



Consumption Outlook

First half 2010

Key messages

- The positive elements of the external environment of the Spanish economy are distinguished by the **recovery of the emerging countries and the US**, which would create the conditions for global economic growth of around 4%.
- However, there are significant elements of **uncertainty in Europe** deriving from increased risk aversion and the fragility of growth. In 2010, the area will grow by 0.7%.
- In this context, and once the impact of fiscal consolidation measures has been accounted for, **Spanish GDP will shrink by 0.6% in 2010**, while in **2011 it should grow by 0.7%**.
- In spite of the medium- and long-term benefits of fiscal consolidation, **VAT increase** is expected to have **a negative effect on consumption in the short-term**
- The **consumer durable** production and trading sectors will be keenly **affected by the withdrawal of fiscal stimulus packages** in Spain and Europe and by the **rise in financial tensions**
- Medium-term outlook for the motor vehicle sector: the **number of per capita cars in Spain** is **nearing a saturation point**. Increasing external competitiveness and boosting the replacement rate will be key to growth

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Economic growth and car consumption in Spain: is there a saturation point?

The global economy is dominated by two conflicting forces:

Positive spillover from the cyclical upturn in the US and in the emerging markets



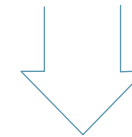
- **Growth in 2010:**
World: 4.2%
US 3%
Latin America 4.6%
Asia 5.8%

• **Commodity prices**

• **World trade:** will grow by 7% in 2010

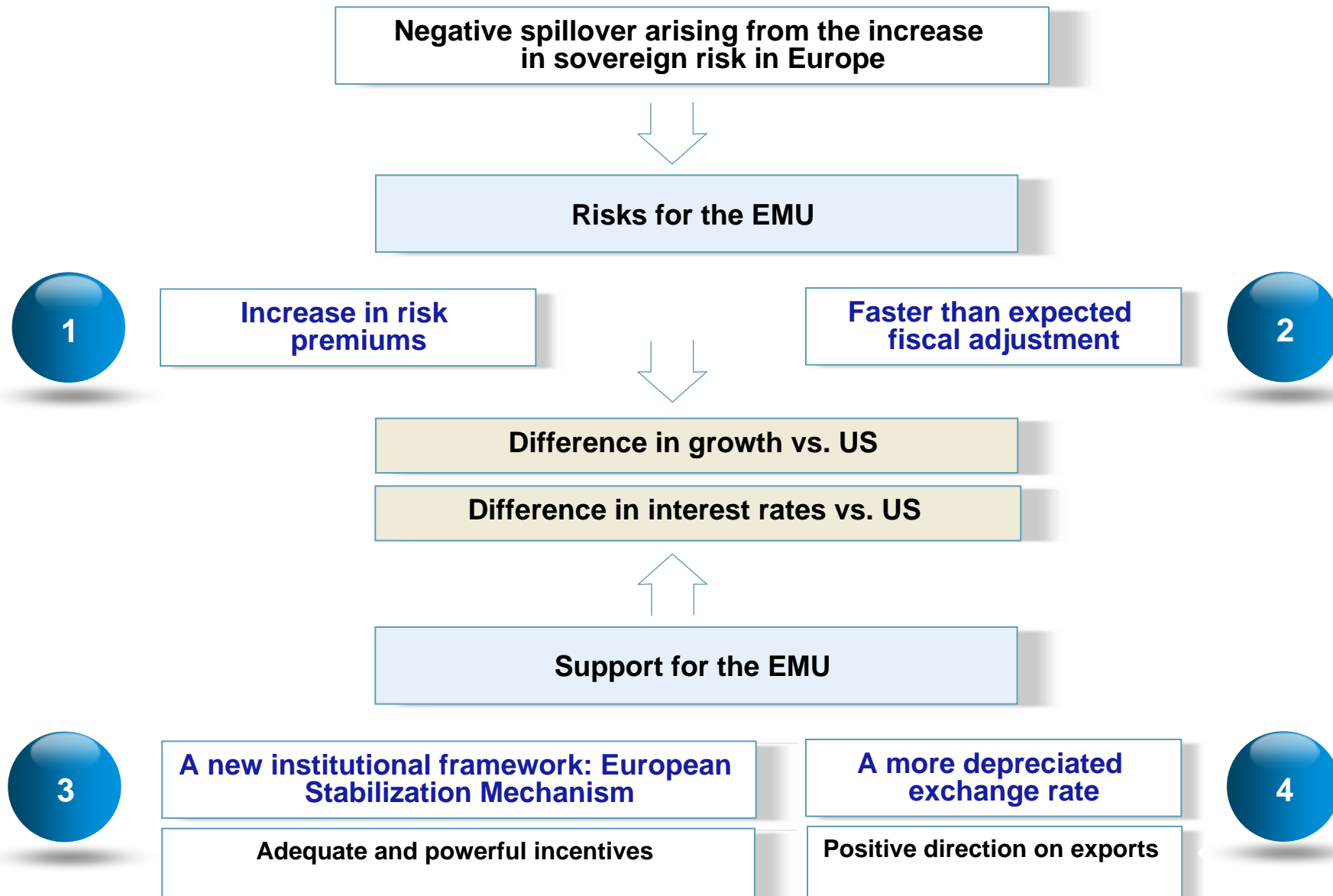


Negative spillover from the increase in risk premium spreading from Europe



- **Risk premium**
- **Fiscal consolidation**
- **Confidence**
- **EMU growth in 2010: 0.7%**

International scenario: the challenges ahead for a sustained recovery



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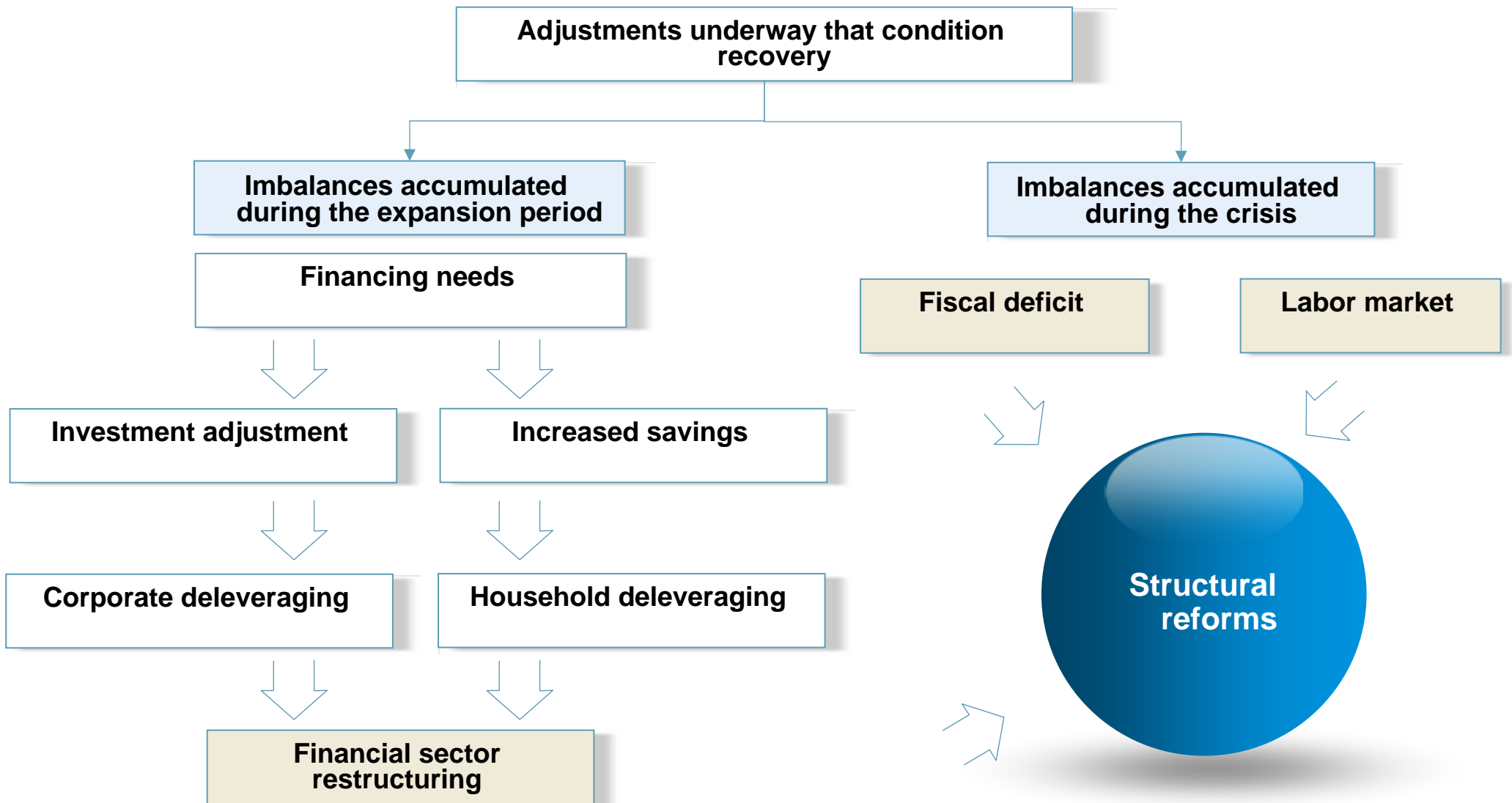
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Spain: an adjustment that is at an advanced stage in the private sector and a necessary and feasible fiscal consolidation



Spain: an adjustment that is at an advanced stage in the private sector and a necessary and feasible fiscal consolidation

An adjustment that is at an advanced stage in the private sector

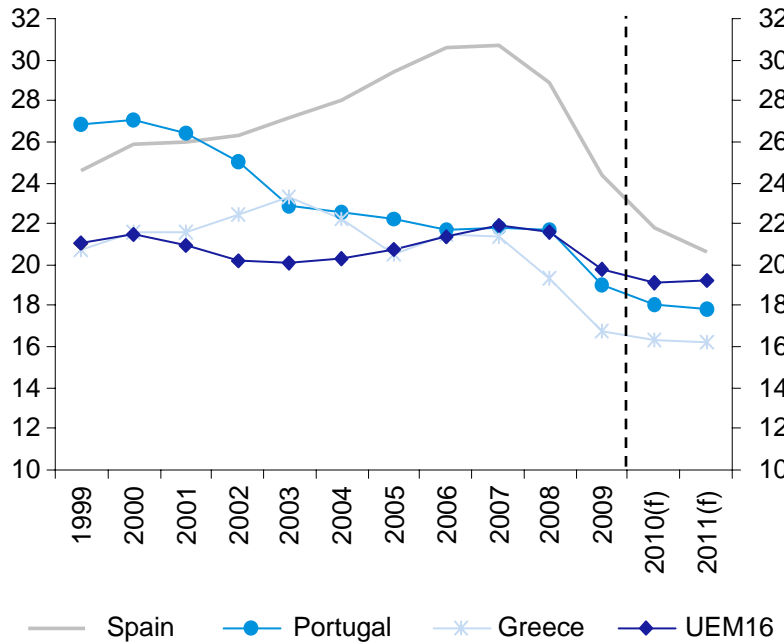
The private sector has made significant progress in its adjustment process, with a considerable reduction in its financing needs

The **current account deficit** recorded in recent years in Spain is a reflection of the dramatic increase in investment **rather than a lack of competitiveness or a low saving rate**

Domestic investment rate

GFCF as percentage of GDP

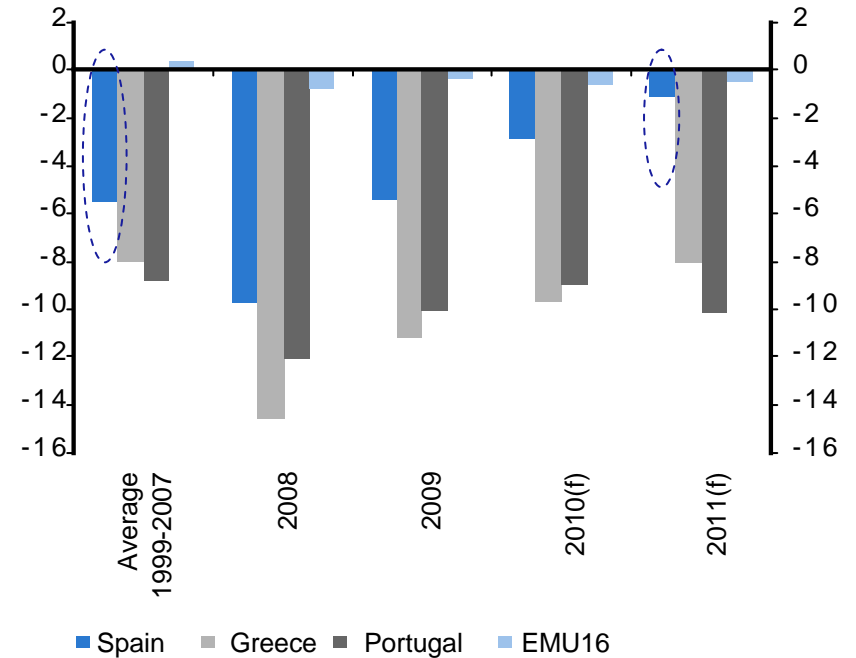
GFCF: Gross fixed capital formation
Source: BBVA Research based on INE and AMECO



