This annual report not only revises, for the fourth consecutive year, our classification of key emerging economies, but also improves on the EAGLEs methodology to achieve that goal. First, we incorporate virtually all emerging countries in the analysis (including frontier ones). Second, we use a more accurate definition of what is a developed market. Third, our benchmark for a country to be in the Nest group of the EAGLEs is now more stable.

After rethinking the EAGLEs concept and estimating potential growth for all of those countries, 7 countries remain being EAGLEs, namely China, India, Indonesia, Russia, Brazil, Turkey and Mexico (Korea and Taiwan are upgraded to developed economies). All EAGLEs outperform the G6 average threshold of contributing USD490bn to global growth in the next ten years. EAGLEs and Nest countries are expected to contribute 65% of global growth in the next ten years, led by China (30%) and India (11%), while the G7 group will add 19%.

Special topics
Factors behind portfolio flows in emerging markets
Updating our projections for the middle classes
Are EAGLEs and Nest countries ready for income transition?
Credit deepening
Trends in South-South trade and global value chains
## Index

**Summary**

- Key takeaways in 2013
- External environment improves
- Idiosyncratic factors gain weight in the emerging world

**2. Rethinking EAGLEs**
- Box 1. Improvements to the methodology

**3. New forecasts for the next ten years**
- 2014 membership update
- The global role of EAGLEs and Nest countries

**Special topics**

- Tapering and EM portfolio flows: Changing underlying forces with limited room to the downside
- Are EAGLEs and Nest countries ready for income transition?
- Different positions, different challenges
- Emerging countries’ credit deepening: In the search for a healthy credit path
- Trends in South-South trade and global value chains: Gravitating around the Asian factory

**Box 2. A dynamic factor model for portfolio flows**

**Box 3. An update on the growing middle class in the emerging world: The EM Middle-Class Revolution will accelerate**

**Box 4. The Pacific Alliance**

---

**Closing date: March 2014**
Summary

Fourth annual report of the Emerging and Growth Leading Emerging Economies (EAGLEs)

The emerging world appears to be facing a more challenging outlook, at least in the short term. Growth disappointed last year in most emerging countries, while market volatility increased. Capital flows were once again strongly influenced by the Fed’s Quantitative Easing (QE) exit strategy. The negative mood on emerging markets since the second half of 2013 has refocused investors on countries’ idiosyncratic factors, especially as regards macro vulnerabilities and political unrest.

We believe this refocus should be seen as a healthy development in so far as emerging markets will face more pressure to strengthen their economic policies. Growth will continue, unevenly among different countries according to their policies, as the economic recovery in the developed unfolds, supporting external demand.

The fact that the future is not predestined is very deep-rooted in the EAGLEs methodology, with countries’ growth prospects being scrutinised on a yearly basis. As countries which constitute the EAGLEs group need to contribute to global growth over and above a certain threshold.

Rethinking EAGLEs: key takeaways

We have revised our methodology to improve our metrics and thus adapt to a rapidly changing environment:

- We establish more accurate criteria to distinguish developed from emerging economies. In particular we adopt IMF’s criteria, which allow countries to be upgraded from emerging into developed economies. This is the case of Korea and Taiwan, which have been EAGLEs since the first ranking in 2010 and now form part of the developed group.
- To be more homogeneous we now include all emerging economies in the sample of candidates countries belonging to EAGLEs and Nest groups, dropping previous discretionary premises (until now we had been excluding both frontier markets and those with international sanctions).
- We have established a new threshold for the Nest group. Being previously based on the projections of a single G6 country, namely the one with the smallest contribution to global growth, the threshold was very sensitive to the forecasts of one single country and, therefore, very volatile. We have now opted for the average contribution of non-G7 developed countries with a GDP of over USD100bn PPP-adjusted in 2013.

New membership

As a result of these changes and the update of trend and potential growth in the next 10 years, the new membership lists are:

- The EAGLEs group shrinks from 9 to 7 countries. China, India, Indonesia, Russia, Brazil, Turkey and Mexico remain members of the EAGLEs group. Korea and Taiwan are no longer eligible for the EAGLEs and Nest groups as they are now rated as developed economies.
- The Nest group widens from 14 to 19 countries and is even more geographically diverse with 5 incoming countries: Saudi Arabia, Iraq, Iran, Kazakhstan and Qatar. All members from last year remain: Nigeria, Thailand, Colombia, the Philippines, Malaysia, Vietnam, Pakistan, Bangladesh, Poland, Egypt, Peru, South Africa, Chile and Argentina.
- The EAGLEs and Nest countries together will contribute 65% of global growth during the next ten years. China will continue to contribute much more than any other country in the world (30%) followed by India (11%), which is pretty similar to the contribution of the US, a country more than three times larger.
Special topics
In addition to the membership update, in the final sections of this Fourth Annual Report we analyse a number of key issues for emerging markets in the current juncture:

1. Tapering and Emerging Markets portfolio flows: Changing underlying forces with limited room to the downside

Monetary policy and more recently exit strategies of the Fed's QE have been behind the various waves of risk-on/off sentiment in financial markets. While this global "push" factor has been the dominating force driving capital flows to Emerging Markets (EMs) during the last two years, the announcement of the tapering is propelling a more intense role for local "pull" factors. Beyond this, the correction of the excess of capital inflows to EMs, as helpful as it might be to reset some too risk prone investments and to provide an incentive to good economic policies, has been pretty sharp leaving limited space for an additional downside.

2. An update on the growing middle class in the emerging world: The EM Middle-Class revolution will accelerate

We expect one billion people in EAGLEs and Nest countries to leave behind their poor and low-income status by 2025. In the same vein near 1350 million people from Eagles and Nest will join the EM middle classes during the next decade. Beyond this, new 195 million people will become rich in an accelerated trend compared to the previous decade. China and India will be by far the main drivers of these trends.

3. Are EAGLEs and Nest countries ready for income transition?: Different positions, different challenges

Emerging countries share a promising future under strong growth and rapid income transition, but their hurdles and needs are diverse, being their economies at different stages of development. In this section we assess the readiness of EAGLEs and Nest countries to face these challenges. Different positions, different challenges.

4. Emerging countries’ credit deepening: In the search for a healthy credit path

"Credit deepening": extra-loose monetary policies and exit strategies in the developed world have increased concerns about how sustainable credit growth might be in emerging countries. In turn, insufficient financial penetration could eventually become a hurdle for growth. In this section we present our measure of how healthy credit growth is in EAGLEs and Nest countries.

5. Trends in South-South trade and global value chains: Gravitating around the Asian factory

Trade flows between emerging economies have quadrupled in the last 15 years on rapid economic growth, trade liberalisation, the fragmentation of production and specialisation patterns. This pattern will be reinforced by bilateral trade agreements and strategic alliances (i.e. Pacific Alliance). China has clearly changed the global picture of Global Value Chains (GVC) supporting the Asian countries integration in South-South trade, increasing the trade sensitivity to output during recessions but limiting the effects of real exchange rates.
1. Key takeaways in 2013

External environment improves

Growth in developed economies remained soft in 2013 but gained traction throughout the year, especially in the second half (Figure 1.1). The G7 average for manufacturing PMIs returned to above the expansionary threshold in June and maintained an upward trend thereafter (with the noticeable exception of France), showing in most cases their record highs since 1Q11. In contrast, activity in emerging economies lost momentum in 2013, posting a significant slowdown in the first half of the year, which, with the exception of Turkey among the EAGLEs, was not completely offset by the recovery since the end of the summer.

One of the most salient features for the emerging world in 2013 is that, as a result of the improving outlook in the US, the Federal Reserve started to unwind monetary stimuli, reducing the amount of assets it purchases through the QE3 programme (the so-called tapering). Unemployment rates in the US remain in a downward trend and the deleveraging process appears to be generally concluded, anticipating further reductions in liquidity injections. As shown later on in the fourth section, this process is having a significant impact on portfolio flows to emerging markets.

Some economic policy developments help to explain why the outlook for developed economies improved last year:

- General elections in Japan at the end of 2012 brought not only a change of Prime Minister (Shinzo Abe) but also a complete revision of economic policies (“Abenomics”), implementing a set of front-loaded measures to boost activity since the beginning of the year.

- The ECB’s commitment to the Eurozone in 2012 was reinforced last year by the agreement on the roadmap towards a banking union. Tail risks have diminished significantly and peripheral sovereign spreads have narrowed considerably. At the end of the year, Ireland returned to the markets while Spain exited its banking sector rescue package.

