

July 10, 2009

Research Update:

Banco Popular Español Lowered To 'A' On Asset Quality Deterioration; 'A-1' Rating Affirmed; Outlook Negative

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Overview

- Spanish bank Popular's asset quality deterioration accelerated in first-quarter 2009, and we expect the weakening to remain pronounced over the coming quarters, albeit at a lower pace than in the first quarter, leading to high levels of problem assets.
- We are lowering our long-term rating on Popular to 'A' from 'A+' and affirming the 'A-1' short-term rating.
- The negative outlook reflects the possibility that, in the context of the current severe recession in Spain, continued meaningful worsening of Popular's asset quality could severely impair the bank's financial performance.

Rating Action

On July 10, 2009, Standard & Poor's Ratings Services lowered its long-term counterparty credit rating on Spain-based Banco Popular Español, S.A. (Popular) to 'A' from 'A+'. The outlook is negative.

At the same time, we affirmed the 'A-1' short-term rating on Popular.

Rationale

The downgrade reflects our expectation that Popular, as it faces Spain's economic recession, will accumulate a higher level of problem assets through the downturn than we anticipated when we last reviewed ratings on the bank on March 4, 2009. Our expectation stems from the reported sizable acceleration in Popular's new problem assets in first-quarter 2009 and the likelihood in our view that the bank will continue to have significant new problem assets, although possibly not accelerating, in the coming quarters.

We note that Popular's asset quality indicators weakened sharply in the first quarter of 2009, after an already meaningful deterioration in 2008. The bank's high real estate exposures continue to worsen considerably. In addition, Popular started to exhibit a more marked deterioration across all other loan portfolios in 2009, including its core small and midsize enterprise (SME) portfolio. We expect Popular's asset quality metrics (including nonperforming loans, repossessed assets, and other problem assets such as certain restructured loans) to continue deteriorating, albeit at a slower pace than in the last quarters, and reach comparatively weak levels amid the difficult economic environment and the still-adjusting real estate sector. We believe Popular's high customer concentration and exposure to vulnerable

debtors adds risks. Existing reserves (including still available generic loan loss reserves) and resilient operating profitability will likely help Popular cover expected losses from its deteriorating portfolio.

The ratings continue to reflect our view of Popular's sound franchise. As Spain's fifth-largest banking group, Popular shows adequate business and geographical diversification, but it is less diversified internationally than many other large universal domestic international banks.

We also factor into the ratings that--despite the bank's track record of a focused strategy--the credit deterioration Popular is experiencing evidences in our opinion a greater degree of aggressiveness than we anticipated. In this context and after several top management changes in the past few years, in our view management is confronting the challenge of seeing Popular through a rougher-than-expected downturn while preserving the bank's financial profile.

Popular's resilient revenue generation and excellent operating efficiency remain, in our opinion, its major financial strength. We consequently incorporate into the ratings our expectation that Popular's comparatively still-sound revenue generation stand to enable it to absorb significantly higher loan loss provisioning and, despite pressure on bottom-line returns, remain profitable through the downturn. We therefore also expect that Popular will likely maintain generally stable levels of capitalization.

We view Popular as having high systemic importance within the Spanish banking sector. Under Standard & Poor's criteria, we consider the Spanish authorities to be supportive rather than interventionist. Our ratings on Popular consequently include the soft benefits derived from being a bank in a regulated and supervised environment with access to extraordinary liquidity. The ratings on Popular reflect our opinion of its stand-alone credit profile and do not include any explicit uplift for extraordinary government support.

Outlook

The negative outlook reflects the possibility that, in the context of the current severe recession in Spain, continued meaningful worsening of Popular's asset quality could severely impair the bank's financial performance. At the current rating level, we expect Popular to be able to absorb the impact of a high level of problem assets through its existing reserves cushion and the provisioning charges to be recognized in 2009-2010. We also believe the bank should be able to report weaker but still reasonably positive results, and adequate capitalization. However, if we think that these expectations will not be met, and/or we foresee further acceleration of asset quality problems, we could downgrade Popular. In particular, signs of a deeper-than-anticipated downturn in 2010 and/or a continuation of the negative environment in 2011 could also pressure the ratings.

If financial stress leads us to consider a further downgrade of Popular, we would typically assess the potential for the state to provide the bank extraordinary support, and the extent to which we would incorporate it into the ratings. We anticipate that integrating explicit state support into the ratings on Popular could partly mitigate the negative impact of any further weakening in the bank's stand-alone credit profile.

We could revise the outlook to stable if, all other things being equal, Popular's asset quality deterioration abates significantly, performance throughout 2009 remains resilient, and we also foresee prospects of a milder-than-expected 2010.

Ratings List

Downgraded

	To	From
Banco Popular Espanol, S.A.		
Long-Term Counterparty Credit Rating	A/Negative	A+/Negative
Certificate Of Deposit	A/A-1	A+/A-1
BPE Capital International Ltd.		
Senior Unsecured (1 issue)*	A	A+
Subordinated (3 issues)*	A-	A
BPE Finance International Ltd.		
Senior Unsecured (4 issues)*	A	A+
BPE Financiaciones S.A.		
Senior Unsecured (6 issues)*	A	A+
Subordinated (2 issues)*	A-	A
Popular Capital Europe B.V.		
Subordinated (1 issue)*	A-	A
Popular Capital S.A.		
Preferred Stock (3 issues)*	BBB-	BBB
Popular Preference (Cayman) Ltd.		
Preference Stock (2 issues)*	BBB-	BBB

*Guaranteed by Banco Popular Espanol, S.A.

Ratings Affirmed

Banco Popular Espanol, S.A.	
Short-Term Counterparty Credit Rating	A-1
Commercial Paper	A-1

NB. This list does not include all ratings affected.

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