

# Where is the Global Economy Heading?

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# Outline

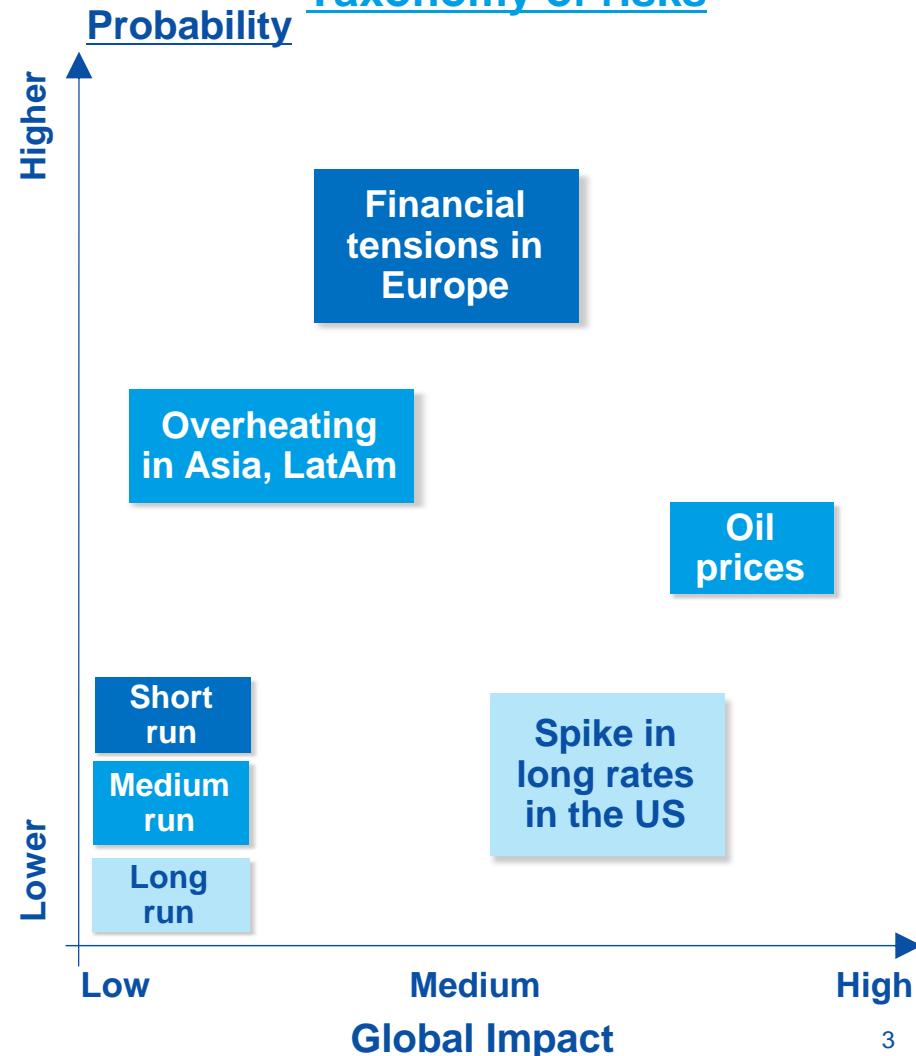
- 1 Exiting the great recession: global shocks and decouplings
- 2 North America: the outlook brightens
- 3 A window of opportunity in Europe
- 4 Emerging economies on track for a controlled slowdown
- 5 The long run and the potential of emerging countries

# Baseline Scenario and risks

## Baseline Scenario

- Decoupling in the global economy will continue, both growth and policy wise
- Oil prices will remain high and volatile
- Outlook for the US has improved, but a fiscal adjustment is needed.
- Institutional and economic reforms in Europe will continue although in a partial way.
- Asia and Latin America will keep on growing strongly. Overheating risks increasing
- In the long run, the crisis will dent potential growth in advanced economies. Emerging markets will surge relatively unscathed.
- The impact of Japan's earthquake are not easy to asses yet. In the short-run is a textbook supply shock. Risks are focused on nuclear threat and disruption of energy generation for a longer period of time.

## Taxonomy of risks

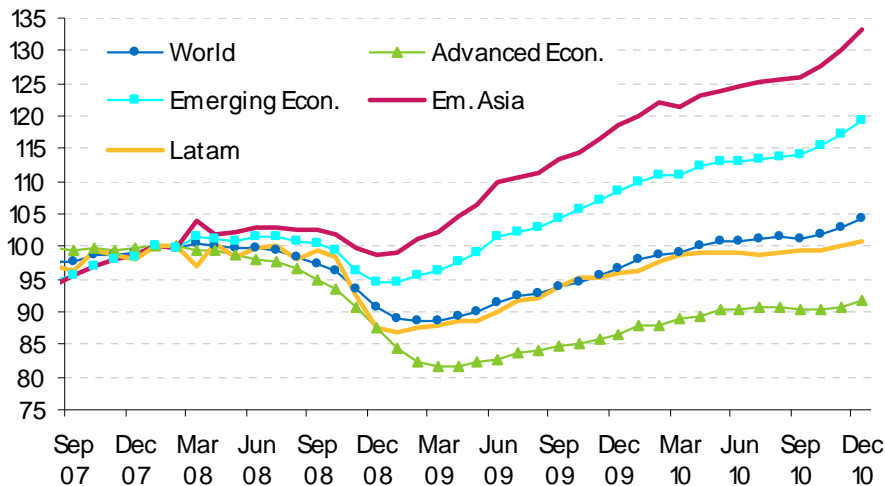


# Global shocks and decouplings

After the synchronized hit of the global financial crisis, advanced and emerging economies have been exiting the crisis at very different paces

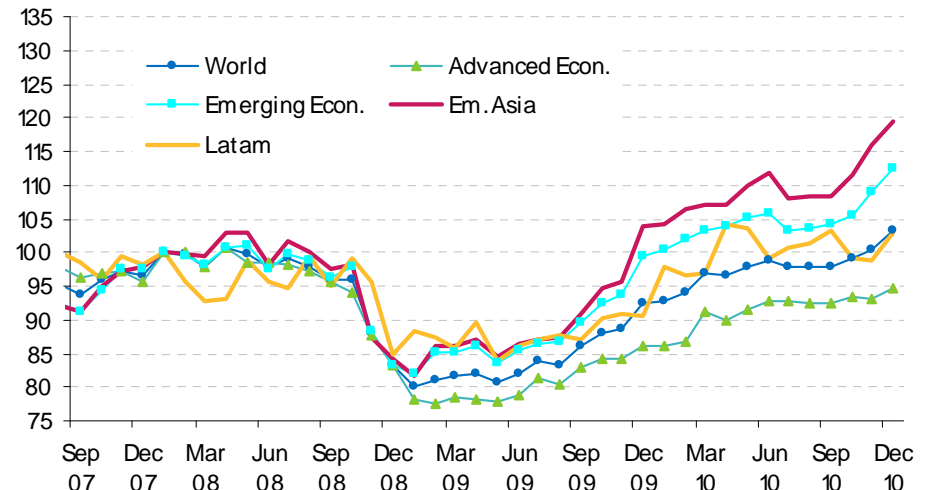
Industrial production (Index Jan 2008=100)