- Fiscal issues were again at centre-stage in the US. After the fiscal cliff was averted in January, political confrontation reigned during the summer. This time brinkmanship went so far that the country faced an administrative shutdown in October, which implied renewed downward pressures on the sovereign rating. However, the situation took a surprising turn for the better, and a budget deal was signed in December.
Idiosyncratic factors gain weight in the emerging world

Among emerging countries, only the Philippines surprised to the upside in 2013, while the vast majority of economies recorded lower GDP growth than expected at the beginning of last year (Figure 1.2). Downward revisions have been generally softer for Asian economies than for other regions (0.4pp on average vs. 1pp respectively), although India is one of the markets with the largest negative adjustments, together with Russia, Mexico and Brazil.

As a result of these disappointing figures, there are now renewed concerns over growth sustainability in emerging economies. Two are the main factors driving this uncertainty after a period of abundant external liquidity:

- The Fed’s exit strategy: portfolio flows and market valuations in emerging countries have shown a high degree of sensitivity to speculation and action on the Fed’s QE programme (see fourth section for details).

- Reform momentum: concerns here cover a wide range of structural challenges, from avoiding bottlenecks due to rapid growth to generating new growth sources under a decreasing population premium and/or averting social unrest.

As we have highlighted in other reports, macroeconomic vulnerabilities are today much lower in general terms than in previous crises. In fact, the sovereign rating upgrade cycle continued in 2013, with Mexico, Turkey, Colombia, Peru and the Philippines improving one notch on average for the three main agencies.

However, as idiosyncratic factors become more important, complacency is no longer a valid growth policy and how different countries respond to challenges will be crucial (see fifth section for details). Although the final impact remains to be seen, some countries have already been proactive in tackling these challenges, such as the long-awaited reforms in Mexico (affecting energy, fiscal and education issues) or the comprehensive reform package presented in China at the Third Plenary Session of the 18th Communist Party Congress.

Episodes of unrest were limited in 2013, with the most serious being the military coup in Egypt. The social and political situation will be more centre-stage this year, with elections in many emerging countries, including Brazil, India, Indonesia and Turkey. Attention will be also on relations between Iran and the West since the lifting of some sanctions, as well as on potential spillovers from tensions in Ukraine.
2. Rethinking EAGLEs

The EAGLEs concept was born in 2010 in search of giving transparency, flexibility and dynamism to the identification of the most relevant economies in the emerging world.

Our goal was to identify which emerging economies would be contributing more to world growth in the next ten years than the largest developed economies, i.e. the G7 countries. For the EAGLEs threshold we excluded the US due to its extraordinary size, while we set the G6 member with the smallest contribution as the Nest threshold.

According to initial criteria, 45 emerging markets were selected as potential candidates to become EAGLEs or belong to the Nest group. Exclusion of other non-advanced countries was founded on discretionary premises like their consideration as frontier markets or under extremely adverse domestic conditions such as war or international embargoes.

At this point, making the most of dialogue with followers of the EAGLEs project, we have decided to introduce three adjustments to our methodology (Figure 2.1 and Box 1 for details).

Two of these changes affect the sample of countries included in the analysis, reducing even more discretion and increasing transparency:

- We have adopted the IMF classification to distinguish emerging from developed economies.
- We now include all emerging economies in the sample of potential members of the EAGLEs and Nest groups, dropping the previous discretionary premises mentioned above.

The third adjustment establishes a new threshold for the Nest group:

- In order to avoid sensitivity to forecasts of only one country, and have a more stable threshold we adopt a broader benchmark: non-G7 developed economies with GDP of over USD100bn PPP-adjusted in 2013.

We consider that these changes do not modify the underlying philosophy of the EAGLEs concept. In fact, we believe that the adjustments reinforce our dynamic approach, improving our metrics and adapting them to a rapidly-changing environment.

---

**Figure 2.1**

**Adjustments to our methodology**

<table>
<thead>
<tr>
<th>Definition of emerging economies</th>
<th>Before</th>
<th>Now</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sort of consensus from different sources</td>
<td></td>
<td>IMF criteria and groupings</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sample of potential members</th>
<th>Before</th>
<th>Now</th>
</tr>
</thead>
<tbody>
<tr>
<td>45 countries; discretionary exclusion</td>
<td>All emerging economies</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Nest threshold</th>
<th>Before</th>
<th>Now</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lowest contribution of a G6 economy</td>
<td>Average contribution of non-G7 developed economies with GDP &gt; USD 100bn</td>
<td></td>
</tr>
</tbody>
</table>

Source: BBVA Research
Box 1. Improvements to the methodology

Criteria to define the condition of a country as emerging economy

We now reference our sample of emerging countries to the IMF grouping of emerging and developing economies included in the World Economic Outlook. We choose this classification as provided by an international organisation, leaving aside considerations by private institutions such as investment banks (or ourselves). In addition, the choice of the IMF is consistent with the use of their projections for those countries we do not cover in depth at BBVA Research.

We present below the criteria as stated by the IMF itself:

"The main criteria used by the WEO to classify the world into advanced economies and emerging market and developing economies are (1) per capita income level, (2) export diversification—so oil exporters that have high per capita GDP would not make the advanced classification because around 70% of its exports are oil, and (3) degree of integration into the global financial system. In the first criteria, we look at an average over a number of years given that volatility (due to say oil production) can have a marked year-to-year effect. Note, however, that these are not the only factors considered in deciding the classification of countries".

"This classification is not based on strict criteria, economic or otherwise, and it has evolved over time. The objective is to facilitate analysis by providing a reasonably meaningful method of organizing data. Reclassification only happens when something marked changes or the case for change becomes overwhelming. For example, Malta joining the euro area was a significant change in circumstances that warranted a reclassification from an emerging market and developing economy to an advanced economy".

"Some countries remain outside the country classification and therefore are not included in the analysis. Anguilla, Cuba, the Democratic People's Republic of Korea, and Montserrat are examples of countries that are not IMF members, and their economies therefore are not monitored by the IMF. Somalia is omitted from the emerging market and developing economies group composites because of data limitations".

The most important implication of adopting these criteria is that we have dropped Korea and Taiwan from the list of candidates. Both countries have been members of the EAGLEs since the beginning of the project. In addition, three economies in Eastern Europe have been reclassified as developed markets: the Czech Republic, Estonia and the Slovak Republic (the last two already members of the European Monetary Union).

Set of emerging countries included in the sample of candidates

In order to be fully consistent with our goal of transparency we have widened the sample of emerging economies to include all countries that comply with the above-mentioned IMF definition, regardless of their domestic conditions.

This adjustment results in the inclusion in the set of candidates of some significant economies which have been excluded in previous EAGLEs Annual Reports:

- Previously considered frontier markets, most of which are commodity producers, such as Saudi Arabia and Kazakhstan.
- Countries under extremely adverse domestic conditions. This has been the case of Iraq and Iran. Saudi Arabia, Iraq and Iran last year met the eligibility criteria to be part of the Nest group, while Kazakhstan was very close to the threshold.

A new benchmark and threshold for the Nest group

Since 2010, the eligibility criteria for membership of the Nest group was to be an emerging economy contributing less to world growth in the next ten years than the G6 average but more than the G6 market making the smallest contribution, which has been always Italy throughout this period.

We have observed that this benchmark brings high sensitivity to forecasts of only one country, and particularly one with expected low growth.

For these reasons we consider it more appropriate to take a group of economies as a reference, as in the case of the EAGLEs threshold. We wanted to set a benchmark of developed countries with a smaller size than the G6 although big enough to be meaningful markets.

This group corresponds to those non-G7 developed economies under the IMF definition which today have GDP of over USD100bn PPP-adjusted:

- Ranked from largest to smallest: Korea, Spain, Australia, Taiwan, the Netherlands, Belgium, Sweden, Hong Kong, Switzerland, Austria, Singapore, Czech Republic, Greece, Norway, Israel, Portugal, Denmark, Finland, Ireland, New Zealand and Slovakia.
- We exclude the following developed countries as they do not reach the USD100bn threshold: Slovenia, Luxembourg, Estonia, Cyprus, Iceland, Malta and San Marino.
3. New forecasts for the next ten years

2014 membership update

As a result of adjustments to the methodology previously explained, selection criteria applied in the 2014 update are as follows:

- For each country in the world we calculate the change in real GDP between 2013 and 2023 in PPP-adjusted 2013 USD. We use the IMF/WEO projections for countries for which we do not make projections and extrapolate their 2018 growth rates to 2023.

- Once we have ranked estimations according to the expected change in GDP, we select countries from those rated as emerging economies by the IMF:
  - The EAGLES are defined as those emerging economies contributing more than the average of the G6 countries to world growth in the next ten years.
  - The Nest group is formed by those emerging economies contributing less than the average of the G6 countries to world growth in the next ten years but more than the average of non-G7 developed countries with GDP of over USD100bn PPP-adjusted.

According to these criteria, these are the most relevant facts of the 2014 update (Figure 3.1):

- China, India, Indonesia, Russia, Brazil, Turkey and Mexico remain as solid members of the EAGLEs group, with contributions to world growth comfortably above the G6 threshold.

