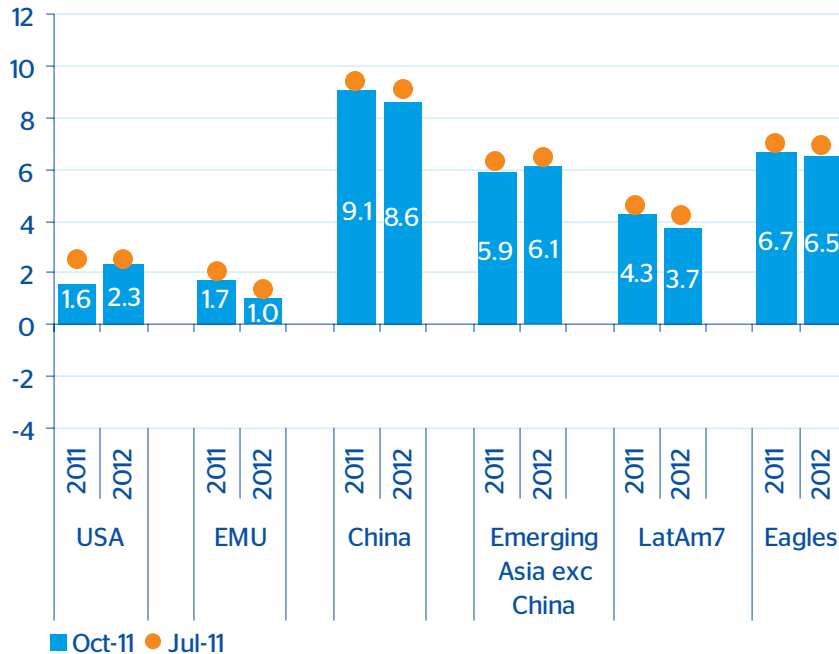
Contagion to emerging markets

Section 1

Global growth outlook: emerging markets remain dynamic

GDP growth (% yoy)

Source: BBVA Research



Increasing probability of risk scenarios in Europe

Downgrades to growth forecasts for developed economies

Continued resilience by emerging economies, despite global risk

Section 1

EU Summit 26/10: partial solution, with unresolved issues

What was needed?

- Clear response to (un)sustainability of Greek debt
- Stronger firewalls to sovereign debt in the EMU
- Push for further reforms
- Strengthen banking system: capital and liquidity
- Advances in euro area governance

Result

- 50% haircut, with doubts surrounding voluntary participation and solvency
- EFSF leveraged as insurance and an SPV, but still doubts about its firepower
- **More reforms, especially in Italy**
- Low efficient of recapitalisation with doubts as to whether markets will reopen
- No clear roadmap to a fiscal union or Eurobonds

Section 1

Slow and weak recovery, with risks already appearing

European sovereign debt crisis: key factor shaping the economic outlook going forward

Baseline scenario

- Orderly restructuring of Greek debt; EFSF avoids contagion to core countries
- Reopening of wholesale markets to European banks
- Global growth continues and European countries meet commitments

Slow and weak recovery with financial stress remaining high for some time

Risk scenarios

- Disorderly default of Greek debt; EFSF avoids contagion to core countries
- Closed markets, liquidity crunch, run on banks and/or *credit crunch*
- Greater global economic weakness and reform fatigue

Recession in developed economies and sharper slowdown in emerging economies

Contents

Section 1

International environment: politics takes centre stage in the economic debate

Section 2

Spain economic outlook: slowdown, with risks on the downside

Section 3

Household consumption: fragile, due to the weakness of its drivers

Section 4

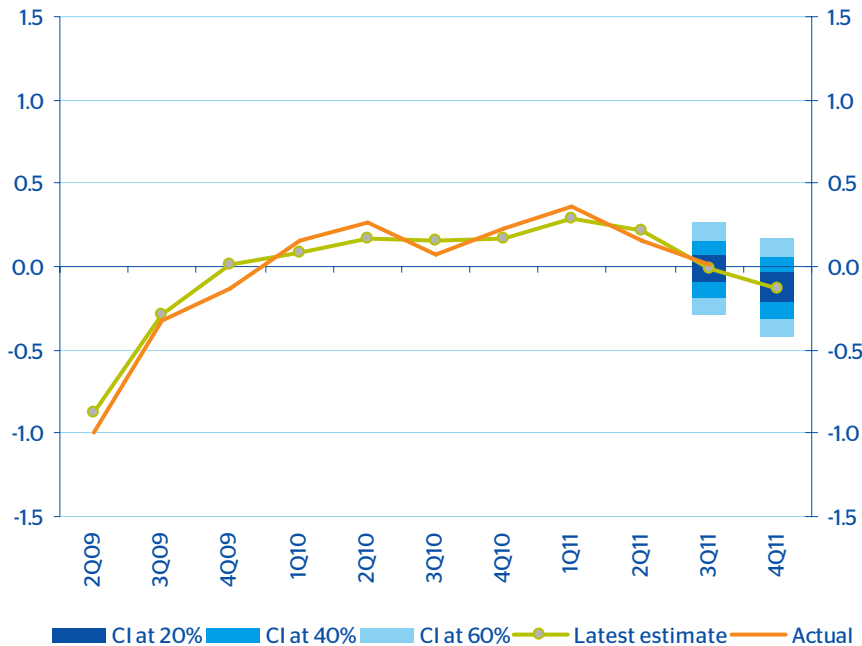
Demand for durable goods: nonexistent and unlikely to improve in the short term

Section 2

Spain economic outlook: slowdown, with risks on the downside

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

Source: BBVA Research



- Increase in risk premium
- Deterioration of global growth
- Weakness of domestic demand



Greater risk of recession

Section 2

Spain economic outlook: slowdown, with risks on the downside

Spain: macroeconomic forecasts

Source: BBVA Research based on INE data

(y-o-y growth rate)	2009	2010	2011 (f)	2012 (f)
National Final Consumer Spending	-2.3	0.6	-0.3	-0.4
Households	-4.4	0.7	0.0	0.3
Public administration	3.8	0.2	-1.3	-2.3
Gross Fixed Capital Formation	-16.4	-6.0	-4.0	-0.2
Domestic Demand (*)	-6.5	-1.0	-1.2	-0.4
Exports	-10.2	13.5	9.3	5.4
Imports	-16.9	8.9	1.9	0.9
External Demand (*)	2.8	0.9	2.0	1.3
GDP pm	-3.7	-0.1	0.8	1.0
Pro-memoria				
GDP w/o housing investment	-1.5	0.8	1.2	0.9
GDP w/o construction	-0.8	2.0	2.3	1.5
Total employment (LFS)	-6.8	-2.3	-1.7	-0.8
Unemployment rate (% active pop.)	18.0	20.1	21.5	22.1
Total employment (FTE)	-6.6	-2.4	-1.7	-0.9

(*) growth contributions

Baseline scenario:

- i) Orderly restructuring of Greek debt; the ECB continues to buy bonds while implement an expanded EFSF, preventing contagion;
- ii) Reopening of wholesale markets to European banks;
- iii) Peripheral economies fulfil their commitments

**Materialisation of risks
jeopardises this outlook**

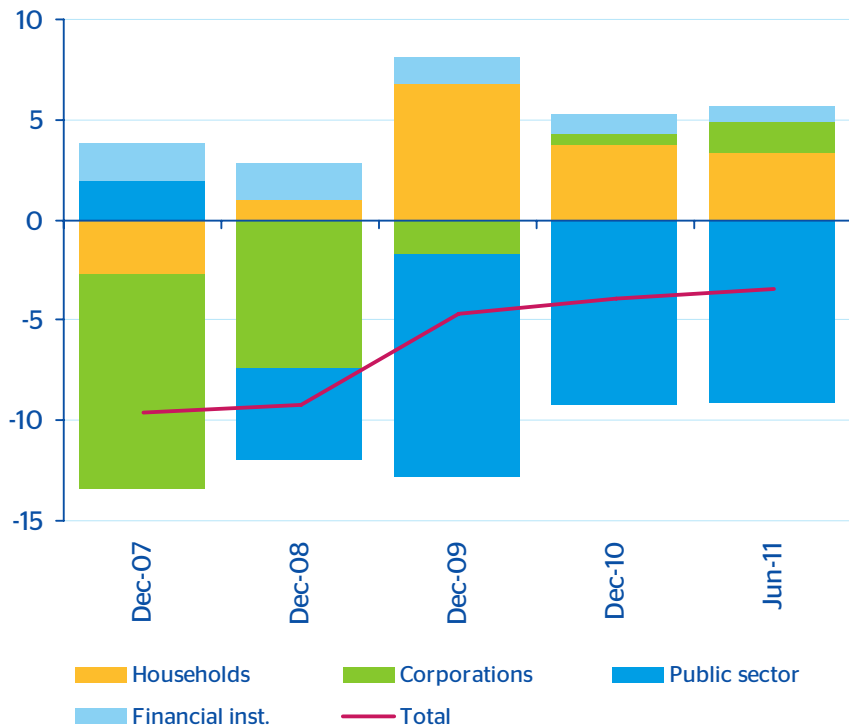
Section 2

The challenges of the Spanish economy

Spain: external financing capacity

(% of GDP)

Source: BBVA Research based on INE data



Adjustment to financing needs through:

- Orderly deleveraging, with a strong financial system and access to markets
- Reduction of public deficit (*S-I*)
- Boost to competitiveness with ambitious structural reforms

Section 2

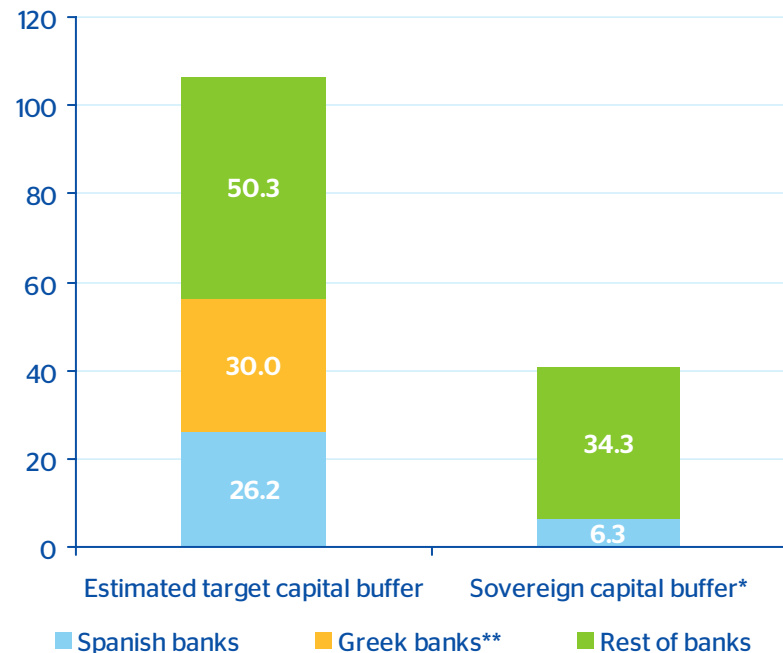
The challenges of the Spanish economy:

1. Bank restructuring

EBA: estimated capital requirements

(billion euros)