Source: BBVA Research and CPB



Exports (Index Jan 2008=100)

Fuente: BBVA Research and CPB

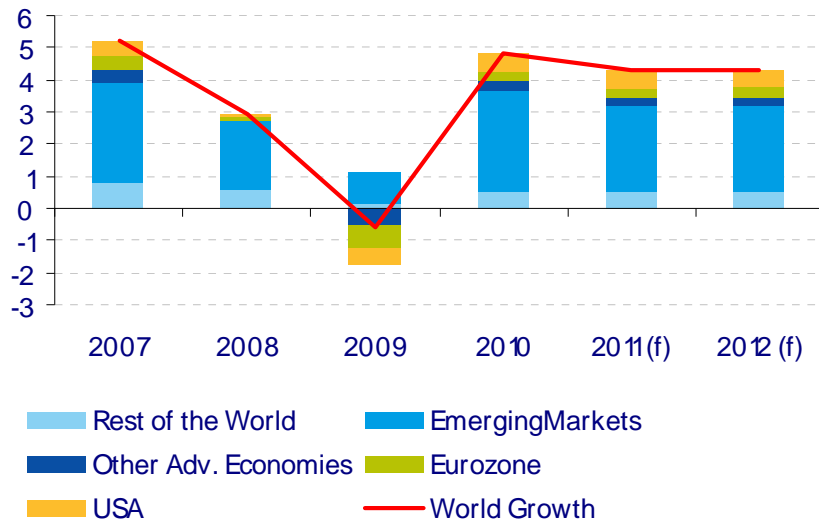


# Global shocks and decouplings

The outlook is for continued strong global growth but with very different situations: emerging/advanced, US/EMU, and within EMU

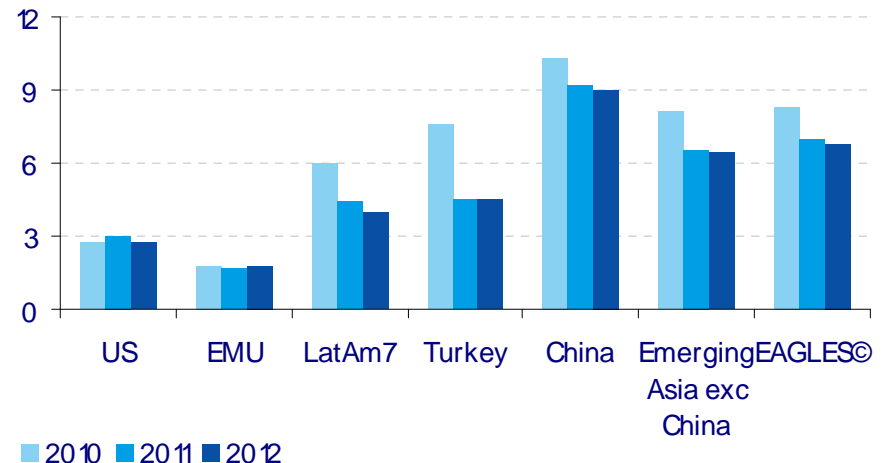
Contributions to GDP growth (%)

Source: BBVA Research



GDP growth forecasts (%)

Source: BBVA Research

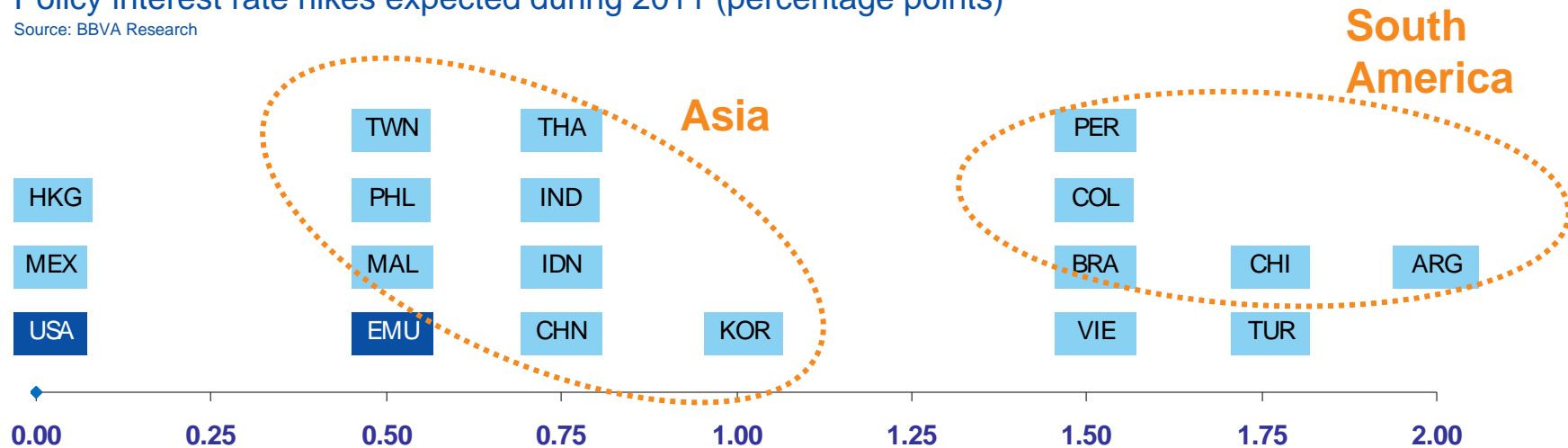


# Global shocks and decouplings

Diverging growth leads to a decoupling of fiscal and (especially) monetary policies across countries/regions

Policy interest rate hikes expected during 2011 (percentage points)