- Korea and Taiwan are dropped from the EAGLEs as they are both now considered developed economies.

- The number of countries in the Nest group increases from 14 to 19 due to both the extension of the sample and to the lower threshold:
  - All members from last year remain in the group: Nigeria, Thailand, Colombia, the Philippines, Malaysia, Vietnam, Pakistan, Bangladesh, Poland, Egypt, Peru, South Africa, Chile and Argentina.
  - Geographical diversification widens further with new members, now including markets in Western Asia and the Middle East: Saudi Arabia, Iraq, Iran, Kazakhstan and Qatar.

Figure 3.1
EAGLEs and Nest members in 2014

Source: BBVA Research
The global role of EAGLEs and Nest countries

Emerging economies have gained share in global GDP at a fast pace since the beginning of this century. This trend is expected to continue in the next ten years, reinforcing shifting economic forces around the world (Figures 3.3 and Table 3.1):

- Emerging markets will explain 73% of global growth between 2013 and 2023, with EAGLEs contributing up to 51%, the Nest group close to 14% and other emerging countries another 8%.

- Developed countries will account for 27% of the increase in world GDP in the next ten years; the largest contribution corresponds to the US (12%), clearly surpassing those from the G6 economies (7%) and non-G7 markets (8%).

The following developments are worth highlighting for the EAGLEs group:

- A general downward revision to expected growth in the next ten years (Figure 3.2):
  - China is heading to lower growth figures as a result of economic rebalancing, population aging and a rapid development progress.
  - Brazil and India suffer the largest downward correction in the long term, raising concerns over reform momentum. In contrast, odds are on the rise for a significant upgrade in potential growth for Mexico.
  - Negative revisions for Russia and Indonesia are concentrated on headwinds in the short and medium term. The same applies to Turkey, although fully offset by better long-term projections; average growth remains then relatively constant for Turkey.

- However, the share of EAGLEs in global growth is not substantially altered:
  - Despite the expected slowdown, China and India play in another league and will contribute respectively 30% and 11% to global growth between 2013 and 2023. Their rapid growth is behind the boom of the middle classes in the emerging world (see Box 3 in fifth section for details).
  - Indonesia, Russia and Brazil will contribute more than any developed country except the US. As the outlook for Brazil is deteriorating faster than is the case for Russia, the latter has recouped fourth position in the EAGLEs ranking.
  - Turkey will add more to the increase of world GDP than Germany despite being around a third of its size at present.
  - Mexico will contribute more than the UK, France and Italy.

---

Source: BBVA Research, IMF*
In the case of the Nest group, these are the main takeaways of the 2014 update:

- **New member Saudi Arabia ranks at the top and very close to the EAGLEs threshold.** Egypt, which was an EAGLE until 2012, held this position last year, but political turbulence is driving a further deterioration of its economic outlook.

- **Nigeria, Thailand and Colombia show contributions to global growth comparable to those from large developed economies** like France or Spain.

- **The Philippines and Pakistan improve their growth outlook and gain positions in the ranking**, sharing a sort of “middle-class” group with Malaysia, Vietnam, Bangladesh and Poland.

- **Argentina and South Africa move down in the ranking** on lower growth projections and will now contribute less than Italy, our previous Nest benchmark.

- **Despite downward revisions, new member Iraq is the fastest-growing country among EAGLEs and Nest groups.** In contrast, its much larger neighbour Iran shows one of the lowest growth rates, although it could climb in the rankings if the international embargo is fully lifted; in fact, Iran was above the EAGLE threshold in 2012.
• Nest membership of small countries relies on high growth rates and is therefore highly sensitive to outlook changes. This is the case of Iraq, Vietnam, Bangladesh, Peru, Chile, Kazakhstan and Qatar.

Finally, we would like to highlight once again the regional shift in the global economic powerhouse from the Atlantic to the Pacific area (Figure 3.4):

• Global growth will be concentrated in the Asia-Pacific region, which will account for more than 75% of the increase in GDP between 2013 and 2023. Emerging Asia, the US and Latin America will be the key players.

• Western Europe progressively moves out of the crisis, but its contribution to global growth will remain limited (7%), slightly above that of Eastern Europe (6%).

• Africa and Middle East are the only emerging regions to improve their relative performance in the next ten years; commodity producers are increasing their relevance as a part of global value-chains, headquartered mainly in China.

Figure 3.4
Contribution of regions to world growth in the next ten years (%)
Table 3.1
Contribution to world growth 2013-23

<table>
<thead>
<tr>
<th>Country</th>
<th>2013</th>
<th>2023</th>
<th>2013-23 change</th>
<th>Ann. avg. (%)</th>
<th>2013-23 change</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>13,401</td>
<td>25,992</td>
<td>12,591</td>
<td>30.3</td>
<td>6.8</td>
</tr>
<tr>
<td>India</td>
<td>5,010</td>
<td>9,762</td>
<td>4,751</td>
<td>11.4</td>
<td>6.9</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1,292</td>
<td>2,394</td>
<td>1,102</td>
<td>2.7</td>
<td>6.4</td>
</tr>
<tr>
<td>Russia</td>
<td>2,561</td>
<td>3,398</td>
<td>837</td>
<td>2.0</td>
<td>2.9</td>
</tr>
<tr>
<td>Brazil</td>
<td>2,417</td>
<td>3,185</td>
<td>768</td>
<td>1.9</td>
<td>2.8</td>
</tr>
<tr>
<td>Turkey</td>
<td>1,170</td>
<td>1,831</td>
<td>661</td>
<td>1.6</td>
<td>4.6</td>
</tr>
<tr>
<td>Mexico</td>
<td>1,847</td>
<td>2,463</td>
<td>616</td>
<td>1.5</td>
<td>2.9</td>
</tr>
<tr>
<td>G6</td>
<td>2,658</td>
<td>3,148</td>
<td>490</td>
<td>1.2</td>
<td>1.7</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Nest</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Saudi Arabia</td>
<td>929</td>
<td>1,413</td>
<td>485</td>
<td>1.2</td>
<td>4.3</td>
</tr>
<tr>
<td>Nigeria</td>
<td>479</td>
<td>919</td>
<td>440</td>
<td>1.1</td>
<td>6.7</td>
</tr>
<tr>
<td>Thailand</td>
<td>673</td>
<td>1,092</td>
<td>419</td>
<td>1.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Colombia</td>
<td>525</td>
<td>893</td>
<td>368</td>
<td>0.9</td>
<td>5.4</td>
</tr>
<tr>
<td>The Philippines</td>
<td>456</td>
<td>791</td>
<td>335</td>
<td>0.8</td>
<td>5.7</td>
</tr>
<tr>
<td>Malaysia</td>
<td>526</td>
<td>857</td>
<td>331</td>
<td>0.8</td>
<td>5.0</td>
</tr>
<tr>
<td>Iraq</td>
<td>248</td>
<td>577</td>
<td>329</td>
<td>0.8</td>
<td>8.8</td>
</tr>
<tr>
<td>Vietnam</td>
<td>360</td>
<td>685</td>
<td>325</td>
<td>0.8</td>
<td>6.6</td>
</tr>
<tr>
<td>Pakistan</td>
<td>575</td>
<td>886</td>
<td>311</td>
<td>0.8</td>
<td>4.4</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>325</td>
<td>629</td>
<td>304</td>
<td>0.7</td>
<td>6.8</td>
</tr>
<tr>
<td>Poland</td>
<td>815</td>
<td>1,118</td>
<td>303</td>
<td>0.7</td>
<td>3.2</td>
</tr>
<tr>
<td>Egypt</td>
<td>552</td>
<td>808</td>
<td>256</td>
<td>0.6</td>
<td>3.9</td>
</tr>
<tr>
<td>Iran</td>
<td>988</td>
<td>1,228</td>
<td>240</td>
<td>0.6</td>
<td>2.2</td>
</tr>
<tr>
<td>Peru</td>
<td>344</td>
<td>582</td>
<td>238</td>
<td>0.6</td>
<td>5.4</td>
</tr>
<tr>
<td>South Africa</td>
<td>595</td>
<td>831</td>
<td>236</td>
<td>0.6</td>
<td>3.4</td>
</tr>
<tr>
<td>Chile</td>
<td>334</td>
<td>525</td>
<td>191</td>
<td>0.5</td>
<td>4.6</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>244</td>
<td>417</td>
<td>173</td>
<td>0.4</td>
<td>5.5</td>
</tr>
<tr>
<td>Qatar</td>
<td>198</td>
<td>368</td>
<td>170</td>
<td>0.4</td>
<td>6.4</td>
</tr>
<tr>
<td>Argentina</td>
<td>761</td>
<td>927</td>
<td>166</td>
<td>0.4</td>
<td>2.0</td>
</tr>
<tr>
<td>Nest threshold</td>
<td>485</td>
<td>641</td>
<td>157</td>
<td>0.4</td>
<td>2.8</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Groups</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>EAGLEs</td>
<td>27,698</td>
<td>49,025</td>
<td>21,327</td>
<td>51.4</td>
<td>5.9</td>
</tr>
<tr>
<td>Nest</td>
<td>9,927</td>
<td>15,547</td>
<td>5,619</td>
<td>13.5</td>
<td>4.6</td>
</tr>
<tr>
<td>Other EMs</td>
<td>6,291</td>
<td>9,747</td>
<td>3,456</td>
<td>8.3</td>
<td>4.5</td>
</tr>
<tr>
<td>G7</td>
<td>32,747</td>
<td>40,517</td>
<td>7,770</td>
<td>18.7</td>
<td>2.2</td>
</tr>
<tr>
<td>US</td>
<td>16,799</td>
<td>21,630</td>
<td>4,831</td>
<td>11.6</td>
<td>2.6</td>
</tr>
<tr>
<td>G6</td>
<td>15,948</td>
<td>18,888</td>
<td>2,939</td>
<td>7.1</td>
<td>1.7</td>
</tr>
<tr>
<td>Other DMs</td>
<td>10,355</td>
<td>13,687</td>
<td>3,331</td>
<td>8.0</td>
<td>2.8</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Regions</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>18,320</td>
<td>23,488</td>
<td>5,168</td>
<td>12.5</td>
<td>2.5</td>
</tr>
<tr>
<td>Latin America</td>
<td>7,488</td>
<td>10,351</td>
<td>2,863</td>
<td>6.9</td>
<td>3.3</td>
</tr>
<tr>
<td>Africa</td>
<td>3,523</td>
<td>5,902</td>
<td>2,378</td>
<td>5.7</td>
<td>5.3</td>
</tr>
<tr>
<td>Middle East</td>
<td>3,515</td>
<td>5,226</td>
<td>1,712</td>
<td>4.1</td>
<td>4.0</td>
</tr>
<tr>
<td>Western Europe</td>
<td>14,557</td>
<td>17,527</td>
<td>2,970</td>
<td>7.2</td>
<td>1.9</td>
</tr>
<tr>
<td>Eastern Europe</td>
<td>6,919</td>
<td>9,488</td>
<td>2,569</td>
<td>6.2</td>
<td>3.2</td>
</tr>
<tr>
<td>Asia exJapan</td>
<td>26,803</td>
<td>49,509</td>
<td>22,706</td>
<td>54.7</td>
<td>6.3</td>
</tr>
<tr>
<td>Japan</td>
<td>4,722</td>
<td>5,411</td>
<td>688</td>
<td>1.7</td>
<td>1.4</td>
</tr>
<tr>
<td>Oceania</td>
<td>1,173</td>
<td>1,623</td>
<td>450</td>
<td>1.1</td>
<td>3.3</td>
</tr>
</tbody>
</table>