Current account balance

As percentage of GDP

Source: BBVA Research based on IMF



Spain: an adjustment that is at an advanced stage in the private sector and a necessary and feasible fiscal consolidation

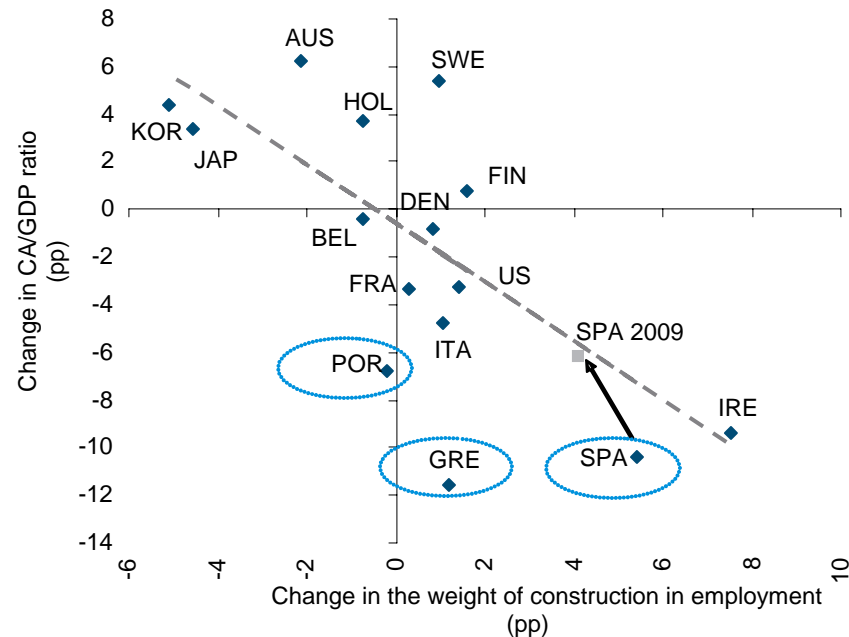
An adjustment that is at an advanced stage in the private sector

The private sector has made significant progress in its adjustment process, with a considerable reduction in its financing needs

The need for financing for **residential investment** created **imbalances in the current account**. While investment is adjusting in the sector, financing needs are also adjusting at the same rate, while in other countries the adjustment process is being delayed

Construction employment share and current account balance: 1996-2007

Source: BBVA Research based on AMECO



Spain: an adjustment that is at an advanced stage in the private sector and a necessary and feasible fiscal consolidation

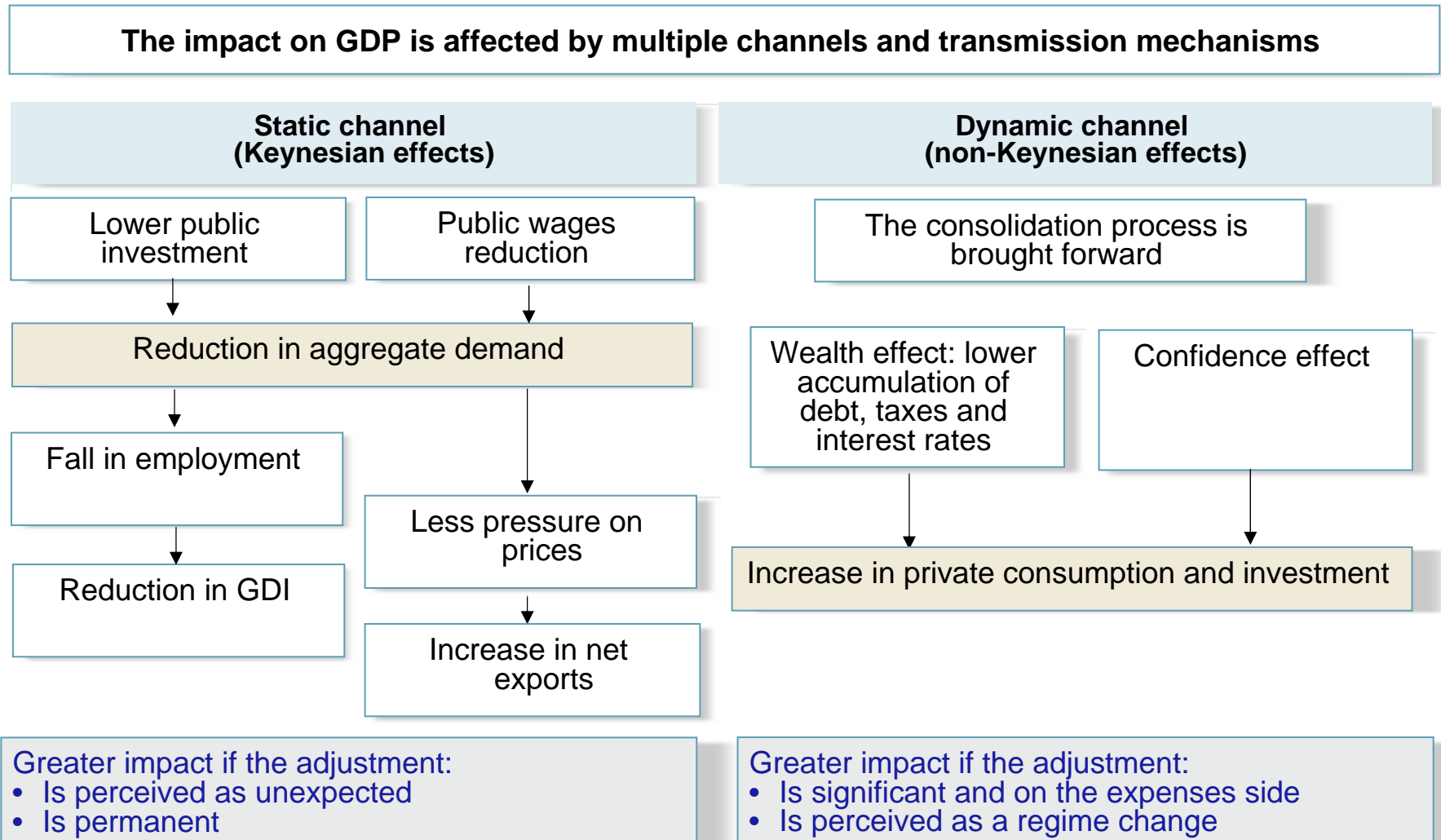
Public sector adjustment

	Measures	Reduction of Public deficit (% of GDP)	Details of the measures
Previous measures	Withdrawal of discretionary measures	2.7%	<ul style="list-style-type: none"> • Infrastructure Plan E (0.8% of GDP) • Elimination of the 400 euro income tax credit
	Increase in earning tax	1.0%	<ul style="list-style-type: none"> • Increase in VAT (2pp), capital income and other indirect taxes
	Immediate Action Plan	0.5%	<ul style="list-style-type: none"> • Reduction in public investment and public consumption
New measures	Adjustment plan submitted to the EC	1.5%	<ul style="list-style-type: none"> • 5% paycut and wage freeze (0.6 % of GDP) • Reduction in public investment (0.6 % of GDP) • Non-reevaluation of pensions and welfare policies
	Cyclical impact on deficit	1.0%	<ul style="list-style-type: none"> • Recovery of activity in 2012 and 2013
	Further necessary measures	≅ 1.5%	<ul style="list-style-type: none"> • Uncertainty surrounding the effectiveness of the adjustment plan is reduced
		8.2%	<ul style="list-style-type: none"> • Deficit would fall from 11.2% in 2009 to 3% of GDP in 2013

Spain: an adjustment that is at an advanced stage in the private sector and a necessary and feasible fiscal consolidation

Public sector adjustment

Uncertainty surrounding the short-term impact of the new fiscal measures



Spain: an adjustment that is at an advanced stage in the private sector and a necessary and feasible fiscal consolidation

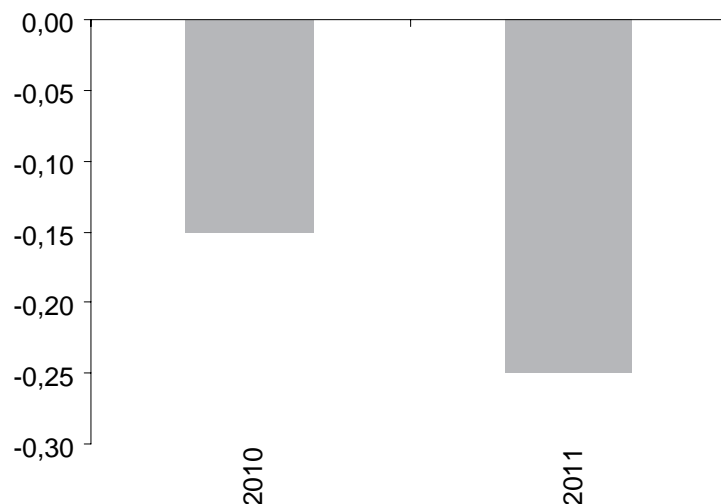
Public sector adjustment

Uncertainty surrounding the short-term impact of the new fiscal measures

Impact of the additional fiscal policy measures on GDP

(on % y-o-y)

Source: BBVA Research



Macroeconomic Forecasts						
(y-o-y growth rate, %)	2009		2010		2011	
	Spain	EMU	Spain	EMU	Spain	EMU
Household consumption	-5,0	-1,0	-0,2	0,1	0,4	0,6
Public consumption	3,9	2,3	1,4	0,9	0,2	0,5
Gross Fixed Capital Formation	-15,2	-10,8	-8,8	-2,8	-2,7	0,6
Equipment and other prod.	-20,6	-15,5	-7,9	-2,3	-1,1	0,3
Capital Goods	-22,9	-17,1	-3,8	-2,4	-0,1	-0,2
Construction	-11,1	-7,2	-9,4	-2,8	-3,7	0,9
Housing	-24,5	-9,4	-16,5	-4,7	-5,6	-0,8
Internal Demand (*)	-6,4	-3,2	-1,9	0,1	-0,4	0,8
Exports	-11,3	-12,8	5,3	6,2	5,6	7,6
Imports	-17,7	-11,4	-0,2	4,8	0,9	6,7
External Demand (*)	2,8	-0,8	1,3	0,6	1,1	0,5
GDP	-3,6	-4,0	-0,6	0,7	0,7	1,3
Pro-memoria						
GDP excluding housing	-1,8	-3,7	0,4	1,0	1,1	1,4
GDP excluding construction	-2,2	-3,7	0,8	1,2	1,5	1,3
Total employment (LFS)	-6,8	-1,8	-2,7	-0,5	-0,3	0,3
Unemployment rate (%)	18,0	9,4	19,4	10,4	19,2	10,6
Current account (%GDP)	-5,4	-0,8	-3,0	-0,6	-1,1	-0,5
Public surplus/deficit (%GDP)	-11,2	-6,3	-9,6	-6,6	-6,6	-5,2
CPI media anual	-0,3	0,3	1,2	1,0	1,0	1,2

(*) contributions to GDP growth

Source: INE, Bank of Spain and BBVA Research

Fiscal **consolidation** is necessary but **not sufficient**: it must be accompanied by other **structural reforms**, which will determine the final effects of the fiscal adjustment on growth

Spain: an adjustment that is at an advanced stage in the private sector and a necessary and feasible fiscal consolidation

The need for ambitious structural reforms: the financial sector

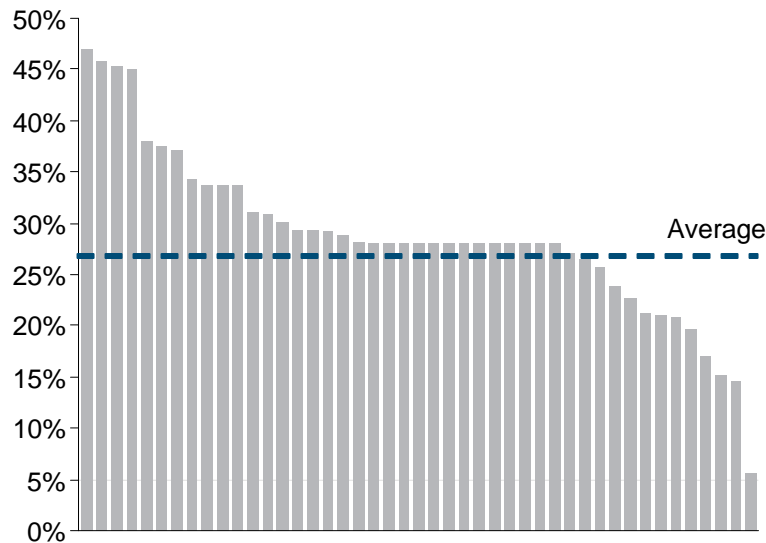
Although solvency problems in the Spanish financial sector are minimal they need to be addressed decisively.