Source: BBVA Research based on EBA data



* The sovereign capital buffer is indicative and can already be covered by existing CT1 capital if the CT1 ratio exceeds 9%

** No information on the sovereign capital buffer has been provided by Greek banks, not to conflict with pre-agreed arrangements under EU/IMF programme

Beyond EBA recapitalisation: high solvency and greater liquidity

- Restructure with rigorous writedown of valuations (*fair value*) of distressed assets
- Bank recapitalisation is falling short of required capital
- Quick restructuring of banks intervened
- Decrease of excess capacity

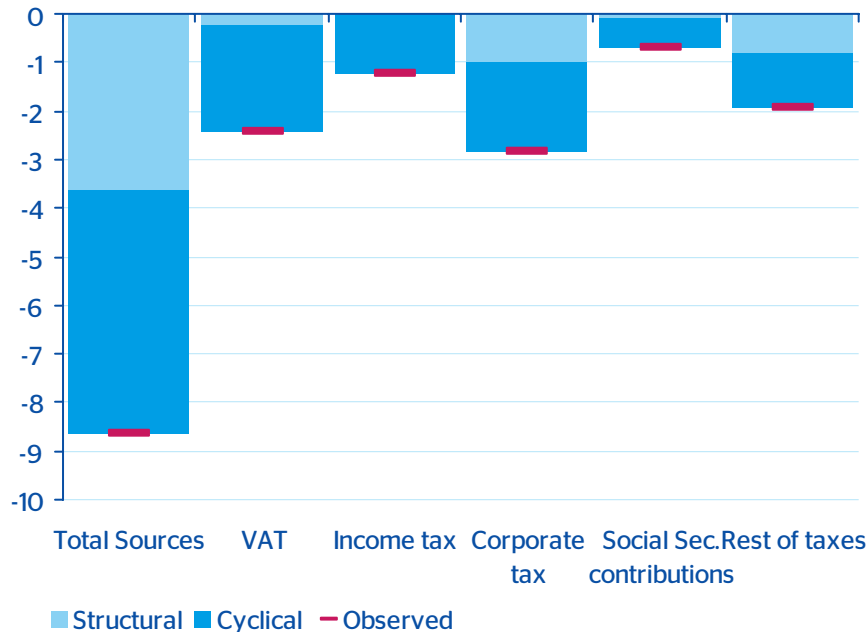
Section 2

The challenges of the Spanish economy:

2. Fiscal consolidation

Public administrations: change in non-financial income 2007-2009 (% of potential GDP)

Source: BBVA Research based on MEH and INE data



Greater confidence over fiscal adjustment

- Lower financing requirements of public administrations
- Adjust spending to constantly lower public income (% GDP)
- Offer certainty with an ambitious Constitutional Law implementing constitutional reform
- Increase transparency and medium-term planning (multi-year budgets)

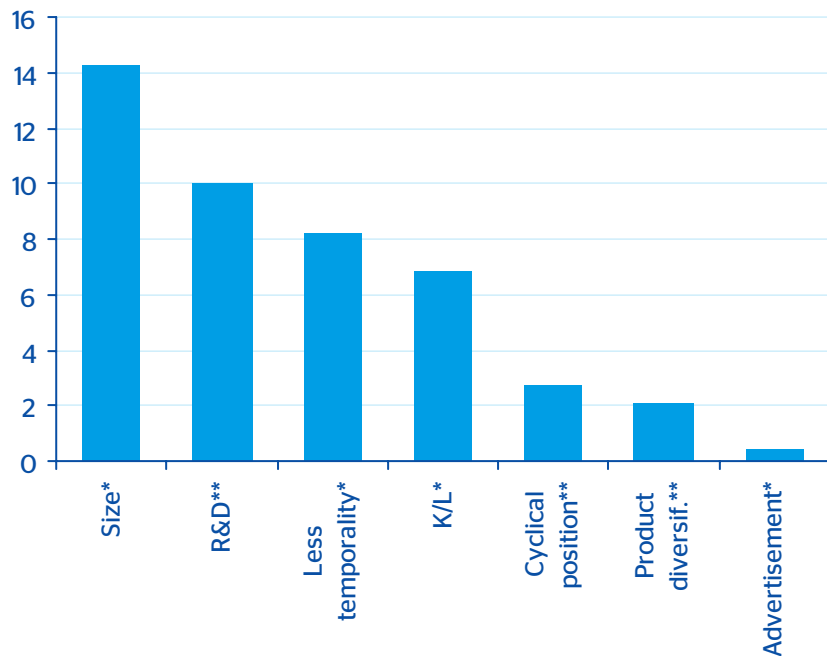
Section 2

The challenges of the Spanish economy: 3. Stepping up the pace of reform

Spain: drivers of export probability

(Marginal effects)

Source: BBVA Research based on BSS data (SEPI foundation)



Note: * in %; ** in pp; the marginal effect of size; K/L ratio and advertisements costs are calculated based on a 1% increase in the corresponding variable; the marginal effect of temporary contracts corresponds to a one percentage point reduction on the average sample value; R&D, expansive cyclical position and diversification are categorical variables whose marginal effects is computed from value 0 to value 1 (e.g. no R&D activity to R&D activity)

Improve competitiveness

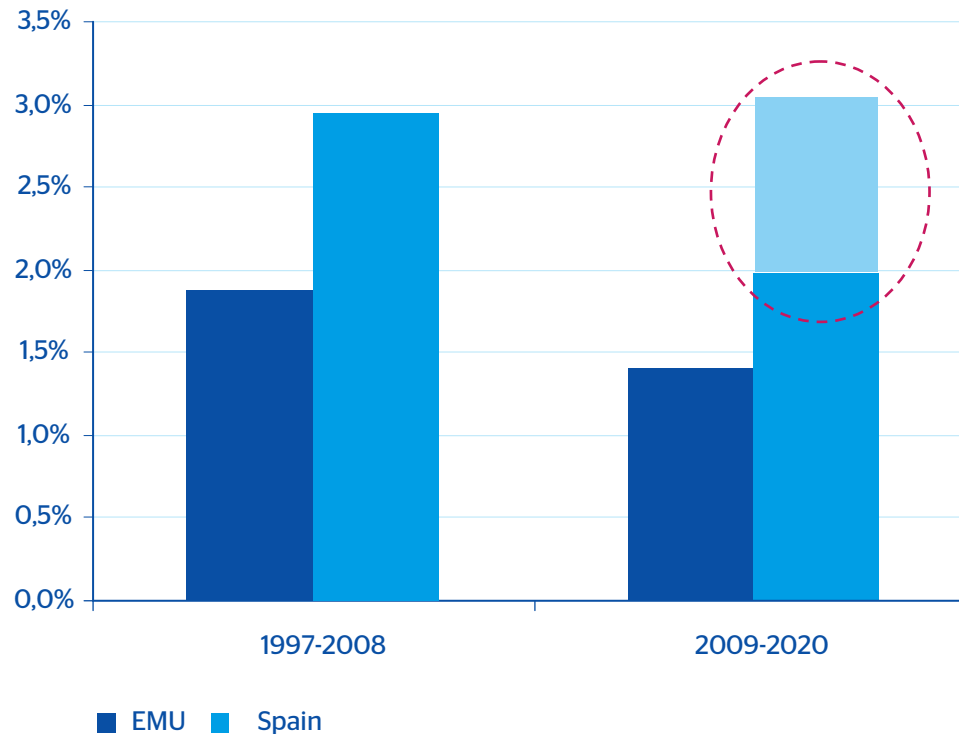
- Help growth of SMEs
- Reduce start-up and management costs
- Ambitious collective bargaining reform
- Reduce temporary rate and encourage dual training

Section 2

The challenges of the Spanish economy: 3. Stepping up the pace of reform

Spain vs. EMU: Potential GDP (% yoy)

Source: BBVA Research



Contents

Section 1

International environment: politics takes centre stage in the economic debate

Section 2

Spain economic outlook: slowdown, with risks on the downside

Section 3

Household consumption: fragile, due to the weakness of its drivers

Section 4

Demand for durable goods: nonexistent and unlikely to improve in the short term

Section 3

Household consumption: weak fundamentals

1. Job destruction

2. Increase in risk aversion

3. Liquidity pressure and return on savings

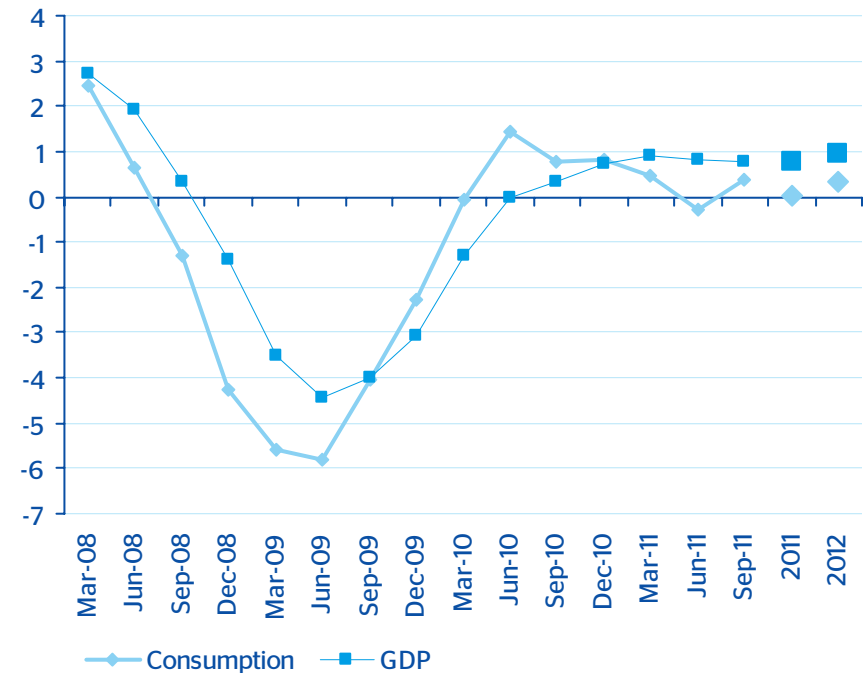
4. Private sector deleveraging

5. Implications of public sector deleveraging

6. Low interest rates

Spain: Household consumption (% yoy)

Source: BBVA Research based on INE data



Section 3

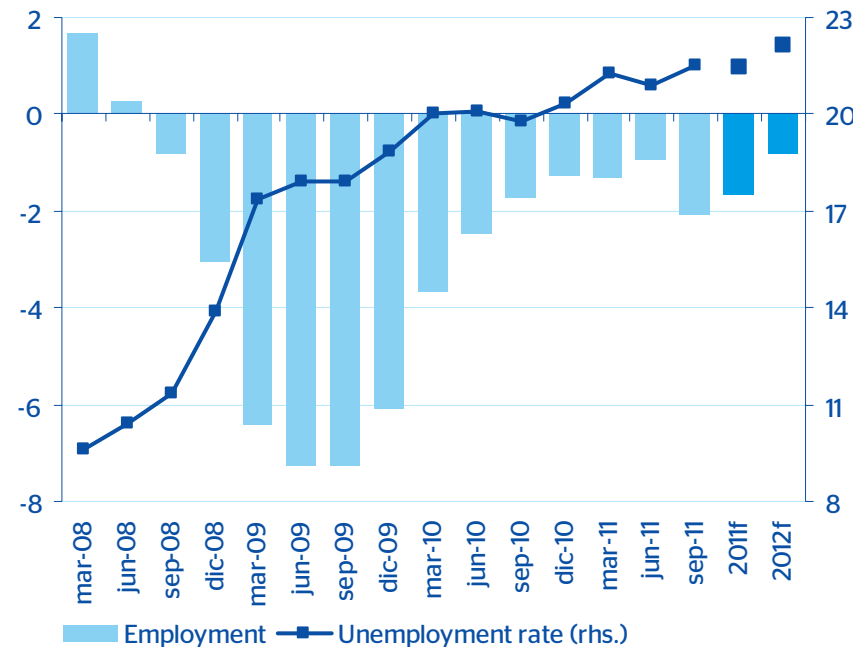
Household consumption: weak fundamentals