| World     | 87,019| 128,523| 41,504         | 100.0         | 4.0            |

*Assuming exchange rates move against USD move according to inflation differential with the US.
**Assuming constant exchange rates against USD.
*G7 = Emerging Markets; DMs = Developed Markets; Nest threshold = the average contribution of non-G7 developed economies with a GDP over USD100bn PPP-adjusted in 2013.
Source: BBVA Research, IMF
Special topics

4. Tapering and EM portfolio flows: Changing underlying forces with limited room to the downside

Portfolio flows across Emerging Markets (EMs) have been particularly volatile over the past few years. Financial distress at the beginning of the crisis was followed by monetary policy reactions in developed economies and emerging countries triggering global push and local pull forces favourable for flow dynamics across EMs. Subsequent actions and discussion over the exit strategies of central banks in developed economies - particularly the Fed - were behind the various waves of risk-on/risk-off sentiment in financial markets, and as a consequence portfolio flows in EMs were navigating according to changes in sentiment. In what follows we will review the recent movements in capital flows leveraging on the conclusion extracted from our analysis.

The years of excess

From July 2012 to May 2013, a risk-on sentiment dominated among Developed Markets (DMs) following the famous speech by Mario Draghi and the Fed’s announcement of QE3, while EMs were experiencing times of historically low vulnerability readings. These supporting push and pull factors led to strong and sustained flows into emerging markets, strong currency appreciations, excess equity returns and historically low EM risk premiums across the board.

This behaviour drove excess investment into EMs of about USD225bn (Figures 4.1 and 4.2). We estimate that c.65% of these flows were allocated into fixed-income assets and the rest into equities. According to our estimations, retail investors were responsible for 75% of the total and we believe that global push factors linked to the general risk-on sentiment in financial markets were the main drivers of these inflows (representing c.60%).

---

The tapering episodes

The announcement of the normalisation of monetary stimuli in line with the modest recovery in the US and other developed countries - especially with the Fed’s QE3 tapering on 22 May - reduced the relative appeal of EMs by reducing the interest rate differential and changing relative risk premiums vis-à-vis EMs. This triggered a sudden portfolio rebalancing in favour of DMs, with a bias towards under-priced European assets. The rebalancing was a natural hedge in a context of changing global forces. In fact, by the end of 2Q13, equity prices and bond spreads in EMs reached levels of the previous crisis, while global portfolios rebalanced away from EMs at a pace only seen during the Lehman episode (Figure 4.4).

The correction was primarily driven by overreacting retail investors prone to herd behaviour, who clearly misunderstood the message from Fed officials. Institutional investors sold EM assets mainly in the most important and liquid markets, such as Brazil, Mexico, Turkey and Russia but were not responsible of the sell-off as their portfolio allocation was better aligned to equilibrium levels in EMs.

There were three factors behind the sell-off: (i) the “uncertainty” about the Fed’s exit strategy; (ii) the slowdown and additional worsening expectations of EM growth; and (iii) margin calls prompting portfolio managers to sell the key countries in the main EM indexes in their global portfolios, without discriminating between countries.

As mentioned before, global push factors were losing steam while regional EM pull factors and strengths were challenged (Figure 4.3). According to our models, c.65% of the correction was due to global push factors while the rest was attributable to relatively less benign pull factors towards the EM region.

As a result, by 3Q13, 65% (c.USD150bn) of the above-mentioned excess had been corrected. Retail investor disposals of EM securities represented c.65% of the total correction as they had incurred the largest excess.

Once the news of the tapering was fully priced-in by financial markets and the communication channels of central banks in developed countries had been tuned up, institutional investors started to restructure their portfolios, discriminating according to the relative soundness of individual emerging markets. A flight to quality among EMs was in place and as such exchange rate, equity and risk premium corrections diverged among EMs. The severity of net flow dynamics away from these countries differed accordingly (see Figure 4.2).
Thus from mid-3Q13 up to February 2014, idiosyncratic factors seemed to be dominating capital flows. In fact, from mid-3Q13 up to the end of the year there was an additional adjustment to EMs' balance sheet of c.USD80bn; only c.30% of this figure was due to global/regional factors, highlighting the increasing leverage of capital flows onto idiosyncratic forces. Retail investors were once again behind the bulk of the adjustment (90% of the total correction).

New challenges ahead

Portfolio reallocation continued at a rapid pace in 1Q14, driving the correction of previous excesses into the undershooting area. We estimate that cumulative EM flows could now be around 17% below equilibrium but the undershooting has been uneven across countries, ranging from 45% in Brazil and a 25% in Russia to a still modest overshoot in Mexico or Turkey, which were the top outperformers in the accumulation period.

This latest trend is in part a legacy of the above-mentioned market discrimination, uncertainty about elections in large emerging markets (Turkey, Brazil, India and Indonesia), but also the result of global/regional factors resurfacing due to the colliding of scattered tensions in various emerging EMs (Ukraine and Russia) which have triggered a re-acceleration of capital outflows. We estimate that this episode (Ukraine-Russia) is liable of c.65% of the correction experienced since mid-February.

The duration and severity of the current undershooting will again depend on the forces in place. This will rely not only on the nature of the investor and the excess accumulated so far, but also on the underlying drivers. As shown in Figure 4.5, shocks to global factors such as from increased risk aversion or hikes in the global cost of capital are severe but usually last no longer than a month, while shocks to local idiosyncratic factors are less severe but tend to last four times as long. Speculating which factors will dominate from now on (all other things being equal) may help to anticipate the length and severity of this excess correction (Figure 4.6).
Box 2. A Dynamic Factor Model for Portfolio Flows

We use a version of a dynamic linear model. Our set-up comprises a measurement equation block (1) and a state equation block (2).

