The Global Environment

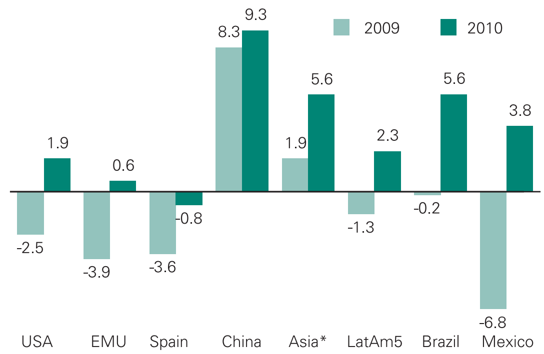
The symptoms of improvement are consolidating, more intensely in the U.S. than in Europe, and in the emerging economies as well. The risks of the scenario are downward, given the support still provided by the policies of demand and help to the global financial sector, the positive outcome of which is still pending.

Three months after the publication of the last Mexico Watch, the world economy continues to experience a clear improvement, with many economies recording positive quarterly growth, although with very heterogeneous rhythms of advance between the more developed areas and the emerging economies. The more developed countries are now showing the first symptoms of recovery, despite many of them having been damaged by the accumulated imbalances in the previous expansive phase. This improvement will be moderate, heterogeneous and subject to uncertainties with a downward trend. The reason is that the main support elements of spending, mainly that of private consumption, are still in a process of adjustment following past excesses—the case of the leverage level—or don't show an important improvement—the case of employment—. Moreover, the financial systems, in the process of recapitalization, and public balances, in a process of deterioration due to the impact of the recession and of the support measures implemented, show a latent frailty that is not independent of the scenario of future growth. Its effect on the real economy in the short and long term is not insignificant, so that it should remain among the priorities of the agenda.

In the U.S., the preliminary growth datum for the fourth quarter of 2009 (5.7% quarterly annualized) anticipated expectations: a faster recovery than in Europe, although it is still far from achieving growth supported in its propulsion capacity of private self-sustained, not dependent spending—more than half is due to the growth of inventories—. In this sense, the main downward risks are in the intensity and duration that the unleveraging process will ultimately have on households and in the possibility that the job market will take longer than expected in recording employment growth in a recurrent manner. Thus, it is probable that the growth of domestic demand, and therefore, that of the overall economy, will continue to be relatively weak during the next quarters. Our projection for GDP growth in 2010 is around 2%, far from that of the recession of 2009, with a GDP drop of 2.5%, but lower than that of the consensus, given that we give greater weight to the need of families to increase their savings and concentrate a greater proportion of these to paying off debt or purchasing financial assets, and in a lower proportion, to consumption.

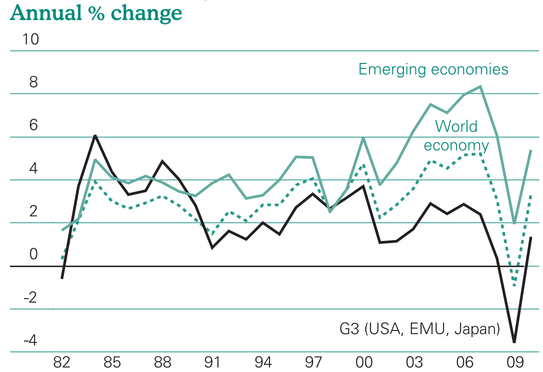
In Europe, the economic scenario presents relatively similar characteristics, although with more negative aspects as regards the vulnerability of its financial sector or the recovery of its labor markets, which suggests a slower recovery pace than in the U.S. in 2010. It is true that the confidence and activity data in recent months reflect a growing dynamism in the economies of the European Union, but pending adjustments and the flexibility to adapt to them is lower. Moreover, the fiscal situation in many of these countries, with deficit

