Moody's Investors Service

Global Credit Research
Rating Action
19 DEC 2008

Rating Action: Banco Popular Espanol, S.A.

Moody's downgrades Banco Popular Espanol to Aa2/B; negative outlook

Madrid, December 19, 2008 -- Moody's Investors Service today downgraded the long-term debt and deposit ratings of Banco Popular Español, S.A. (Banco Popular) to Aa2 from Aa1 and its bank financial strength rating (BFSR) to B from B+. Moody's also downgraded the bank's subordinated debt ratings to Aa3 from Aa2 and the ratings on preferred shares to A1 from Aa3. The short-term ratings were affirmed at Prime-1. All ratings have a negative outlook.

Moody's said that the downgrades of Banco Popular's ratings were prompted by the combination of the following factors:

(1) The bank's relatively high exposure to the real estate and construction sectors (measured as a percentage of its Tier 1 capital and its loan book), which is close to the median for lower-rated domestic banks. This is mitigated somewhat by the fact that around 50% of Banco Popular's exposure to these sectors relates, in terms of its large single borrowers, to construction companies for which either the company displays a more diversified business mix and/or Banco Popular's exposure to the company is unrelated to the real estate sector.

(2) The rapid deterioration in its asset quality indicators, as evidenced in the almost-threefold increase in problem loans reported as at end-September 2008 at 2.4% of gross loans, up from 0.85% as at end-September 2007.

The downgrade also takes into account Moody's expectation that credit trends for the Spanish banking system will remain negative across all asset classes. In this regard, Moody's noted that, although the bank's exposure to the real estate and construction sectors has been the main driver of the growth in its problem loans, the remaining asset classes, although also deteriorating, present a stronger performance which, in the case of mortgages to households which account for around 20% of the loan book, compares very favourably with rated peers.

Moody's added that Banco Popular enjoys sufficient regulatory capital ratios -- with core capital at 6.78% at end-September 2008, which compares favourably with domestic peers -- as well as close to EUR1,500 million generic loan loss provisions -- that would add an additional 150 basis points to core capital -- and healthy earnings growth that should help it to cushion the expected deterioration in its asset quality without undue risks to its solvency. More specifically, taking the above factors into consideration and applying a 25% provision requirement to the stock of problem loans, according to Moody's calculations, Banco Popular could absorb a 5.5 times increase in its existing problem loans and still maintain a sound core capital ratio above 6%. Any deviation from these estimates would likely lead to further downward rating pressure.

With regard to other financial fundamentals, in light of the ongoing liquidity constraints as the disruption in access to wholesale funding continues to affect banks worldwide, Moody's views positively the actions taken by Banco Popular's management to build up a sizeable liquidity buffer of ECB-eligible assets that ensures a positive net funding gap for the following 12 months if wholesale markets (including domestic CP, interbank and other market funds) remain closed for a period of 12 months.

Banco Popular's ratings also incorporate its high portion of recurring earnings with a low market risk appetite, a more granular loan book than the average for the system, and profitability and cost efficiency ratios above the average for Western European peers.

The negative outlook on Banco Popular's ratings reflects Moody's view of the pressures that are likely to arise in the event that the pace of deterioration in asset quality observed in the first three quarters of 2008 continues into 2009, which will considerably weaken its risk absorption capacity.

Banco Popular's Aa2/Prime-1 debt and deposit ratings incorporate Moody's assessment of a high likelihood of systemic support in case of need. As a result, these ratings enjoy a one-notch uplift from the bank's Aa3 baseline credit assessment (the measure of its standalone financial strength that maps from the B BFSR).

The following ratings were downgraded with a negative outlook:

Banco Popular Español, S.A.: bank financial strength rating to B from B+ and long-term deposits to Aa2 from

Aa1.

Popular Preference (Cayman) Limited: Preferred shares to A1 from Aa3.

Popular Capital, S.A.: Preferred shares to A1 from Aa3.

BPE Financiaciones, S.A. senior debt to Aa2 from Aa1 and subordinated debt to Aa3 from Aa2.

Popular Finance Europe BV: senior debt to Aa2 from Aa1

BPE Finance International Ltd: senior debt to Aa2 from Aa1

Popular Capital Europe BV: subordinated debt to Aa3 from Aa2.

BPE Capital International Ltd: subordinated debt to Aa3 from Aa2.

The following ratings were affirmed:

Banco Popular Español, S.A.: Short-term deposits and commercial paper at Prime-1.

Outlook changed to negative from stable:

Banco Popular Español, S.A.

Popular Preference (Cayman) Limited

Popular Capital, S.A

BPE Financiaciones, S.A.

Popular Finance Europe BV

BPE Finance International Ltd

Popular Capital Europe BV

BPE Capital International Ltd

The last rating action on Banco Popular was on 13 April 2007, as part of the application of Moody's Joint Default Analysis and updated bank financial strength rating (BFSR) methodologies. The BFSR was downgraded to B+ from A- and the debt rating was upgraded to Aa1 from Aa2.

The principal methodologies used in rating Banco Popular are the "Bank Financial Strength Ratings: Global Methodology" and "Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology", which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Rating Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory.

Banco Popular Español is headquartered in Madrid. At the end of September 2008, total assets amounted to EUR110 billion.

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