1. $Y(t) = c(t)X(t) + V(t)$ \quad $V(t) \sim \text{i.i.d.}$
2. $X(t)=A(t)\times X(t-1) + Z(t)+F(t)W(t)$ \quad $W(t) \sim \text{i.i.d.}$

Together they build a so-called State Space Model. In this, the measurement equation block relates an observable variable ($Y$) to unobservable states or latent factors. The state equation block (2) allows for time dynamics of the above-mentioned latent factors so that the estimated states may evolve through time and may allow predictions of the measurement equation recursively. The procedure uses typically a Kalman Filter approach and Maximum Likelihood estimation.

In our model, in the measurement block (1) $Y$ is a matrix of $n$ capital flows. These flows are related to a number $m<n$ of unobservable estates or latent factors ($X$). The relation between $Y$ and $X$ relies on the specification of (C) which renders the final shape of the latent factors.

In our analysis we estimate country flows (relative to assets) as the outcome of three factors: a global factor, an EM factor and an idiosyncratic factor. The global factor bodes well with global push forces such as excess liquidity, global risk aversion, or Fed fund expectations. The EM factor has to do with regional specific forces for emerging markets not included in the global variables. The idiosyncratic factor is related to local pull factors such as rate differentials.

Following the model dynamics we forecast these factors recursively so as to obtain forecast values of our capital flows.

At this stage of the model, we only exploit the MA structure of the state equation block. While this is advisable for computational reasons, it does not allow gathering richer time dynamics between factors or fetching additional information beyond that included in the country flows themselves (there is no $Z$ in our model). For this reason the forecast ability of the model might be limited to the very short term. However since we use data at fairly high frequency (weekly flows), we remain confident in our forecast one month ahead.

This approach is consistent with previous work analysing underlying factors behind country flows, such as Fratzscher (2001), Miao and Pant (2012) and Lundblad and Ramadorai (2011). More recently, the IMF’s Pilot External Report has introduced a new framework in which capital flows rely on structural and temporary factors very similar to those in our model.
5. Are EAGLEs and Nest countries ready for income transition? Different positions, different challenges

The annual update of EAGLEs and Nest groups presented in the third section is founded on baseline long-term projections. However, although membership is quite robust in general terms, significant deviations may arise due to economic shocks, as well as to socio- and geopolitical unrest. Growth paths could be derailed by several factors.

This has been the case of macroeconomic disequilibria, which were at the centre of recurrent crises in emerging economies during the 80s and 90s. However, as we have frequently pointed out, vulnerabilities have been substantially corrected in these markets during the last 15 years and today the general prospects for facing financial headwinds is much better:

- Fiscal and current account structural balances are not worrying.
- Low public, external and private (households and corporations) debt levels.
- Limited exposure to foreign exchange risks.
- No significant deviations of private credit ratios from structural references (see sixth section for details).

However, the absence of severe macroeconomic disequilibria is perfectly compatible with short-term market pressures on certain economies. We consider these warnings to be healthy for policy action and helpful to erase potential vulnerabilities in the medium-long term.

In previous annual reports we have referenced risk analysis to vulnerability matrices, which cover a multi-dimensional set of variables ranging from macroeconomic risks to growth hurdles. This year we want to complement and reinforce our vulnerability assessment by distinguishing emerging economies according to their stage of development and pointing out concomitant challenges.

No single development strategy suits every country

Emerging countries share a promising future under strong growth and rapid income transition, but hurdles and needs are not identical as economies are at quite different stages of development:

- Low-income countries:
  EAGLEs and Nest countries with GDP per capita between USD2,000 and USD8,000 in PPP-adjusted terms: India, Indonesia, Bangladesh, Egypt, Iraq, Nigeria, Pakistan, the Philippines and Vietnam. In these countries:
    - Economic policies should reduce vulnerabilities and institutions build stable political and economic conditions.
    - There are many open fronts in the social field, increasing risk of unrest with increasing and youth population (Figure 5.1): poverty reduction challenges, expected increase of inequality (according to the Kuznets curve), job-demanding demographies and provision of basic services such as a sanitation or primary education.
    - Supportive demographics, urbanisation, high returns from investment and low wages in basic manufacturing define their competitive advantages.

3. Read our quarterly country risk analysis for details: www.bbvaresearch.com/KETD/ketd/img/tematicas/riesgos/pais/index.jsp
Middle income countries:

This group covers countries with GDP per capita between USD10,000 and USD21,000, a range in which the vast majority of EAGLEs and Nest members lies; we identify three subgroups according to their progress:

- **In the early stages**: China, Thailand, Colombia, South Africa and Peru.
- **Intermediate position**: Brazil, Iran, Kazakhstan, Mexico and Turkey.
- **Transitioning to developed standards**: Malaysia, Russia, Argentina, Chile and Poland; former EAGLEs Korea and Taiwan climbed out of this category and became advanced economies.

In these countries:

- Urbanisation is well advanced and the economy shows a high degree of tertiarisation, while industrial activities turn to more diverse and sophisticated manufactures supported by an expanding middle classes (as shown in Box 3 in the fifth section).
- As factor accumulation moderates and wages rise, economies should look for new sources of growth to overcome the so-called middle-income trap; countries need to build capacities through higher education and technological skills, as well as avoid bottlenecks through infrastructure investment and healthy financial deepening (see Figure 5.2 and the sixth section respectively).

High-income countries:

Here we include advanced economies, which have an average GDP per capita close to USD40,000. In these countries:

- Production processes are characterised by diversification, sophistication, complexity and innovation (Figure 5.3), while the population enjoys welfare systems.
- Population aging, fiscal sustainability, increasing inequality and excessive leverage are some of the main challenges.
- Oil-producers and Nest members Saudi Arabia and Qatar fulfil the income criteria, but they are excluded from the developed economy classification by the IMF as they have limited product diversification.
How qualified are EAGLEs and Nest to face income transition

Following our review of the main features in different development stages, we now present a brief rating of strengths and challenges for EAGLEs and Nest countries in each income group. For this purpose we take as reference information compiled in the above-mentioned vulnerability matrices (Tables 5.1 and 5.2).

These are the main highlights for low-income countries, ranked by the balance of their strengths and weaknesses:

- Indonesia and the Philippines seem to be better-positioned to face the challenges ahead, although both should start improving fundamentals for productivity growth.

- India has scope to correct macro disequilibria, improve the business climate and reduce poverty.

- The main risks for Vietnam are on the external side (high trade openness and sensitivity to food prices) and on a relatively advanced demographic transition, with increasing pressure to generate alternative sources of growth.

- Countries with higher population growth also show the weakest institutional and social framework. The situation is particularly adverse in Bangladesh, Nigeria, Iraq and Pakistan, while Egypt faces a difficult political transition.

Regarding different subgroups of middle-income countries:

- In the early stages:
  - China is better-positioned to take further steps in income transition, although it should keep an eye on the effects of population aging and excessive leverage.
  - Colombia and Peru have scope to improve infrastructure quality and, as in the case of Thailand, start increasing technological efforts; the two Latin American countries should also aspire to increase product diversification, reduce their external deficits and smooth their uneven income distribution.
  - South Africa has good fundamentals to increase productivity, but macro disequilibria and risks of social unrest are considerable due to severe demographic pressures, high unemployment and excessive inequality.
Intermediate position:
- Turkey and Mexico share balanced potential growth, as well as the challenge to extend trade to faster-growth markets. Macro disequilibria are lower and reform momentum more intense in the case of Mexico, while in Turkey there is room to increase female participation rates and reduce the structural current account deficit.
- The main challenges for Brazil are improving perceptions of its business climate, correcting macro disequilibria and reducing social inequality.
- Iran and Kazakhstan are quite sensitive to China's demand and commodity prices. The institutional framework has substantial scope for improvement in Iran as well.

Transitioning to developed standards:
- Fundamentals for productivity growth are quite positive in Chile and Malaysia, including a favourable investment climate and institutional framework.
- Both Russia and Poland face slow growth in trade partners (mainly in the EU) and, like any other country in Emerging Europe except Turkey, a shrinking labour force. However, they differ significantly in other challenges; short-term macro disequilibria are relevant for Poland, but Poland clearly outperforms Russia in terms of its institutional framework and product diversification.
- Argentina could make the best of its growth potential by improving the investment climate and the quality of infrastructure.

Finally, for high-income countries:
- Oil revenues in Qatar and Saudi Arabia keep macro vulnerabilities at low levels, while they have helped to build top-class infrastructure; however, both economies are still highly sensitive to energy prices.

