

Consumption Outlook

Second half 2013

Madrid, December 18, 2013

Main messages

- 1 **Rebalancing of global growth but not without risk.** Higher contribution to growth by developed economies and lower deterioration in emerging markets
- 2 **The Spanish economy has begun to grow moderately,** underpinned by exports, and a fiscal adjustment that became better distributed over time
- 3 **Private consumption,** especially in the case of durable goods, **has shown the first recovery signs** following the improvement of its determining factors
- 4 A **favorable pattern in consumer finance** has allowed an increase in domestic demand
- 5 The **insufficient adoption of new technologies by companies** limits e-commerce growth in Spain
- 6 The **ageing** of the Spanish population **might have a positive impact on household consumption** in the coming decades

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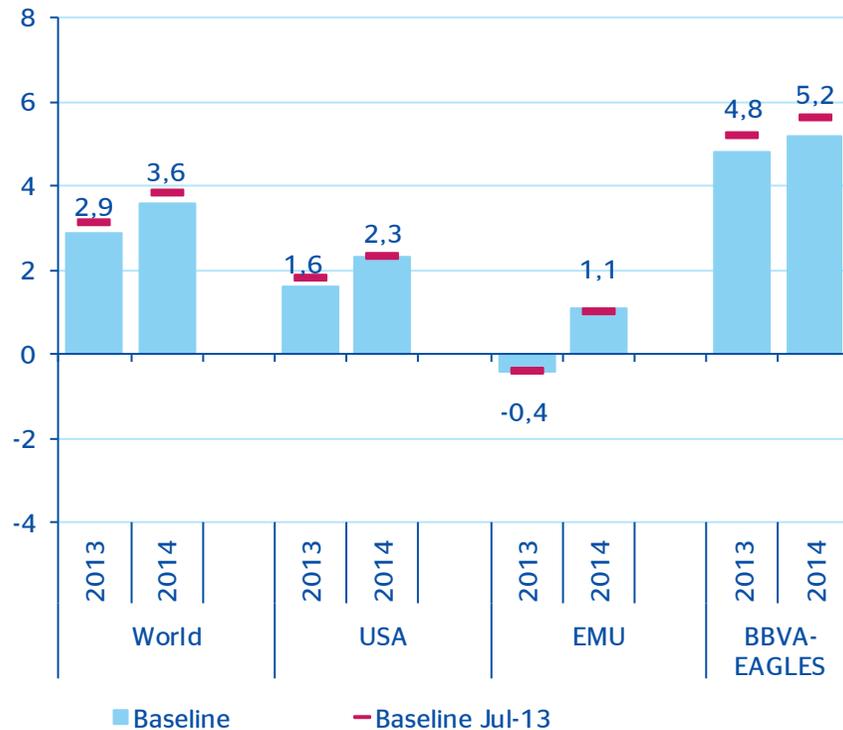
Deconstructing two myths: 1) do we consume less as we get older?, 2) are Spanish products suitable for e-commerce?

Section 1

Rebalancing of global growth

Economic growth (%)

Source: BBVA Research and Haver



Global recovery continues, with increasing support from advanced economies

Slowdown in emerging markets, particularly in Asia

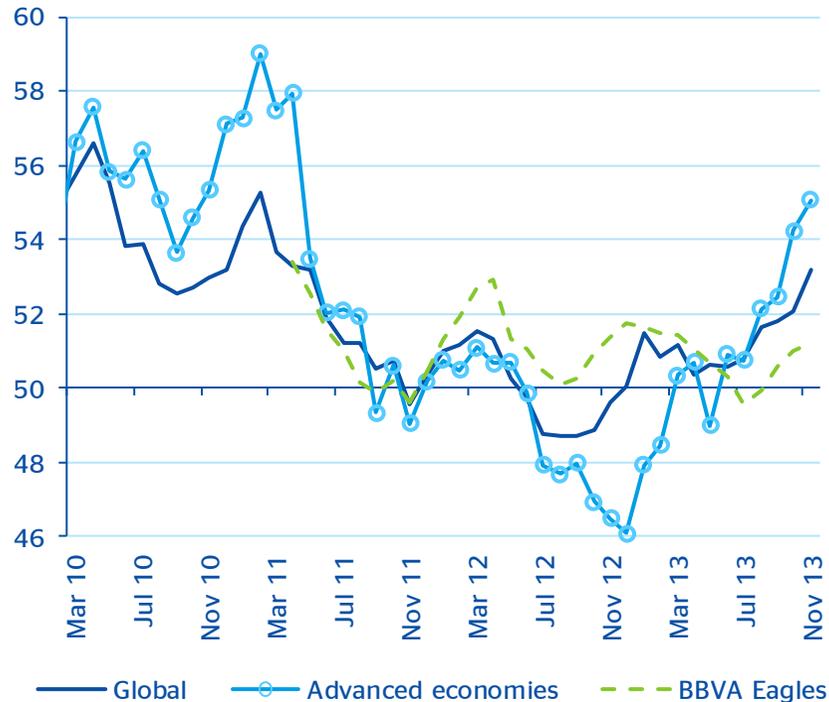
Risks are less extreme, but still tilted to downside

Section 1

Rebalancing of global growth: improvement in advanced economies

Global: manufacturing PMIs

Source: BBVA Research based on Markit Economics data



Improved cyclical outlook in advanced economies ...

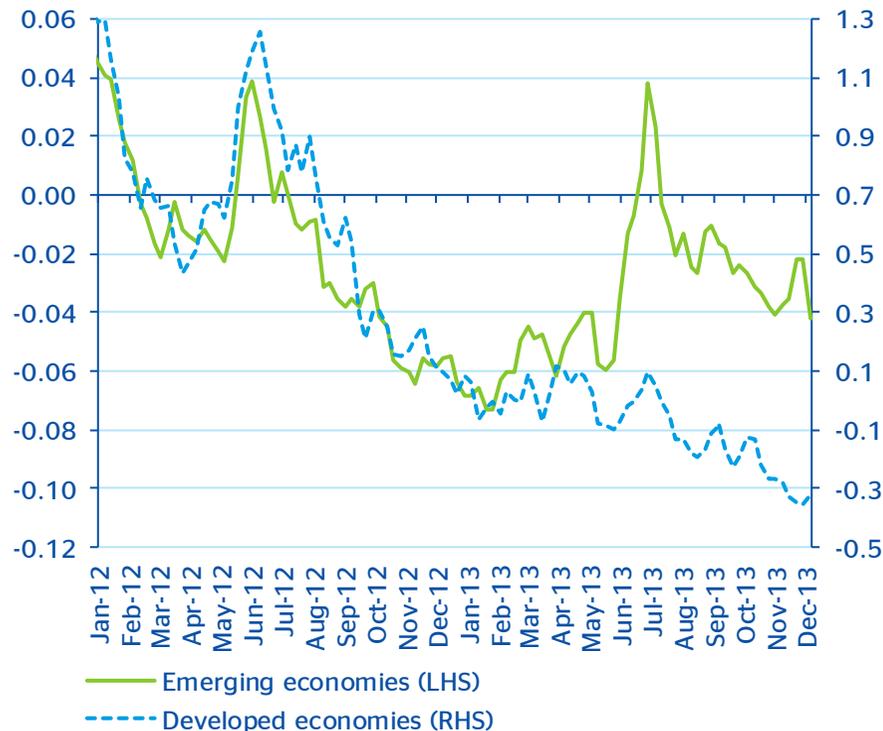
... while waiting for improvements in GDP growth

Section 1

Rebalancing of global growth: lower deterioration in emerging markets

BBVA Research Financial Tensions Index: developed and emerging economies

Source: BBVA Research



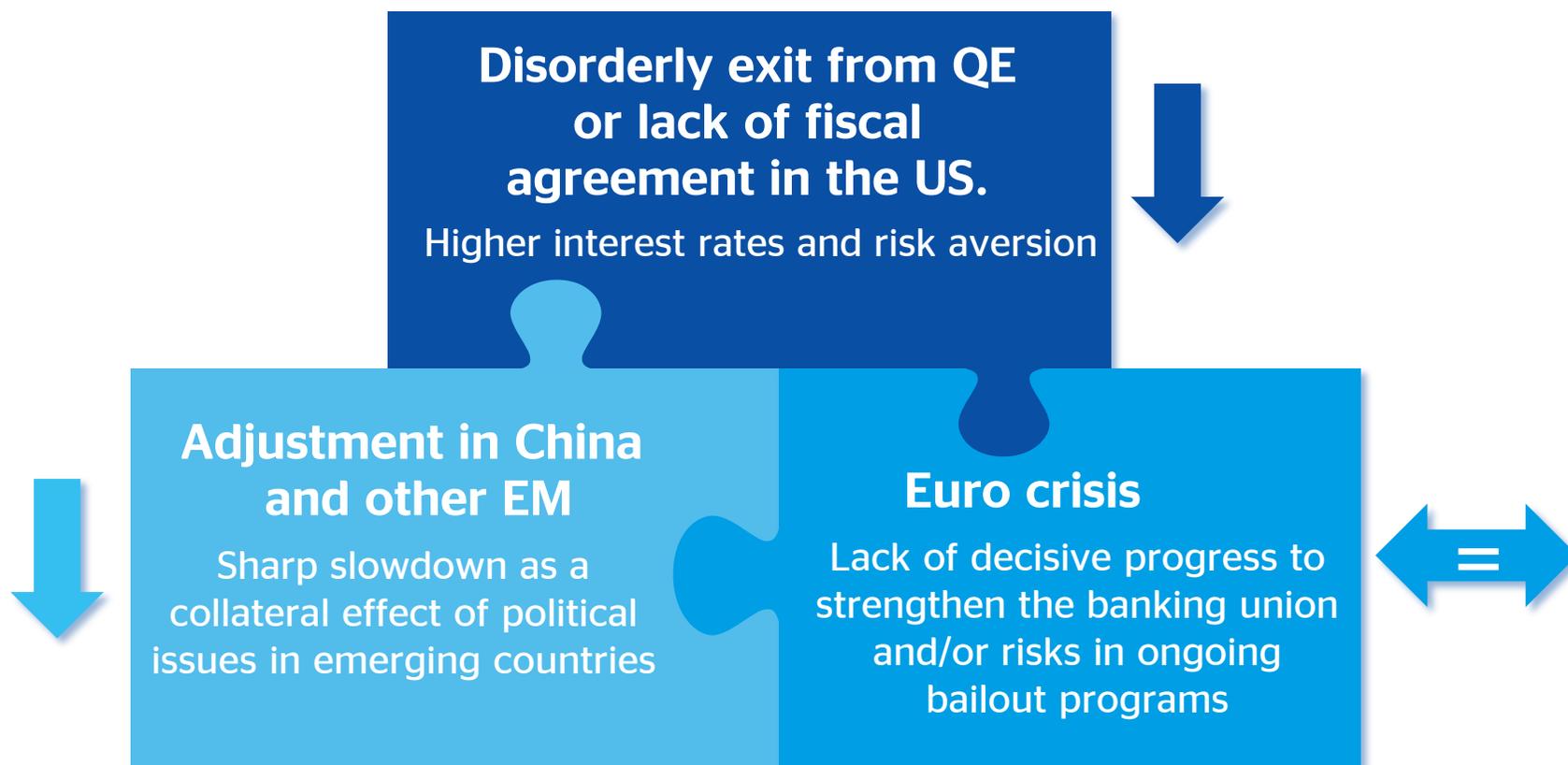
After the slowdown in growth that followed the announced imminent cut in the pace of asset purchases by the Fed (*tapering*), ...