Source: BBVA Research

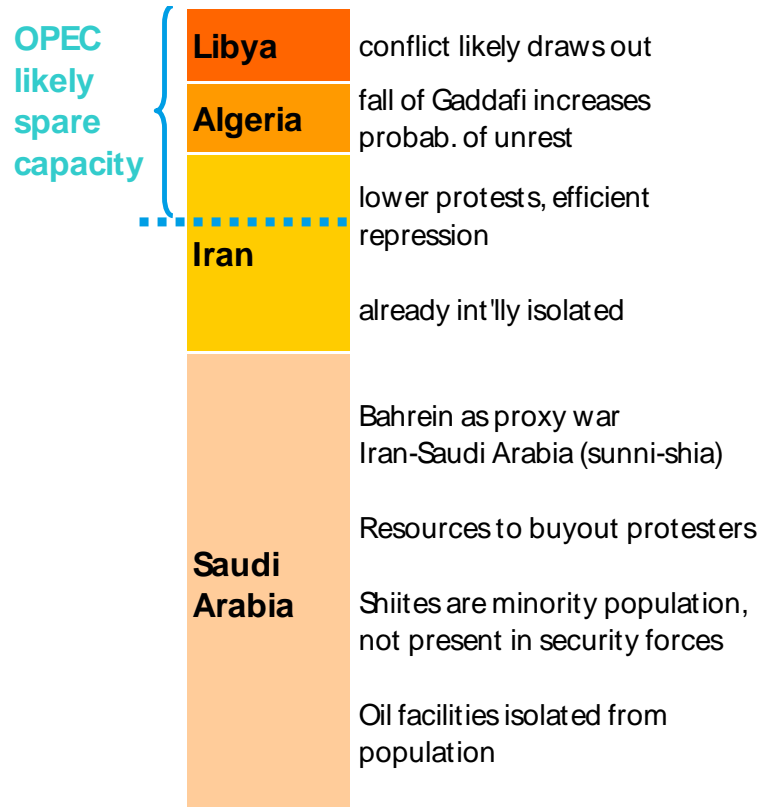


# Global shocks and decouplings

Geopolitical scenarios for the MENA region highly uncertain: fallout on oil markets hard to assess. However more volatility should be expected

Heat map of unrest in MENA oil producing countries  
(height of boxes proportional to oil production on Dec. 2010)

Source: BBVA Research



## Effect on oil markets depending on:

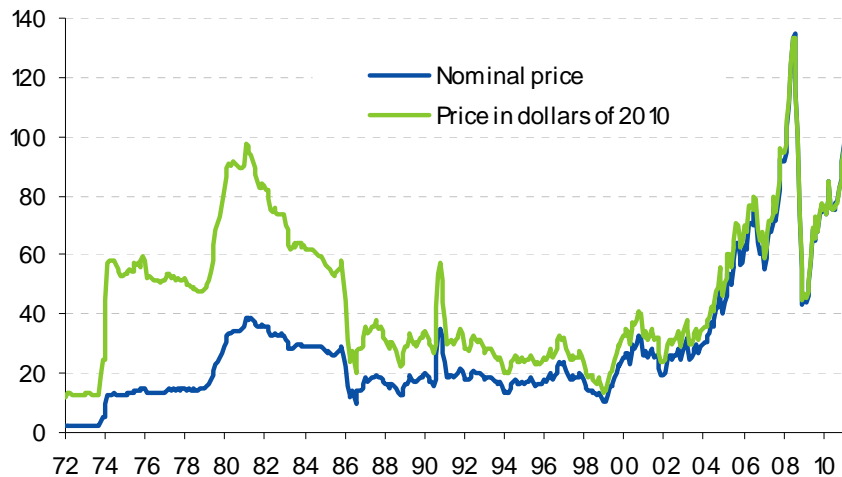
- True extent of reduction in production
- True level of OPEC spare capacity
- OPEC (Saudi Arabia) possible new target price
- Willingness of OECD countries to use strategic oil reserves
- Lingering geopolitical risk premium

# Global shocks and decouplings

Recovery risks being derailed by oil shock, especially in advanced economies. Contrary to 2004-2010, recent price spike derives from a negative supply shock, potentially more damaging to growth.

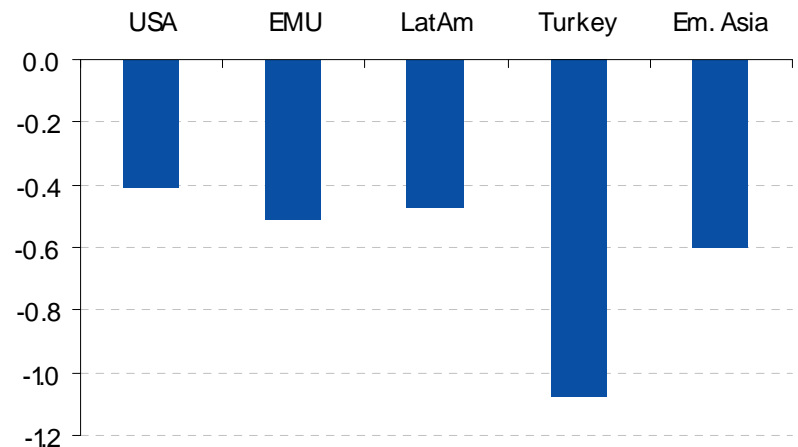
Oil prices in real terms

Fuente: BBVA Research



Effect on 2011 growth of oil prices sustained at 130 USD

Source: BBVA Research and OEF





# Outline

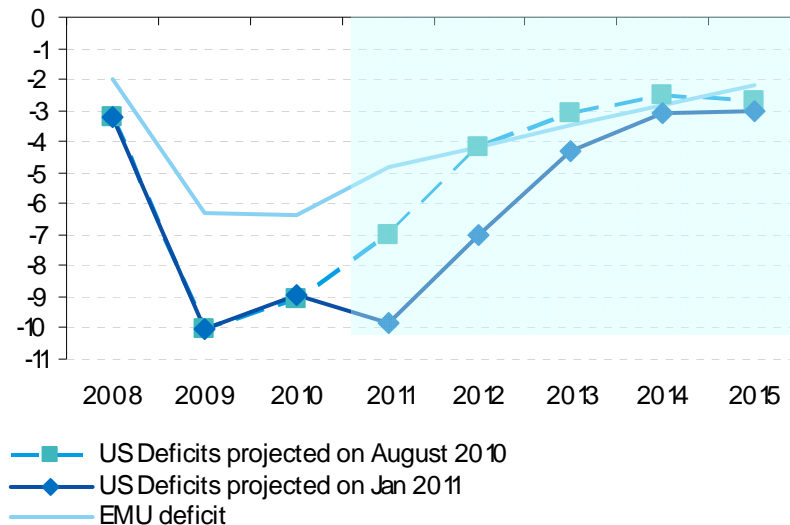
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# Brighter outlook in the US

Data confirms a low probability of a double dip in the US, as fiscal and monetary policy continue supporting growth. Risks are roughly balanced