Figure 5.3 GDP per capita and Global Competitiveness Index (GCI)\(^5\) in selected economies

GCI data not available for Iraq
Source: BBVA Research, WEF

---

5: [www.weforum.org/issues/global-competitiveness](http://www.weforum.org/issues/global-competitiveness)
### Table 5.1: Macroeconomic Risks Matrix

<table>
<thead>
<tr>
<th>Variable</th>
<th>A: Growth model risks</th>
<th>B: External demand risks</th>
<th>C: Macro disequilibria</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Growth acceleration</td>
<td>Expected labour force</td>
<td>Expected trade</td>
</tr>
<tr>
<td></td>
<td>[Avg growth 2013-23]</td>
<td>productivity growth</td>
<td>partners' openness</td>
</tr>
<tr>
<td></td>
<td>/ UN</td>
<td>/ BBVA-IMF-UN</td>
<td>exports' dependency</td>
</tr>
<tr>
<td></td>
<td>/ UN</td>
<td>Indicator 1-7, 2013-14</td>
<td>% of total exports</td>
</tr>
<tr>
<td></td>
<td>/ WEF</td>
<td>%, latest / IMF</td>
<td>2014-2018 average / IMF</td>
</tr>
<tr>
<td></td>
<td>%, latest / IMF</td>
<td>Weighted avg growth 2013-23 / BBVA-IMF</td>
<td></td>
</tr>
<tr>
<td></td>
<td>%, latest / IMF</td>
<td>% of total exports, 2012 / WTO</td>
<td></td>
</tr>
<tr>
<td></td>
<td>%, latest / IMF</td>
<td>Expected fiscal balance</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Expected external balance</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Public debt</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>External debt</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>-4.5</td>
<td>-0.1</td>
<td>7.0</td>
</tr>
<tr>
<td>India</td>
<td>-2.0</td>
<td>1.3</td>
<td>5.5</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1.2</td>
<td>1.4</td>
<td>4.9</td>
</tr>
<tr>
<td>Russia</td>
<td>-4.5</td>
<td>-1.0</td>
<td>3.9</td>
</tr>
<tr>
<td>Brazil</td>
<td>-0.9</td>
<td>0.8</td>
<td>1.9</td>
</tr>
<tr>
<td>Turkey</td>
<td>-2.9</td>
<td>1.1</td>
<td>3.5</td>
</tr>
<tr>
<td>Mexico</td>
<td>-0.2</td>
<td>1.4</td>
<td>1.5</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>-2.3</td>
<td>1.9</td>
<td>2.3</td>
</tr>
<tr>
<td>Nigeria</td>
<td>-0.1</td>
<td>2.9</td>
<td>3.8</td>
</tr>
<tr>
<td>Thailand</td>
<td>-0.4</td>
<td>-0.1</td>
<td>5.1</td>
</tr>
<tr>
<td>Colombia</td>
<td>0.2</td>
<td>1.2</td>
<td>4.2</td>
</tr>
<tr>
<td>Philippines</td>
<td>0.4</td>
<td>1.9</td>
<td>3.6</td>
</tr>
<tr>
<td>Malaysia</td>
<td>-1.5</td>
<td>1.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Iraq</td>
<td>-4.4</td>
<td>3.2</td>
<td>5.4</td>
</tr>
<tr>
<td>Vietnam</td>
<td>-2.5</td>
<td>0.7</td>
<td>5.9</td>
</tr>
<tr>
<td>Pakistan</td>
<td>-1.0</td>
<td>-2.3</td>
<td>2.3</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>0.7</td>
<td>-2.1</td>
<td>5.1</td>
</tr>
<tr>
<td>Poland</td>
<td>-1.7</td>
<td>-1.0</td>
<td>4.2</td>
</tr>
<tr>
<td>Egypt</td>
<td>-1.1</td>
<td>1.6</td>
<td>2.2</td>
</tr>
<tr>
<td>Iran</td>
<td>-4.6</td>
<td>0.9</td>
<td>1.3</td>
</tr>
<tr>
<td>Peru</td>
<td>-0.9</td>
<td>1.4</td>
<td>3.9</td>
</tr>
<tr>
<td>South Africa</td>
<td>-1.5</td>
<td>-0.7</td>
<td>2.7</td>
</tr>
<tr>
<td>Chile</td>
<td>-0.5</td>
<td>0.5</td>
<td>4.1</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>-3.9</td>
<td>-0.5</td>
<td>5.0</td>
</tr>
<tr>
<td>Qatar</td>
<td>-9.7</td>
<td>1.8</td>
<td>4.5</td>
</tr>
<tr>
<td>Argentina</td>
<td>-6.6</td>
<td>0.8</td>
<td>1.2</td>
</tr>
</tbody>
</table>

**Notes:**
- EAGLEs: Economies at Risk of Growth and External Linkages
- Nest: Economic Outlook
- Over EAGLEs & Nest: Above avg, On average, Below avg

### Table 5.2
Potential breaks to growth matrix

<table>
<thead>
<tr>
<th>Dimension</th>
<th>A. Institutional factors</th>
<th>B. Social unrest risks</th>
<th>C. Inclusive growth challenge</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market</td>
<td>Investment climate</td>
<td>Public</td>
<td>Food prices</td>
</tr>
<tr>
<td></td>
<td>Governance</td>
<td>Food in the consumption</td>
<td>Food in the consumption</td>
</tr>
<tr>
<td></td>
<td>State fragility</td>
<td>basket</td>
<td>basket</td>
</tr>
<tr>
<td>Variable</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Definition and source</td>
<td>[Avg world ranking for 10 indicators, 1-185, DB 2014]</td>
<td>[Average of 6 indicators, 0-25, 2012]</td>
<td>Lane index, 0-25, 2012 / Haver-FAO]</td>
</tr>
<tr>
<td>China</td>
<td>97</td>
<td>-0.5</td>
<td>6</td>
</tr>
<tr>
<td>India</td>
<td>122</td>
<td>-0.3</td>
<td>13</td>
</tr>
<tr>
<td>Indonesia</td>
<td>111</td>
<td>-0.4</td>
<td>9</td>
</tr>
<tr>
<td>Russia</td>
<td>90</td>
<td>-0.7</td>
<td>7</td>
</tr>
<tr>
<td>Brazil</td>
<td>110</td>
<td>0.1</td>
<td>6</td>
</tr>
<tr>
<td>Turkey</td>
<td>79</td>
<td>0.0</td>
<td>7</td>
</tr>
<tr>
<td>Mexico</td>
<td>76</td>
<td>-0.2</td>
<td>5</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>51</td>
<td>-0.5</td>
<td>9</td>
</tr>
<tr>
<td>Nigeria</td>
<td>130</td>
<td>-1.1</td>
<td>16</td>
</tr>
<tr>
<td>Thailand</td>
<td>41</td>
<td>-0.3</td>
<td>7</td>
</tr>
<tr>
<td>Colombia</td>
<td>71</td>
<td>-0.3</td>
<td>11</td>
</tr>
<tr>
<td>Philippines</td>
<td>102</td>
<td>0.5</td>
<td>11</td>
</tr>
<tr>
<td>Malaysia</td>
<td>23</td>
<td>0.3</td>
<td>5</td>
</tr>
<tr>
<td>Iraq</td>
<td>122</td>
<td>-1.3</td>
<td>20</td>
</tr>
<tr>
<td>Vietnam</td>
<td>95</td>
<td>-0.5</td>
<td>8</td>
</tr>
<tr>
<td>Pakistan</td>
<td>111</td>
<td>-1.2</td>
<td>16</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>118</td>
<td>-0.8</td>
<td>12</td>
</tr>
<tr>
<td>Poland</td>
<td>70</td>
<td>0.8</td>
<td>0</td>
</tr>
<tr>
<td>Egypt</td>
<td>118</td>
<td>0.7</td>
<td>11</td>
</tr>
<tr>
<td>Iran</td>
<td>132</td>
<td>-1.1</td>
<td>12</td>
</tr>
<tr>
<td>Peru</td>
<td>67</td>
<td>-0.2</td>
<td>6</td>
</tr>
<tr>
<td>South Africa</td>
<td>67</td>
<td>0.3</td>
<td>8</td>
</tr>
<tr>
<td>Chile</td>
<td>55</td>
<td>1.2</td>
<td>2</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>67</td>
<td>-0.8</td>
<td>9</td>
</tr>
<tr>
<td>Qatar</td>
<td>66</td>
<td>-1.6</td>
<td>4</td>
</tr>
<tr>
<td>Argentina</td>
<td>117</td>
<td>-0.2</td>
<td>2</td>
</tr>
</tbody>
</table>

Over EAGLES\&Nest:

<table>
<thead>
<tr>
<th></th>
<th>Above avg</th>
<th>On average</th>
<th>Below avg</th>
</tr>
</thead>
</table>

EAGLES Economic Outlook
Madrid, March 2014
Box 3. An update on the growing middle class in the emerging world: The EM Middle-Class Revolution will accelerate

Last year we devoted a special chapter of the EAGLEs Annual Report to the role of people in emerging countries. One of the key aspects we then analysed was the growth of the middle classes and the implications for global consumption.

This section contains an update of our projections, and rolls our forecasts forward to 2025. Additionally:

- We have adapted the scope of analysis to the new composition of EAGLEs and Nest groups; we have therefore dropped Korea from the emerging economies and added projections for new Nest members Iran, Iraq, Kazakhstan and Qatar based on World Bank data; unfortunately we lack income distribution data for Saudi Arabia.

