

IMPLOSIVE ECONOMY

The economic recession in Spain will reach abysmal proportions. Unemployment will explode, private consumption will severely contract over the first quarter and exports will also be in negative territories. Dwellings investment will be dramatically scaled down, continuing the trend of 2008, while productive investment will know a particularly sharp deterioration. The multiple packages of fiscal measures taken will marginally mitigate the risk of a national disaster. On a longer horizon, the possibility of a fiscal emergency cannot be discarded.

Much more unemployment and much less consumption

Unemployment rate is rising very rapidly and already by the end of January 200,000 more people joined the number of those in search of a job, for a total of 3.3 million. This represents an increase of 47% over the previous year and it is the consequence of a deterioration in all the sectors of the economy, with the construction sector in particularly bad shape. According to the Prime Minister, José Luis Rodríguez Zapatero, the last stimulus package approved at the end of 2008 should bring about 300,000 new jobs by the spring 2009. Yet, even if the numbers were true, they should be put into the perspective of monthly rises of unemployment of around 150,000 over the last quarter of 2008 and equal increases expected over the first semester of 2009. Unemployment rate, already at the highest level since 1996, could therefore reach 17% by the end of 2009.

Households spending will in turn retrench, with most of the contraction in private consumption to be expected over the first semester of 2009, while the significant moderation of consumer prices and the impact of the measures taken by the government should start to favour a slight recovery after the summer. Indeed, as far as prices are concerned, inflation will continue to fall at least as rapidly as it mounted over 2007. Already in December, inflation slowed to a 40-year low of 1.4%, almost 4pp down from the peak of July. We expect it to further fall over the first semester 2009 and to be slightly negative over the summer. To contribute to the high volatility of Spanish inflation is the high dependency of Spain on oil imports, which account for almost half of the domestic energy bill. Moreover, the dependency of Spanish growth over the last years on private demand also boosted the domestic CPI comparatively more than in other European countries and its significant contraction will also bring down inflation at a particularly fast pace. As far as investments are concerned, the scenario is particularly gloomy. Dwelling investments will continue to contract sharply: we forecast a contraction of almost 12% during 2009 and no recovery before 2011. These numbers will negatively contribute to the growth of domestic private investment, which will be considerably negative in 2009 (-9%) and it will pick up again only during 2010. Exports are also likely to subside, the recent data on intra-trade within the EU leaving very little hope of a contribution to growth coming from external demand. Yet imports will fall even more dramatically, leaving some rooms for a slightly positive net trade contribution. Overall, the Spanish economy should contract of 2.1% in 2009, a staggering 5.8pp fall within just two years.

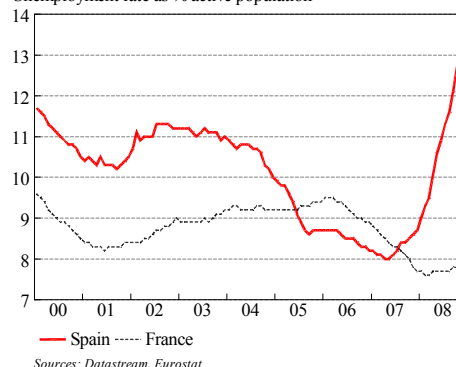
Mounting fiscal imbalances

Despite a relatively strong position in its public finances until the beginning of 2008, the Spanish fiscal position has deteriorated very rapidly and the country has transformed its last year surplus into a deficit which is likely to jump to much more than the current level, reaching peaks of 10% of GDP over the course of 2009. As a consequence, the public debt, comparatively low until last year, has already grown larger and it is set to further increase once the fiscal stimulus will be registered into the national accounting books. We expect it to be almost twice bigger than in 2007, reaching 55% of GDP by the end of 2009 (rescue of the banks included).