World Economy: GDP Growth
Annual % change



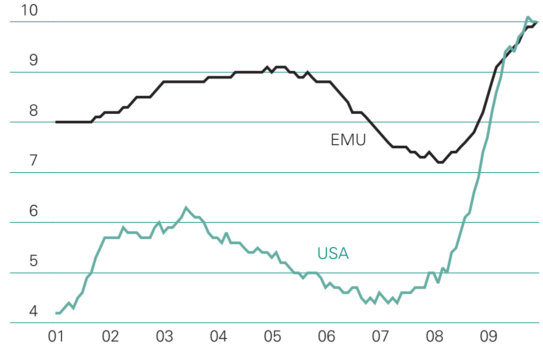
* Does not include China
LatAm5 Argentina, Colombia, Chile, Peru and Venezuela
Source: BBVA ERD

World Economy: GDP Growth
Annual % change



Note: Forecast for 2010
Source: BBVA ERD

Unemployment Rate
% of active population

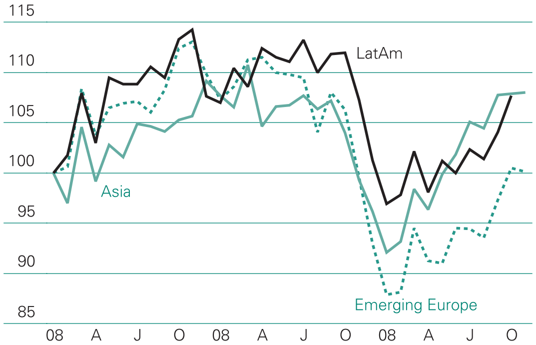


Source: Datastream

BBVA

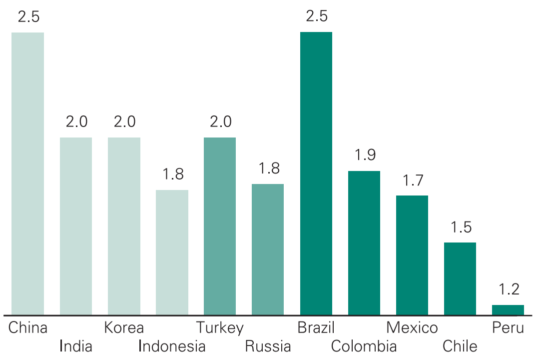
Emerging Economies: Industrial Production

Index January 2007 = 100



Source: BBVA ERD

Emerging Economies: Withdrawal Strategies Indicator

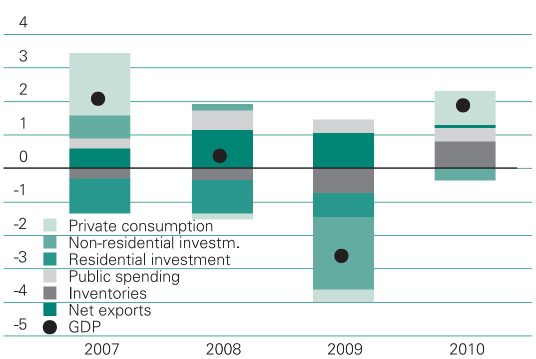


Note: Higher values are consistent with earlier tensions in monetary policy

Source: BBVA ERD

USA: Contributions to GDP Growth

Percentage points



Note: Forecast for 2010

Source: BBVA ERD

and debt levels growing at high rates, limits the maneuvering margin for economic policies and raises the need of implementing feasible adjustment programs. Because of all this, European economic growth is expected to be 0.6% in 2010.

In the emerging economies, we begin to observe high growth rates, with China a good example of this, with 10.7% annual growth in the fourth quarter of 2009, the highest growth rate of the last two years. In addition, various indicators of activity and spending, such as industrial production and retail trade show marked growth. All of this has motivated the first steps of the Chinese authorities to gradually reduce credit incentives and withdraw other stimuli. Although this process is not exempt of risks, the Chinese government has sufficient tools to manage this transition without substantially affecting growth, so it is expected that progress in activity in the Asian region will be sustained over time.

As regards Latin America, the most recent indicators for the region continue to show a positive tone, with levels of activity that are now nearing those before the contraction occurred in the second half of 2008. Maintaining orthodox policies during the expansive phase limited the accumulation of external or fiscal imbalances characteristic in previous growth cycles, and the timely measures of economic policy implemented after the crisis broke out, have allowed many of these economies to mitigate its impact and attract new foreign capital flows. Nevertheless, the entry of capital flows in some emerging markets has begun to awaken uncertainties regarding pressures on the prices of some assets and on the exchange rate. For the next few months, we anticipate the beginning of the withdrawal of monetary incentives (fundamentally in Brazil), although the persistence of historically low inflation rates, and the environment of inflation targets among the respective central banks suggest that, in general, there is still room to dilate the increases in official interest rates.