..., financial tensions eased with its subsequent delay ...

..., curbing the capital flight in some emerging markets and improving their outlook

Section 1

Risks are less extreme, but still tilted to the downside



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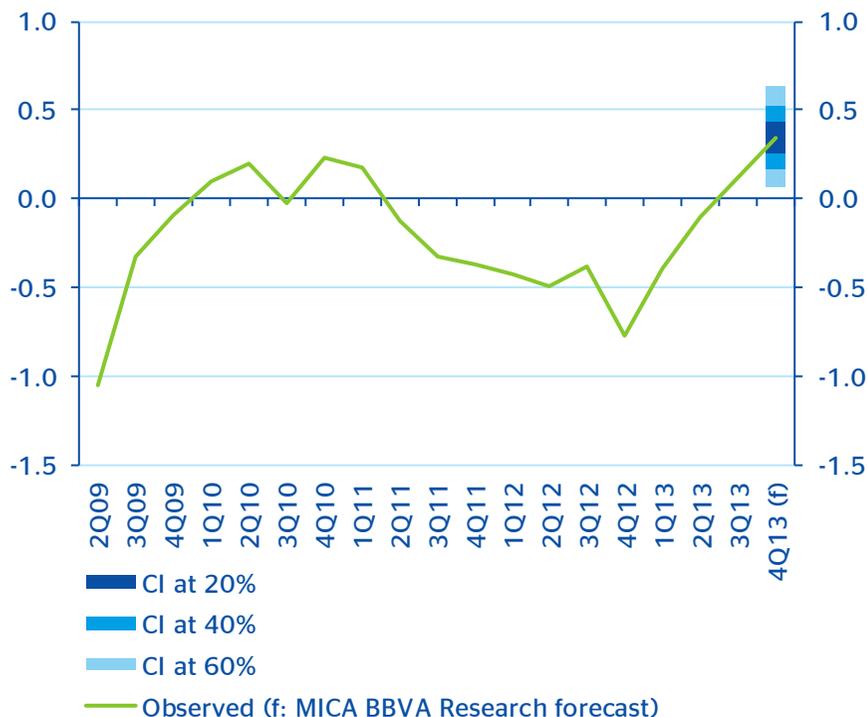
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Section 2

The Spanish economy bottomed out in 2013

Spain: GDP growth and MICA-BBVA forecasts (q/q%)

Source: BBVA Research, based on National Institute of Statistics data



3Q13: domestic demand once again made a positive contribution to growth after 3 years "in the red"...

..., while external demand remained on track

Reasons: lower financial tensions, a less contractive fiscal policy and dynamic exports

4Q13: information available points to growth of around 0.3%

Section 2

Recovery is following the stylized facts of previous cycles

Variables before the cycle	Export growth	✓
	Gross operating surplus	✓
	Investment in machinery and equipment	✓
	New credit operations (flow)	Stable
=	GDP growth	Stable
Lagging variables	Employment growth	Stabilizing
	Growth in the stock of credit	Declining

Section 2

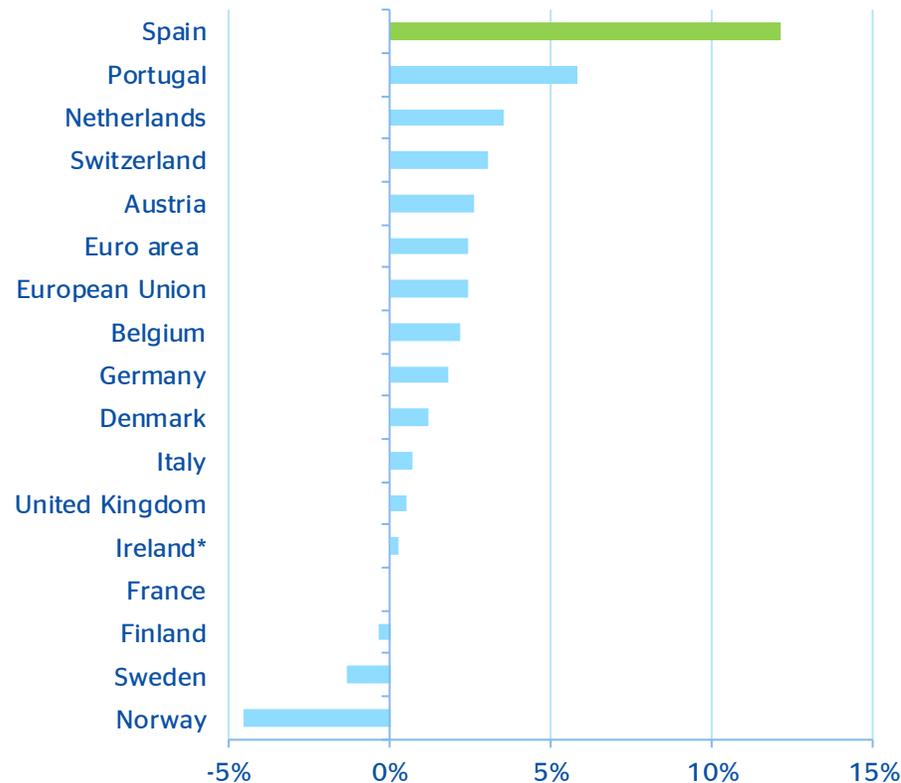
Growth in exports: exceptional performance in Eurozone

Total exports

(cumulative variation 1Q12-3Q13 in %, swda)

(*): Data to 2Q13

Source: BBVA Research based on Eurostat



Spanish exports have grown in the last year despite the recession in the EU

This is partly due to an increase in the share of exports to BBVA-EAGLES countries and other developed economies...

... but also to gains in Spanish competitiveness in both price and quality

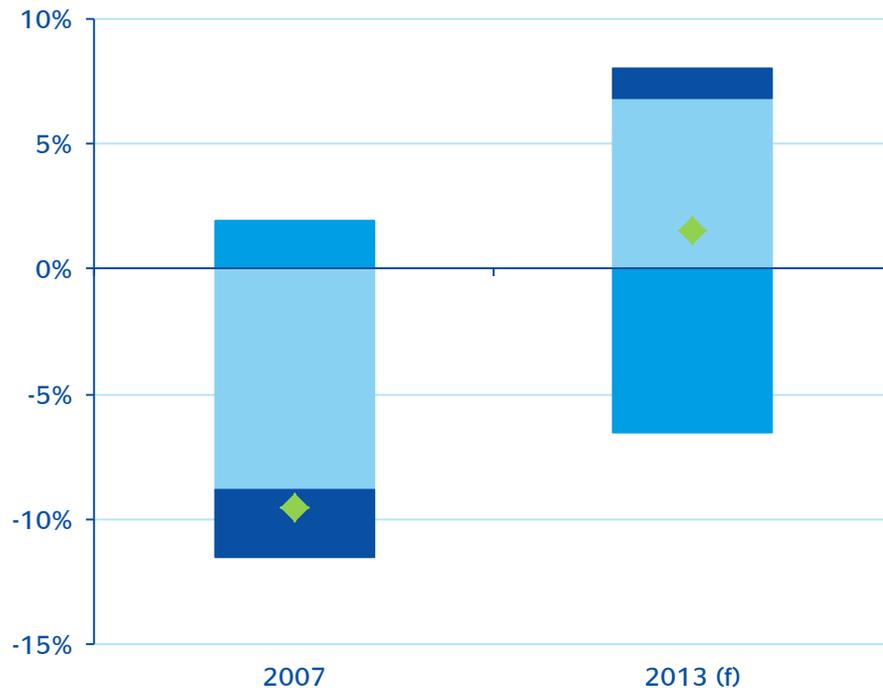
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Wage moderation and increased productivity improve companies' positions

Spain: net foreign borrowing (-) / lending (+) needs

(% GDP)

Source: BBVA Research, based on National Institute of Statistics data



The maintenance of savings in the private sector and the reduction of investment...

... have allowed a deleveraging process against the rest of the world over the last 5 years...

... improving the position of companies and allowing them to start investing once decreased uncertainty consolidates

■ Households ■ Financial and nonfinancial companies ■ Public sector ◆ Total

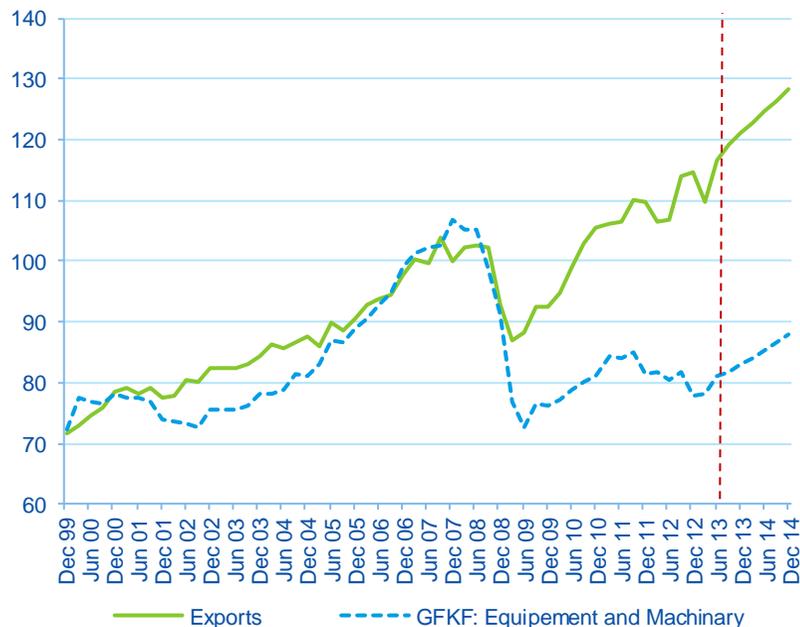
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Greater strength of investment ...