1 Deterioration of the labour market

- Acceleration of **job destruction** + outlook of **stagnation** → worse outlook for the labour market → further drop in real household income in 2012

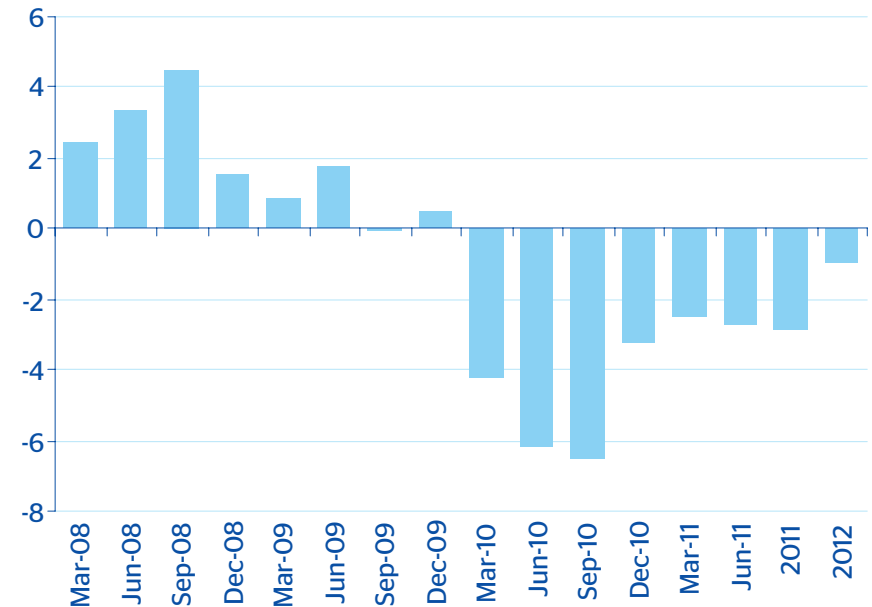
Spain: employment and unemployment rates (%)

Source: BBVA Research based on INE data



Spain: real GDHI (%)

Source: BBVA Research based on INE data



Section 3

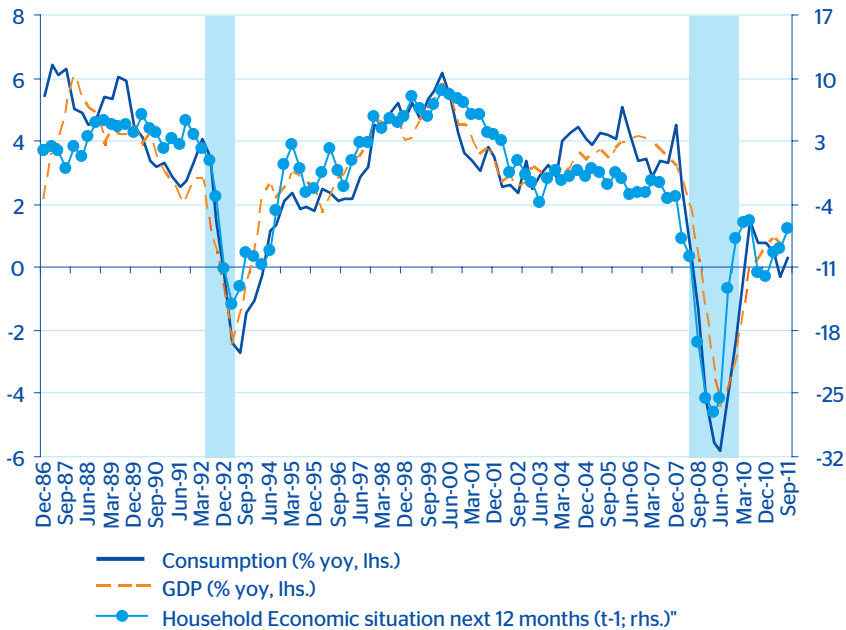
Household consumption: weak fundamentals

2 Increase in risk aversion

- **Uncertainty** set to remain **high**, spurring **precautionary saving** in detriment to consumption

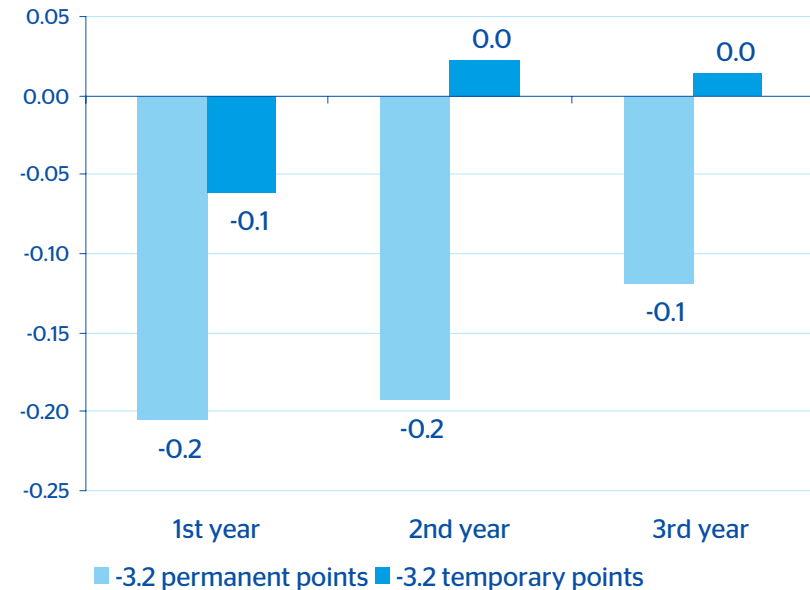
Spain: household consumption, GDP and confidence indicator (t-1) (%)

Source: BBVA Research based on INE and EC data



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

Source: BBVA Research



* Confidence indicator based on household perception of future economic situation

Section 3

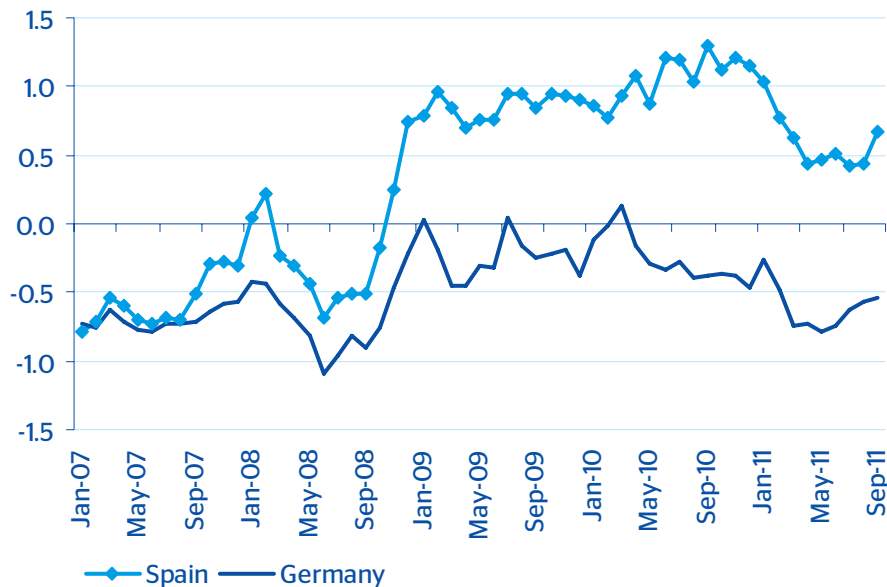
Household consumption: weak fundamentals

3 Liquidity tensions and return on savings

- **Liquidity pressure** leads to offers of higher rates on deposits, **stimulating savings** in detriment to consumption

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

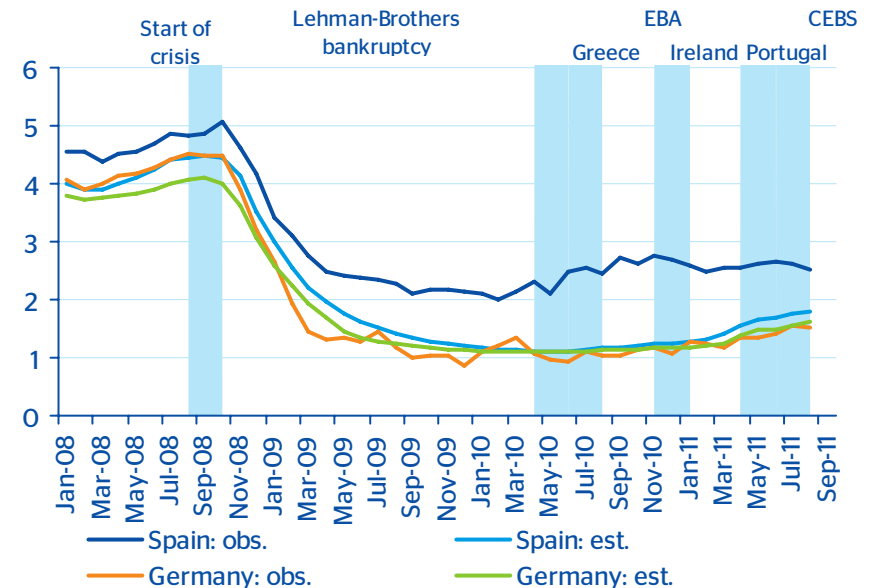
Source: BBVA Research based on central bank data



Spain vs. Germany: 1-year deposit rates

(New transactions)

Source: BBVA Research



Section 3

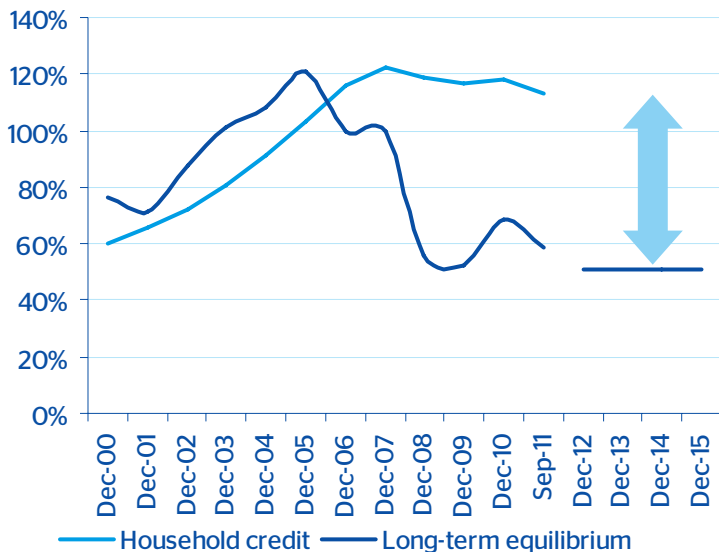
Household consumption: weak fundamentals