- In line with the EAGLEs approach, we include a benchmark for projections for emerging markets, adding forecasts for the G7 economies using income data from Eurostat and UNU-WIDER.

Finally, in order to simplify income classes, we have combined population previously rated as “Poor” and “Low-income” in a new category: “Poor and Low-income”. This change arises from difficulties in defining the poverty line, a quite sensitive issue, and from our focus on estimating the middle classes.

Development is quite heterogeneous

EAGLEs and Nest countries show significant differences in GDP per capita, which are also reflected in the share of each income group in total population (Figure B.3.1):

- Small oil-producer Qatar is clearly an outlier, as it has a very large share of affluent and high middle class, even above developed standards.

- Countries close to high income levels, such as Turkey and Chile, today have a wider medium middle class than low-income population.

- Middle-income countries, such as China, Mexico, Peru and Colombia, are undergoing a boom of the new middle classes.

- Low-income countries, like those in the Indian subcontinent, are still struggling with high poverty rates.

China and India to lead income mobility

According to the new projections, some trends are worth highlighting for emerging markets up to 2025 (Figure B.3.2):

- One billion people in EAGLEs and Nest countries will leave behind their poor and low-income status during this period. Most of this people will become lower middle class, which will grow by 660 million and reach 2.2 billion.

- Medium and high middle classes will almost triple during this period, climbing to 740 and 340 million people, respectively, while the affluent segment will quadruple and reach 250 million by 2025.

Relative changes to income classes will be significant across the board of emerging economies but China and India will be by far the main drivers of these trends:

- The Chinese population will undergo a significant transition to medium-high income levels, while India is expected to reduce poverty rates considerably while generating a large low middle class.

- Indonesia and to a lesser extent Vietnam will also make a significant contribution to the reduction of poverty and the increase of the low middle class.

- Latin America and Emerging Europe will explain around 15% of the growth in higher income classes (medium, high middle class and affluent).

- Demographic pressure will be very intense in low-income countries and some of them (Bangladesh, Nigeria and Pakistan) will not generate enough growth to reduce the number of poor people.

---


6. We have also corrected some errors in our calculations, for which we apologize. However, these errors, which are related to income distribution, do not alter the underlying trends.

Figure B.3.1
Population by GDP per capita in emerging countries compared with Developed Markets (DMs) (2013) (%)

Source: BBVA Research

Figure B.3.2
Population by GDP per capita in emerging economies (EAGLEs and Nest countries*) (1980-2025)

*All countries except Saudi Arabia
Source: BBVA Research
6. Emerging countries’ credit deepening: In the search for a healthy credit path

Credit cycles, as well as boom and bust episodes, have been recurring events during recent decades. At present, most of the countries deleveraging after lengthy periods of credit growth are advanced economies, but extra-loose monetary policies and exit strategies in the developed world have increased concerns about how sustainable credit growth might be in emerging markets.

For these reasons we have been looking for a measure of how healthy credit growth is. On the one hand, our interest lies in vulnerability assessment as excessive credit could lead to banking and economic crises. And on the other hand, we also want to establish whether increasing financial penetration could be insufficient in itself and eventually become a hurdle for growth.

In this section we summarise the findings of our econometrics panel data model on private credit presented in previous research9.

Long-term credit determinants

Structural levels of credit to GDP ratios depend on several macroeconomic, regulatory, market structure and institutional variables. These relations are also non-linear and interact with each other.

For instance, we estimate that credit increases progressively when income per capita rises, but, while the pace of growth is fairly slow for low-income economies, it starts to accelerate fast for middle income countries and boom as transition to high-income is completed (Figure 6.1).

The main findings of the complete factor breakdown are as follows:

- The contribution of GDP per capita to increased credit penetration in emerging economies has been limited so far, although we expect it to increase as countries enter the credit acceleration area with higher income elasticity.
- Macroeconomic stability is one salient feature of EMs in the last 15 years. As a result, interest and inflation rates have moved structurally downwards, with the most significant effect recorded for Latin America.
- In general terms, investment has a relatively limited role and low explanatory power on its own. However, some significant exceptions are present, particularly China, which still enjoys an investment rate well above the global average, making a positive contribution to credit expansion.
- The regulatory and institutional framework is friendlier for credit in Asia than in Latin America or Emerging Europe, although it is improving slightly in these two regions as well. The rapid growth in income will increase pressure to maintain an appropriate framework for credit.


“Excess credit: Mind the gap... But which one?”, BBVA EAGLEs Economic Watch, February 2014. www.bbvaresearch.com/KETD/fbin/mult/140226_EW_Excess_Credit_Mind_the_Gap_butch_one_tcm348-427709.pdf?ts=332014
Credit gaps: the healthy path

The credit gap is the difference between the actual credit to GDP ratio and the estimated structural level. A positive (negative) gap would imply excessive (insufficient) credit.

Based on this approach, we can rate regions as follows:

- A positive gap explains a substantial share of the ratio increase in Emerging Europe during the second half of the nineties.
- Latin America and Emerging Asia had a negligible credit gap during the nineties as a result of introducing healthy practices after the excesses of the 90s.
- Among Asian economies, China has had a persistent and large positive credit gap since the 90s, which accelerated its growth after the global recession in 2009, mainly due to the substantial growth of shadow banking activities.

One significant result of the analysis is that, contrary to common thought, private credit to GDP ratios are not significantly different from the levels implied by per capita income. However, better regulatory and institutional conditions would help to boost further penetration of credit, and avoid potential bottlenecks in the future.

Figure 6.1
Ratio of credit to the private sector over GDP (%) and GDP per capita (PPP-adj. USD) (2013)

Note: the trend represents the long-term relationship between GDP per capita and the ratio of credit regardless of other variables which play a relevant part in our model, bubble size is proportional to the absolute value of GDP.
Source: BBVA Research and IMF
7. Trends in South-South trade and global value chains: Gravitating around the Asian factory

In the 80s and 90s, southern countries (i.e. emerging economies) were involved in less than 40% of total world trade and, more importantly, South-South transactions represented merely 6% of the total. At present, EMs have increased their share of international trade to 60% and South-South flows have climbed to 15% (Figure 7.1).

The main factors behind the increase in South-South trade are:

- **Rapid economic growth** of the South during the last few decades.
- **Further progress in trade liberalisation**.
- **Fragmentation of production** through global value-chains (GVCs).
- **Commodity revenues** on increasing demand and favourable terms of trade.

Asia has played a key role in the increase of South-South trade, with growing links with other emerging regions based on specialisation patterns. In particular, China has become the factory of the world and has boosted global value-chains.

As a result of more participation of global value-chains in world production, the use of traditional gross flows distorts the analysis of international trade and it is much better to account for transactions in value-added terms.

The combination of these trends in South-South trade is reflected in as many opportunities as challenges for emerging economies. **Production and export strategies** will be crucial to define the role of each market and should include different dimensions:

- **Connection and importance of exports**.
- **Value retention**.
- **Exposure to external shocks** (diversification and market power).
- **Technological content** and chances of upgrading the economic structure.

This section includes our recent analysis on these topics:\n
---


Factors behind the increase in South-South trade

The value of South-South trade flows quadrupled in the first decade of this century as a result of the following main drivers:

- **Rapid growth of Southern countries:**
  - Share of world GDP remained relatively constant during the 80s and 90s around 20% in nominal terms, whereas this figure has doubled in the last decade and climbed to 40% in 2012.
  - This boost has provided both a larger productive base for exports and a larger demand for imports, fostering trade flows with the North as well as intra-regional transactions.

- **Trade liberalisation:**
  - World average tariffs started a steady decline in mid-90s, with Asia among the most benefited regions and supported by an increasing role for regional and bilateral trade agreements rather than WTO rounds\(^{11}\) (like the recently signed Pacific Alliance, introduced in the Box at the end of this section).
  - China’s entry into the World Trade Organisation (WTO) in 2001 has substantially increased its presence in international world trade transactions, fostering global competition on its massive low-wage workforce.

- **Fragmentation of production:**
  - Development of global value chains, led by China, has increased trade flows of inputs for transformation, as well as parts and components for assembling.

- **Commodity revenues:**
  - Demand of commodities has grown substantially on rapid economic growth in the South. As production is concentrated in the emerging world, increasing flows have made a significant contribution to South-South trade.
  - In addition to this volume effect, an increasing demand has pushed up prices to historically high levels.

---

Asia the centre of gravity, China the world factory

During the last three decades, Asia’s share in South-South trade has increased steadily from less than 20% to more than 40% in 2012, boosted by intra-regional flows and led by China with a large contribution from ASEAN countries as well. However, Asia’s trade flows with other regions in the South are also very significant, representing almost 50% of total South-South trade (Figure 7.2).