Spain: exports and investment in equipment and machinery

(2008=100)

Source: BBVA Research, based on National Institute of Statistics data



Expected recovery in the Eurozone and dynamic exports ...

... should lead to a recovery of investment in equipment

In fact, in the first three months of the year it grew 5.3%

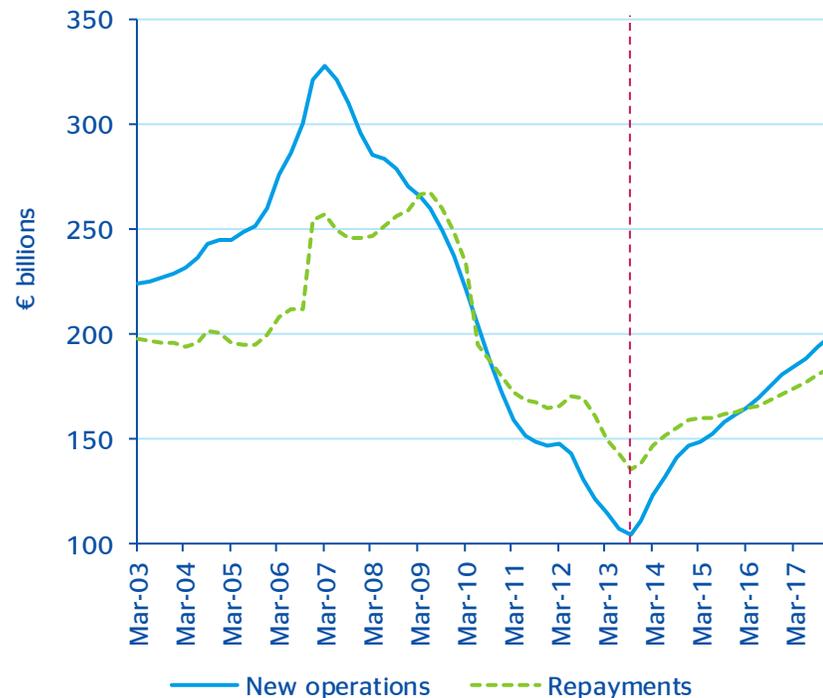
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Improvements in credit flows

Spain: new credit operations and repayments to the domestic private sector

(Trend)

Source: BBVA Research based on Bank of Spain



The Spanish economy has to go through an inevitable deleverage process...

... which is compatible with the provision of credit for solvent projects

Credit flows are expected to recover starting in the first half of 2014

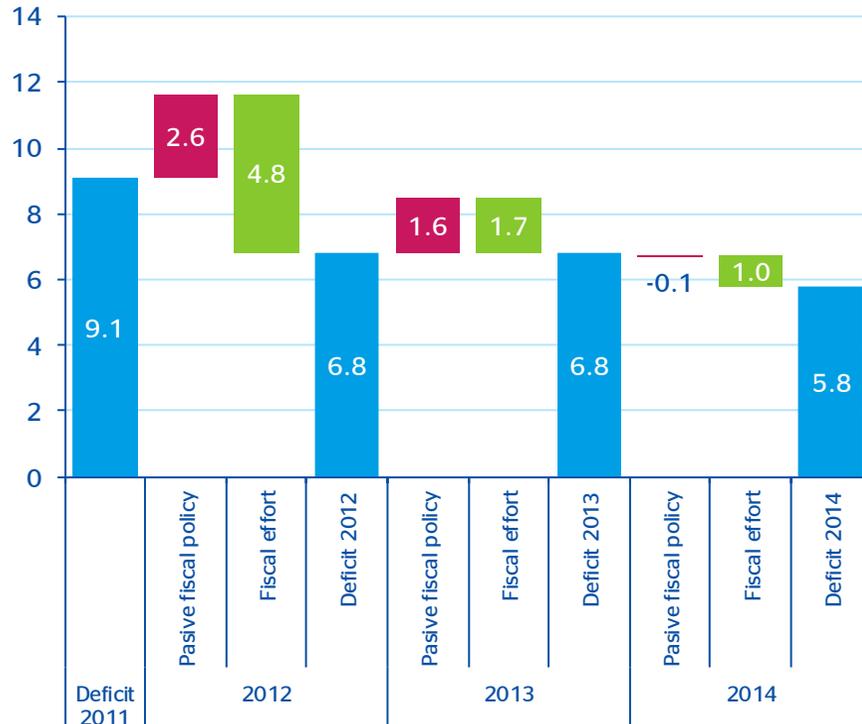
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Fiscal consolidation: lower efforts in the short term

General government: public deficit breakdown excluding aid to the financial sector

(% GDP)

Source: BBVA Research based on Ministry of Finance



The fiscal effort has been significant in 2012 and 2013...

... and will ensure that public deficit remains at around 6.8% of GDP

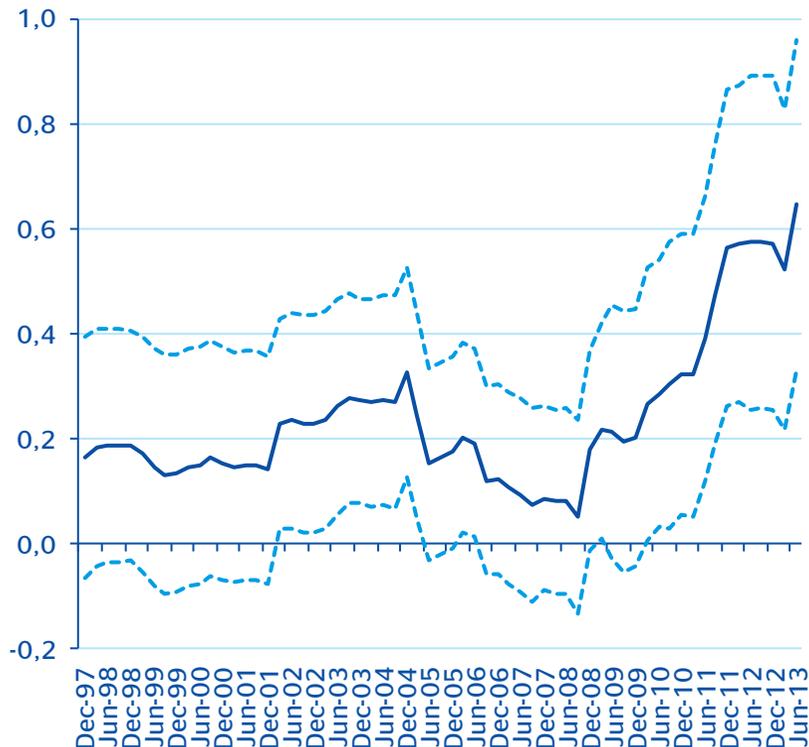
Deficit targets that are more consistent with recovery will lead to GDP growth in 2014

Section 2

The labor market is stabilizing

Spain: short-term employment-to-GDP elasticity (q/q %)

Reduced VAR in first differences, 72-quarter rolling window
 Source: BBVA Research, based on National Institute of Statistics data



Job destruction has slowed down, in part as a result of wage moderation

If labor institutions had been more appropriate at the start of the crisis the destruction of a million jobs could have been avoided

The elasticity of employment to GDP has increased during the crisis. How will it behave during the recovery?

Section 2

The real-estate cycle: "This time is different"

Spain: residential investment, compared with previous recessions

(Maximum during expansion = 100)

Source: BBVA Research, based on National Institute of Statistics data



The recovery of investment in the real-estate sector tends to run ahead of the cycle...

... however, the current over-supply will make it unlikely that this time it will accompany the recovery (effect vs cause)

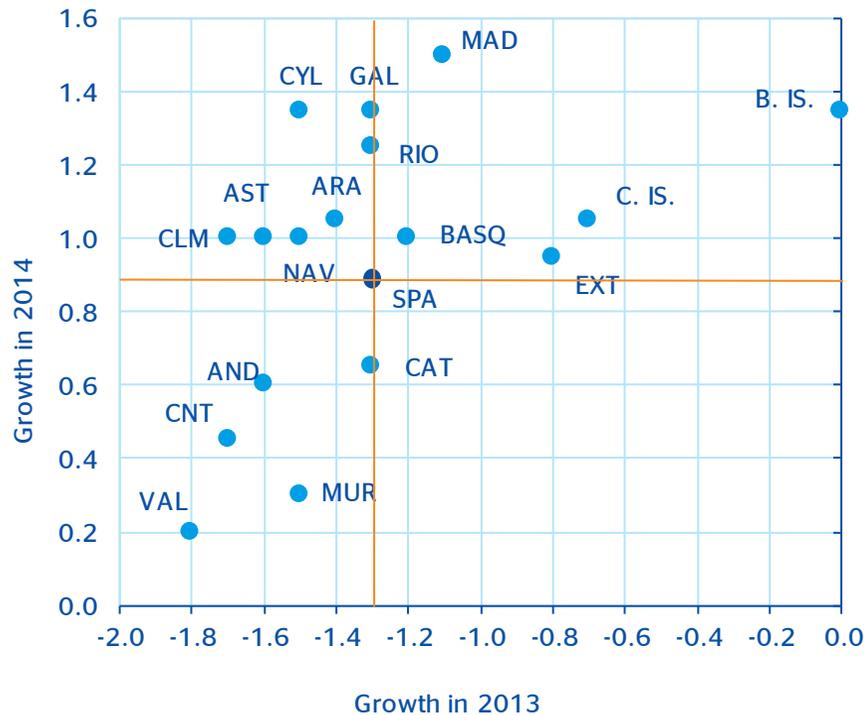
The reform process must also ensure an efficient redistribution of resources between sectors

Section 2

2014: the start of recovery

Spain: GDP growth by autonomous region

(% y/y)
Source: BBVA Research



Spain has bottomed out in 2013 with a GDP fall of 1.3% and will begin to grow in 2014 by 0.9%

Regional variations are due to the heterogenous fiscal efforts in 2012, the uneven target deficits for 2013 ...