4 Private sector deleveraging (1/4)

- Empirical international evidence shows that:
 - deleveraging started late after the financial crisis arose,
 - and is a gradual process that in developed economies will last around 5 years

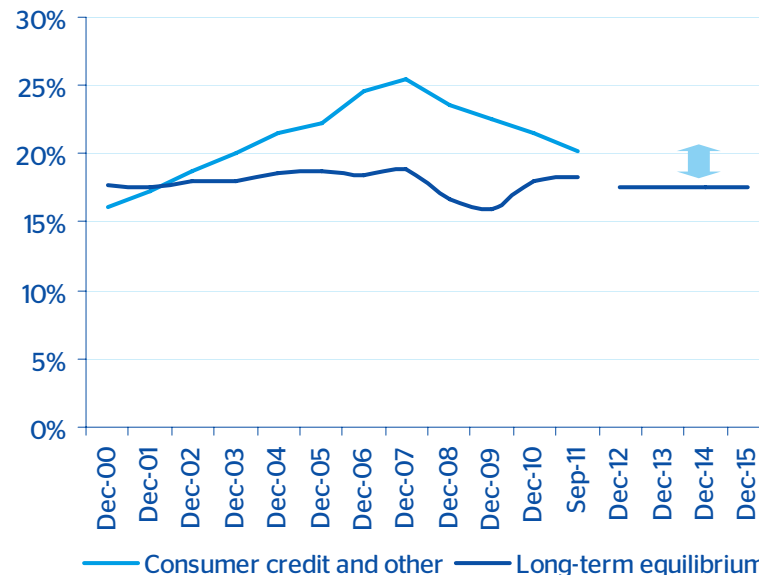
Spain: household credit (% GDI)

Including securitisations
Source: BBVA Research



Spain: consumer credit and other (% GDI)

Including securitisations
Source: BBVA Research



Section 3

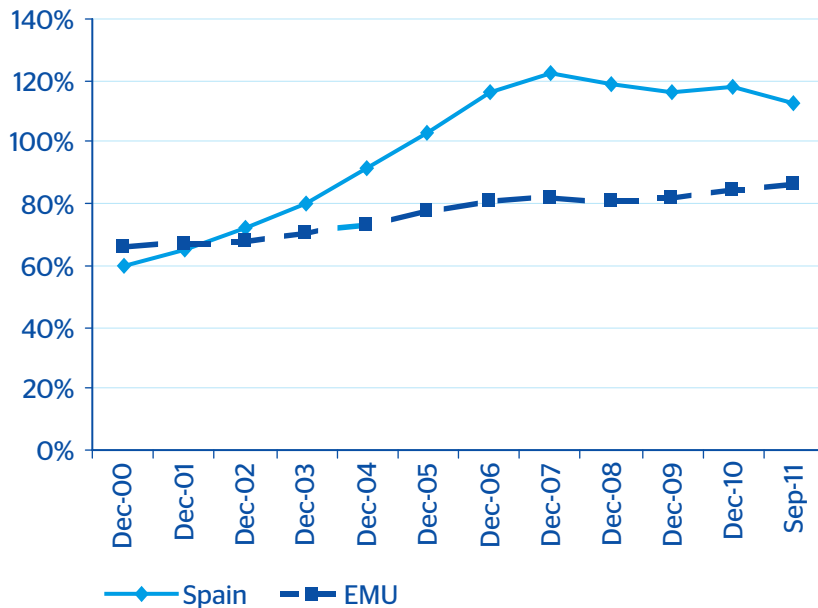
Household consumption: weak fundamentals

4 Private sector deleveraging (2/4)

- **Household credit:** still far from converging with the EMU (30pp of GDI)
- Sharper decrease in **consumer credit** in Spain, accelerating **convergence**

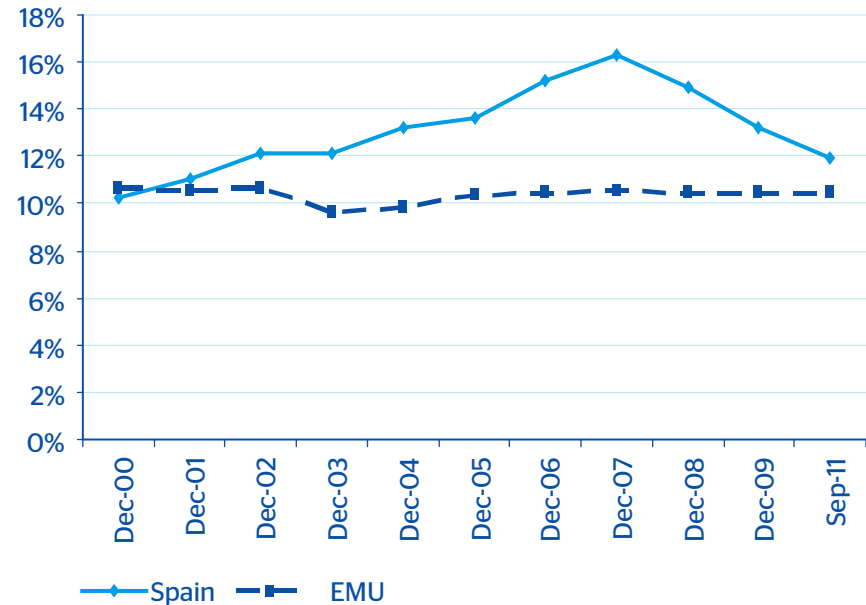
Household credit* (% GDI)

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



Consumer credit (% of GDI)

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



Section 3

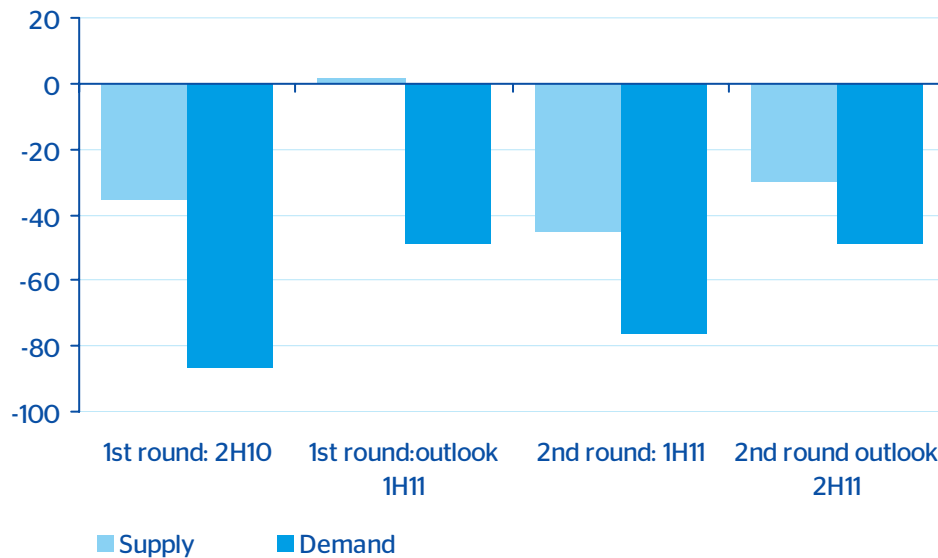
Household consumption: weak fundamentals

4 Private sector deleveraging (3/4)

- The results of the **2nd round of the BBVA Business Trends Survey (BTS)** indicate the both scant demand and limited supply are behind the worse performance of consumer finance

Perception of credit supply and demand: balance of answers

(<0 indicates a worsening)
Source: BBVA Research



Demand for loans fell by more than the survey predicted in December 2010, but slightly less than in 2H10

Harsher financing conditions which, according to BTS participants, led consumer credit supply to contract

Car dealerships and furniture business: the sectors hit hardest by the fall in consumer lending

Section 3

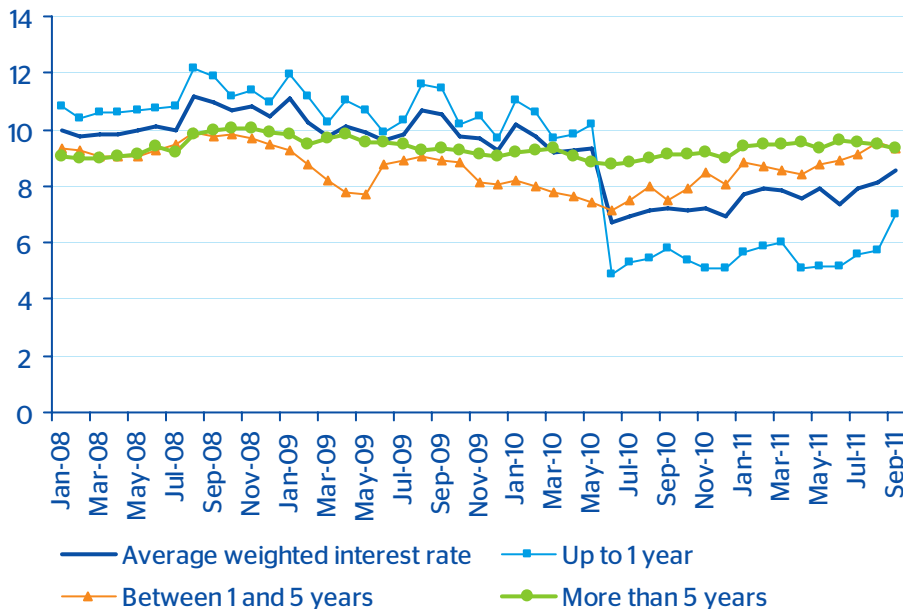
Household consumption: weak fundamentals

4 Private sector deleveraging (4/4)

- **Lingering financial stress**, the outlook for **weak demand** and **high default** do not bode well for an increase in consumer credit in the short and medium term

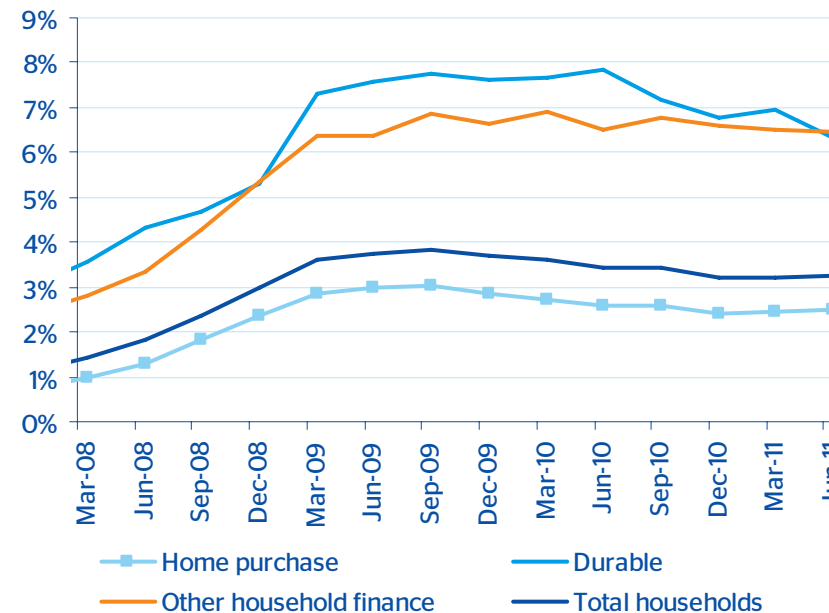
Spain: interest rates on new consumer loans (%)