Growth perspectives continue subject to downward risks, especially in the developed economies.

The global recovery is facing specific downward and highly inter-related risks, especially in the developed economies. The first of these refers to the strategy of suspension of the exceptional measures of economic policy adopted more or less intensely since the last quarter of 2008, both in monetary and fiscal matters. The premature suspension of these measures, as we noted in our previous publication, could seriously damage the incipient recovery, since many economies today are still very dependent on incentives from the public sector. The order of withdrawal from the different areas is also a relevant factor in this context, since to date, and particularly in the developed economies, there is little evidence that the final spending of families and companies supported on the sustainable growth of disposable income has been relieved by public spending as the main vector for growth. It is not in vain that the cycle of inventories is mainly leading this phase of incipient growth. Until this composition is modified, there is a clear risk that the withdrawal of fiscal incentives will damage the growth of many economies.

At the same time, the implementation of believable adjustment plans in the medium term is indispensable, which makes the equilibrium between maintaining the fiscal support while it is necessary and at the same time making its withdrawal believable, one of the key factors. However, this support policy without precedent, has a tangible cost in terms of risk for sovereign balances and consequently, for future financial stability. While this situation doesn't presume additional risks, monetary policy should continue to be lax for a still prolonged period of time. The fact that inflation expectations in the developed economies continue at stable levels, core inflation grows moderately and the capacity for use is at historically low levels, allows for a certain maneuvering margin with regard to the withdrawal of non-conventional support policies for liquidity.

In the financial sphere, progress to date continues to be moderate, so the risks are still latent. One of the priorities in all agendas should be to continue to strengthen the banking systems of many economies. All of this is in order to normalize the channel of credit, which has been only partially recovered up to now. To this is added a risk of a regulatory nature, which has its origin in the reform proposals launched to date, and the costs of which, in terms of uncertainty and heterogeneity, threaten to implicate disparities in the rules of the game, behaviors that stimulate regulatory arbitration and could lead to a lower appetite (or a higher cost) to expand capital on the part of the public sector, thereby compromising global financial stability.

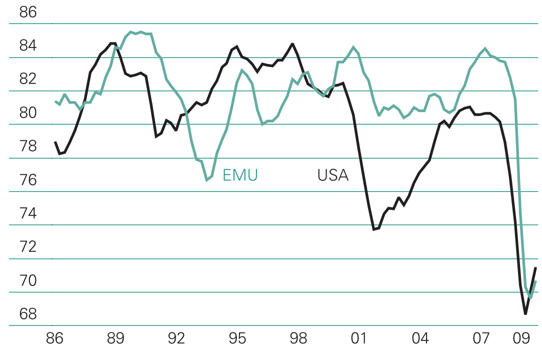
The financial markets are stabilizing, although fragility is still latent

The continuity of the policies of low official interest rates in the developed countries with expectations of contained inflation has allowed tensions in the markets to stabilize progressively, serving also to anchor the yield curves of public debt, which continue to show historically low long-term rates.

The performance of the stock markets at a global level reflected the uncertainties mentioned above. In the last quarter of the year, the earnings that had been seen until then, tended to moderate. Nevertheless, this pattern was clearer in the developed economies than in the emerging markets, where there were still significant capital entries in the latter part of 2009.