... and the exposure to external demand

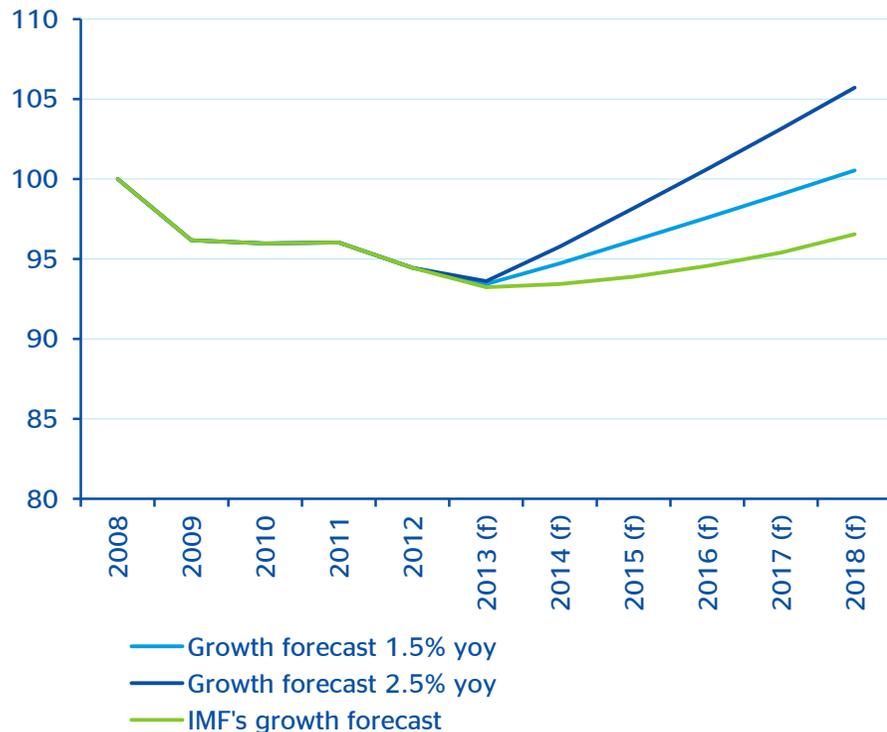
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The need of continuing the reform processes

Spain: GDP growth in different scenarios

(2008=100)

Source: BBVA Research, based on National Institute of Statistics and IMF



Relatively negative scenarios such as those of the IMF would imply more than one lost decade

The objective would be to implement the reforms needed in order to increase the economy's growth potential

In their absence, the unemployment rate will remain high and recovery will be slow

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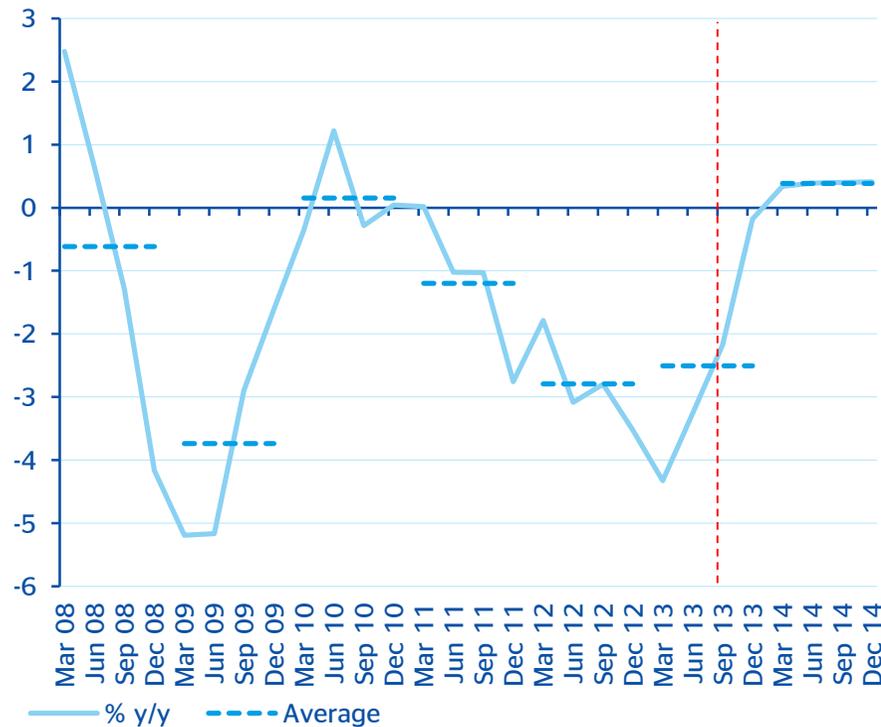
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Household consumption: signs of recovery in 2H13, growth in 2014

Spain: private consumption growth (%)

Source: BBVA Research based on the National Institute of Statistics



Factors that determine consumption:

Disposable income:

- Change of cycle in the labor market

Wealth:

- Increase in financial wealth

Likelihood to consume:

- Lower uncertainty

Debt:

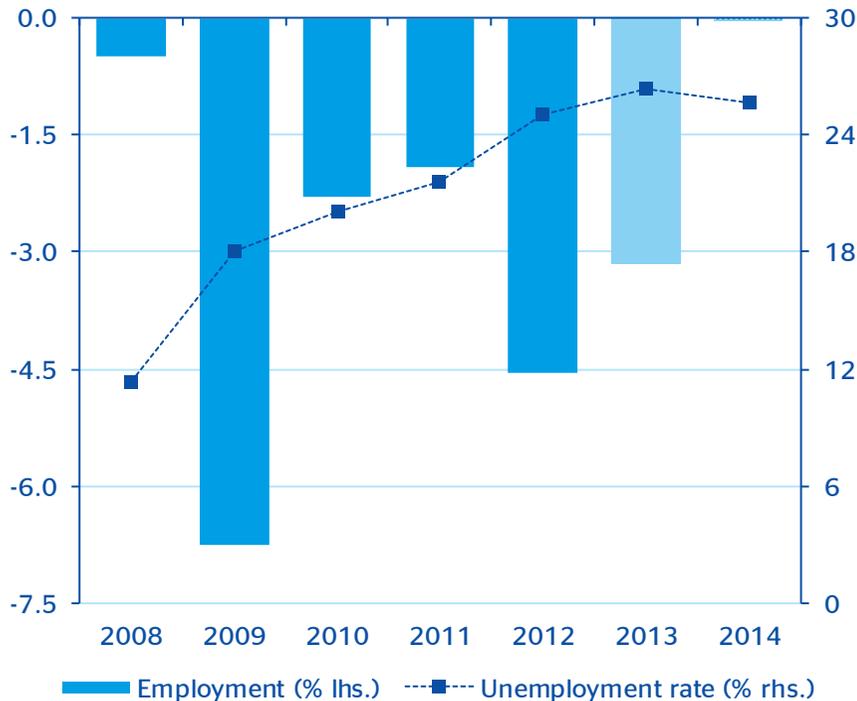
- Deleveraging of the private sector
- Deleveraging of the public sector

Section 3

Household consumption: signs of recovery in 2H13, growth in 2014

Spain: change in employment and unemployment rate (%)

Source: BBVA Research based on the National Institute of Statistics



1. Change of cycle in the labor market

The labor market reform has helped to rebalance the adjustment between quantities (employment) and prices (wages) ...

..., which has helped to avoid a larger decline in the number of employed people over the last year

Sustained employment recovery will come in 2H14..., but increases in employment can also happen in 1H14

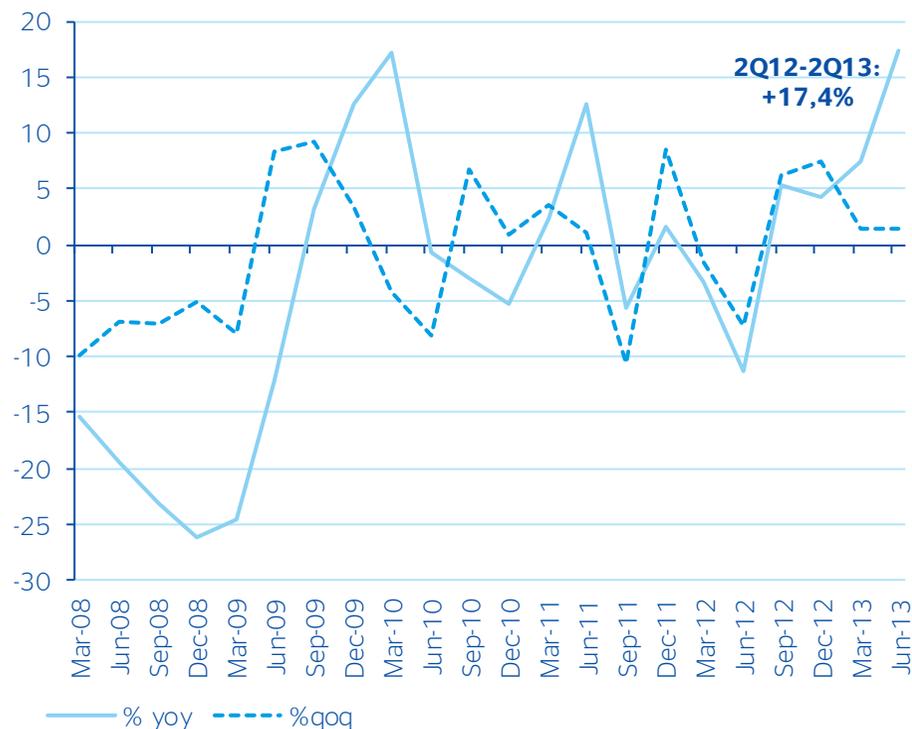
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Household consumption: signs of recovery in 2H13, growth in 2014

Spain: real net financial wealth

(Deflated by the consumption deflator, swda figures, %)

Source: BBVA Research based on BoS and National Institute of Statistics



2. Increase in financial wealth

The easing of financial tensions has helped stock prices and has reduce financing costs → Δ of net financial wealth

BBVA Research estimates:

Quarterly Δ in real net financial wealth of 1% → Cumulative 0.2% Δ of private consumption over the next 4 quarters