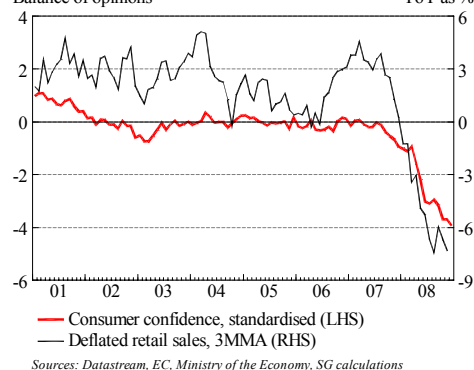
Growing fiscal imbalances, together with expectations of a sharp recession in 2009 and a weak recovery in 2010 (due to the lack of competitiveness of most of the Spanish manufacturing industry), are at the origin the recent S&P downgrade of the Spanish sovereign debt (from AAA to AA+) and of the spiking debt-servicing costs for the Spanish government: spreads of the 10-year Spanish bonds over the German ones have widened from 28bp in June 2008 to more than 114bp in January and they are likely to continue to widen over the coming months.

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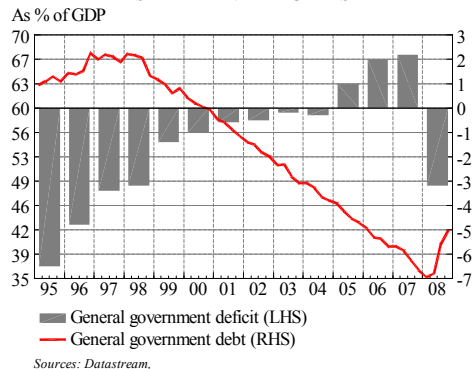
SOARING UNEMPLOYMENT
Unemployment rate as % active population



CONSUMER CONFIDENCE AT HISTORICAL LOWS
Balance of opinions YoY as %



PUBLIC DEBT WILL INCREASE THREE TIMES FASTER THAN IT DECREASED
As % of GDP



SPAIN

<i>% Change at annual rate, 2000 Prices</i>	2006	2007	2008(f)	2009(f)	2008 Q3	2008 Q4(f)	2009 Q1(f)	2009 Q2(f)
Private consumption	3.9	3.5	0.5	-2.2	-3.8	-3.2	-3.0	-2.0
Public consumption	4.6	4.9	5.4	6.8	8.6	8.0	7.0	6.0
Expenditure on capital goods	8.6	7.1	1.3	-6.9	-0.7	-7.8	-11.0	-9.2
Expenditure on construction	5.9	3.8	-4.5	-11.3	-13.3	-14.0	-16.0	-9.0
Total investment	7.1	5.3	-1.8	-9.2	-7.4	-11.0	-13.6	-9.1
<i>Contrib. of inventories to GDP growth</i>	0.2	-0.1	-0.1	-0.1	-0.1	-0.4	-0.3	0.0
Domestic demand (incl. inventories)	5.0	4.1	0.7	-2.5	-2.7	-3.7	-4.3	-2.3
Exports of goods and services	6.7	4.9	2.8	-3.9	3.6	-6.0	-6.5	-6.4
Imports of goods and services	10.3	6.2	0.9	-4.6	-3.3	-3.0	-6.5	-6.5
External trade contribution	-1.5	-0.8	0.4	0.5	2.1	-0.6	0.4	0.4
Gross Domestic Product (GDP)	3.9	3.7	1.1	-2.1	-1.0	-4.7	-4.1	-1.9
<i>% change year-on-year</i>	3.9	3.3	-0.9	-0.8	0.9	-0.9	-2.3	-2.9
Consumer prices (CPI)	3.6	2.8	4.1	0.7				
<i>% change year-on-year, end of period</i>	2.7	4.3	1.5	2.1				
Productivity per head	0.7	0.8	1.3	-0.9				
Compensation per head	3.1	3.6	5.2	5.0				
Unit wage costs	2.4	2.8	3.8	5.9				
Employment	4.1	3.1	-0.1	-0.5				
Unemployment rate	8.5	8.3	11.3	15.7				
Real Disposable income	3.6	2.5	2.0	1.9				
Household saving rate	11.1	10.2	11.6	15.0				

(National accounts adjusted to seasonal and calendar effects)

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