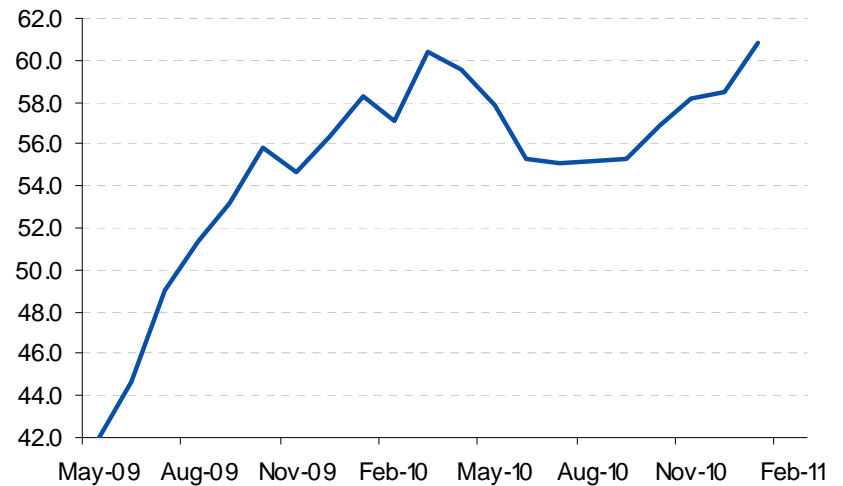
US and EMU public deficits (% of GDP)

Source: BBVA Research and CBO



US: Business confidence

Source: BBVA Research and Haver Analytics



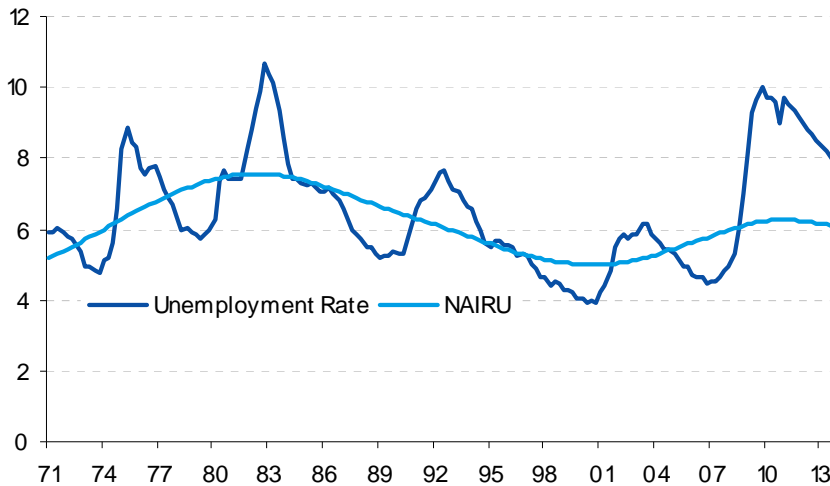
# Brighter outlook in the US

But some cyclical vulnerabilities remain...

- Unemployment doing better but still high
- Long-term fiscal risks continue to exit

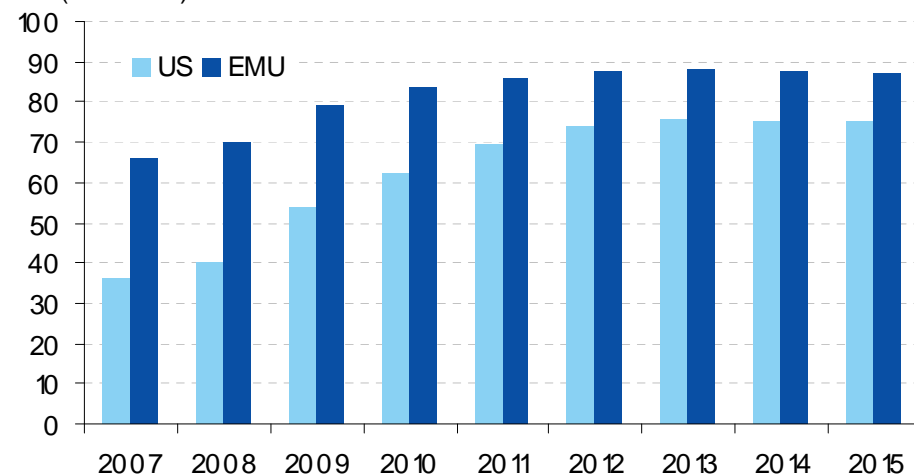
EEUU: unemployment rate

Source: BBVA Research and Bureau of Labor Statistics



Public Debt in US and EMU (% GDP)

Source: BBVA Research and CBO



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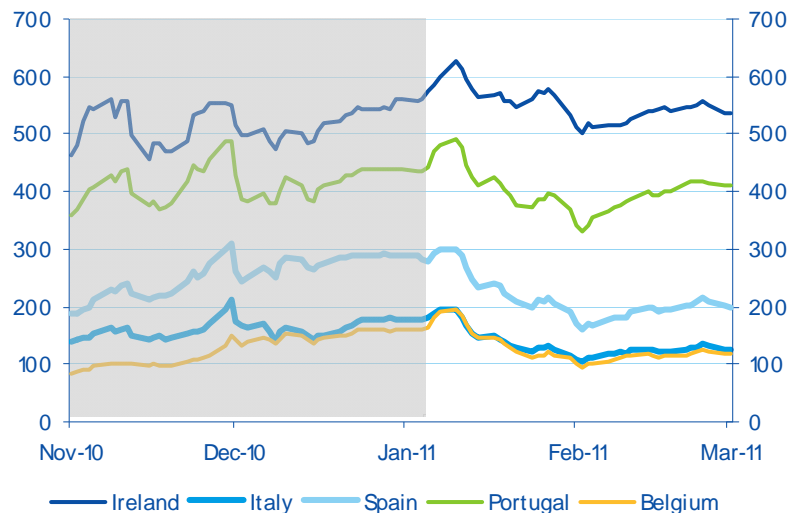
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# A window of opportunity in Europe

In the fourth quarter of 2011, financial tensions surged again in Europe. European authorities have a window of opportunity, which they should not miss

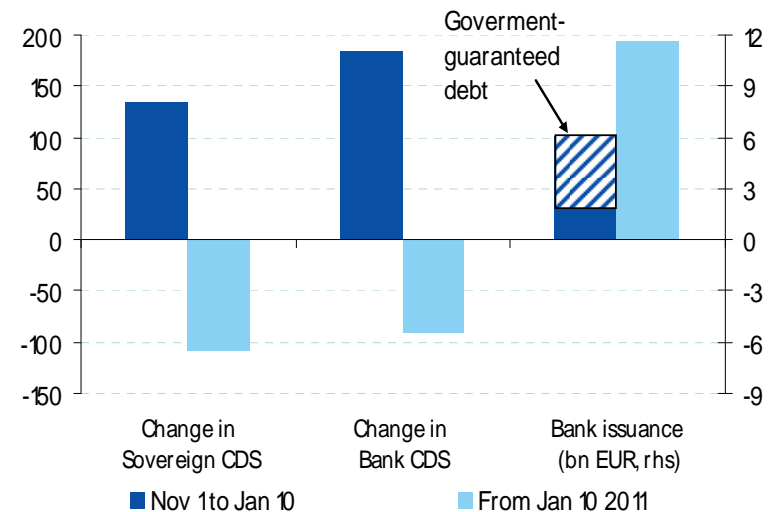
Sovereign CDS differentials against Germany

Source: BBVA Research and Bloomberg



Spain: 5-year CDS and bank issuance

Source: BBVA Research and Bloomberg



# A window of opportunity in Europe

European governance: our preferred outcome

## Short run

Liquidity and solvency to restore confidence

### Liquidity problems

- Improve EFSF

### Solvency problems

- Solvency tests
- Haircuts, no bail in
- Conditionality

## Long run

Strong framework for crisis prevention and resolution

### Crisis Prevention

- Macro surveillance
- Fiscal rules
- Automatic sanctions

### Crisis Resolution

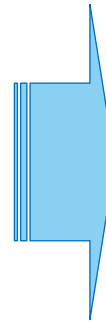
- “Bail-in”

# A window of opportunity in Europe

What can come up from “Grand Bargain” of European authorities in March?