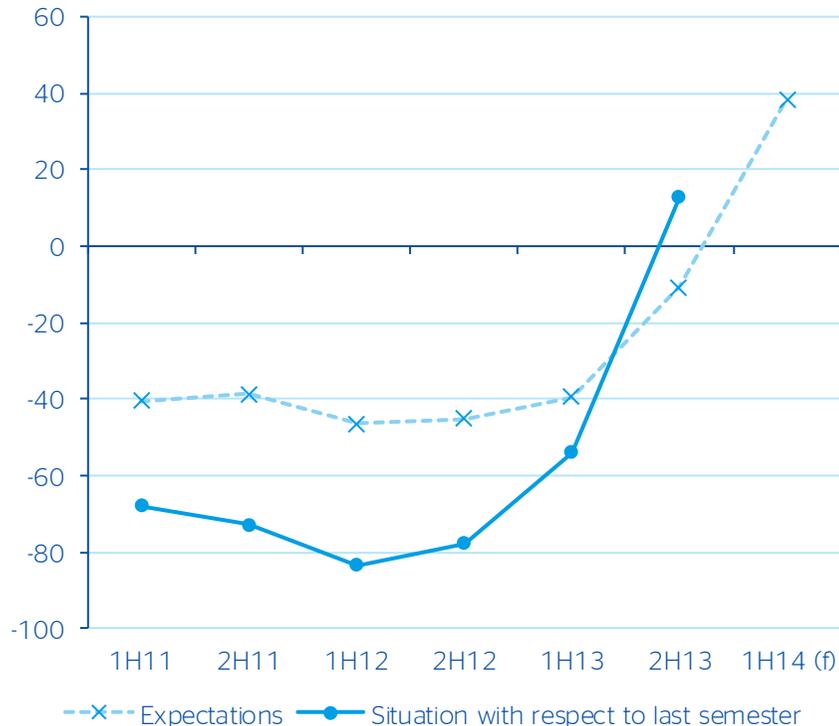
Real net financial wealth: Δ 17.4% since 2Q12 → +3.2 pp of consumption growth until 2Q14

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Household consumption: signs of recovery in 2H13, growth in 2014

BBVA Business Trends Survey: expectations of the economic situation

(Net responses. A value <0 indicates a worsening)
Source: BBVA Research



3. Less uncertainty, both in macroeconomic terms...

The perception about the economic situation has improved over the last six months ...

... more than it was expected six months ago

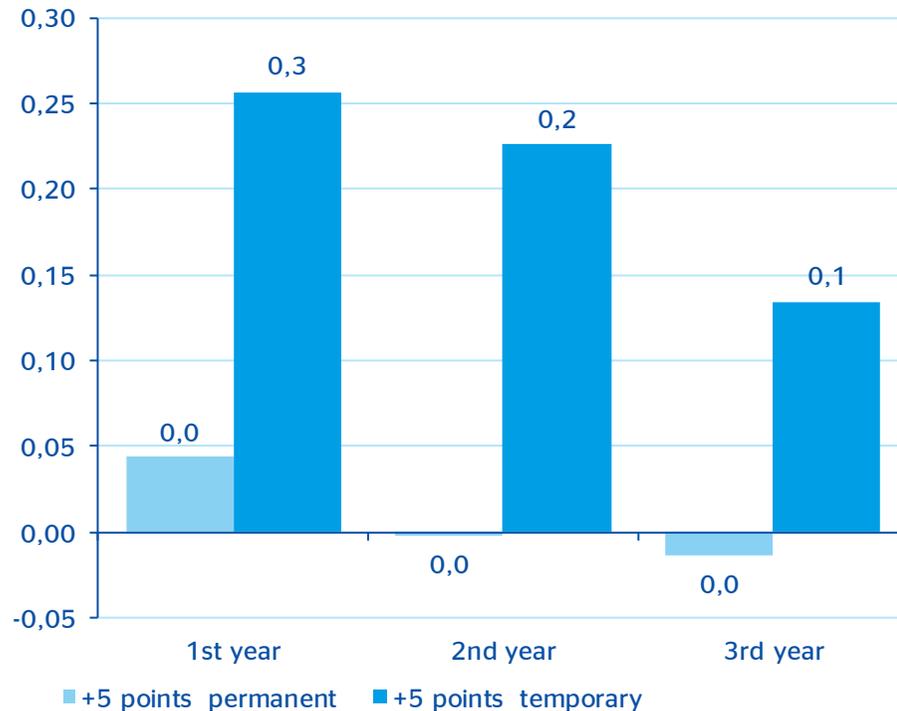
1H14: positive outlook

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Household consumption: signs of recovery in 2H13, growth in 2014

Spain: impact of a 5-point confidence increase* on the level of consumption (%)

(*) Perception of the household regarding its future economic situation
 Source: BBVA Research, based on National Institute of Statistics and European Commission



3. ..., and in microeconomic terms

Lower uncertainty encourages consumption at the expense of saving

Household's saving rates will remain at historically low levels

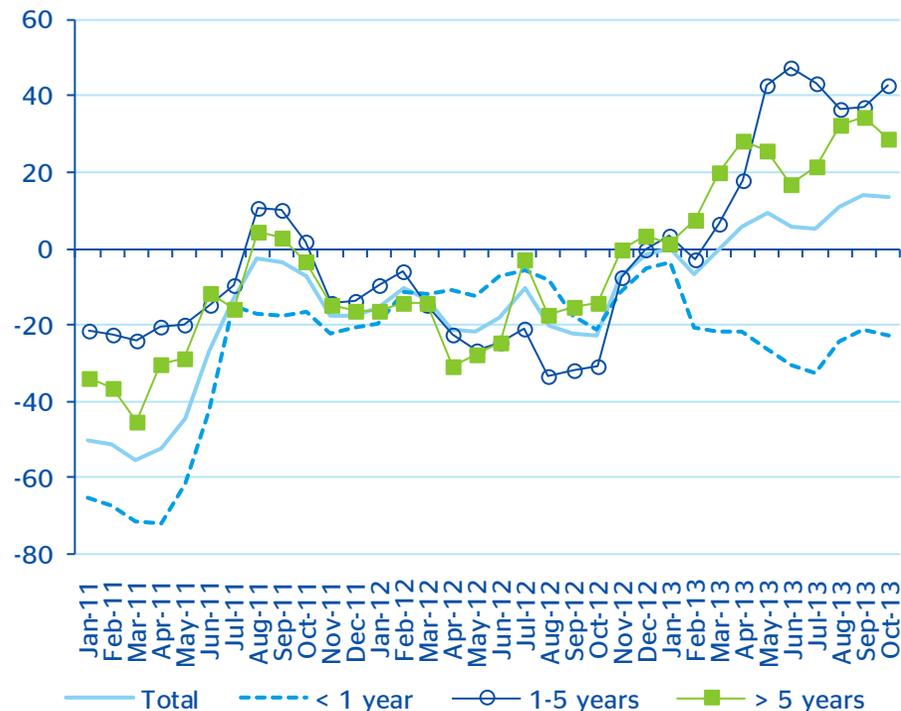
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Spain: new consumer financing operations

(% y/y of third-order moving average)

Source: BBVA Research based on Bank of Spain



4. Household deleveraging (I)

New consumer credit operations have grown between January and October due to the increase in mid and long term financing ...

..., within a context of deleveraging and high interest rates

Leverage ratio (over GDP): in line with European economies (6.1%)

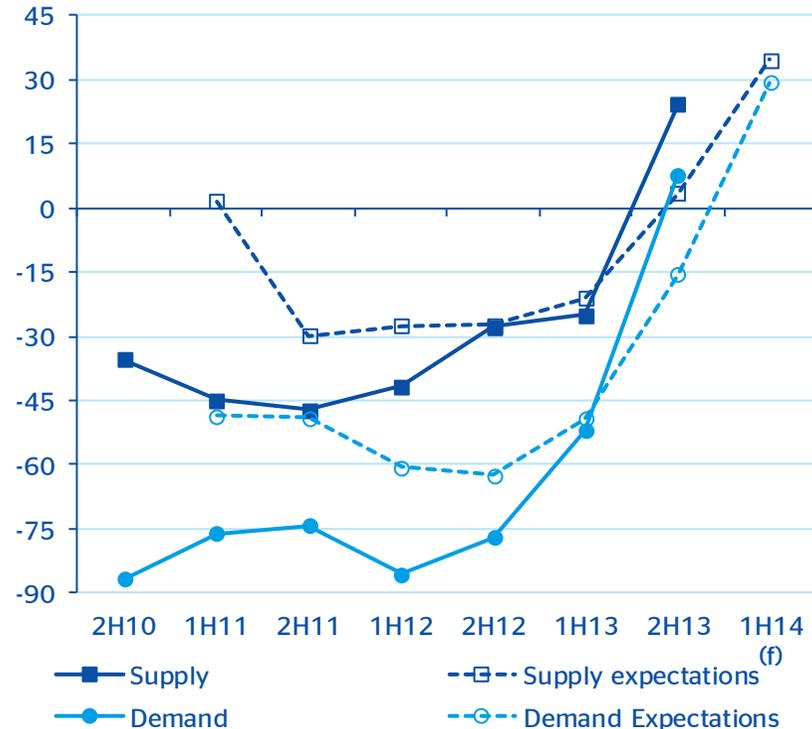
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BBVA Business Trends Survey: expectations of supply and demand for consumer credit

(Net responses. A value of <0 indicates a worsening)

Source: BBVA Research



4. Household deleveraging (II)

Recovery in consumer finance was already noted in the 1H13 Business Trends Survey

The 2H13 Business Trends Survey suggests that it has evolved better than expected ...

..., and it will continue to do so, at least during the first half of 2014

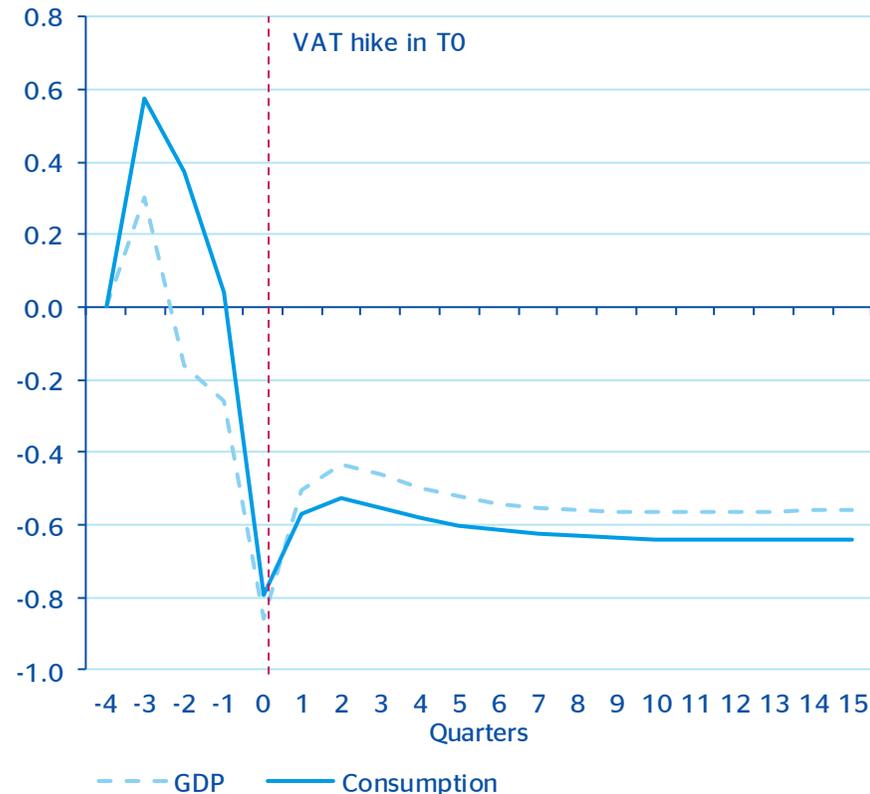
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Spain: response to a 2-pp increase in VAT

(Deviation from trend, %)

Source: BBVA Research. Simulations with REMS



5. Consequences of public sector deleveraging

The increase in VAT alters the inter-temporal pattern of household consumption ...

