BBVA's Economic Research Department and BBVA Finanzia release
Consumption Watch

BBVA's Economic Research Department expects Spanish household consumption to slow in 2008 and 2009

- **BBVA's Economic Research Department forecasts a significant slowdown in household consumption in 2008 and 2009 in Spain, due to lower growth in disposable income, weakness in the job market and household wealth, worsening financial conditions and an erosion in consumer confidence**

- **Nevertheless, spending still looks set to grow by more than 1% thanks to the supports underpinning household finances: a job market that is more flexible than in the past, families' accumulated wealth, the expected moderation in financial burdens and the soundness of the banking system**

- **Demand for automobiles should continue to slump, though the drop could be limited by households' improved access to financing (especially in 2009), as shown in SEE-BBVA's EFCA indicator**

- **This issue of *Consumption Watch* contains a detailed analysis of the furniture industry, where we see encouraging signs: a commitment to industry concentration, price control and hefty investment in gross fixed capital formation. These measures are likely to serve as a support in the face of an economic downturn, a slowdown in construction and strong competition from abroad**

- **Consumption in the autonomous community of Valencia has recently been fueled by a sharp increase in employment and a demographic shock**

BBVA's Economic Research Department forecasts a significant slowdown in household consumption in 2008 and 2009, due primarily to lower disposable income, a weaker job market and less robust household wealth, worsening financial conditions and a drop in consumer confidence. Nevertheless, spending still looks set to increase by more than 1% thanks to the supports underpinning household finances: a job market that is more flexible than in the past, families' accumulated wealth, an expected slowdown in financial burdens and the soundness of the banking system. This information is included in a report entitled *Consumption Watch* published by BBVA's Economic Research Department and presented today in Valencia by Mayte Ledo, Europe and Financial Scenarios Chief Economist, and Ana Rubio, Sectoral Chief Economist. BBVA Finanzia Chairman Gonzalo Toraño was also in attendance.

The new issue of the *Consumption Watch* report includes an analysis of the global and Spanish economic environment, with particular emphasis on trends in spending on durable goods. It examines the situation and outlook of the furniture industry, with a detailed analysis from a local standpoint of the factors shaping consumption in Valencia's economy.

The economic slowdown is intensifying

While previous reports indicated that the Spanish economy was in a cyclical downturn as of late 2007, we can now say that this trend has intensified. Three main factors are to blame.

First, the weakness in some drivers of the Spanish economy which started in early 2007, and in particular the exhaustion of trends which were difficult to sustain going forward, gave way to a soft cyclical downturn. In recent months, a spike in inflation caused by high prices for agricultural and energy raw materials has led to continual delays in expectations for interest-rate cuts in Europe, with forecasts now indicating that these could come at the end of the year, though these look increasingly uncertain.

Second, the financial crisis in international markets has undermined the global economic situation. The credit crunch has spread more than anticipated, pushing up financing costs throughout the economy and marking an end to the period of strong liquidity of years' past.

Finally, the Spanish residential real estate market is slower faster than would be expected judging by its fundamentals.

The slowdown in Spanish household consumption is accelerating

In this scenario, the slowdown in Spanish household consumption begun in the second half of 2005 has intensified, dragged lower by the performance of its main drivers.

On one hand, the growth in households' disposable income looks set continue slackening given the outlook for lower job growth, one of the main factors behind wage growth.

BBVA's Economic Research Department's employment forecasts indicate that after moderate growth in 2008, the job market will come to a halt in 2009.

In addition, growth in household wealth is slowing, due to slumping housing prices and declines in the value of financial assets.

Third, the financing conditions underlying households' access to credit continue to worsen amid higher-than-expected interest rates in two ways: a delay in cuts to key interest rates in Europe and wide spread levels deriving from the financial crisis and tougher financing conditions, as shown by bank loan surveys.

Finally, falling consumer confidence is another drain on spending.

There are still factors driving growth in household consumption

Due to the factors mentioned above, Spanish household consumption, which had already seen a moderate slowdown from more than 4% in 2004-2005 to 3.1% in 2007, should ease further to around 1.7% in 2008 and 1.2% in 2009. That said, this pace of growth is still higher than the increases registered in previous economic downturns. This underscores to the support factors benefiting Spanish households.

These include a job market that is more flexible than in the past, an expected easing of families' financial burdens, the wealth families have accumulated in recent years and the soundness of the Spanish banking system.

What's more, for the first time the Spanish economy is facing an economic slowdown with room to maneuver in fiscal policy. The measures adopted so far should have a limited impact on spending – adding only one or two percentage points -- but we do not rule out additional countercyclical measures which, in any event, must remain temporary and be well timed.

Demand for automobiles remains intact, but access to financing is improving, especially in 2009

In this environment, Spanish consumers appear to be postponing their purchases of new cars, while immigrants are buying fewer used vehicles. Vehicle registrations are expected to end this year down 11.8%, after peaking in 2004 and 2005. In any event, this decline relative to previous years should not go much deeper, as household accessibility lends support.

Indeed, our indicator of household access to auto financing (EFCA indicator) shows a slight improvement in 2008, followed by significant improvement in 2009. This is explained by the fact that household income is still growing, albeit at a more moderate pace, that car prices are being reined in and that, especially in 2009, cuts to key interest rate will facilitate access to financing.

Meanwhile, changes to the vehicle registration tax appear to be encouraging consumers to buy smaller, more environmentally-friendly cars.

The furniture industry: able to weather a complicated environment

This issue includes a focus on the furniture industry and Valencia's regional economy. In an article examining the furniture industry, researchers explain that despite the uncertainties stemming from the current economic environment, in which a slowdown in residential construction is a key issue for the performance of the furniture business, the industry is making changes that will allow it to better weather the situation. Admittedly, the sharp growth seen in the past decade is being threatened by international competition, especially from China, which is squeezing the market share of Spanish companies. However, the industry is wisely looking toward concentration, control over prices and hefty investments in gross fixed capital formation. This is beginning to bear fruit and will have to be monitored going forward.

Employment rates and a demographic shock are behind consumption growth in Valencia.

Finally, the report studies the economy of the autonomous community of Valencia, where the employment rate has been the main driver of real per-capita spending. Growth in population (largely from immigration) and an increase in appetite for spending among Valencians are behind the region's growth in consumption.