## March 11 – Soft Competitiveness pact [German proposal]

- **Fixed retirement age across countries:**  
→ Probably something weaker like vigilance
- **Harmonization of tax bases:**  
→ Probably only voluntary
- **Fiscal rules in the constitution:**  
→ Probably out of the constitution.
- **Suppress wage indexation to inflation:**  
→ Not suppressed



## March 24 – Minor changes to EFSF [Initial proposals → what's likely]

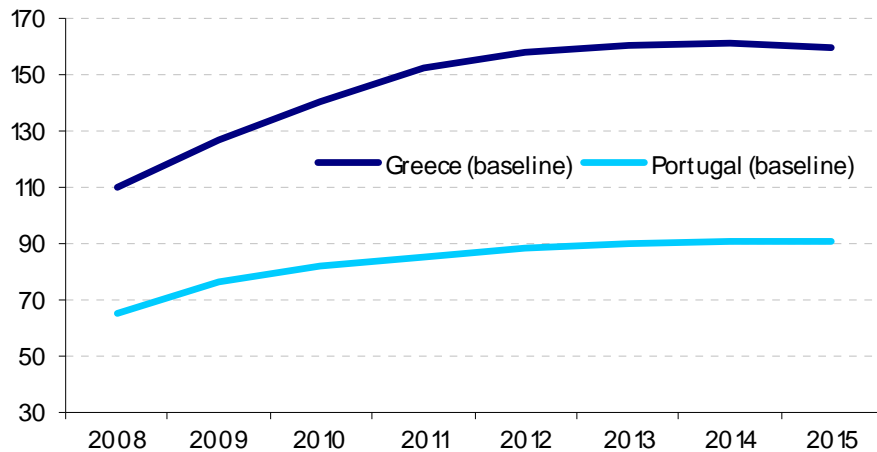
- **Increase EFSF/ESM:** → Probably only up to its current nominal ceiling.
- **EFSF/ESM more flexible, to buy bonds in secondary markets:** → Germany, Austria, Finland and Netherlands strongly against it.
- **Renegotiation of loan terms to Ireland / Greece:** → Germans against it but could agree
- **When to apply Bail-ins:** → big risk if they want to apply it soon to Greece

# A window of opportunity in Europe

Assessing solvency is key: there is a high heterogeneity in public debt outlooks in peripheral Europe

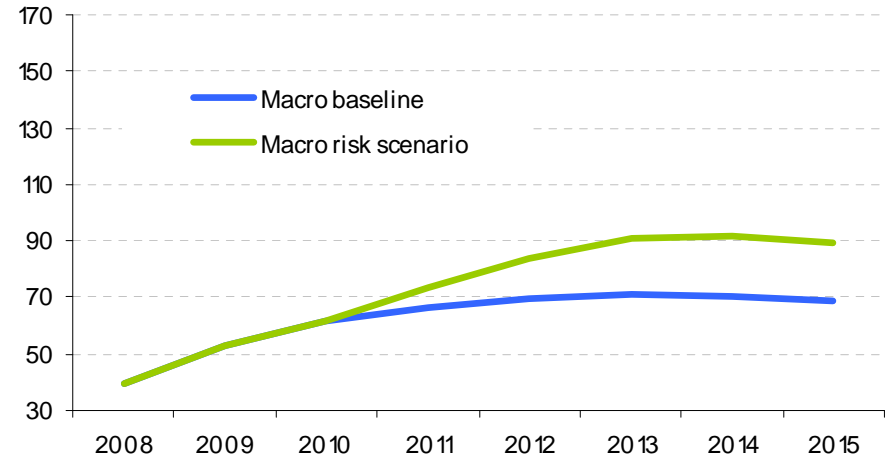
Greece and Portugal: Public debt (% GDP)

Source: BBVA Research



Spain: Public debt scenarios (% GDP)

Source: BBVA Research





# A window of opportunity in Europe

Economic reforms in Spain are happening: very necessary to reap the benefits of governance reform in Europe

## Fiscal consolidation

### Fiscal adjustment continues

- Inroads in transparency and fiscal discipline
- **Although doubts about regional governments, situation is improving**

### Pension reform

- Substantial reform, improves medium-term solvency of the system
- **Still somewhat more generous than German system**

## Financial System

### Steps taken in the right direction

- Clear route to restructuring
- Encourages private sector participation
- Likely conversion into banks

### • **Doubts about willingness of private capital to participate**

- **However muted by recent announcement of Middle Eastern governments and SWF**

## Labor market

### Positive assessment of reforms

- Lower firing costs
- German model (Kurzarbeit)

### Implementation of labor reform still pending

- **Uncertainty on conditions for firing**
- **Dual markets only reduced, not eliminated**

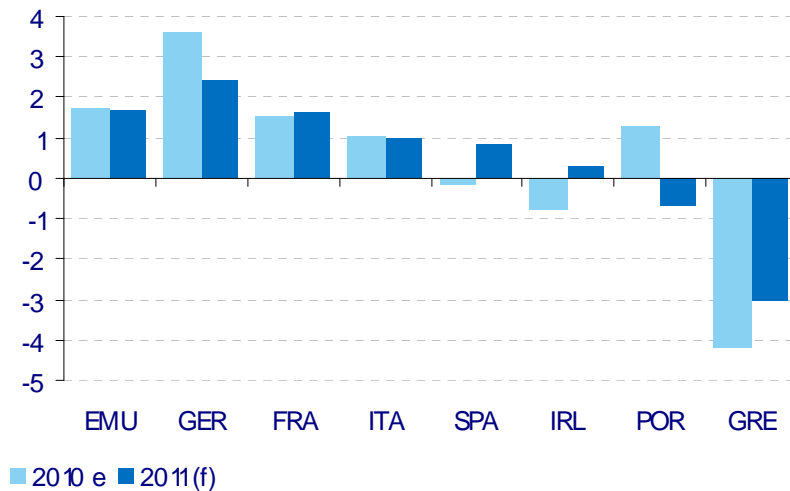
# A window of opportunity in Europe

Heterogeneous cyclical outlook in Europe. In Spain growth will be supported by external demand during first half of 2011, but will not be strong enough to reduce unemployment substantially.