..., and has permanent effects on its level of expense

Nevertheless, the transfer of the increase in VAT to prices was limited (of around 1 point)

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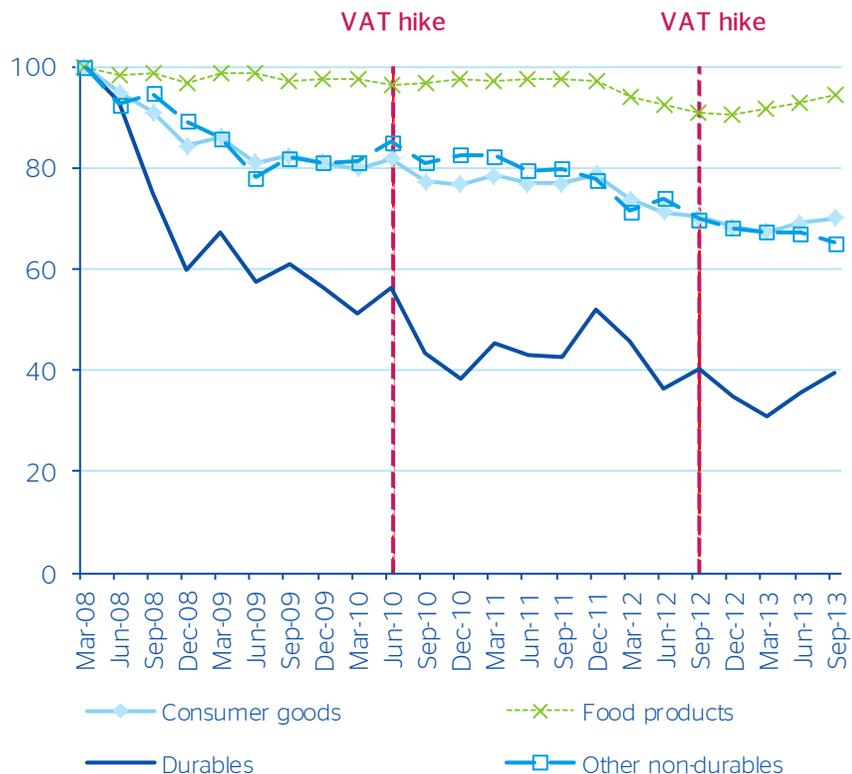
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Demand for durable goods: the worst part is over

Spain: availability of consumer goods

(swda data, 1Q08 = 100)

Source: BBVA Research, based on Ministry of the Economy



Consumption of durable goods may have bottomed out ...

..., after the collapse in 4Q12 and 1Q13 ...

..., triggered by the consequences of the VAT hike and the elimination of the public employee bonus

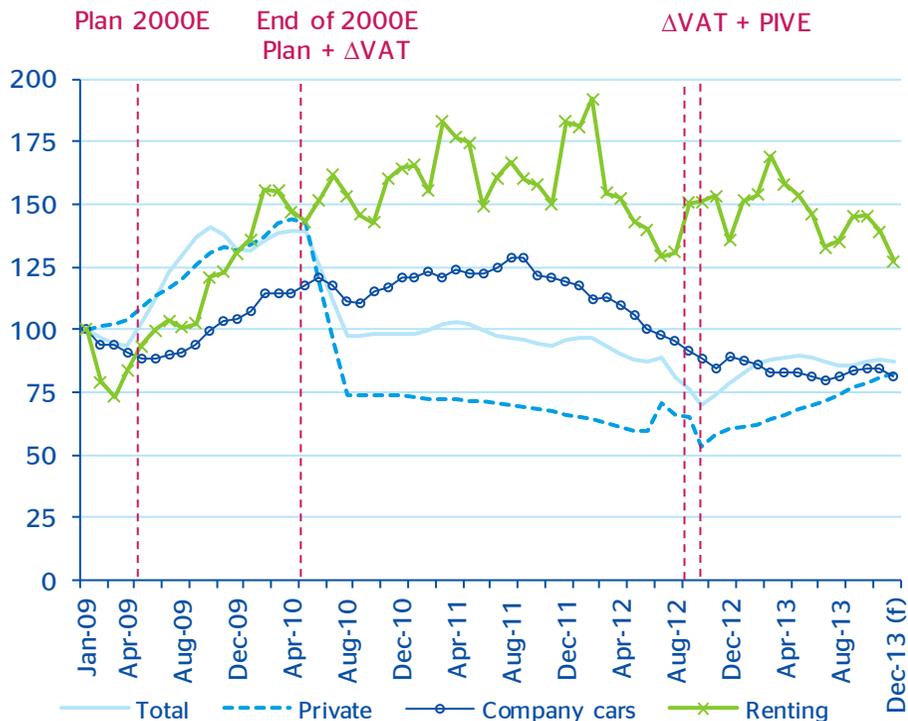
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Demand for durable goods: the worst part is over

Spain: private car registrations per channel

(swda data, 3MA, Jan-09 = 100)

Source: BBVA Research based on ANFAC and Ganvam data



Vehicles: sales pattern shaped by the PIVE (Efficient Vehicle Incentives Program)

The private channel is responsible for the increase in registrations in 2013 ...

..., accompanied by the business channel in 2H13

The PIVE has limited the negative impact of the VAT hike (less than 680,000 registrations in 2013 without it) ...

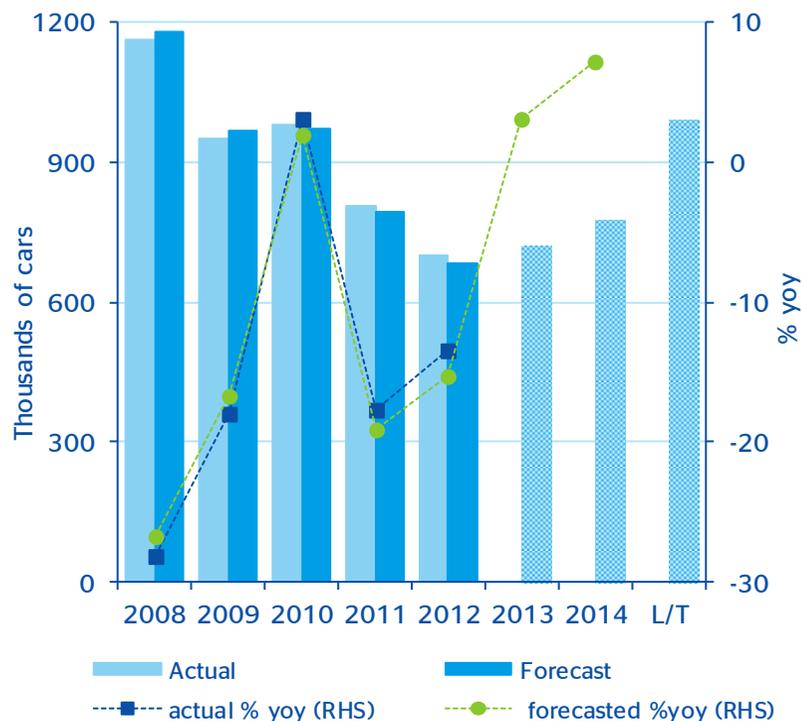
..., but it has not prevented the continued ageing of the vehicle fleet (52.3% of private cars are 10 years old or older) and the increase in the UC/NC ratio (2.2)

Section 4

Demand for durable goods: the worst part is over

Spain: car registrations

Source: BBVA Research



Growth in car registration dependent on the PIVE being maintained

2013: around 720,000 units

2014: shaped by whether the bonus will be maintained or eliminated ($\Delta 7.5\%$ if the PIVE is extended)

The improvement in its determining factors (pcGDP, unemployment and oil relative prices) could offset the impact of the elimination of the PIVE

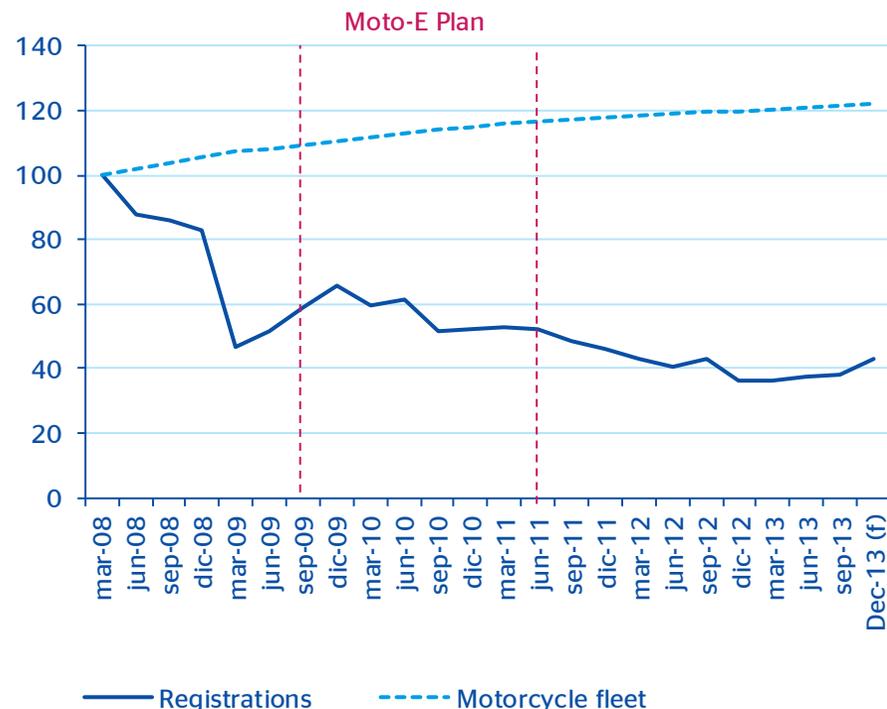
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Demand for durable goods: the worst part is over