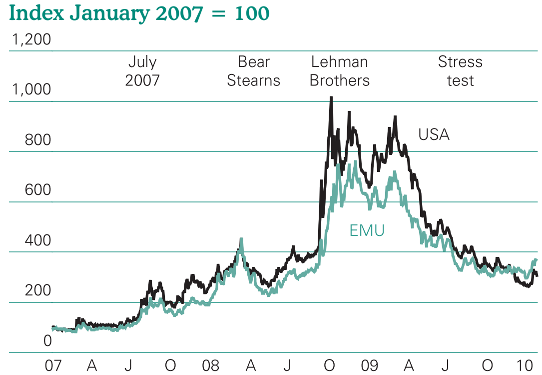
In the foreign exchange markets, the most relevant trend was the sensitivity of the dollar to investors' appetite for risk, with depreciations of the U.S. currency against the currencies of the main emerging markets. Thus, while the feeling in the markets was dominated by optimism regarding recovery and the perception of a clear undervaluation of risk assets, the dollar tended to depreciate, both against the currencies of other developed markets and against those of emerging countries. Toward the end of the year, and in 2010, the dollar recovered some of the ground lost, supported by a greater aversion to risk and a more negative turn in the valuation of other economies (especially in Europe). In 2010 it is expected that this pattern will tend to intensify and the dollar would tend to appreciate against the euro, but to depreciate against the emerging currencies.

Utilization Capacity of the Economy
%



Source: BBVA ERD with Datastream data

Financial Tensions Indicator
Index January 2007 = 100



Note: First major normalized components of the differential OIS series, implicit volatility of the U.S. Stock Exchange, bank CDS and corporate CDS
Source: BBVA ERD

Exchange Rate
Dollars per euro

Note: Forecast as of February 2010
Source: BBVA ERD

Fuente: BBVA

United States Indicators and Forecasts

	2008	2009	2010	I'09	II'09	III'09	IV'09	I'10	II'10	III'10	IV'10
Economic Activity											
GDP (US$ billions)	14,441	14,259	**14,798**	14,178	14,151	14,242	14,463	**14,657**	**14,737**	**14,785**	**15,012**
Nominal growth (%)	2.6	-1.3	**3.8**	-1.4	-2.4	-2.1	0.8	**3.4**	**4.1**	**3.8**	**3.8**
Real growth (%)	0.4	-2.4	**1.9**	-3.3	-3.8	-2.6	0.1	**1.7**	**2.4**	**2.3**	**1.1**
GDP deflator	2.1	1.2	**2.3**	1.9	1.5	0.6	0.7	**2.6**	**2.6**	**2.2**	**1.8**
Personal consumption (real % change)	-0.2	-0.6	**1.4**	-1.5	-1.7	-0.2	1.1	**1.3**	**1.8**	**1.4**	**1.2**
Government consumption (real % change)	3.1	1.9	**1.5**	1.7	2.5	1.9	1.6	**2.7**	**1.3**	**0.9**	**1.0**
Gross fixed investment (real % change)	-5.1	-18.4	**-0.9**	-18.8	-21.0	-19.5	-14.1	**-3.3**	**-0.2**	**0.2**	**-0.2**
Construction[1]	-22.9	-20.4	**5.2**	-23.9	-25.6	-18.9	-12.1	**0.1**	**8.3**	**5.8**	**7.0**
Industrial production (real annual % change)	-2.2	-9.6	**-7.6**	-11.6	-12.9	-9.3	-4.5	**-7.6**	**-7.6**	**-7.6**	**-7.6**
External Sector (constant US$ billions)											
External balance	-708	**-390**	**-283**	-417	-396	-433	**-464**	**-240**	**-288**	**-367**	**-296**
Total exports	1,831	**1,560**	**1,251**	1,509	1,494	1,574	**1,663**	**1,275**	**1,284**	**1,253**	**1,190**
Total imports	2,539	**1,950**	**1,534**	1,888	1,833	1,976	**2,104**	**1,500**	**1,557**	**1,609**	**1,471**
Current account balance (% of GDP)	-4.9	**-3.0**	**-2.0**	-2.9	-2.8	-3.0	**-3.2**	**-1.6**	**-2.0**	**-2.5**	**-2.0**
Prices (annual % change)											
Final annual inflation	0.1	2.7	**1.2**	-0.4	-1.4	-1.3	2.7	**2.4**	**1.9**	**1.7**	**1.2**
Average annual inflation	3.8	-0.4	**2.0**	0.0	-1.2	-1.6	1.4	**2.3**	**2.4**	**1.8**	**1.3**
Other Indicators											
Primary fiscal balance[2] (% of GDP)	-3.2	-9.9	**-10.7**	—	—	—	-9.9	**—**	**—**	**—**	**-10.7**

1 Residential investment
2 Fiscal Balance (% of GDP)
Note: forecasts in **bold**