Although most of the **banking system** is **well capitalized**, it is widely **heterogeneous**, with a small group of entities that might have solvency problems. The capital needs of these entities will be around 5% of the GDP in 2013, about half of the maximum debt that can be obtained from the FROB

Challenge: undertake a restructuring that reduces the overcapacity of the entities in which it is concentrated

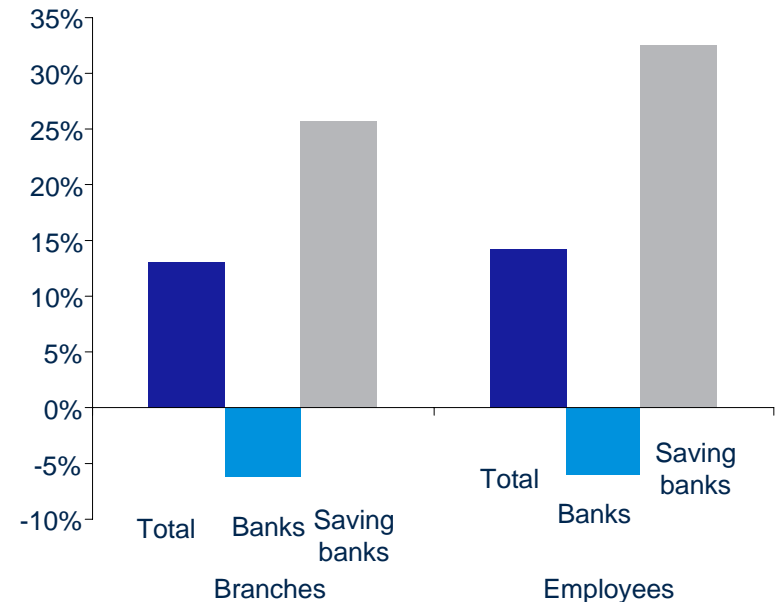
Spain: weight of the construction and real estate sector in the credit portfolio of financial institutions

Source: BBVA Research



Spain: trend in number of branches and employees from 2000 to 2009

(%)
Source: BBVA Research based on BoS



Spain: an adjustment that is at an advanced stage in the private sector and a necessary and feasible fiscal consolidation

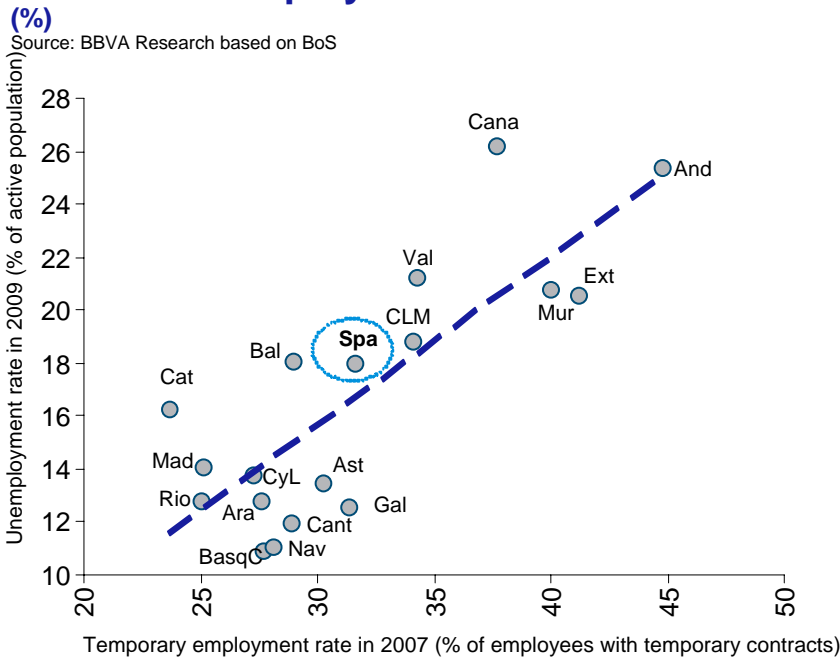
The need for ambitious structural reforms: the labor market

The operation of the Spanish labor market is not optimal

Duality

The temporary employment rate in Spain is still 10 percentage points above the Eurozone, with negative effects in the medium and long-term on productivity, in-company training, geographical and labor mobility, etc.

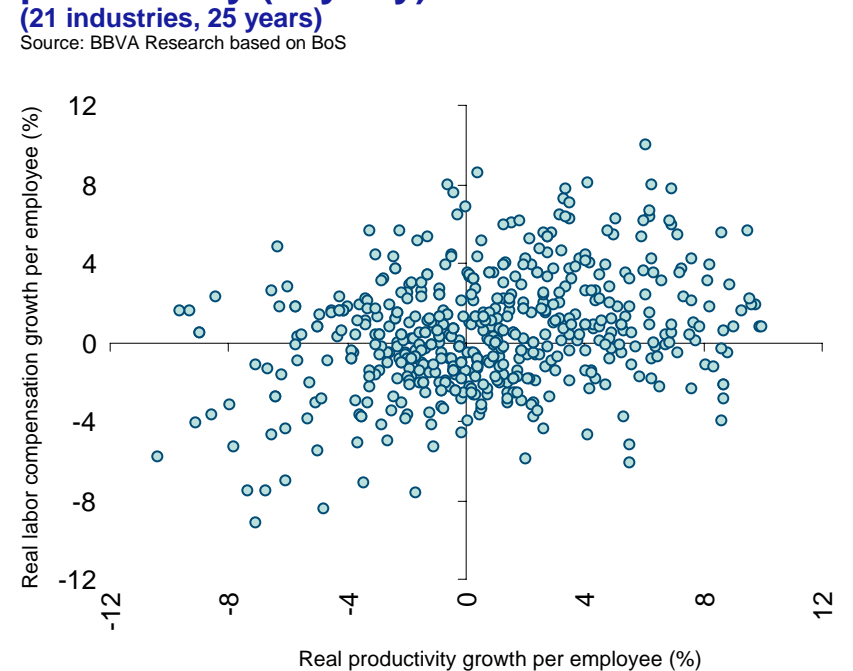
Spain: temporary employment rate in 2007 vs. unemployment rate in 2009 (%)



Inefficient wage determination system

In countries with decentralized wage bargaining (e.g. UK), the wage increase is more related to productivity gains (internal factor) rather than other external variables, as happens in countries with an intermediate (e.g. Spain) or centralized bargaining system

Spain: real labor compensation vs. labor productivity (% y-o-y)



Spain: an adjustment in advanced stage in the private sector and a necessary and feasible fiscal adjustment

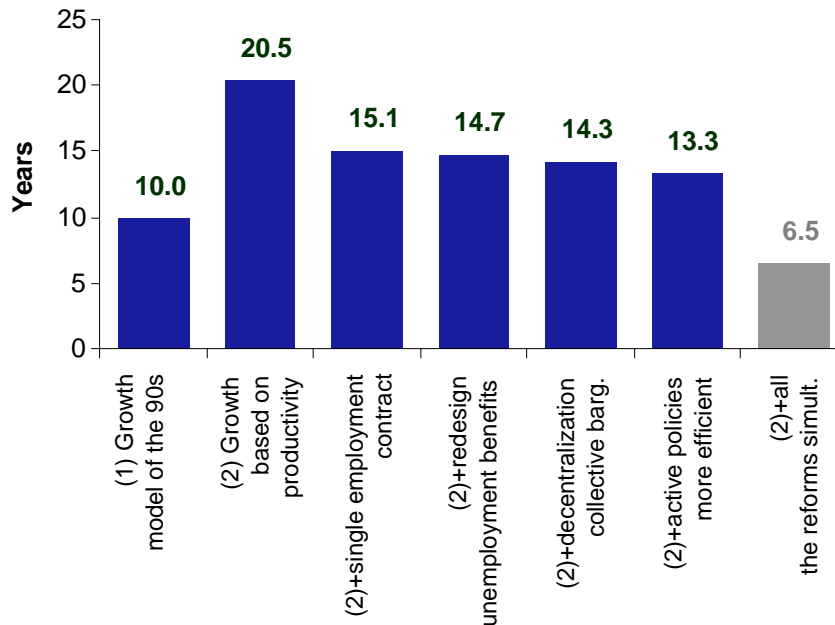
The need for ambitious structural reforms: results

In the absence of ambitious structural reforms, the economy will converge slowly at a growth rate of around 2%, slightly above the EMU growth rate

A favorable combination of structural reforms could take the economy back to growth rates of around 3% more quickly

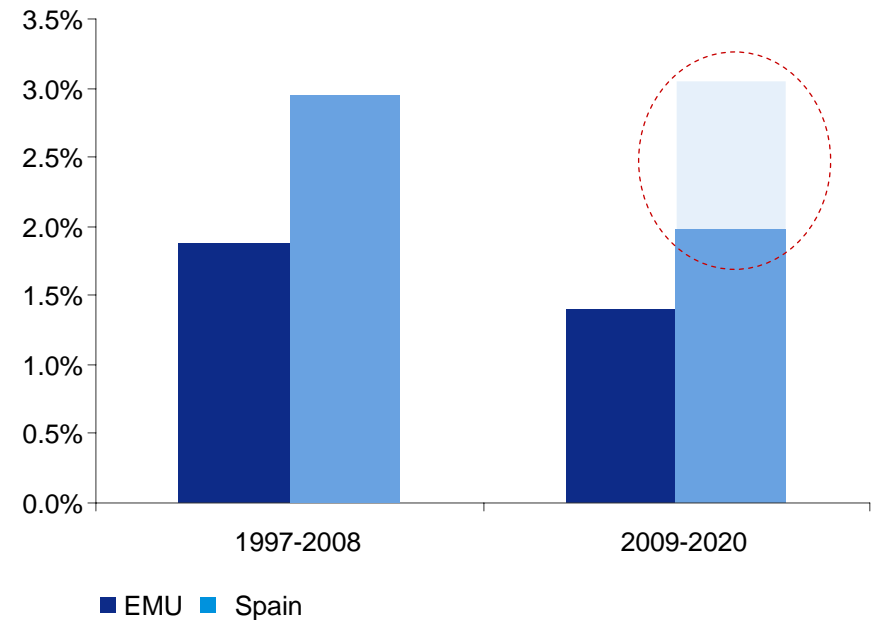
Spain: required time to reduce unemployment rate by 10 points in various scenarios

Source: BBVA Research based on Andres *et al.* (2009)



Spain and EMU: Potential GDP (Annual average change in %)

Source: BBVA Research



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Households' consumption: divergent trend of its fundamental determinants

Credit Growth

The deleveraging process in households continues, but at a slow pace

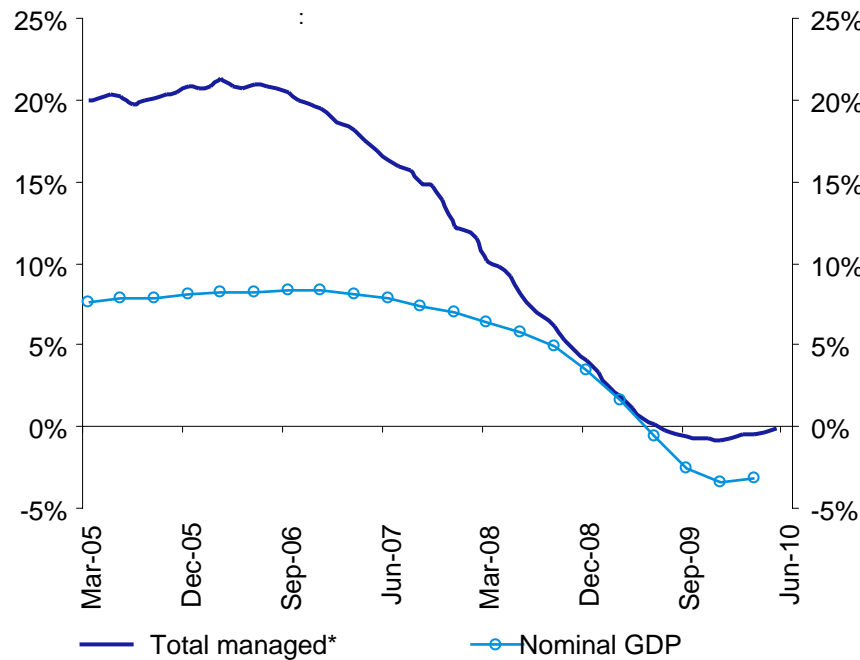
The deterioration in household lending slows down during the first half of 2010

Spain: credit to households and nominal GDP

(% y-o-y)