Source: BBVA Research based on Bank of Spain data



Spain: household default rate (%)

Source: BBVA Research based on Bank of Spain data



Section 3

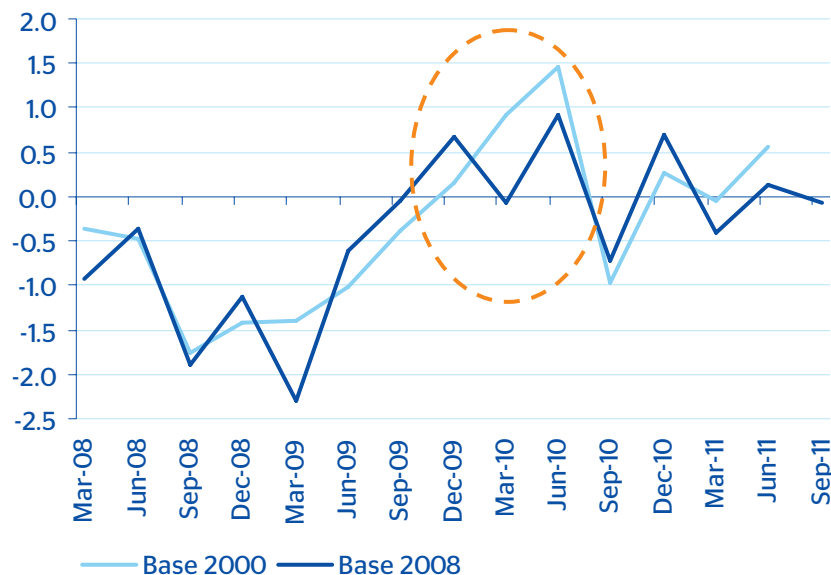
Household consumption: weak fundamentals

5 Implications of public sector deleveraging

- Between 2H09 and 1H10: bringing purchases forward
- Changes in consumer trends and direct contractionary effects due to fiscal policy measures, will cap spending over the forecast period

Spain: household consumption (% qoq)

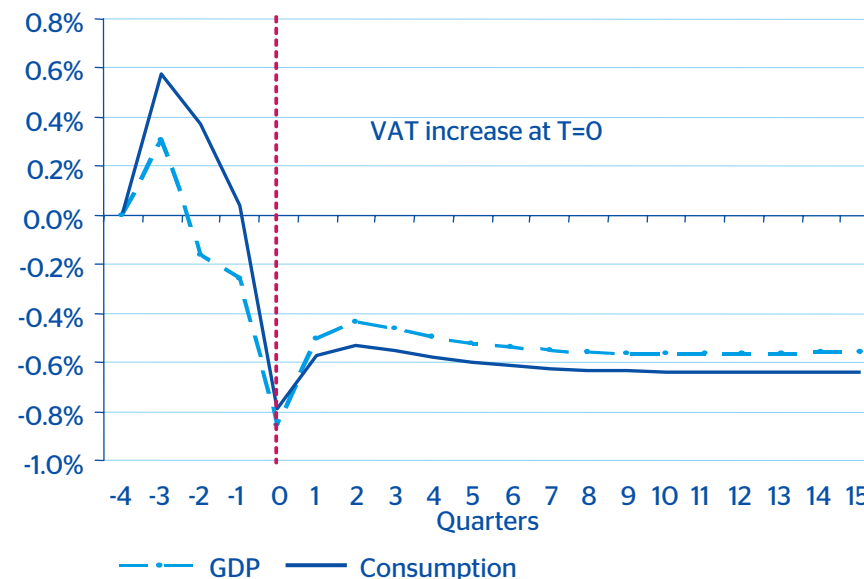
Source: BBVA Research based on INE data



Spain: response to a 2pp VAT hike

(percentage deviation from trend)

Source: BBVA Research



Section 3

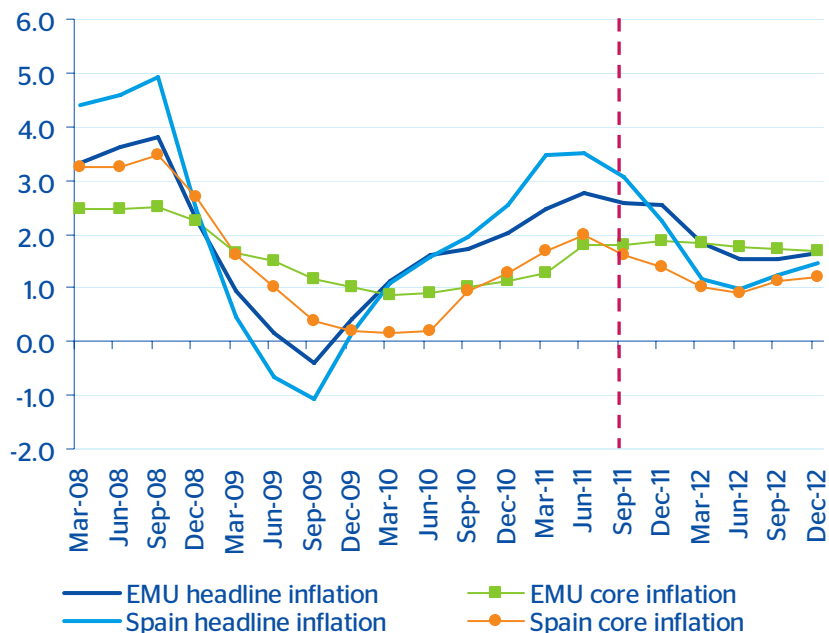
Household consumption: weak fundamentals

6 Low interest rates

- Weak economic growth and a benign inflation outlook should keep **interest rates at historically low levels, limiting the debt burden of households**

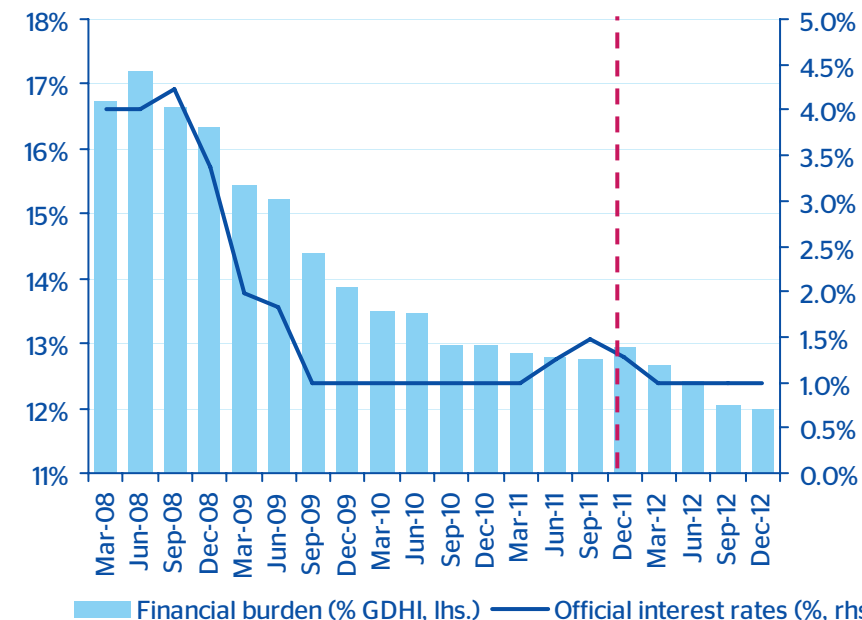
Headline and core inflation

(% yoy)
Source: BBVA Research based on INE and Eurostat data



Debt burden of households and official interest rates

(quarterly averages)
Source: BBVA Research based on INE and ECB data



Contents

Section 1

International environment: politics takes centre stage in the economic debate

Section 2

Spain economic outlook: slowdown, with risks on the downside

Section 3

Household consumption: fragile, due to the weakness of its drivers

Section 4

Demand for durable goods: nonexistent and unlikely to improve in the short term

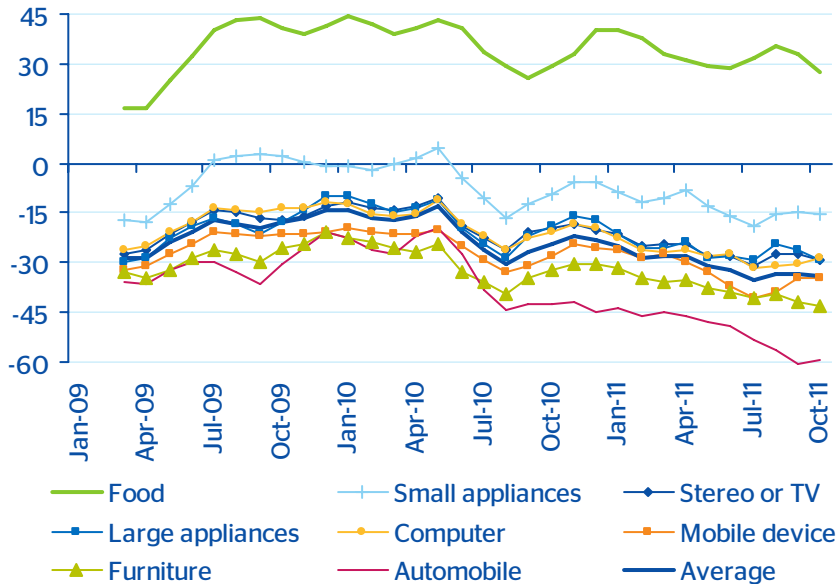
Section 4

Demand for durable goods

- The **steady reduction of household disposable income** has especially hurt domestic consumption of **durable goods**, especially since 2Q11
- The **impact of the VAT hike on prices** halted the **relative cheapening** only in 1H11