China is behind the prominent role of Asia in South-South trade. Economic reforms dating back to the 90s, a growth strategy based on investment and industrial development and its entry in the WTO in 2001 have not only boosted external competitiveness but also increased domestic demand substantially, transforming the economy into the world factory for many manufacturing products (Figure 7.3):

- In 1995 China represented only 5% of global manufacturing output, while this share had climbed up to 27% in 2011. The contribution is much higher when measured over the change during this period, accounting for an extraordinary 41%.

- The country now produces around 50% of world footwear and clothes (80% of new production in the last 15 years) and 40% of non-metallic minerals (60% of incremental production).

- Production is however no longer concentrated in traditional industries, but has been increasing in more sophisticated activities with higher technological content, such as electrical equipment, machinery and transport equipment. Exports of these products have jumped from less than 30% in 1995 to over 50% in 2011.

China is also behind the expansion of global value chains (GVCs), consisting in the fragmentation of the production process in different locations, making the most of comparative and competitive advantages. A clear example is the economic relationship between China and the Gulf countries, which are the main suppliers of Chinese producers’
rapidly increasing energy needs. According to estimates\textsuperscript{12}, China today represents more than 15\% of income generated by GVCs from 5\% in 1995, and is converging fast towards declining shares on the part of NAFTA (20\%) and the European Union (25\%).

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure7.3.png}
\caption{World manufacturing production in 2011 (% of total nominal USD)}
\end{figure}

\textbf{A new trade perspective with value-added flows}

The fragmentation of production processes generates increasing trade flows of intermediate products, such as inputs for transformation, parts and components. As a result of these networks, the real picture of international trade could be misleading if the traditional approach through gross figures is used.

In order to account for genuine economic relations, we have developed the trade analysis on value-added terms, which allows us to identify:

- The contributions of other activities to the production process, not only industrial inputs but also services.
- The country origin of value added in each product and the final destination of the product in which value has been added.
- The real relevance of international trade for economic activity and employment, avoiding double accounting.

These are the main findings of our analysis as a result of these adjustments:

- The rising importance of South-South trade relations may have been overestimated (Figure 7.4), as they retain less value than other regional networks. Reliance on the North remains therefore critical for the South.

- The trade balance with the North improves for most of Southern exporters relative to gross figures, although Mexico and China are noticeable exceptions on lower contributions by textile, footwear and electrical equipment. The Chinese surplus with the US goes down by one third in value added terms.

- The role of commodities and services becomes much more relevant, doubling their share on total flows with respect to gross figures up to 55%. Manufactures have higher potential for vertical integration and product transformation, and for this reason require more inputs.

- Value-added trade figures give a better sense of specialisation patterns in the South and the North. Basic products increase their share in South-North flows from 12% to 20% and services in North-South transactions from 25% to 49%.

**Figure 7.4**
Exports by regional trade network on a gross value and value added basis (2000 and 2009) (USD tn)

Note: export flows
Source: BBVA Research, OECD

**Impact on diversification and commodity security**

One of the conclusions of our analysis on South-South trade is that these flows are driven by specialisation patterns. This basically means that Asia (China) is the world's factory, the centre of new global value chains, and it therefore demands an increasing volume of commodities from other emerging regions such as the Middle East and Latin America, which concentrate resources and reserves (Figure 7.5).

These elements have two main implications:

- There are fewer incentives for economic diversification in commodity producer countries as commodity revenues soar under increasing demand and favourable terms of trade:
  - In South America, product concentration has increased again since the beginning of this century after decades of downward trend
  - In the Gulf countries the increase of non-oil GDP is highly sensitive to energy prices and manufacturing activities remain limited.


The fact that both supply and now demand are located in the emerging world turns commodity security into a South-South issue. In this sense, we would expect tighter economic relations and increasing financial ties between Asia (China) and commodity producers. To a larger extent in the case of energy products and the Gulf countries if the US becomes self-sufficient.

Challenges for southern exporters
Throughout this section we have pointed out some of the competitive challenges that lie ahead for emerging economies, such as value retention and product diversification. We now complete the picture by analysing different characteristics of exports and their relationship with the domestic economy:

- **Economic importance of exports:**
  - We have extended the traditional measure of GDP to include not only goods but also utilities, construction and services. In addition, we estimate the domestic connectivity of exports through production multipliers.
  - Small and medium-sized East Asian economies lead on trade openness, while China outperforms in terms of domestic connection of exports. Latin American economies are less open than average, with Mexico additionally showing a very limited connectivity of trade, which is also the case of Indonesia and Saudi Arabia.

- **Value-retention:**
  - We consider the share of foreign inputs in exports, as well as the weight of imported products in final demand.
  - East Asian countries lag significantly behind in aggregate value-retention, while some commodity producers import a high share of final goods, which eventually drain domestic value-added.

- **Specialisation patterns:**
  - We measure exposure to external shocks through product diversification and world market power.
  - Diversification is more limited for commodity exporters, as well as for specialised manufacturers such as Vietnam, while China is the only emerging country with the global capacity to fix market conditions (not only from the supply but also from the demand side).
- In the case of small economies, for which world market power is much more limited, diversification is the last option for sheltering from external turbulences.

- Technological content:
  - We assess the chances of upgrading the economic structure and supporting long-term growth through productivity gains.
  - Many manufacturing countries have a significant share of exports with technological content rated as medium or high. However, most of them do not have a genuine surplus, as they either import a significant share of these products, just copy the technology or play an 'assembly' role. India stands out as its tech exports consist mainly of computer services.
Box 4. The Pacific Alliance

In 2012, Chile, Colombia, Mexico and Peru signed an integration agreement and created the Pacific Alliance, and could be soon joined by Costa Rica and Panama. Latin America has a long tradition of regional trade agreements: Mercosur, ALBA, Caricom, ALADI, CAN, Unasur... However, none of them could be considered particularly successful so far. The Pacific Alliance is a new attempt to bolster integration in the region and it seems that this time there are more solid reasons for hope.

A more dynamic and larger market than Mercosur

The Pacific Alliance is among the largest economies in the world with USD3.1trn in PPP-adjusted terms, above the average size of a G6 country (Figure B.4.1), and we expect GDP to grow around 4% in the next ten years. Population sums up more than 220 million people, with an increasing share of middle classes.

Despite being smaller than Mercosur (close to USD4trn and 310 million people), the contribution to global growth between 2013 and 2023 will be higher for the Pacific Alliance (USD1.4trn vs. USD1.2trn) as a result of stronger growth (less than 3% in the case of Mercosur).

International trade flows are also higher for the Pacific Alliance (more than USD1trn in 2012) than Mercosur (close to USD900bn), but the integration agreement faces the challenge of increasing the current tiny share of intraregional trade (2% vs. 8% in Mercosur).

Figure B.4.1

Current GDP size (2013) and expected change in the next years for selected markets (PPP-adj. 2013 USD)

A good chance to engage with Asia

The Pacific Alliance creates an appealing economic bloc which aspires to strengthen its economic ties with Asia and become part of world value-chains given its Free Trade Agreements (FTAs) with the US, EU and other developed economies.

China is the largest Asian trade partner of the Alliance members and a significant FDI investor in mining and natural resources projects. Japan and Korea are more focused on manufacturing, particularly in the automotive sector and electronics.

The Pacific Alliance is an attractive market for Asian exporters of consumer goods as members maintain a significant population premium and their middle classes are booming.

Trade benefits

According to the trade protocol, tariffs will be removed for up to 92% products, while they will be gradually reduced for the remaining 8%, mainly concentrated in the agricultural sector. The agreement on rules of origin is also relevant and we expect it to boost regional production chains, enabling each country to take advantage of trade agreements negotiated by other members.

Opportunities for increasing trade among its members are skewed towards Mexico, given the structure of the economy which exports high value-added manufactured goods, whereas its imports of commodities are small.

More than a trade agreement

The Pacific Alliance is not an FTA, but rather a space that promotes integration in different areas: free movement of persons, conservation of, and respect for the environment, academic and student exchange, cultural promotion, stock market integration, development of infrastructure, opening of joint trade offices and participation in fairs and exhibitions in the same space.

For instance, Chile has developed one of the best infrastructure grids in the region with a quality comparable to developed standards. On the other hand, Mexico, Colombia and Peru show a significant gap relative to their peers. Hence, Chile can provide its know-how and experience in this area.

---

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called “BBVA”) to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances; investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates’ salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates’ proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) to which this distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the “financial promotion order”), (ii) are persons falling within article 49(2) (a) to (d) (“high net worth companies, unincorporated associations, etc.”) Of the financial promotion order, or (ii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as “relevant persons”). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not provide any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

“BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance”.

BBVA is a bank supervised by the Bank of Spain and by Spain’s Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.