Spain: motorcycle registrations

(swda data, 1Q08 = 100)

Source: BBVA Research, based on DGT and Anesdor



Motorcycles: seven years later, light at the end of the tunnel

The market could have bottomed out in 1H13

However, there will be fewer than 97 thousand motorcycles registered at the end of 2013 (-4.7%)

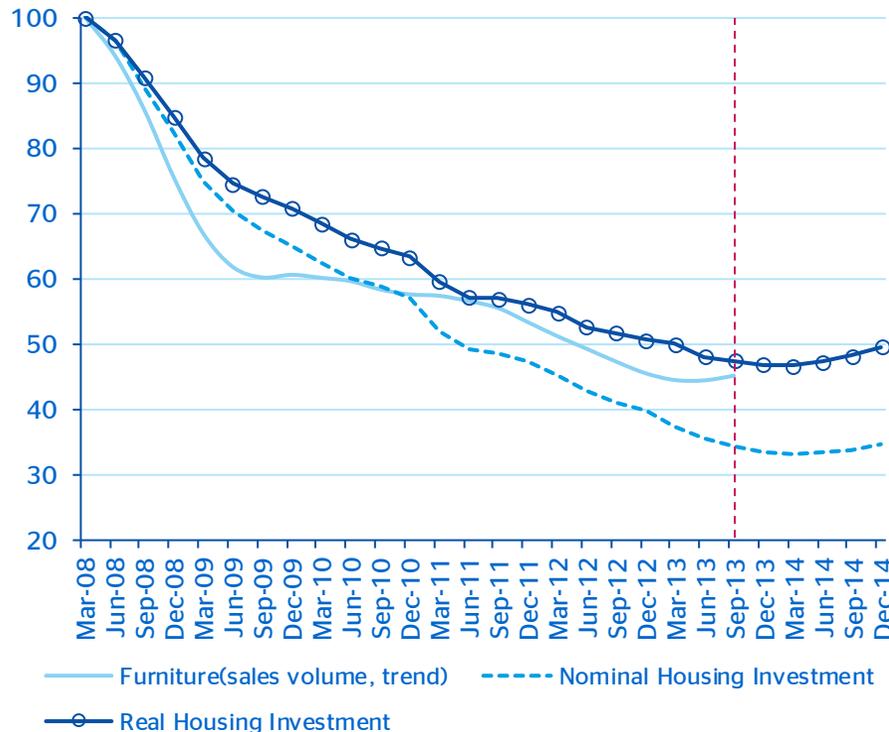
In 2014, 105,000 units could be reached if the fundamentals improve as expected

Section 4

Demand for durable goods: the worst part is over

Spain: business figures for furniture and housing investment (swda data, 1Q08 = 100)

Source: BBVA Research, based on National Institute of Statistics data



Furniture: awaiting housing demand

Stable sales, prices relatively low (-0.9% since Jun-13)

BBVA Research estimates:
1% ∇ q/q in nominal housing investment →
0.6% ∇ cumulative sales

The expected recovery in housing demand during 2H14 will help to encourage furniture consumption

Section 4

Demand for durable goods: the worst part is over

Spain: sales of electrical appliances by household

(% y/y of number of units)

Source: BBVA Research, based on ANFEL data



----- 2012 — Jan-Oct 2012 — Jan-Oct 2013

White line: positive signs..., when the 2nd derivative is analyzed

Sales Jan-Oct 2013: -7.4% y/y (-13.9% in 2012)

Sales were lower in all electrical appliance categories, but all to a lesser degree than in 2012 (except fridges and freezers)

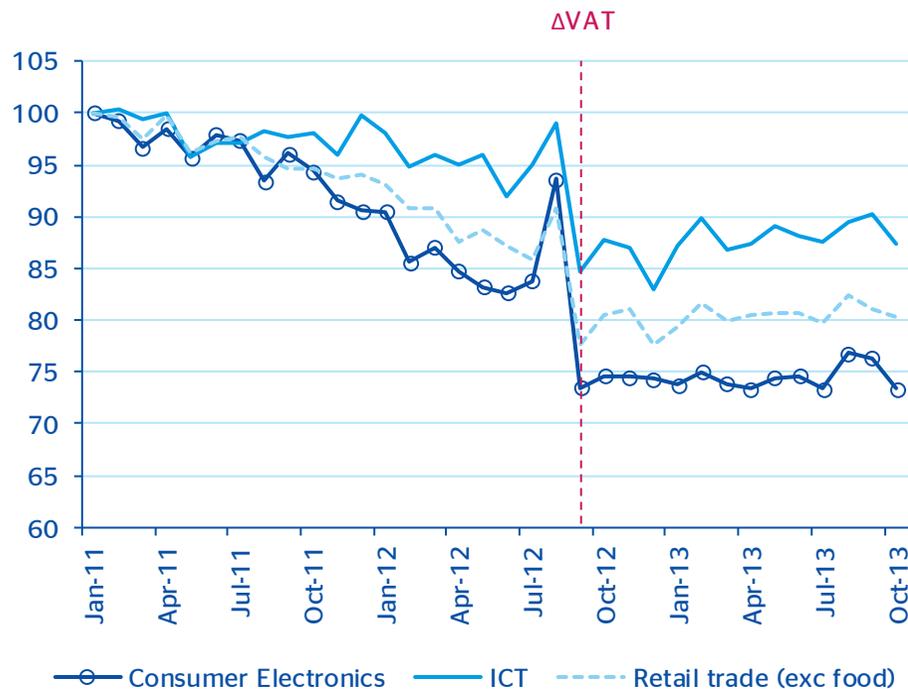
Relative price fall: -1.6% between June and October

Section 4

Demand for durable goods: the worst part is over

Spain: real retail sales of brown goods

(swda data, Jan-11 = 100)
Source: BBVA Research based on Eurostat



Brown lines: falling penetration rates

Sluggish demand: digesting the purchases that were brought forward before the VAT increase

The across-the-board fall in prices has not prompted increased penetration of Spanish homes in 2013 ...

..., except for mobile devices: tablets (16.3%) and mobile telephones (96.1%)

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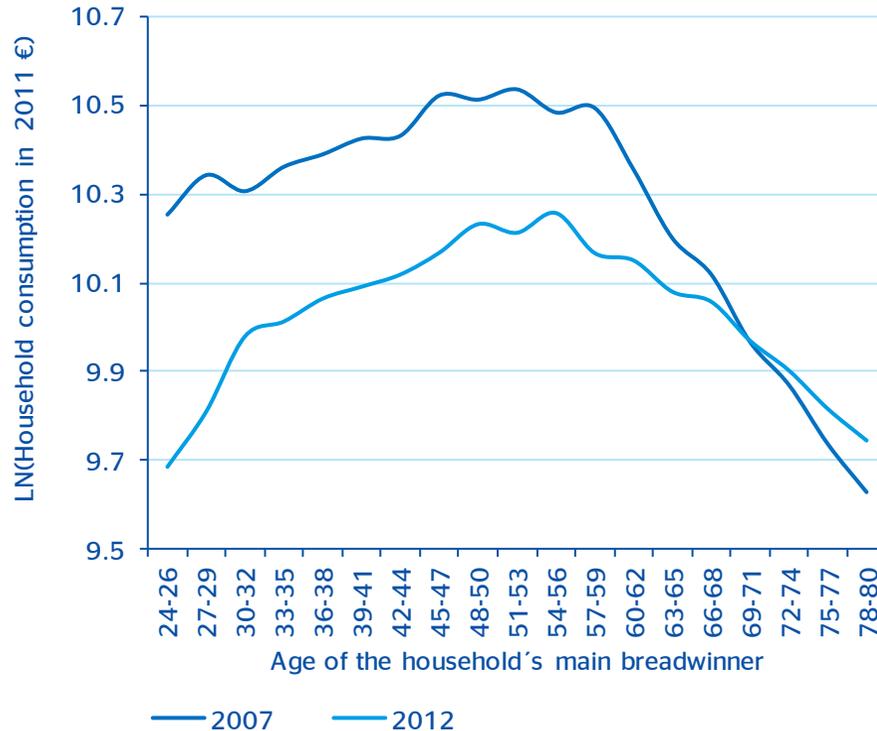
Dismantling two myths: 1) do we consume more as we get older?, 2) are Spanish products adequate for e-commerce?

Section 5

Dismantling two myths: 1) do we consume more as we get older? No

Spain: average consumption per household by main breadwinner's age. 2007 and 2012

Source: BBVA Research based on National Institute of Statistics (Household budget survey)



Box 1

The Spanish population has aged over the last four decades and will continue to do so in the coming decades

Dependency ratio: 16.5% in 1973; 26.7% in 2013; 72.4% (f) in 2050

What consequences this ageing have on consumption spending in Spanish homes?

The cross section data seems to suggest that the consumption by age has an inverted U shape ...