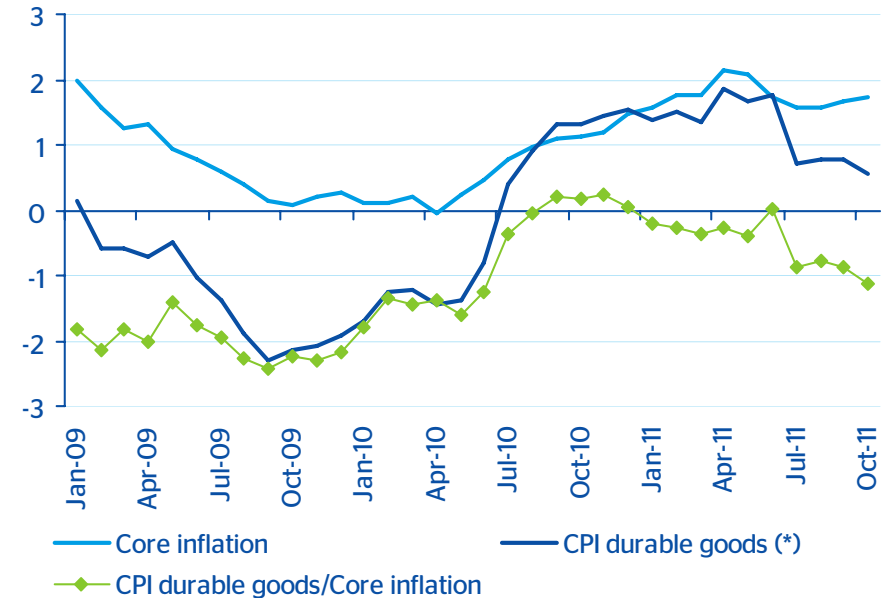
Spain: perception of purchase timing

(Difference of percentages between positive and negative responses, MA3)
Source: BBVA Research, based on Millward Brown data



Spain: inflation

(% yoy)
(* Major appliances, consumer electronics, computer equipment, furniture, cars and other vehicles)
Source: BBVA Research based on INE data



Section 4

Demand for durable goods

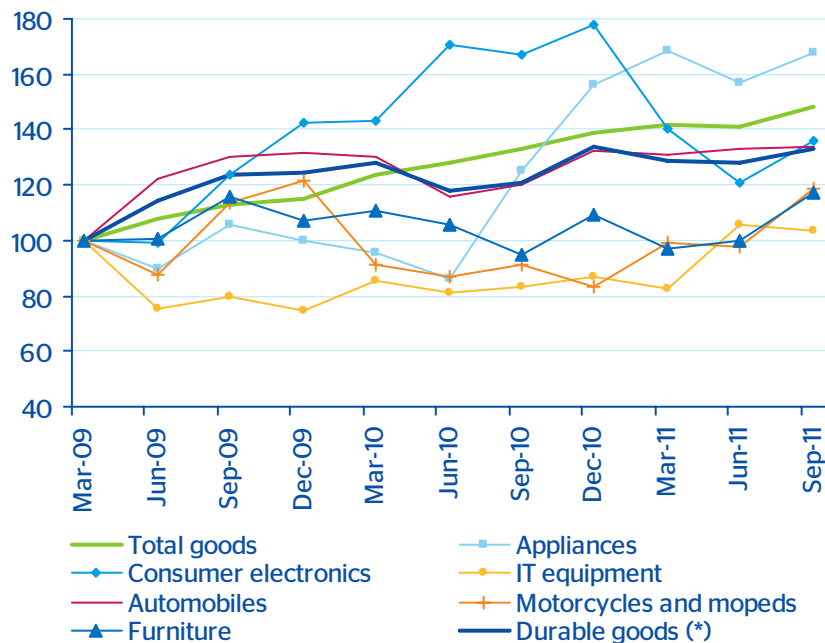
- Increased risk aversion in Europe has caused foreign demand for durable goods to lag the growth of demand for total goods in 2011

Spain: real exports of goods

(SWDA data; 1Q09 = 100)

(*) Major appliances, consumer electronics, computer equipment, furniture, cars and other vehicles

Source: BBVA Research based on Millward Brown data



Mixed foreign demand

- ICT equipment and two wheeled vehicles: better relative performance
- Stagnation of automobile exports
- Consumer electronics: fall from highs

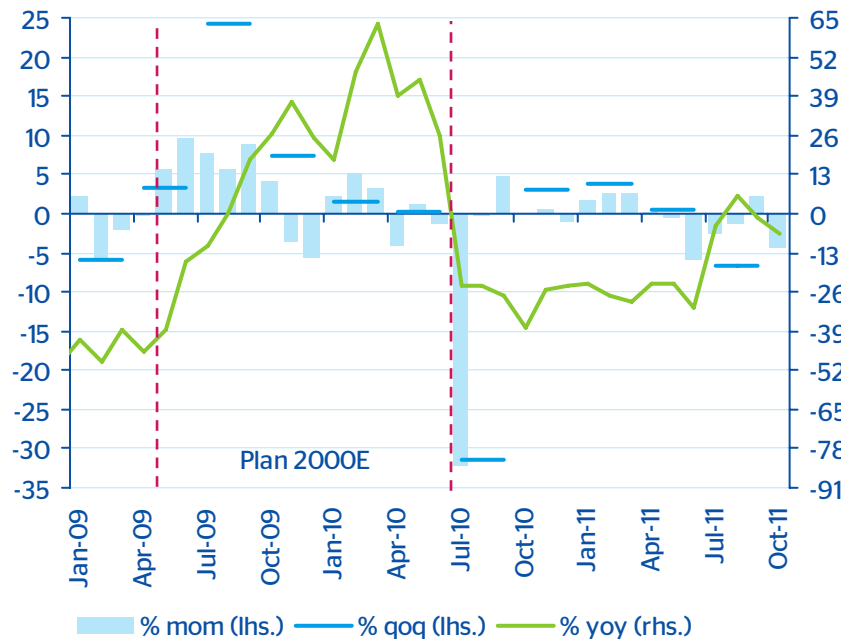
Section 4

Cars: crossing the desert

- **New car (NC)** sales still floundering: registration down since June 11... amid rising prices
- Demand still strong for **used cars (UC)**: 11.3% in 2011 → $UC/NC = 2$

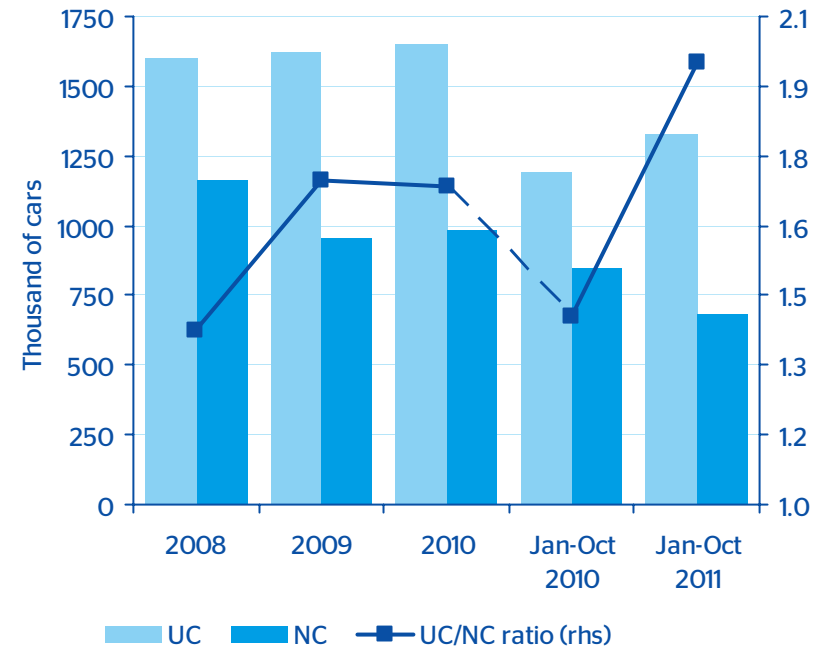
Spain: car registrations

Source: BBVA Research based on ANFAC and Ganvam data



Spain: Used vs. new cars

Source: BBVA Research based on INE data



Section 4

Cars: mixed performances across sales channels and segments

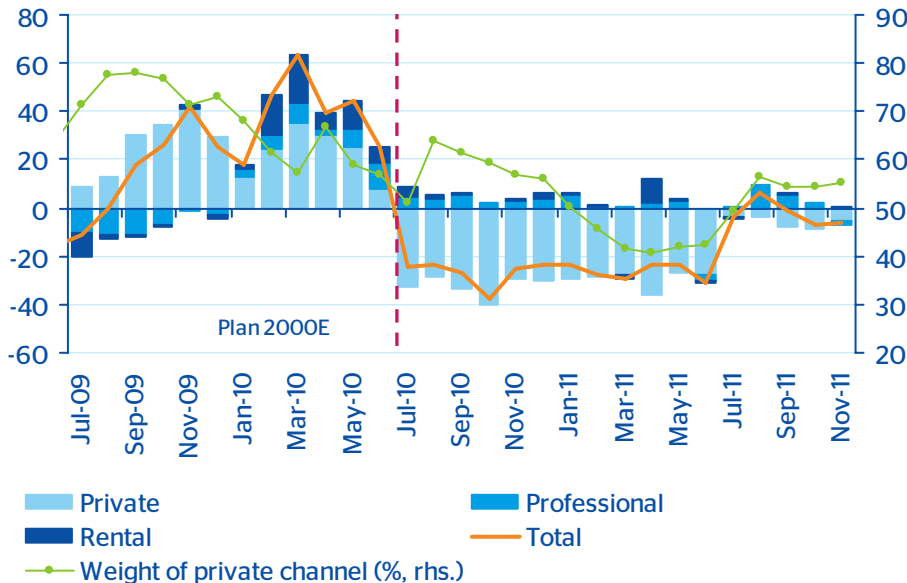
- **Private sales** are still the **main culprit** of the slump in demand
- **Professional dealers** represent **53.2% of 2011 registrations**

- The **main beneficiaries of Plan 2000E (small segments)** lost market share after the plan expired

Spain: car registrations by sales channel

(contribution to % yoy)

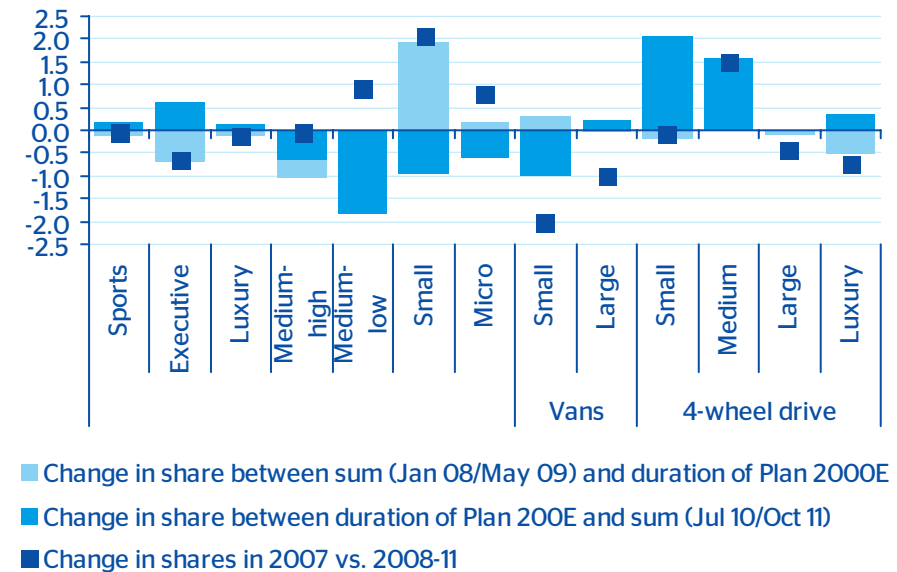
Source: BBVA Research based on ANFAC and Ganvam data



Spain: change in market share by segment

(SWDA data; pp)