Includes securitizations

Source: BBVA Research based on BoS and INE

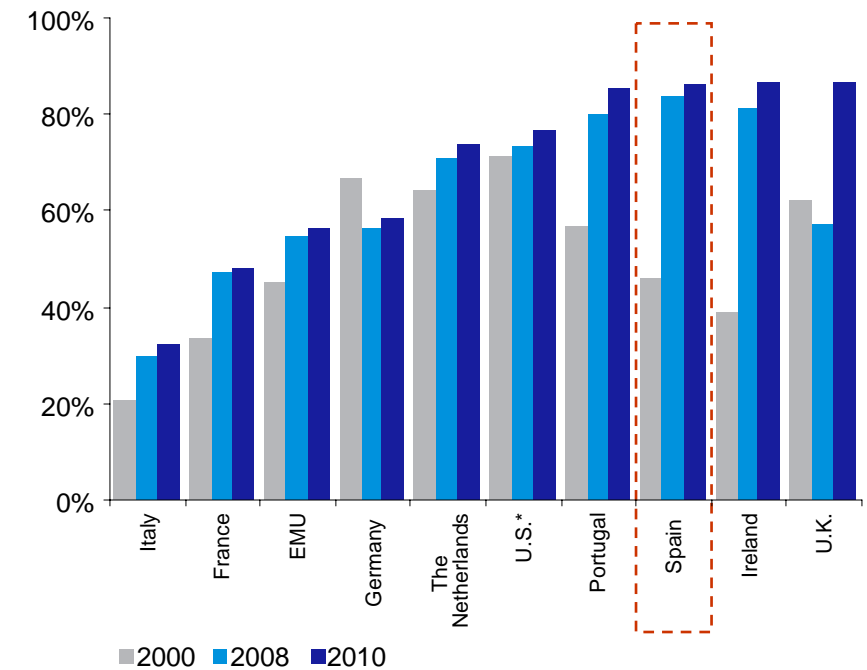


Credit to households

(% GDP)

Latest data: Apr-10, except US (Mar-10)

Source: BBVA Research based on domestic sources.



Households' consumption: divergent trend of its fundamental determinants

Credit Growth

The deleveraging process in households continues, but at a slow pace

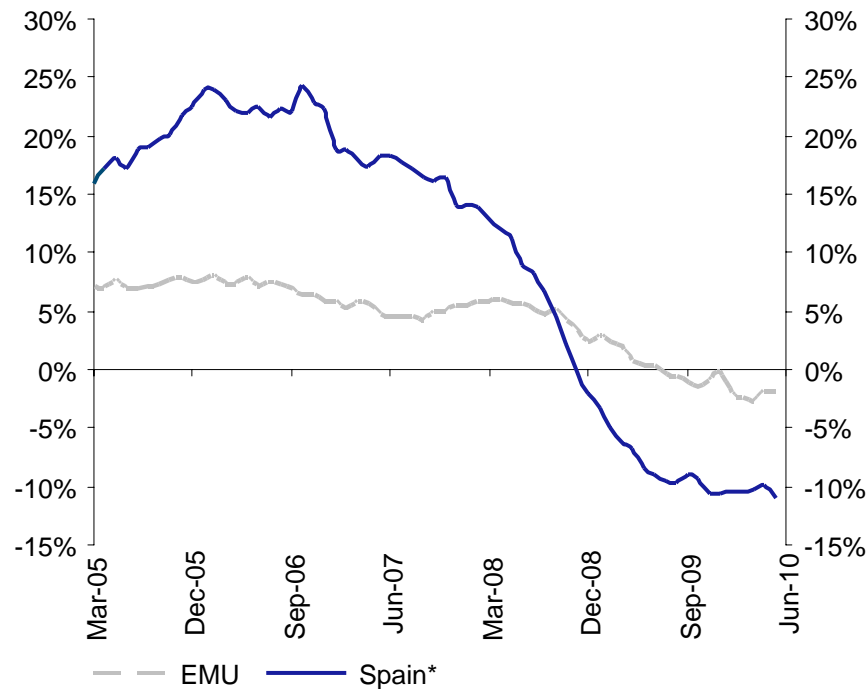
Consumption credit is also falling more slowly, but at comparatively high levels, which speeds up the convergence process with the EMU

Spain: consumption credit

(% y-o-y)

Includes securitizations

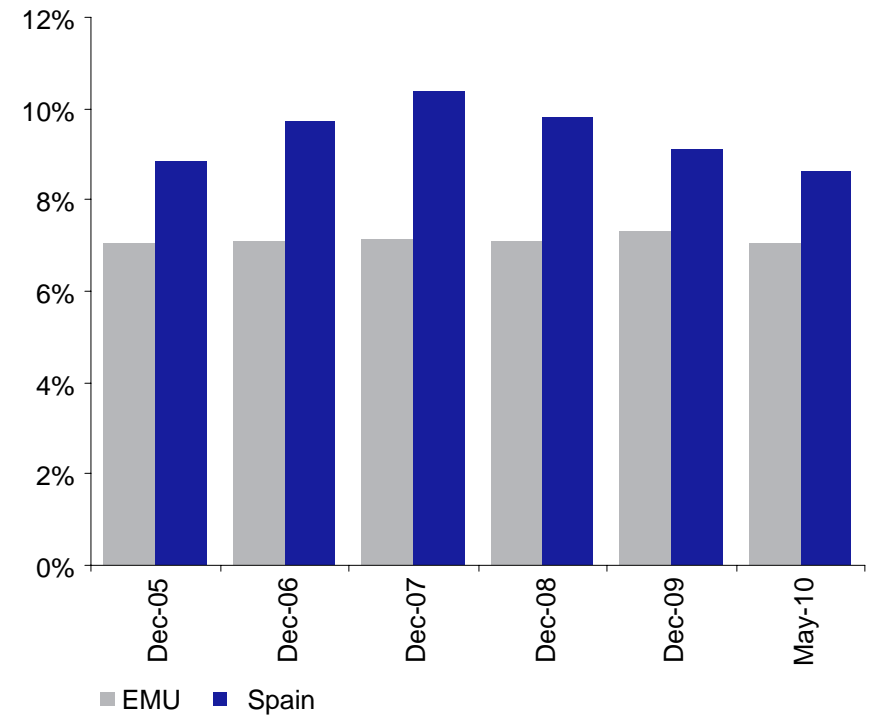
Source: BBVA Research based on BoS and INE



Consumption credit

(% GDP)

Source: BBVA Research based on BoS and ECB



Households' consumption: divergent trend of its fundamental determinants

Credit
Growth

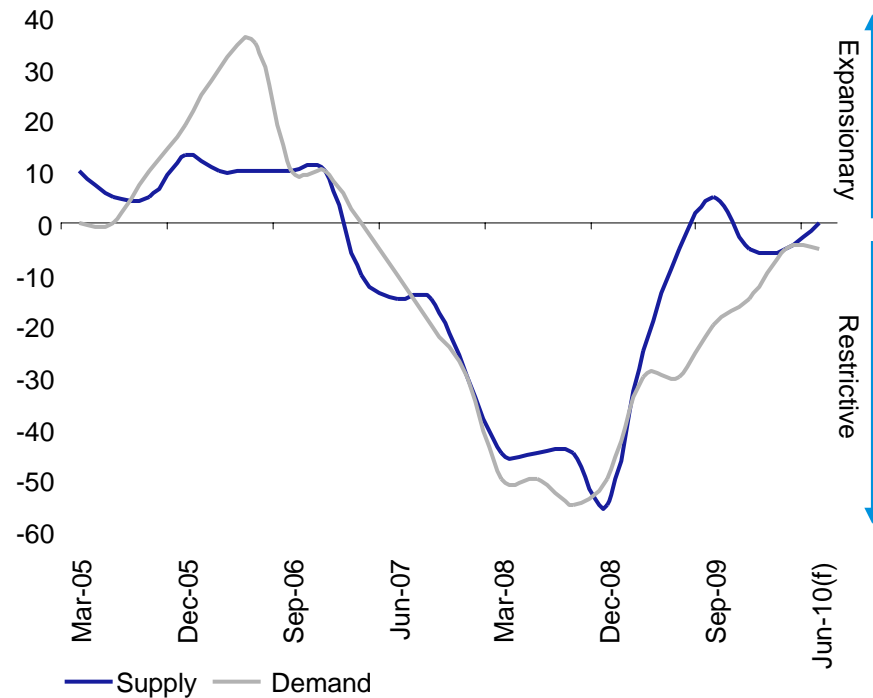
The deleveraging process in households continues, but at a slow pace

Following the worsening registered during the last quarter of 2009, the criteria to approve new company and household loans were relaxed during the first quarter of this year

Spain: bank lending survey

Consumer and other credit

Source: BBVA Research based on BoS



The expectations of the financial entities show that access to credit probably stabilized in the second quarter, though the fall in consumer confidence could have led to another demand drop

Households' consumption: divergent trend of its fundamental determinants

Credit Growth

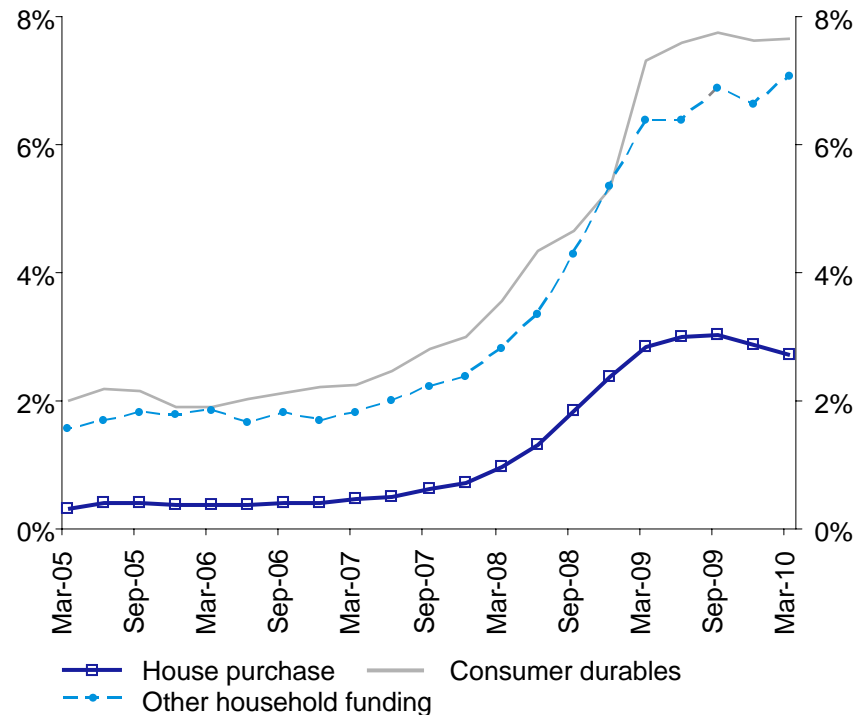
The deleveraging process in households continues, but at a slow pace

Unlike loans for property purchase and refurbishment purposes, the default rate of consumption loans remains high in 2010...