## EMU: Growth forecasts

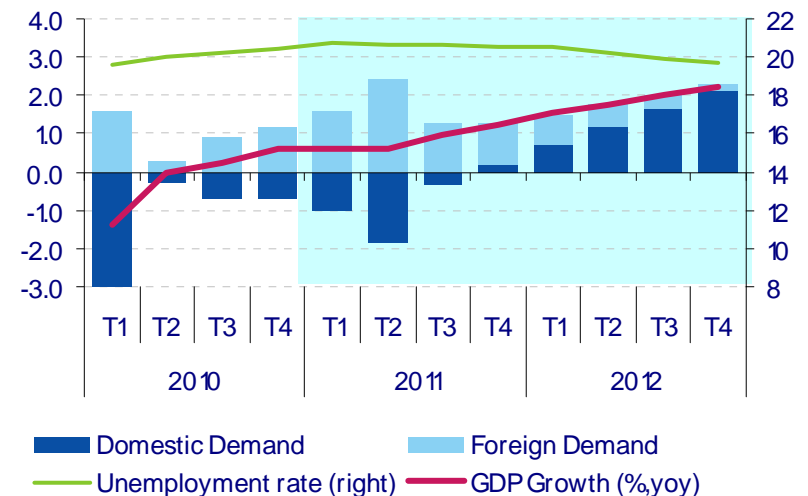
(GDP growth rates, y-o-y)

Source: BBVA Research



## Spain: Growth and unemployment

Source: BBVA Research



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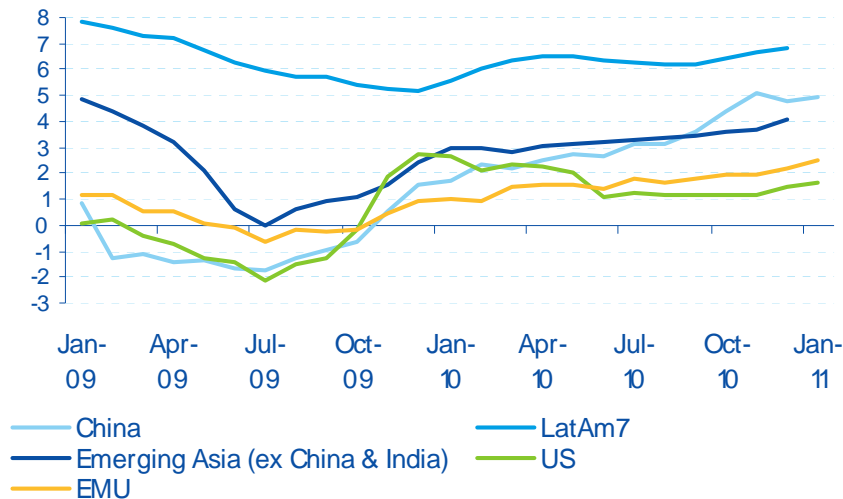
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# EMEs: controlled slowdown

Buoyant domestic demand raise risk of overheating in Asia. The baseline scenario is one of controlled deceleration but monetary and fiscal policies need to be aligned to this objective

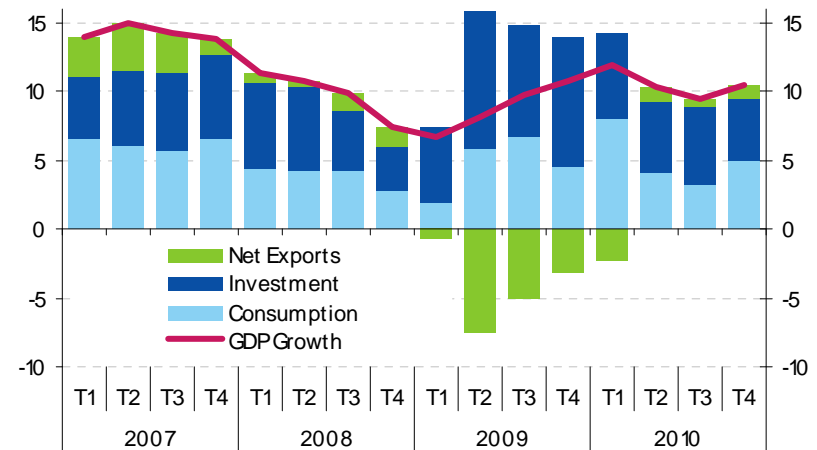
Inflation (% , y-o-y)

Source: BBVA Research and Datastream



China: Contributions to GDP growth

Source: BBVA Research and CEIC



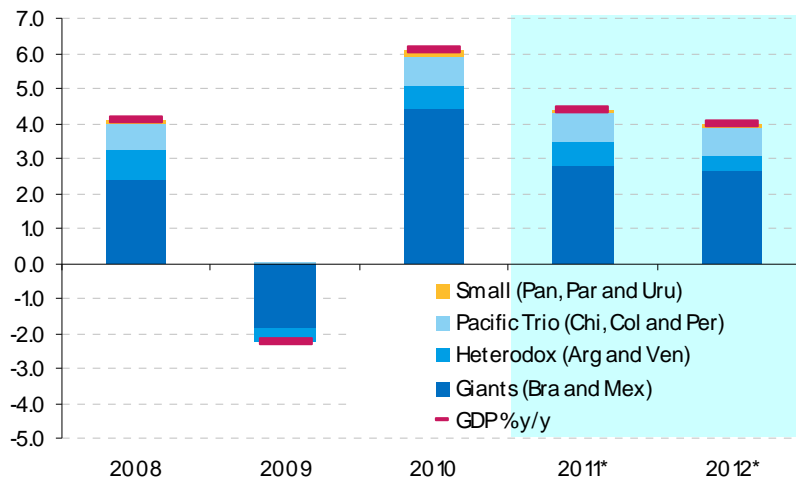
# EMEs: controlled slowdown

Latam will converge to potential growth, with growing external deficits.

- Growth will continue to be supported by domestic demand, after strong readings in 2010.
- High growth and commodity prices have increased public revenues, but expenditure high.
- High commodity prices have only partially compensated the pressure of strong domestic demand on imports. External deficits will keep on growing.