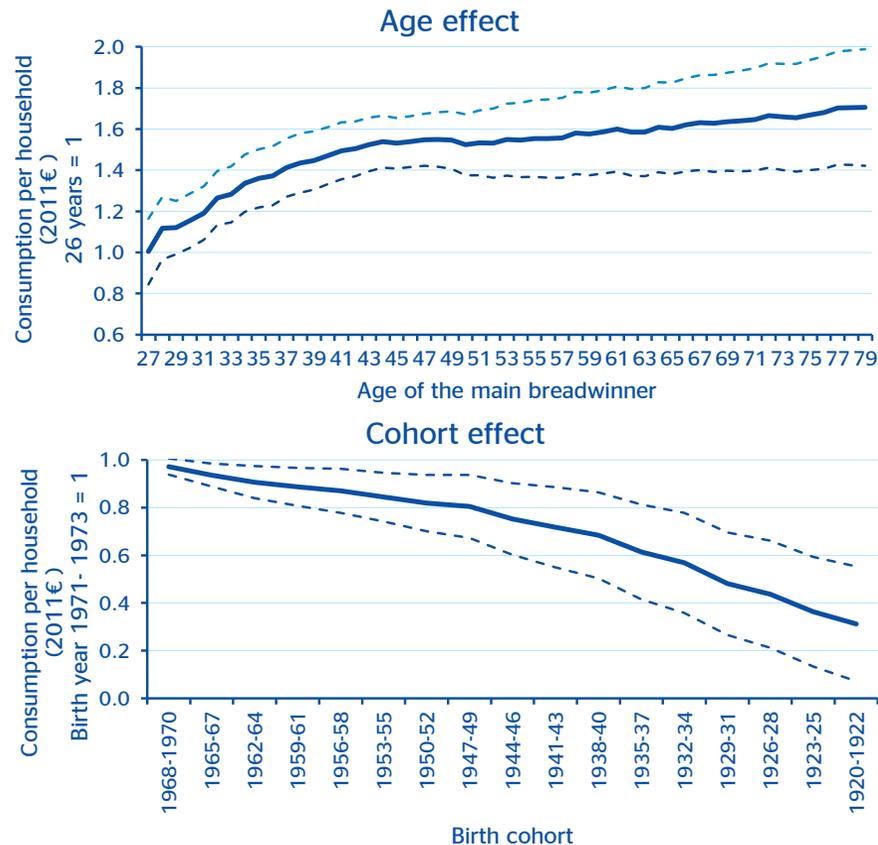
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Dismantling two myths: 1) do we consume more as we get older? No

Spain: relative consumption per household by age and cohort

Source: BBVA Research based on National Institute of Statistics (ECPF-EPF)

Box 1



..., however, this result is not caused by ageing, but by the permanent income (cohort), the size and composition of the household

BBVA Research estimates that consumption is an increasing and concave function of age

'At each age, we consume more than our parents and less than our children will do' → ageing might have positive effects on household spending

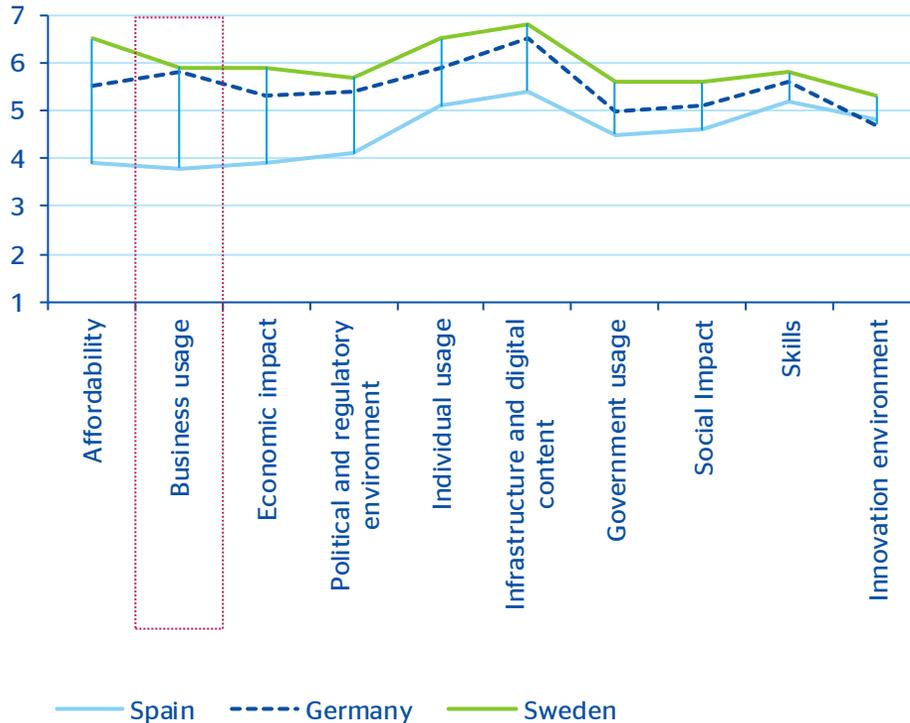
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Dismantling two myths: are Spanish products adequate for e-commerce? Yes

Spain vs Europe: a breakdown of the digital gap

(Scale from 1 (minimum) to 7 (maximum), 2013)

Source: BBVA Research based on WEF



Box 1

The use of new technologies is substantially lower in Spain than in other advanced economies ...

... particularly amongst companies ...

..., which limits the expansion in e-commerce

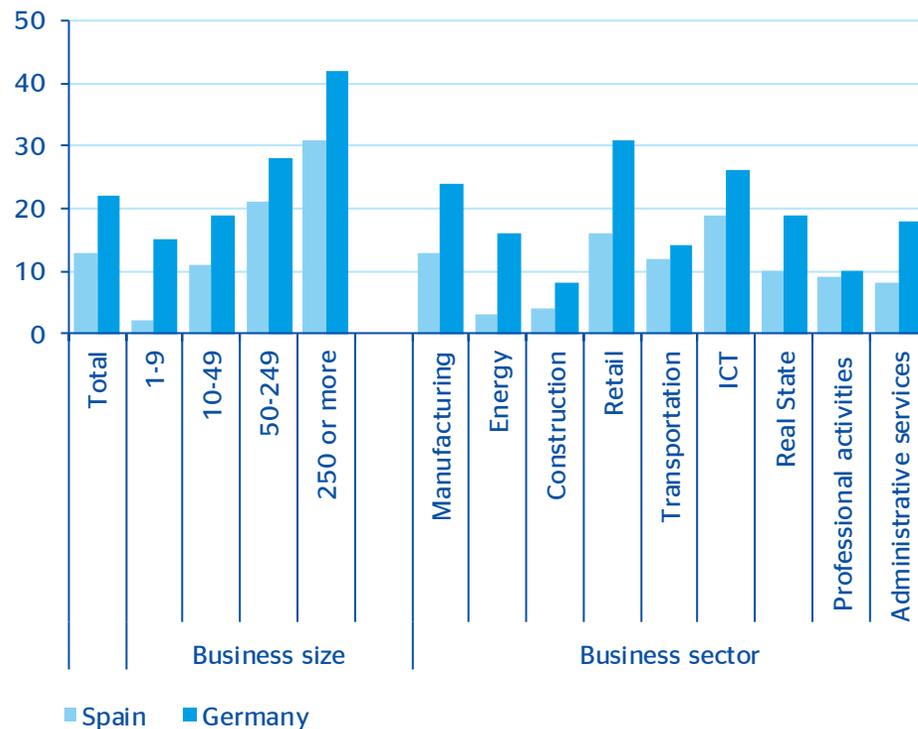
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Dismantling two myths: are Spanish products adequate for e-commerce? Yes

Companies selling online, 2012-13

(Percentage of companies with at least 10 employees where online sales are at least 1% of their total sales)

Source: BBVA Research based on Eurostat



Box 2

In addition to the lack of resources, there are idiosyncratic factors that hamper e-commerce in Spain

In particular, the belief that the product is not adequate to be sold electronically

However, the % of companies that sale online in Spain is lower than in leading countries, regardless of the size or sector of activity (lack of innovation and deficit of human capital)

In short ...

- 1 More balanced composition of **global growth**. Risks are less extreme, but still tilted to downside
- 2 **The Spanish economy** has begun to grow following the stylized facts from previous cycles
- 3 **Private consumption** is rising steadily, underpinned by the improvement in its determining factors and by improved financing ...
- 4 ..., but **no euphoria**: fundamentals are still weak, households are still indebted
- 5 **Durable goods**: the worst part is over
- 6 **E-commerce**: a question of business survival
- 7 **In the long term**, the demographic transition could favor consumption

Consumption Outlook

Second half 2013

Madrid, December 18, 2013

Annex Section 2

Scenario 2013-2014: start of recovery

Spain and Europe: macroeconomic forecasts

Source: BBVA Research based on official bodies

(% YoY)	20 10		20 11		20 12		20 13 (f)		20 14 (f)	
	Spain	EMU	Spain	EMU	Spain	EMU	Spain	EMU	Spain	EMU
Households final consumption expenditure	0.1	10	-12	0.3	-2.8	-14	-2.6	-0.5	0.1	0.7
General government final consumption exp.	1.5	0.6	-0.5	-0.1	-4.8	-0.5	-1.7	0.2	-1.6	0.4
Gross fixed capital formation (G.F.C.F.)	-5.5	-0.6	-5.4	1.7	-7.0	-3.8	-6.4	-3.6	0.7	2.2
Equipment and cultivated assets	4.3	5.6	5.3	4.7	-3.9	-4.2	10	-3.8	6.5	3.4
Equipment and machinery	5.0	5.7	5.5	4.7	-3.9	-4.2	1.1	-3.8	6.5	3.4
Housing	-11.4	-3.0	-12.5	-0.3	-8.7	-3.4	-9.0	-3.0	-0.7	2.0
Other constructions	-8.4	-6.1	-9.2	-0.2	-10.6	-4.9	-12.6	-5.7	-5.3	-0.9
Changes in inventories (*)	0.3	0.6	-0.1	0.2	0.0	-0.5	0.0	0.0	0.0	0.0
Domestic Demand (*)	-0.6	1.2	-2.1	0.7	-4.1	-2.2	-3.1	-1.0	-0.1	0.8
Exports	11.7	11.4	7.6	6.7	2.1	2.7	4.6	1.7	6.3	3.9
Imports	9.3	9.8	-0.1	4.6	-5.7	-0.8	-10	0.4	3.4	3.7
External Demand (*)	0.4	0.7	2.1	0.9	2.5	1.5	1.8	0.6	1.1	0.3
GDP mp	-0.2	1.9	0.1	1.6	-1.6	-0.6	-1.3	-0.4	0.9	1.1
Pro-memoria										
GDP excluding housing	0.8	2.2	1.0	1.7	-1.2	-0.5	-0.9	-0.2	1.0	1.0
GDP excluding construction	1.8	2.7	2.0	1.8	-0.4	-0.2	0.0	0.1	1.4	1.1
Total employment (LFS)	-2.3	-0.5	-1.9	0.3	-4.5	-0.7	-3.1	-0.9	0.0	0.1
Unemployment rate (% Active pop.)	20.1	10.1	21.6	10.2	25.0	11.4	26.3	12.0	25.6	12.0
Current account balance (% GDP)	-4.5	0.0	-3.8	0.1	-1.1	1.2	1.2	2.1	1.8	2.1
Public debt (% GDP) (**)	61.7	85.4	70.4	87.3	85.9	90.6	94.4	94.5	98.4	94.8
Public deficit (% GDP)	-9.6	-6.2	-9.1	-4.1	-6.8	-3.7	-6.8	-2.8	-5.8	-2.4
CPI (average)	1.8	1.6	3.2	2.7	2.4	2.5	1.5	1.5	1.1	1.4
CPI (end of period)	3.0	2.0	2.4	2.9	2.9	2.3	0.6	1.3	1.3	1.4

(*) Contribution to GDP Growth

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

(f): forecast