..., while the interest rates for new operations continue to decrease, especially for medium-term operations

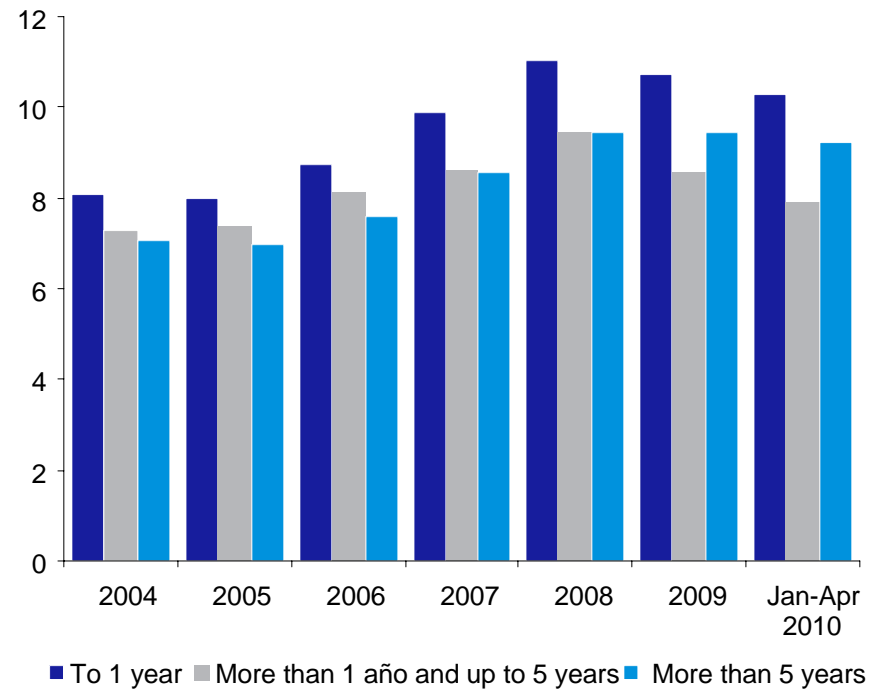
Spain: default rate (%)

Source: BBVA Research based on BoS and ECB



Spain: interest rates on new consumer credit transactions (%)

Source: BBVA Research based on BoS

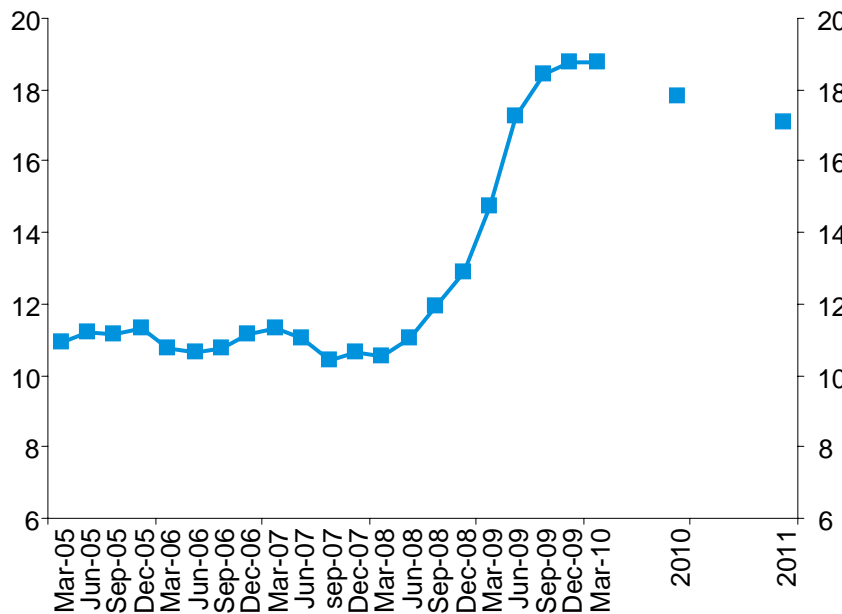


Risk
aversion

Uncertainty remains at high levels, encouraging saving, mainly due to caution reasons

Spain: household savings rate
(% of the GDI)

Source: BBVA Research based on INE



However, not all households behave in the same way: the **differences in risk aversion** and in **household structure explain** a large part of the **varied trend in the tendency to save**

Once we control the income and spending effects, **the probability of saving increases:**

- With the number of wage earners in the household
- When the household size becomes smaller
- With a larger number of dependent children in the household
- When a home is owned
- With the age of the main breadwinner
- When the main breadwinner is employed, etc.

Households' consumption: divergent trend of its fundamental determinants

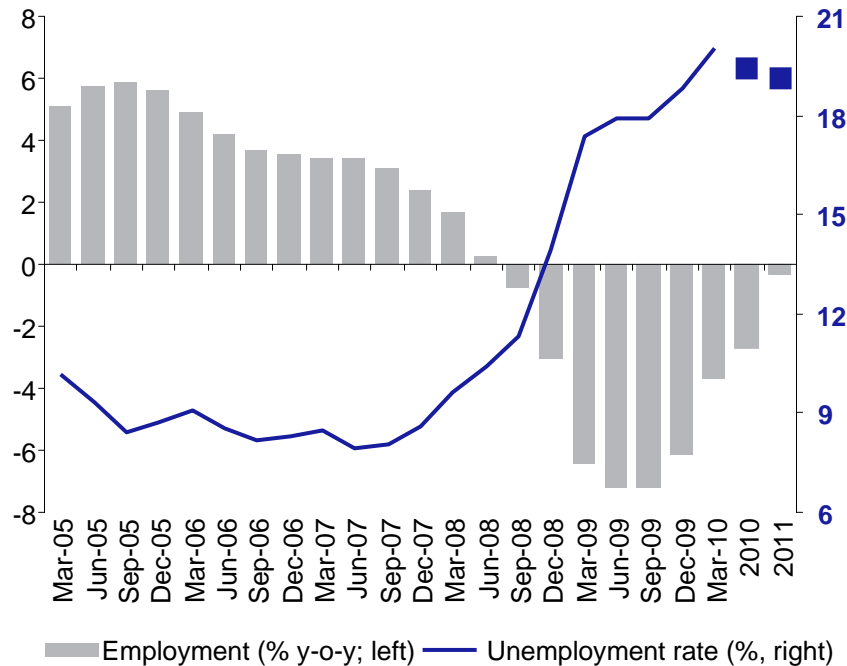
Deterioration of the labor market

The job reduction rate is slowing down but the unemployment rate has hardly dropped

Therefore, the gross household disposable income will be reduced in light of the withdrawal of fiscal stimulus packages

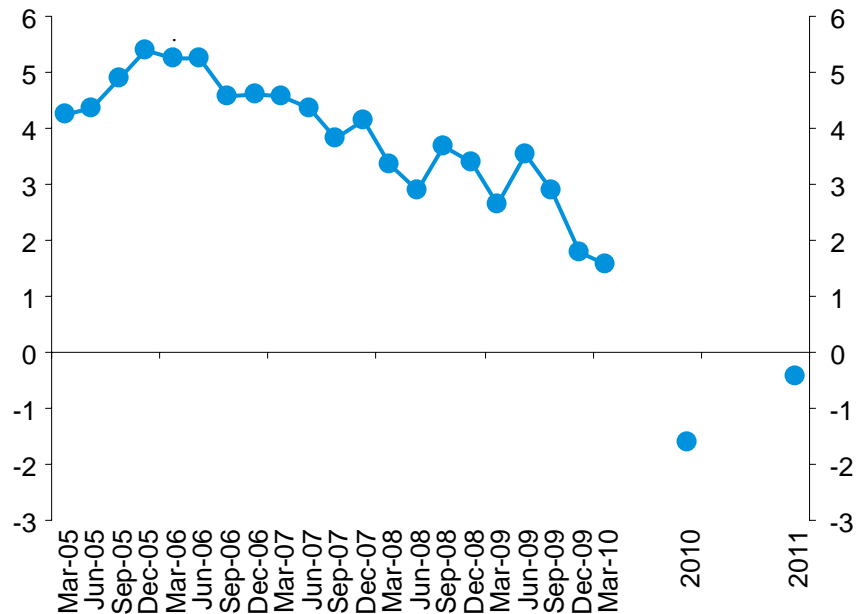
Spain: employment and unemployment rate (%)

Source: BBVA Research based on INE



Spain: real household disposable income (% y-o-y of annual accumulated amount)

Source: BBVA Research based on INE



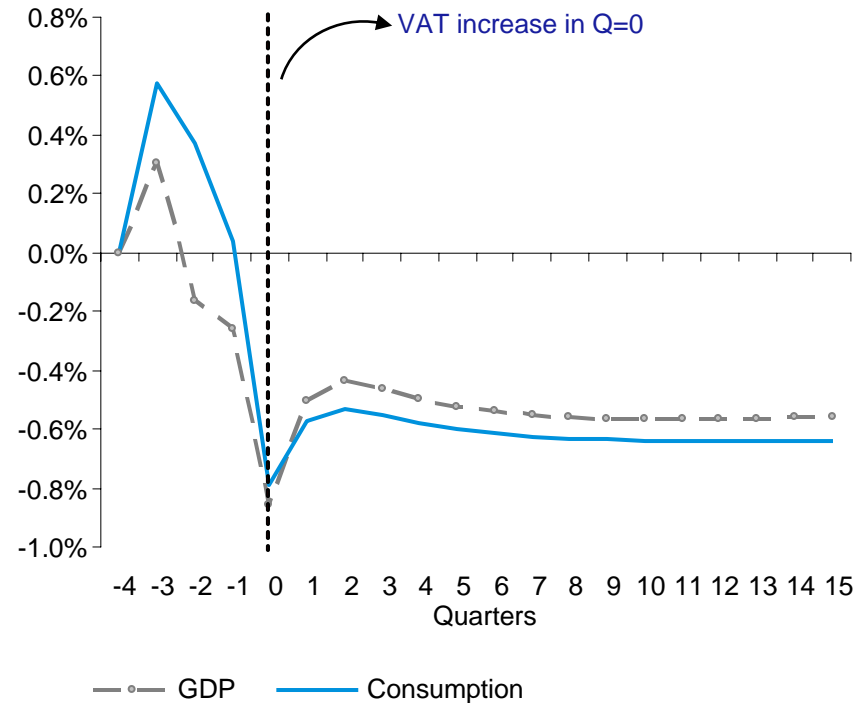
Households' consumption: divergent trend of its fundamental determinants

Fiscal consolidation process

The restrictive fiscal policy measures will reduce demand during the second half of the year

Spain: response to an increase of 2 pp in VAT
(percentage deviation from the trend)

Source: BBVA Research



The VAT increase will have a permanent impact on the *level* of consumption. The negative effect on consumption *growth* will only be noted during Q3 2010

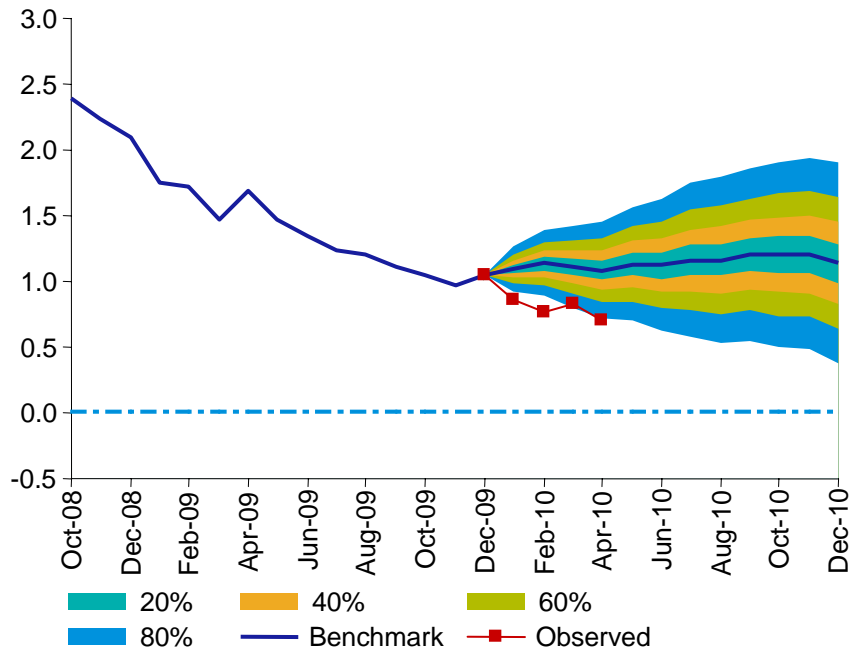
Households' consumption: divergent trend of its fundamental determinants

Inflation and interest rates

The lack of inflationary pressure due to flat demand will cause official rates to remain at 1% towards the end of 2011

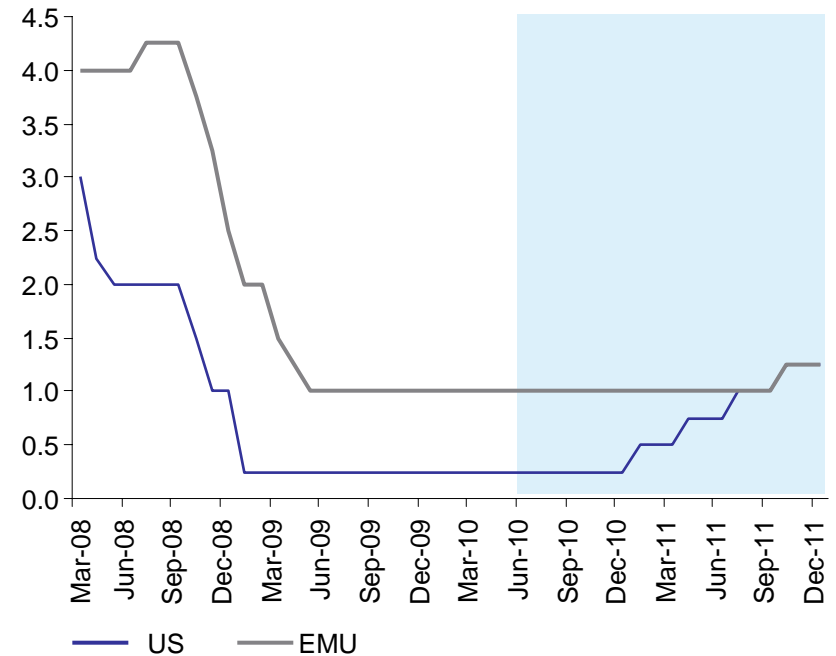
EMU: core inflation (% y-o-y)

N.B.: Benchmark based on ARIMA models
Source: BBVA Research based on Eurostat



Official interest rates (%)

Source: BBVA Research based on ECB and Fed



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Halt in increase of demand for durable goods