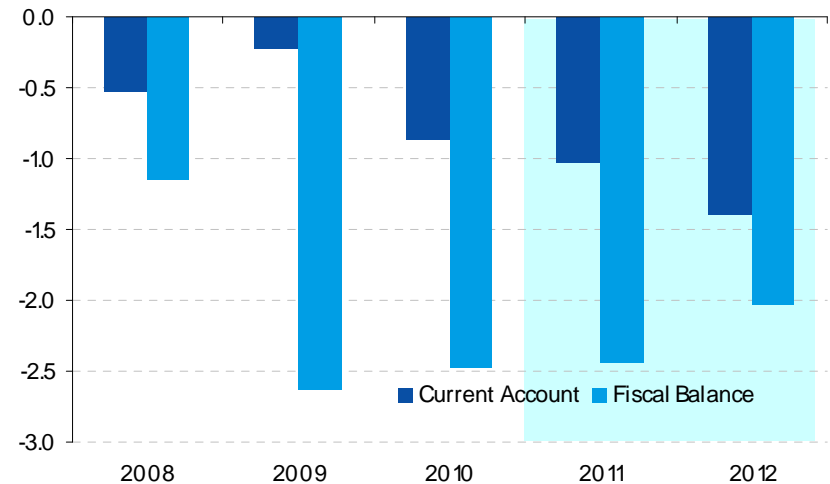
Contributions to Latam growth (% annual)

Source: BBVA Research



Latam: Fiscal and external balance (% annual)

Source: BBVA Research



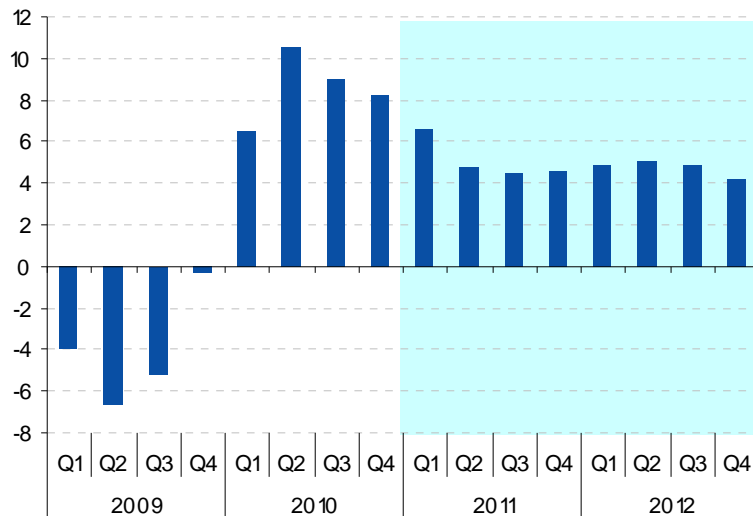
# EMEs: controlled slowdown

## Latam: risks of overheating muted by the expected deceleration

- However, deceleration needs stricter monetary and fiscal policy and there is a risk they may not happen. Overoptimistic expectations on emerging markets also not helping
- Very lax monetary policies in developed countries can flood emerging markets with liquidity (although not yet happening massively (except Brazil))

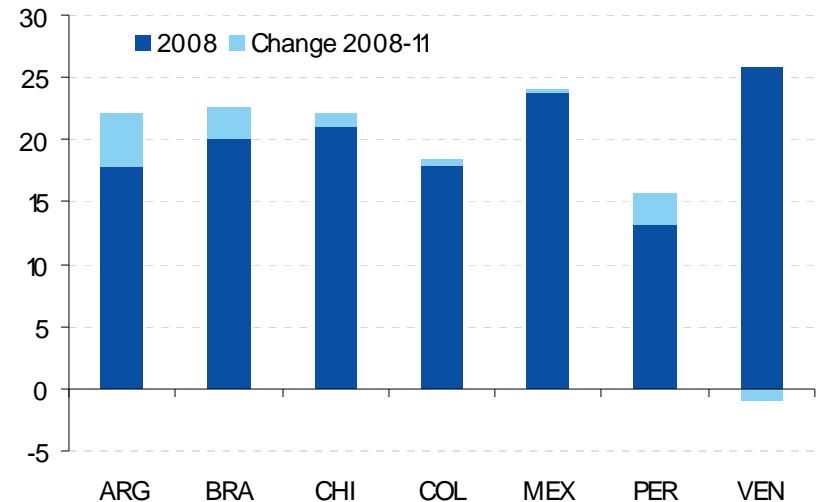
Latam: domestic demand (% annual)

Source: BBVA Research



Latam: government expenditure in 2008 and change 2008-11 (% GDP)

Source: BBVA Research



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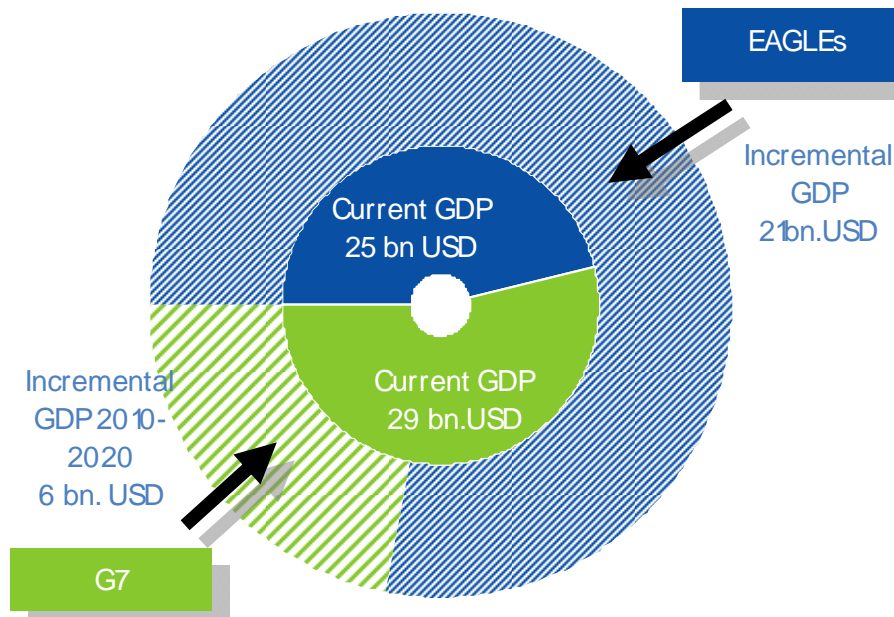
# EMEs potential: the EAGLEs©

## EAGLEs: Emerging and Growth-Leading Economies

- Economies which will add more to global growth than average of the G6 developed economies (G7 ex-US)
- More relevant to new business than size (current GDP): related with new business opportunities
- Not too long horizon for projections (10 years); relevant for business
- Dynamic and flexible: revised yearly and not linked to a given set of countries