Source: BBVA Research based on ANFAC and Ganvam data



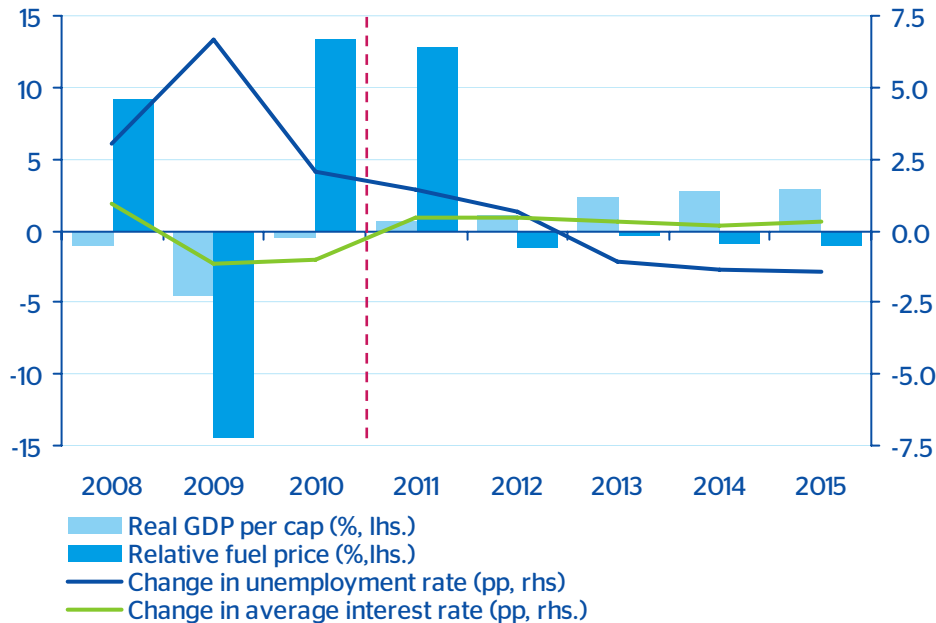
Section 4

Cars: outlook

- If the last two months of the year are in line with forecasts, the number of car registrations in **2011** could be less than **810 thousand**
- The forecast performance of the sector's main drivers suggests **this figure will be flat in 2012 and recover slightly from 2013, rising to almost one million units at the end of 2015**

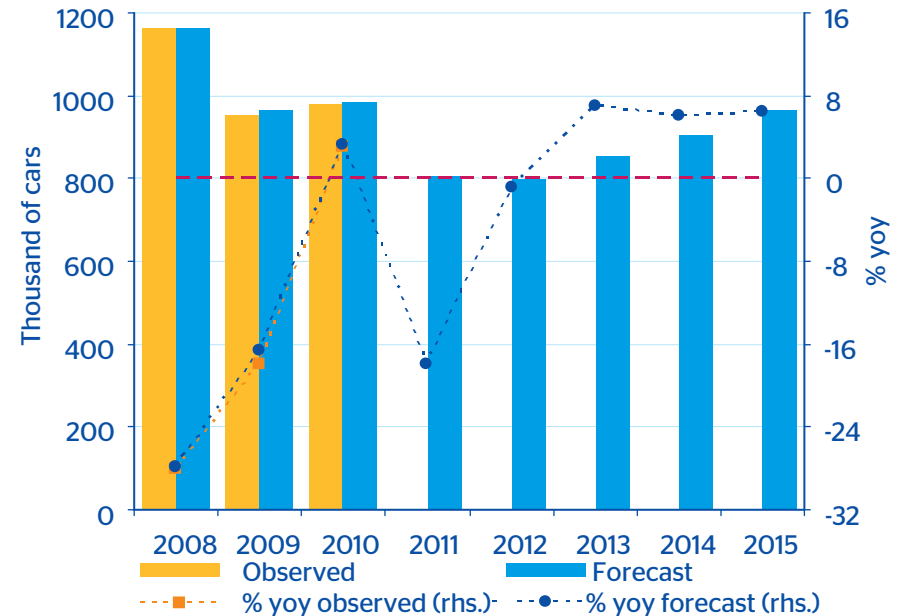
Forecasts for car registration drivers

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



Spain: car registrations

Source: BBVA Research based on ANFAC and Ganvam data



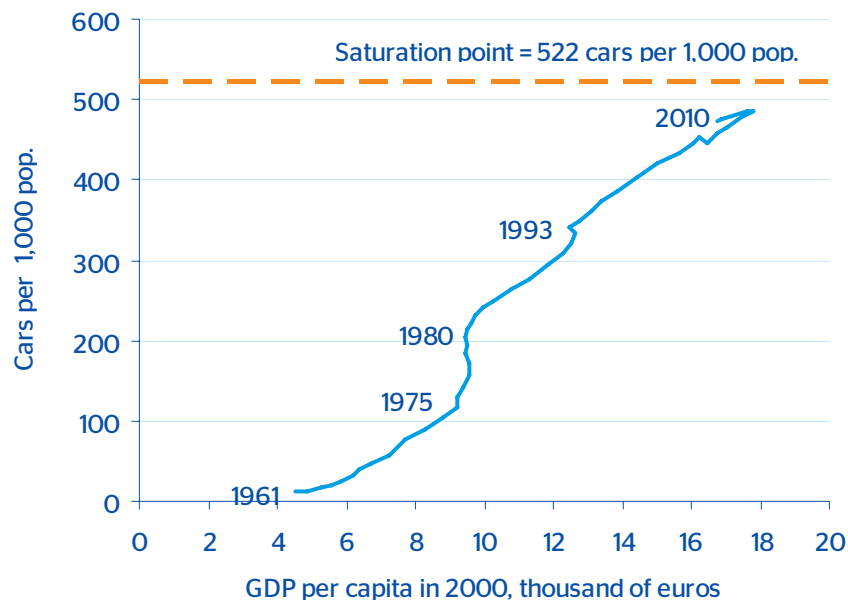
Section 4

Cars: outlook

- Do one million cars **represent long-term** potential demand?
- This depends on:
 - the driving population threshold (and speed with which this is reached) ← GDP pc
 - demographics
 - the vehicle scrappage rate

Spain: number of car vs GDP pc 1961-2010

Source: BBVA Research based on INE, BdE, DGT and European Commission data



Long-term scenarios for potential demand for cars. 2015-2050

Source: BBVA Research and INE

	Adverse scenario	Baseline scenario	Positive scenario
Potential GDP growth	1%	2%	3%
2015: 45.9 million			
Demographics	2026: 44.8 2049: 45.0	2026: 45.3 2049: 45.8	2026: 45.6 2049: 46.9
Cars withdrawn (% of total cars)	Avg 93-95: 3.5%	Avg 90-10: 4.0%	Avg 00-07: 4.5%
Year when convergence at saturation reaches 90%	2038	2029	2026

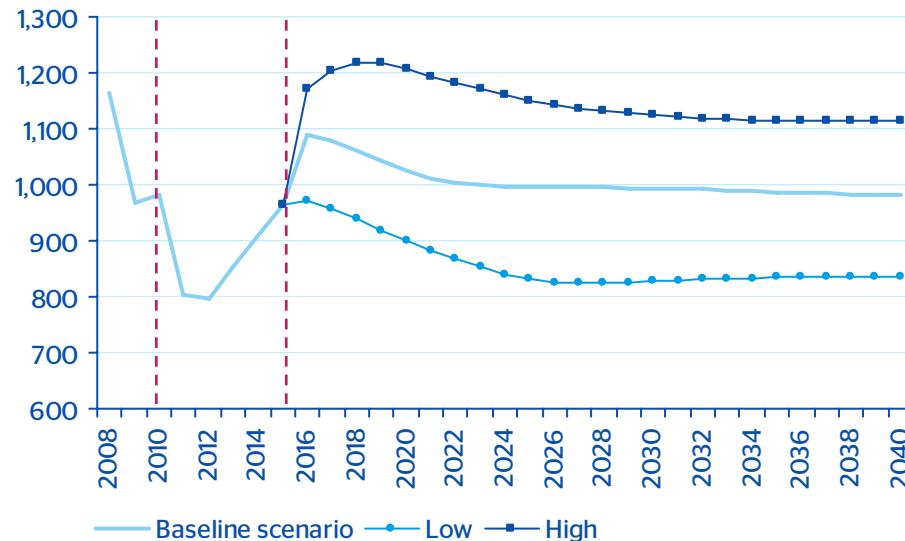
Section 4

Cars: outlook

- Do one million cars **represent long-term** potential demand?
- Introduction of **structural reforms** to drive potential growth + **slight but sustained** increase in the **population** = could increase **car registrations by 13% in the long term**

Spain: car registration scenarios

(Thousands of units)
Source: BBVA Research and INE



Potential demand in each scenario

- Baseline scenario: stabilising at around 980 thousand following the rise in the second half of this decade
- Unfavourable scenario: 825 thousand
- Favourable scenario: 1.1 million

Section 4

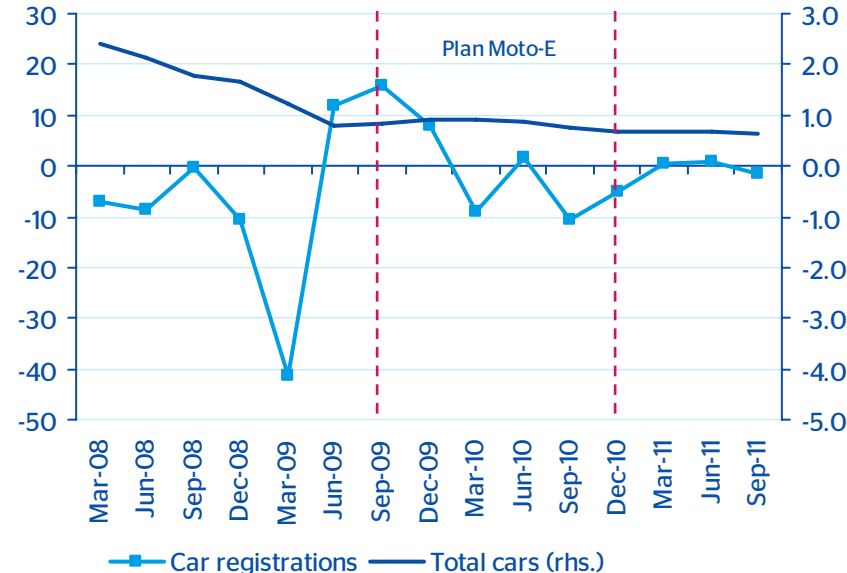
Motorcycles and mopeds: stabilising at lows

- Demand for **two wheeled vehicles (V2Rs)** has continued to **fall** during the first ten months of 2011, albeit at a **slower pace than in 2H10** (-1.5% SWDA vs. 2H10)
- The cause is not the completion of Plan Moto-E (9/7/10-31/12/10)

Spain: moped and motorcycle registrations

(SWDA data,% qoq)

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



What explains the scenario for two wheeled vehicles?