During the first half of 2010, the demand for durables, both domestic and foreign, stopped the slight recovery recorded during the second half of 2009

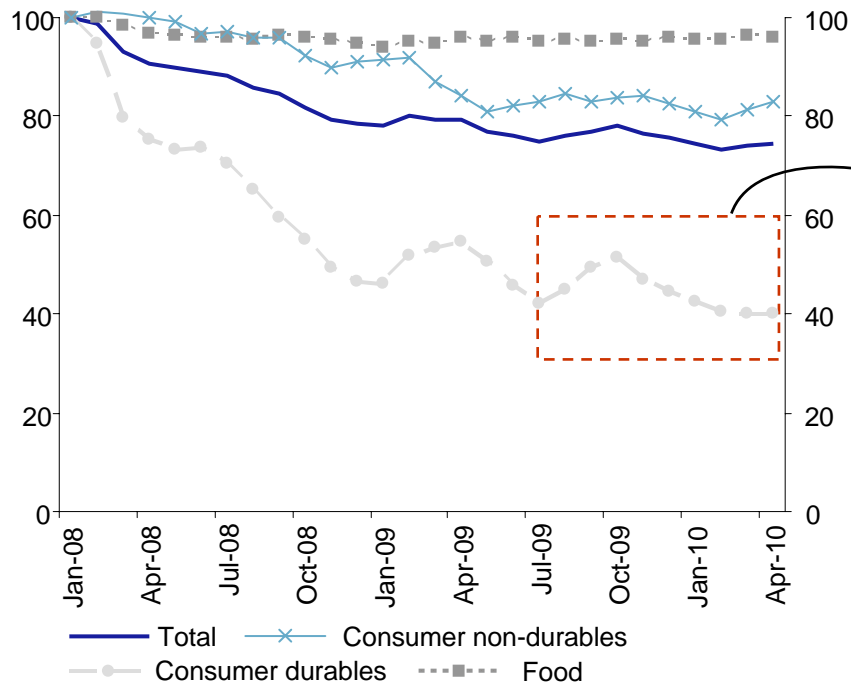
The continued loss of dynamism of its fundamentals, the increase of uncertainty related to the resurgence of financial tensions and the weakening of fiscal stimulus packages explain the drop in **domestic demand**

Spain: availability of consumer goods

(Jan-08 = 100)

seasonally and working day-adjusted data

Source: BBVA Research based on MoE



The anticipation effect resulting from the VAT increase in July 2010 was felt during the second half of 2009

Halt in increase of demand for durable goods

During the first half of 2010, the demand for durables, both domestic and foreign, stopped the slight recovery recorded during the second half of 2009

Exports of durables in real terms registered an accumulated drop of almost 16.4 percentage points between February and April ...

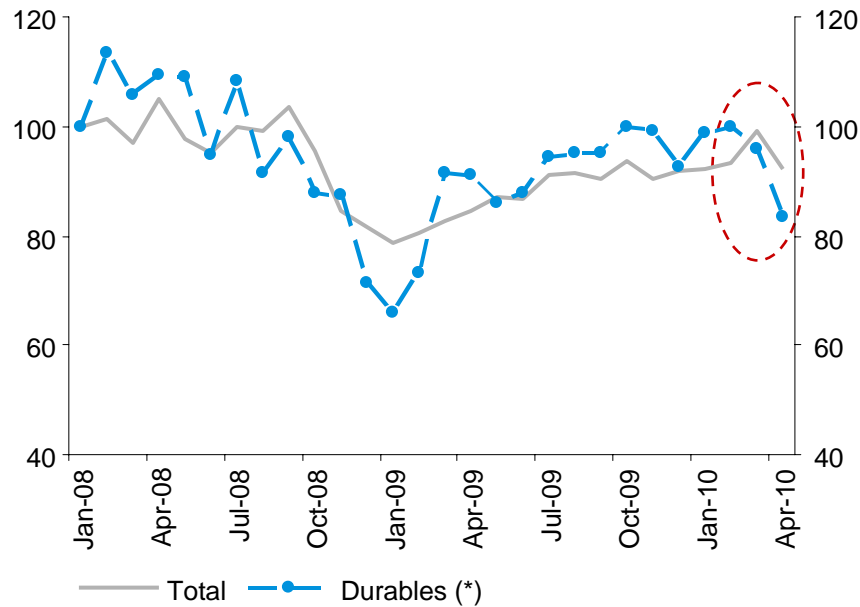
Spain: real exports of goods

(Jan-08 = 100)

seasonally and working day-adjusted data

(*) Electrical appliances, Consumer electronics, IT equipment, Furniture, Motorcycles and cars

Source: BBVA Research based on MoE



Halt in increase of demand for durable goods

During the first half of 2010, the demand for durables, both domestic and foreign, stopped the slight recovery recorded during the second half of 2009

... However, the loss of dynamism in **foreign demand** conceals a heterogeneous trend by type of good

Spain: real exports of goods. Average monthly growth rate (%)							
	Electrical appliances	IT equipment	Consumer electronics	Cars	Motorcycles and mopeds	Furniture	Durables (*)
Jan-95/Dec-07	0.0	0.9	0.7	0.1	0.4	0.4	0.2
Jan-08/Dec-08	-3.3	0.4	-1.6	-4.8	-1.4	-1.8	-3.0
Jan-09/Dec-09	1.2	-2.3	3.2	4.4	2.2	1.0	3.2
Jan-09/Jun-09	-2.8	-8.2	-2.8	8.7	-5.5	-0.2	6.0
Jul-09/Dec-09	-0.1	-3.5	7.2	-0.8	3.4	-0.1	-0.4
Jan-10/Apr-10	3.3	2.8	9.8	-7.1	3.1	0.3	-5.5

Seasonally and working day-adjusted data
Source: BBVA Research based on MoE

The remaining analyzed goods showed positive average monthly growth between January and April 2010, with growth in **consumer electronic** goods being noteworthy

The drop in **car** exports –caused by the end of scrapping programs in most of the countries in our region- has been the main reason for the recent fall in foreign durables trade

Halt in increase of demand for durable goods

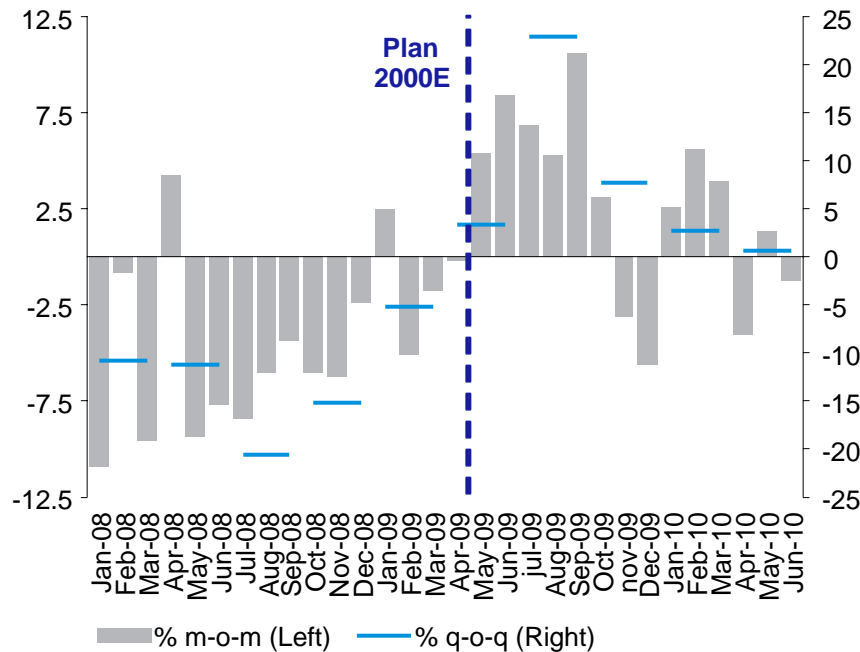
Number of cars

Weakening of demand for cars linked to end of the Plan 2000E

The quarterly growth in car registrations -seasonally and calendar adjusted- dropped from 22.9% between June and September 2009 to 0.7% in the second quarter of 2010

Spain: car registrations

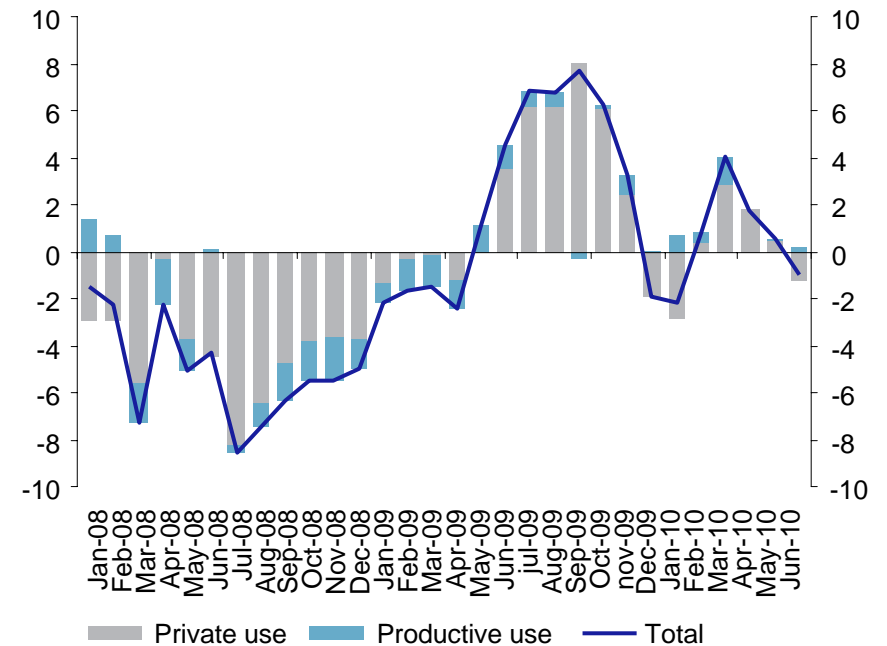
(%)
seasonally and working day-adjusted data
Source: BBVA Research based on ANFAC and Ganvam



The **consumer channel** was the main driver

Spain: car registrations per channel

(3MMA, % m-o-m)
seasonally and working day-adjusted data
Source: BBVA Research based on BoS and ANFAC



Halt in increase of demand for durable goods

Number of cars

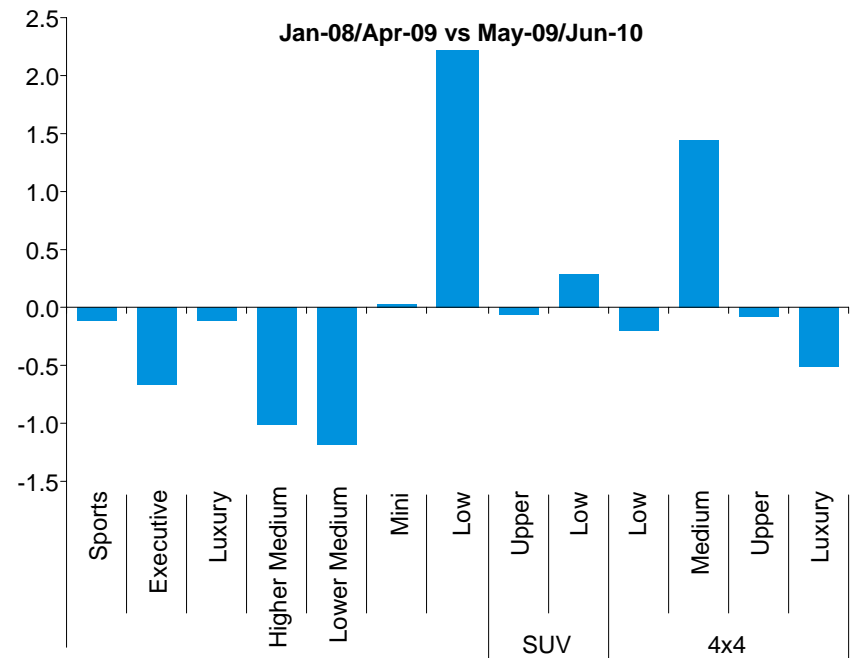
There has been no change in the structure of demand for cars per segment

Two reasons:

- 1. Technological progress**, encouraged by suitable fiscal policy measures, has allowed top-end motor vehicles to be manufactured with a volume of comparatively low emissions, and therefore eligible under the Plan 2000E.
- 2. Imitation effect:** equivalent reduction in price of non-eligible cars

Spain: change in the structure of car registrations per segment (pp)

seasonally and working day-adjusted data
Source: BBVA Research based on ANFAC



Halt in increase of demand for durable goods

Motorcycles and mopeds

The Plan Moto-E is still ineffective

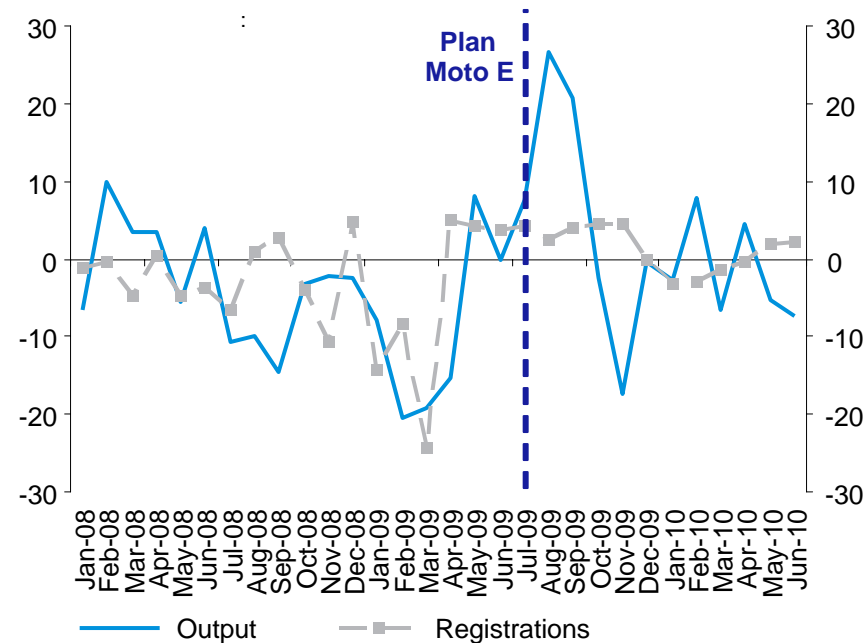
The impossibility of benefiting from the program to purchase a motorcycle with a higher cc and the small number of regions that have implemented it have been the main causes for its poor success.