### EAGLES vs G7: current GDP vs. “new business”

Source: BBVA Research



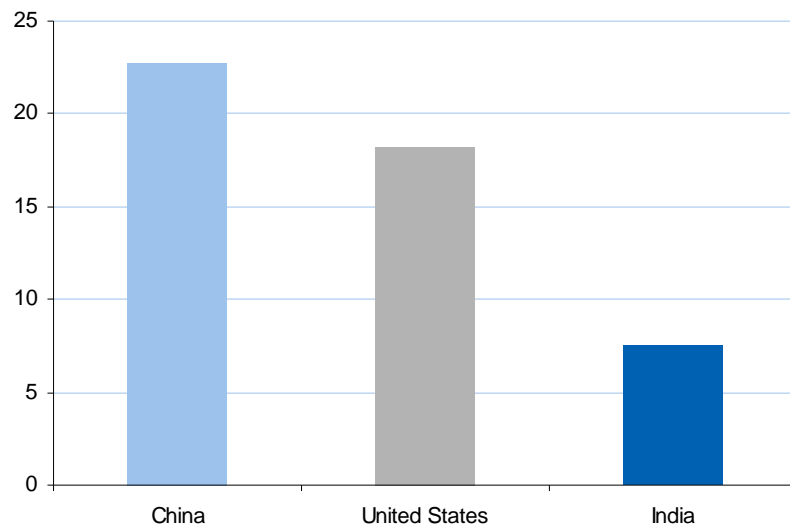


# Who are the EAGLEs? China is on a league of its own

- China is more than a BRIC weighting 70% of the group's contribution to growth
- In 2017 China's GDP adjusted by PPP will be larger than the US
- India is another world class player with an incremental GDP similar to US

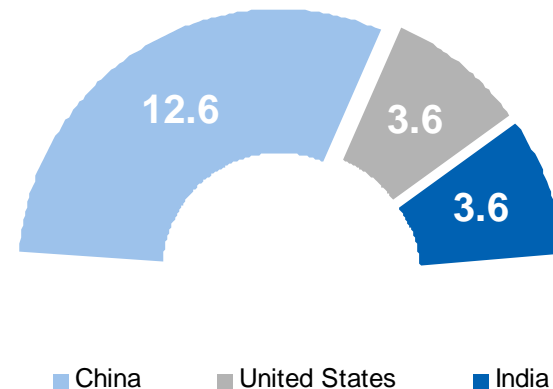
**GDP adjusted by PPP: level in 2020 (trillions)**

Source: BBVA Research and IMF



**GDP adjusted by PPP: change in 2010-2020 (trillions)**

Source: BBVA Research and IMF

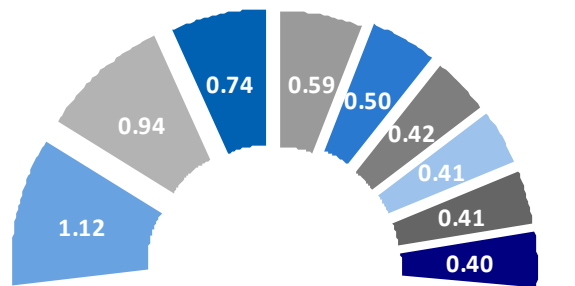


# Who are the other EAGLEs? Taiwan is one!

- Brazil, Indonesia and Korean incremental GDP will exceed that of Japan
- Russia and Mexico will exceed German's contribution
- Egypt, Turkey and Taiwan will play a more important role than UK, Canada, France and Italy!

**GDP adjusted by PPP: change in 2010-2020 (trillions)**

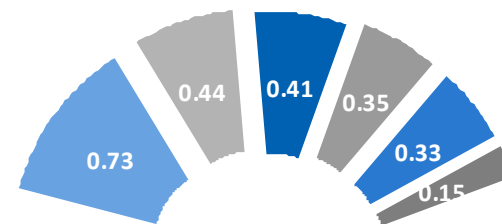
Source: BBVA Research and IMF



■ Brazil ■ Indonesia ■ Korea ■ Russia ■ Mexico  
 ■ Egypt ■ Taiwan ■ Turkey ■ G6

**GDP adjusted by PPP: change in 2010-2020 (trillions)**

Source: BBVA Research and IMF



■ Japan ■ Germany ■ United Kingdom ■ Canada ■ France ■ Italy

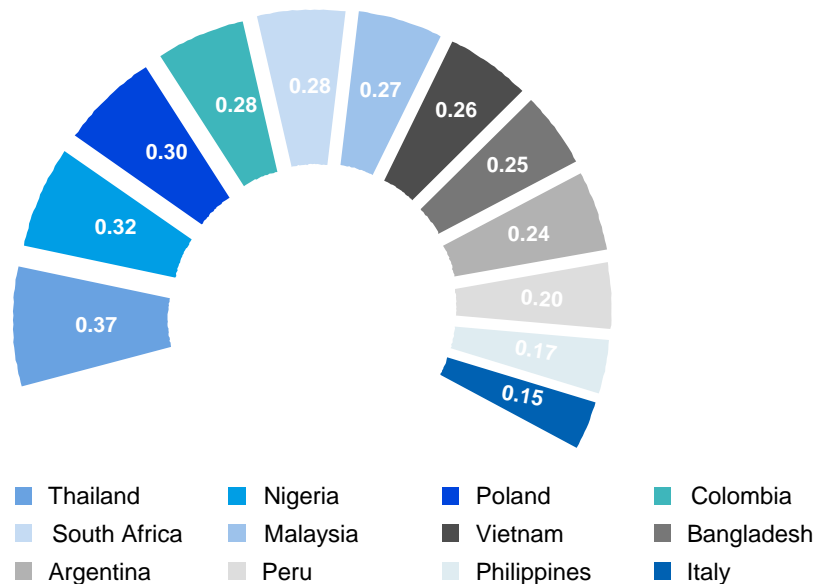
G6 Average: Canada, Germany, France, Italy, Japan and UK

# The Nest: Who can be the next EAGLEs?

- Additionally 11 economies are expected to add to global growth more than Italy, the smallest contributor within the G6

**GDP adjusted by PPP: change in 2010-2020 (trillions)**

Source: BBVA Research and IMF



## Main messages

- The global economy will continue growing strongly but also decoupling, both growth and policy wise; between advanced and emerging economies; between the US and EMU, and within EMU.
- What is now a temporary oil shock risks derailing the recovery in advanced economies if becomes permanent.
- US will continue growing more strongly than Europe. Outlook for the US has improved, but a fiscal adjustment is seriously needed. Markets may not forgive the US otherwise.
- Institutional and economic reforms in Europe will be crucial to solve the financial crisis. It is imperative that Europe takes advantage of a window of opportunity that is closing fast.
- Asia and Latin America will on track for a mild slowdown from very high growth. However, overheating risks have increased.
- In the long run, the crisis will dent potential growth in advanced economies, but emerging markets will surge relatively unscathed.
- Emerging markets will outpace developed ones and become absolutely key for the global economy: Eagles concept shows the 10 most important economies in terms of contribution to global GDP: Taiwan is one of them!

# Where is global economy heading?

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