- Weakness of drivers (youth unemployment, increased uncertainty)
- Regulatory changes (increase in the licence age for mopeds to 15, the transposition of Directive 2006/126/EC almost four years ahead of European requirements)

Section 4

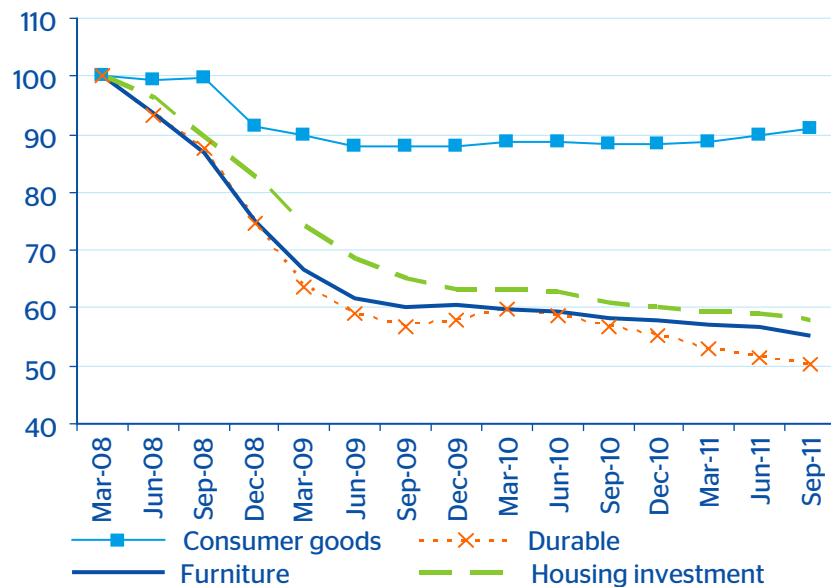
Furniture: in line with housing demand

- During the first nine months of 2011, **furniture sector turnover fell 5.2% (SWDA) more than the figure reported in January-September 2010 (-4.0% SWDA), but half of the drop in turnover reported by the whole durable goods manufacturing sector (-10.5% SWDA)**

Spain: furniture sector turnover

(Trend: Jan-09 = 100)

Source: BBVA Research based on INE data



The rise in VAT in July 2010 and the elimination of deductions for purchases in December 2010 have shaped investment in housing throughout 2011

BBVA Research estimates suggest that a 1% yoy decline in nominal housing investment would (*ceteris paribus*) lead to an accumulated 0.6% drop in turnover

Section 4

Major appliances and brown line products: a sector in the midst of restructuring

Spain: restructuring processes in major appliances and brown products sectors (2009-11)

* D: distribution company; M: manufacturing company

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

Company	Type of company*	Type of restructuring
PC City	D	(-) Store closure and workforce reduction
Urende	D	(-) Store closure
PC City	D	(-) Store closure and workforce reduction
Darty	D	(-) Store closure and workforce reduction
Miró	D	(-) Workforce reduction
Urende	D	(-) Voluntary bankruptcy
Unecsa	D	(-) Bankruptcy
Urende	D	(-) Temporary workforce reduction
Media Markt	D	(+) Store opening
Ecomputer	D	(+) Store opening
Fnac	D	(+) Store opening
Worten	D	(+) Store opening (+ partial takeover of PC City)
<hr/>		
Infinity System	F, M	(-) Temporary workforce reduction
Sanyo	M	(-) Plant closure
Electronic Devices Manufacturer	M	(-) Unwinding
Engel Axil	M	(-) Voluntary bankruptcy
BSH	M	(-) Workforce reduction
Daewoo	M	(-) Workforce reduction following extinction of company
Sharp	M	(-) Temporary workforce reduction

Prolonged contraction in demand +
fragmentation → sector companies
adjust their cost structures

Vertical integration process underway

Seeking synergies and
internationalization: necessary given
the lack of financing and enduring
crisis

Section 4

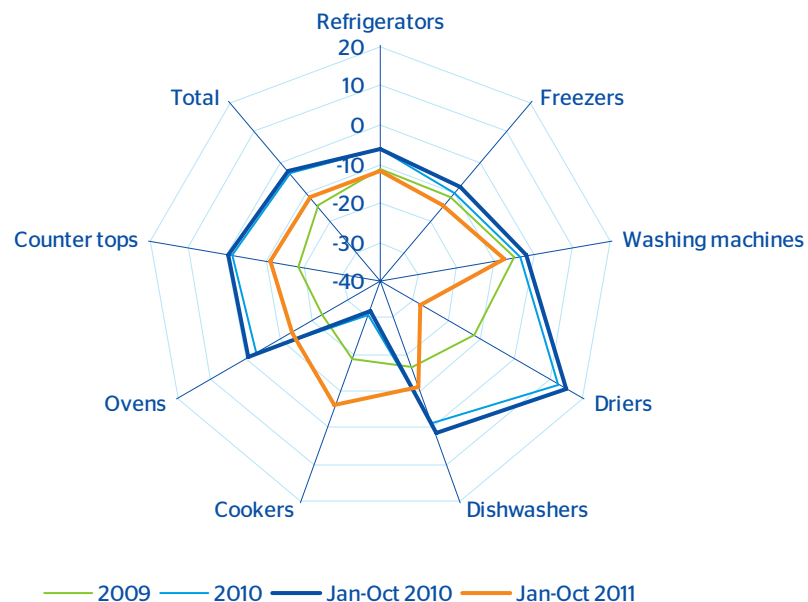
Major household appliances: at 2009 levels

- The extension of the **real estate sector adjustment** has also had **a negative impact on demand for household appliances**
- The **number of units sold dropped 12.0% yoy** (with turnover down 15.4% yoy) in the first ten months of 2011 after falling 4.4% in the same period of 2010

Spain: sales of appliances by product family

(% yoy of units)

Source: BBVA Research based on ANFEL data



Sales of all appliance families were down to October, although sales of cookers, washing machines, dishwashers and counters marked a lower-than-average fall

Section 4

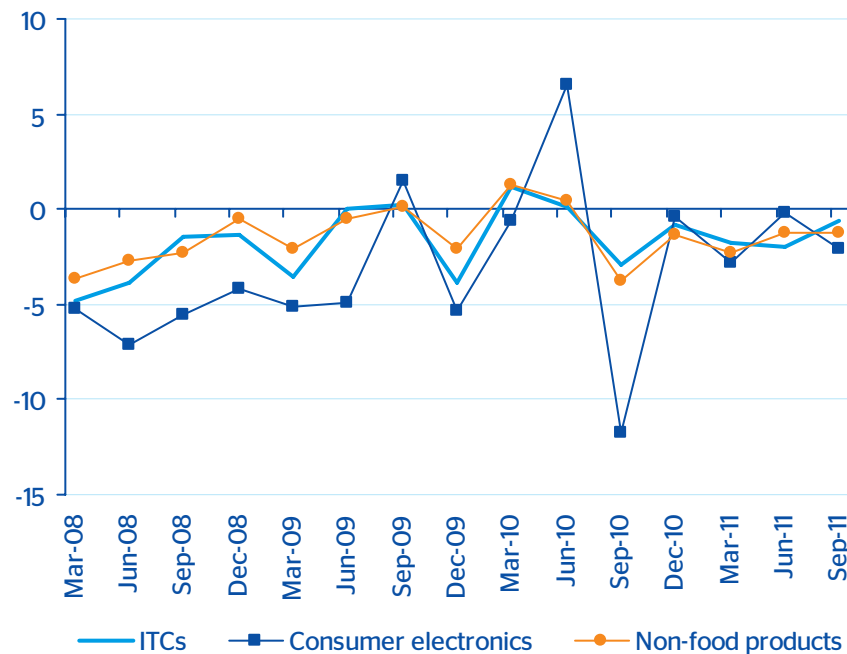
Brown line products: rising penetration rate...but sales are down

- Retail sales of ITC equipment and consumer electronics fell further between January and September (-3.8% SWDA and -5.6% SWDA respectively), in line with the overall trend marked by non-food products
- The persisting deflation is leading to an increase in brown line products in the household

Spain: real retail sales of brown line products

(SWDA Data,% qoq)

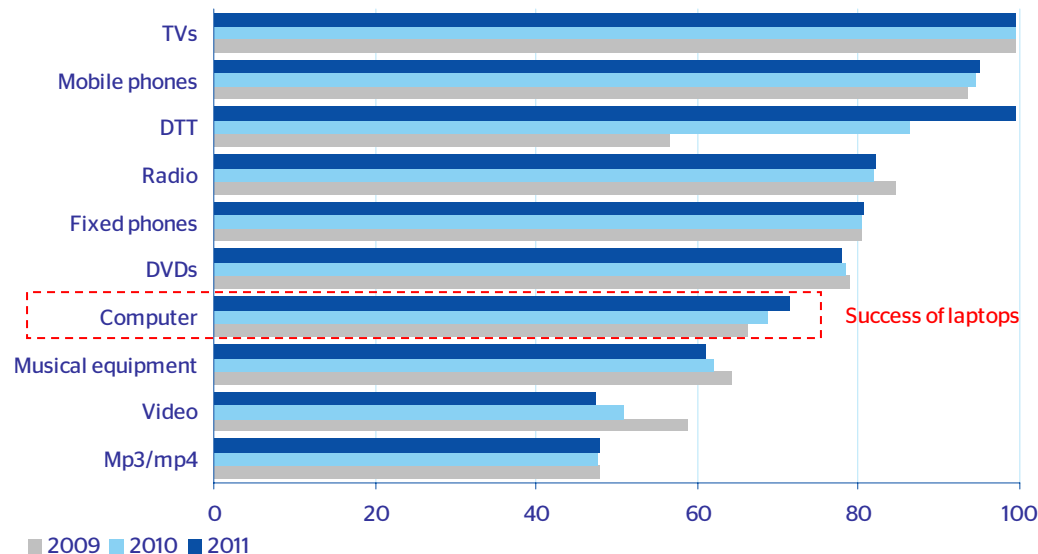
Source: BBVA Research based on INE and Eurostat data



Spain: penetration rate of ITC equipment in households

(% of households)

Source: BBVA Research based on INE data



Key themes

- 1 Global economic outlook:** global growth is slowing and risks are hampering expectations. The structural weaknesses of the developed economies are becoming more evident
- 2 Europe:** the worsening of the sovereign debt crisis is fuelling banking risk and causing economic conditions to deteriorate further. Growth in countries with high risk premiums is being damaged. The measures announced are insufficient in scope
- 3 Spain:** stagnation in 3Q11 preventing sustained job creation. The economy's activity/employment balance remains low and is trending lower. **External demand** remains the driver of growth
- 4** There has been no change in the pace of adjustment and reform which offset rising uncertainty on international financial markets. **The new government must take on the challenge of reforms**
- 5** Weaker drivers suggest **weak consumption** on the medium term horizon, especially for durable goods
- 6** If the sensitivity of **demand for cars** to changes in the determining factors does not vary and these perform in line with forecasts, the number of registered vehicles will **increase from 2013 to nearly one million units by the end of 2015**. This figure corresponds to potential long-term demand for cars in the Spanish economy under reasonable hypotheses on the performance of economic drivers
- 7** The results of the second round of **the BBVA Business Trends Survey** indicated that the decline in consumer financing (due to reasons of supply and demand) could have helped to damage the economic situation of retail sectors more than expected
- 8** Lingering financial stress, the outlook for weak demand and high default levels do not bode well for an increase in **consumer credit** in the short term

Consumption Outlook

Seville, 30 November 2011