Spain: motorcycle production and registration

(3MMA, % m-o-m)

seasonally and working day-adjusted data

Source: BBVA Research based on BoS



Halt in increase of demand for durable goods

Major appliances

Light at the end of the tunnel

The volume of electrical appliance sales rose by 2.8% y-o-y and turnover 3.5% between January and May 2010, from -25.8% recorded in the same period last year

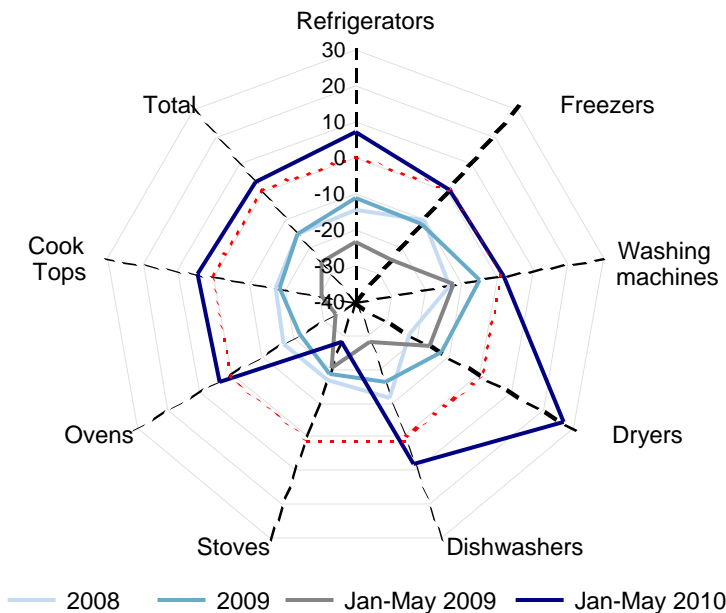
Sales of all types of electrical appliances increased except for stoves

The relative increase in the price of electrical appliance repair services could have contributed to boost demand

Spain: electrical appliances market by family

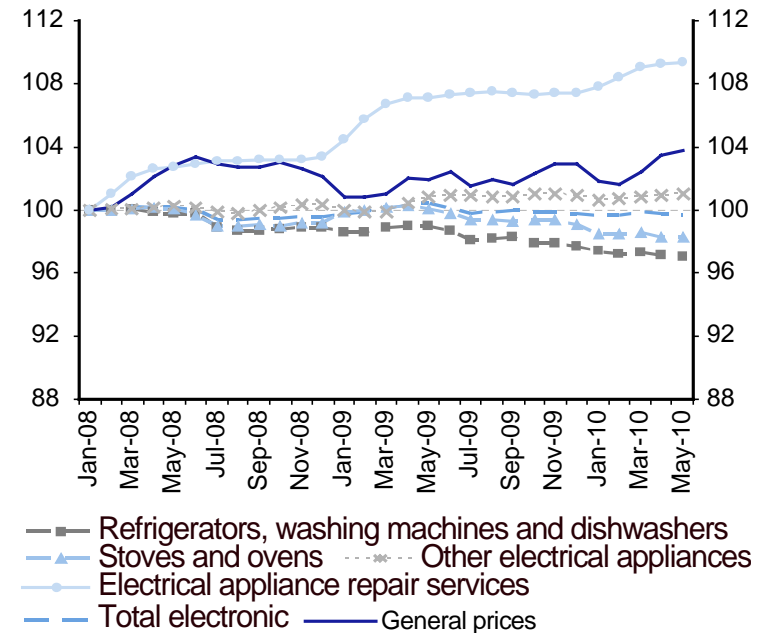
(% y-o-y)

seasonally and working day-adjusted data
Source: BBVA Research based on ANFEL



Spain: consumer prices of electrical appliances (Jan-08 = 100)

seasonally and working day-adjusted data
Source: BBVA Research based on INE



Halt in increase of demand for durable goods

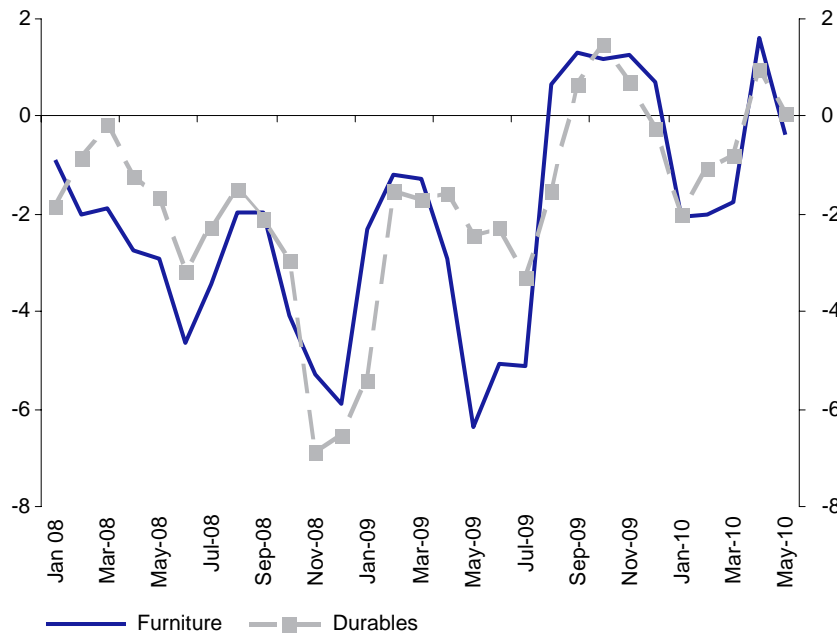
Furniture Trend still affected by the resizing process of the real estate sector

The slight improvement in foreign demand, combined with a temporary curb in the unraveling of the real estate market, have been a boost for real estate construction. The negative outlook regarding the trend of residential investment suggests a fall in real estate construction in the coming quarters

Spain: index of industrial production

(3MMA, % m-o-m)

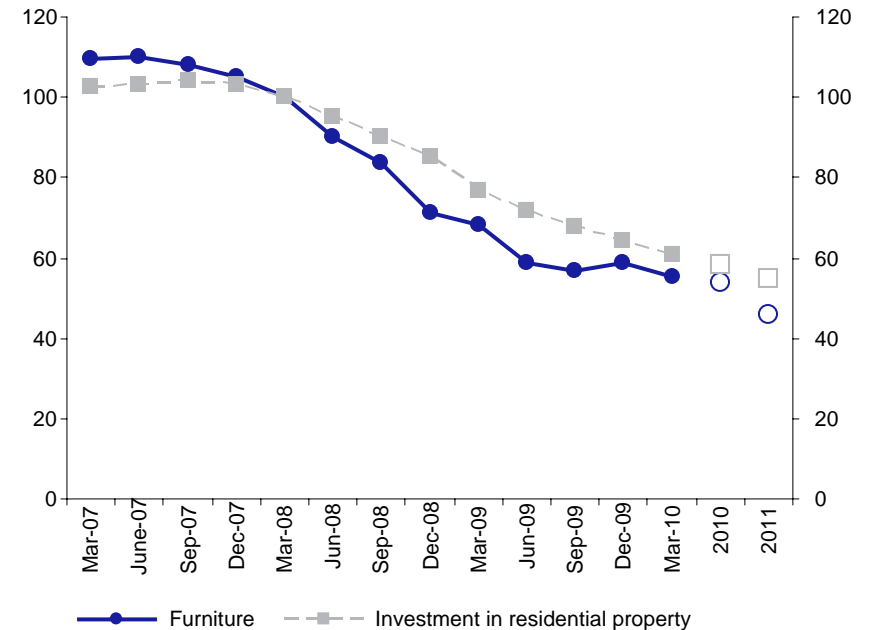
seasonally and working day-adjusted data
Source: BBVA Research based on INE



Spain: furniture production and investment in residential property

(Mar-08=100)

seasonally and working day-adjusted data
Source: BBVA Research based on INE



Halt in increase of demand for durable goods

Consumer electronics and IT equipment

The weakness of domestic demand contrasts with the strength of foreign demand

In spite of the analog switch-off, there appears to be no significant increase in real sales of consumer electronic goods during the first half of 2010

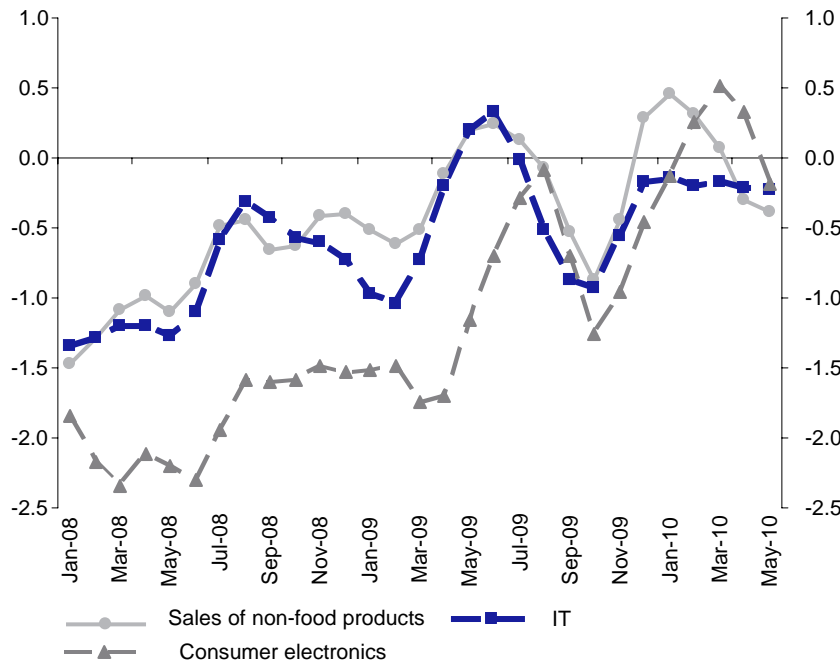
A persistent deflation in prices has prevented domestic demand from falling further

Spain: real consumer electronic sales and IT equipment

(% m-o-m)

Cycle-trend data

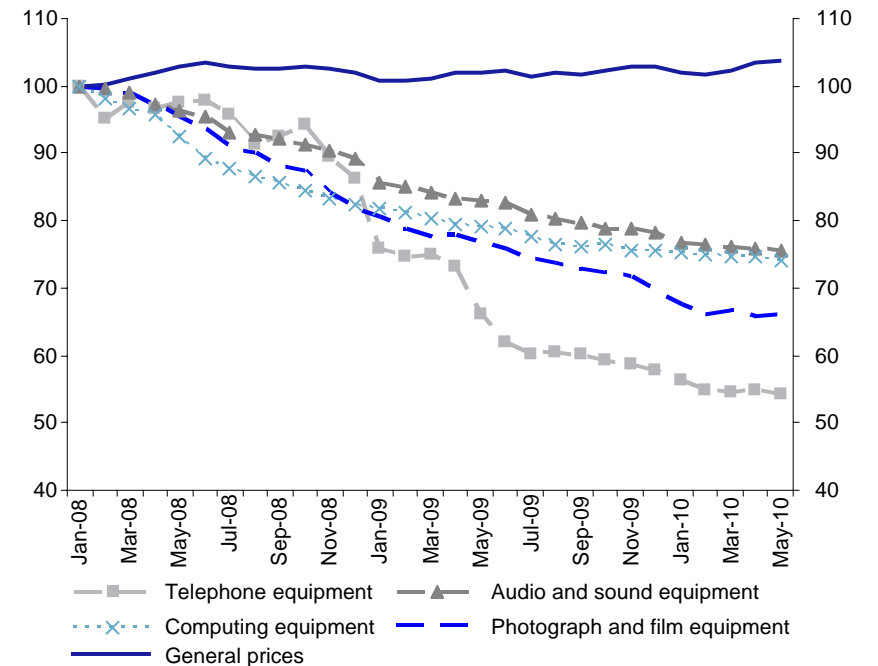
Source: BBVA Research based on Eurostat



Spain: consumer prices. Consumer electronics and IT equipment

(Jan-08 = 100)

Source: BBVA Research based on INE



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Section V

Economic growth and car consumption in Spain: is there a saturation point?

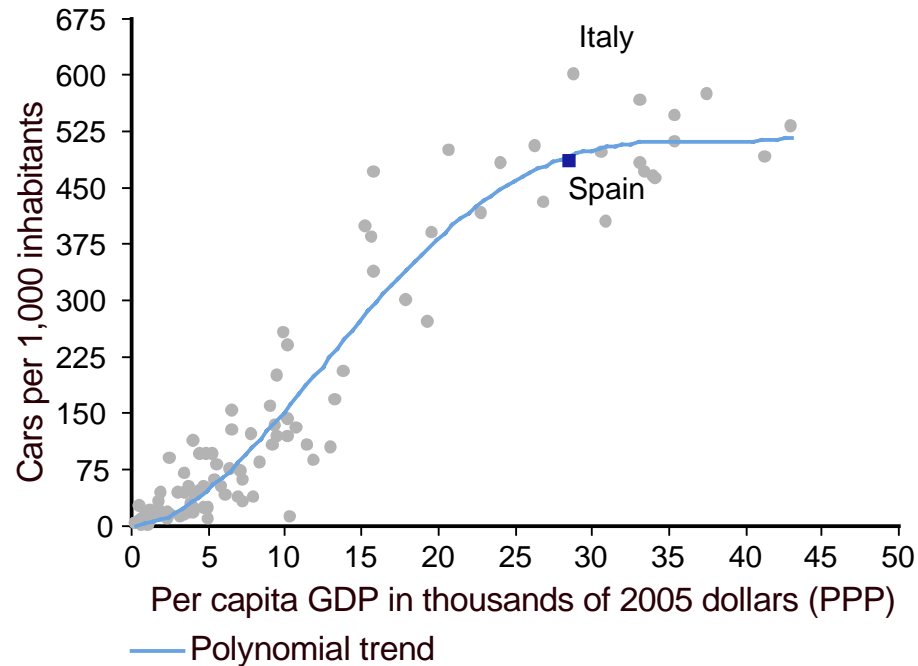
Economic growth and car consumption in Spain: is there a saturation point?

When the car fleet is related to per capita income, a positive and non-linear ratio can be seen, which is confirmed from a static outlook...

Number of cars vs. per capita GDP in 2007

(%)

Source: BBVA Research based on World Bank and Eurostat



Economic growth and car consumption in Spain: is there a saturation point?

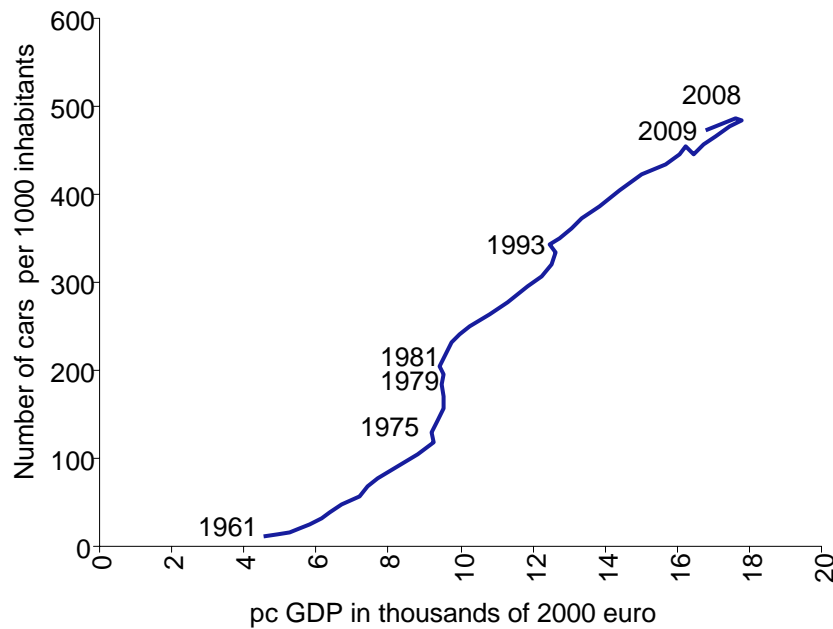
..., and from a dynamic outlook

In Spain, the growth in per capita cars seems to have weakened since mid 1970s, hinting that there is a **saturation point**

Spain: number of cars vs. per capita GDP

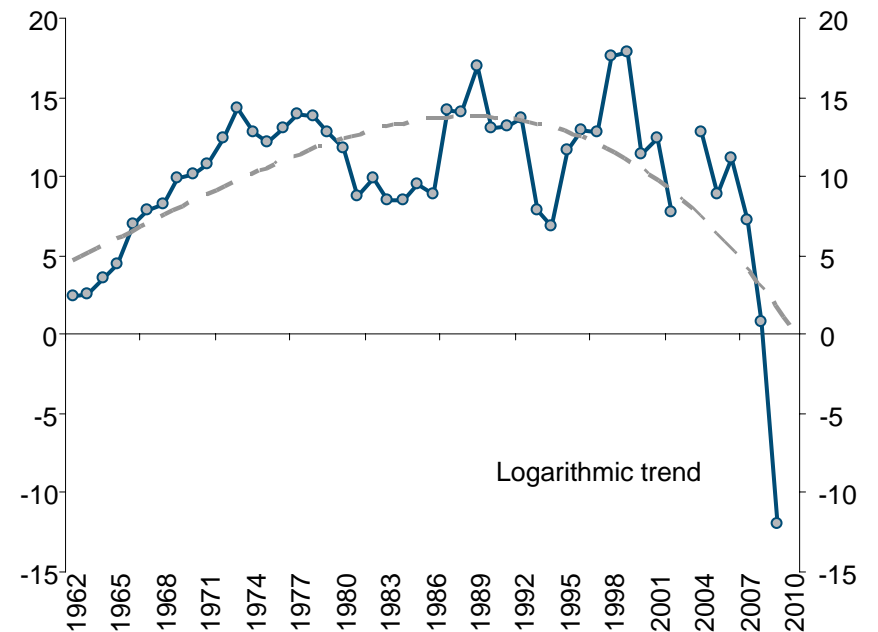
1961-2009

Source: BBVA Research based on BoS and INE



Spain: growth of stock of cars per 1,000 inhabitants (%)

Source: BBVA Research based on INE, BoS and European Commission



Economic growth and car consumption in Spain: is there a saturation point?

the saturation point is estimated for Spain at around 520 cars per 1,000 inhabitants

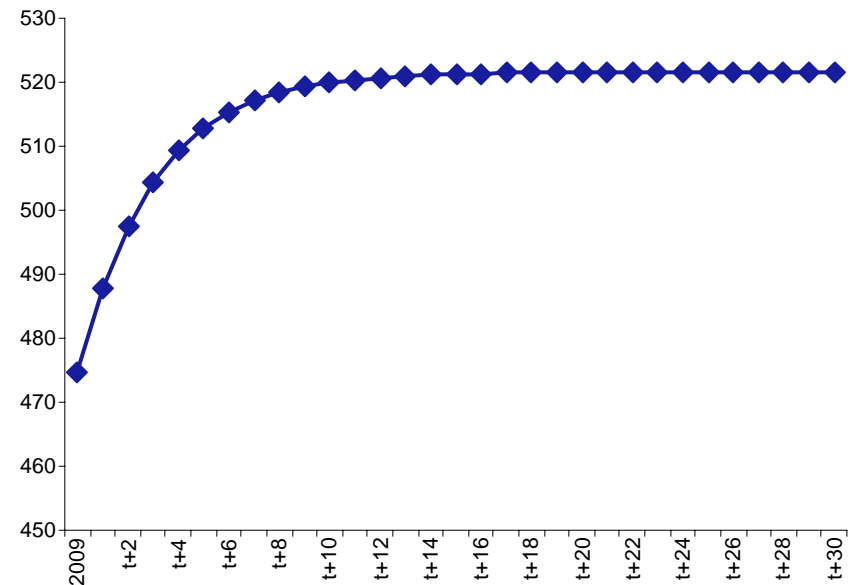
This means that the **growth potential** of per capita cars is around **10%** (from 474 at present)

How long will the Spanish market take to reach its saturation point?:

- The estimate of the parameter that represents the speed of adjustment towards long-term equilibrium shows that convergence is relatively quick:
- Without any substantial changes in supply and demand, 28% of the gap between current fleet of per capita cars and the saturation point would close within the first year;
- In the first seven years 90% of the adjustment should have been completed;
- In 30 years the equilibrium point should have been reached.

Spain: convergence speed to the saturation point of cars per 1000 inhabitants

Source: BBVA Research



Economic growth and car consumption in Spain: is there a saturation point?

Alternatives? At least two

Considering that the demographic trend expected for the next decade will not contribute towards a growth in car demand, there are two alternatives for the motor vehicle sector to avoid a drop in turnover in the medium- and long-term:

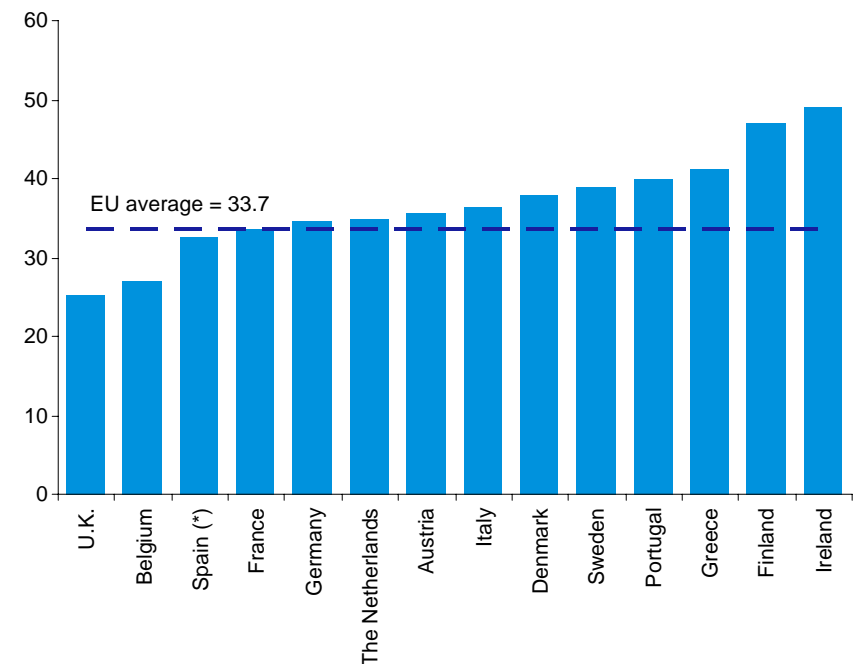
1. **Boost foreign competitiveness**, by increasing exports towards economies that have a significant growth potential and that are further from their saturation point
2. **Increase the car replacement rate**
 - This would require technological breakthroughs that allow **the running cost to be brought down**, increasing energy efficiency and **rising the availability of choice** for consumers

Number of cars over 10 years old in 2008 (%)

(%)

(*) 35.7% in 2009

Source: BBVA Research based on ANFAC



Key messages

- The positive elements of the external environment of the Spanish economy are distinguished by the **recovery of the emerging countries and the US**, which would create the conditions for global economic growth of around 4%.
- However, there are significant elements of **uncertainty in Europe** deriving from increased risk aversion and the fragility of growth. In 2010, the area will grow by 0.7%.
- In this context, and once the impact of fiscal consolidation measures has been accounted for, **Spanish GDP will shrink by 0.6% in 2010**, while in **2011 it should grow by 0.7%**.
- In spite of the medium- and long-term benefits of fiscal consolidation, **VAT increase** is expected to have **a negative effect on consumption in the short-term**
- The **consumer durable** production and trading sectors will be keenly **affected by the withdrawal of fiscal stimulus packages** in Spain and Europe and by the **rise in financial tensions**
- Medium-term outlook for the motor vehicle sector: the **number of per capita cars in Spain** is **nearing a saturation point**. Increasing external competitiveness and boosting the replacement rate will be key to growth



Consumption Watch

First half 2010