

# Recovery, shocks and vulnerabilities

Global Economic Outlook

Madrid, 11 May 2011

## Main messages

- 1 Oil and monetary policy:** oil prices will remain elevated at least in 2011, but effect on growth can be absorbed. Effect on inflation brings forward monetary policy tightening, though at different paces in US and Europe
- 2 European outlook:** March summits have not addressed solvency concerns satisfactorily. Tensions will remain elevated in periphery and decoupling will continue between peripheral and core countries.
- 3 US outlook:** recovery continues but upside risks are now slightly tilted to the downside due to oil prices and a temporary soft patch in Q1. The political noise around fiscal consolidation will add to uncertainty.
- 4 Emerging Economies:** overheating concerns remain, but have worsened especially in Latam, given tailwinds from commodity prices.
- 5 Growth outlook:** no major revisions to growth projections. Slight upward revision in projected growth in emerging economies in 2011, given strong Q1 data. Emerging economies will slow down in 2011 but will continue supporting global growth.

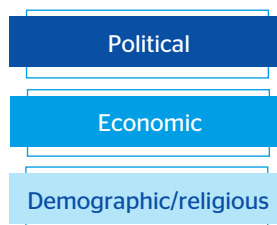
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- 1 Oil prices and the global economy
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- 4 Risks of overheating in emerging economies

## Turmoil in MENA and oil prices

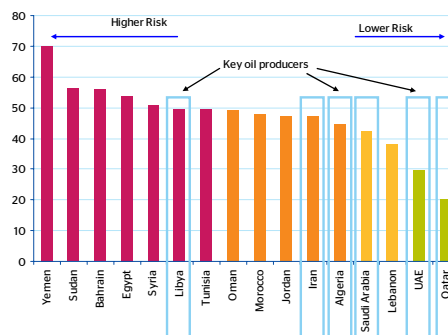
Political instability in the Middle East and North Africa (MENA) can be traced to political, economic and demographic factors that are hard to replicate in other regions.  
Except for Libya, the most important oil producers in the region show only medium to low chances of unrest.

Determinants of political instability in MENA countries



Index of risk of potential unrest in MENA countries

Source: BBVA Research

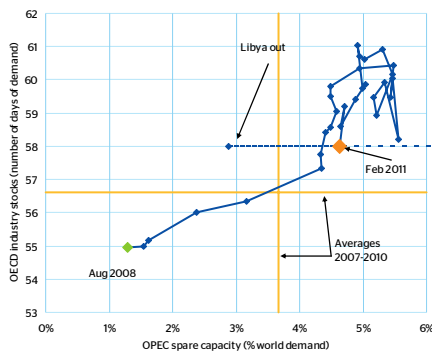


## Turmoil in MENA and oil prices

Oil and other commodity prices will remain elevated during 2011, but they should flex down slowly as contagion to other important oil producers in the region is prevented.

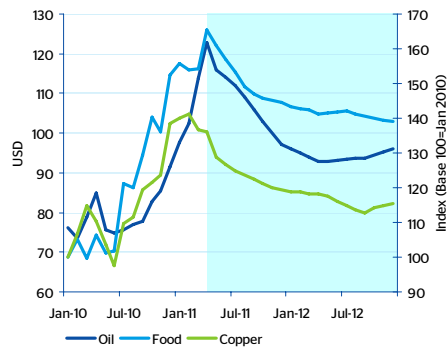
### Oil market buffers

Source: BBVA Research and EIA



### Commodity prices

Source: BBVA Research



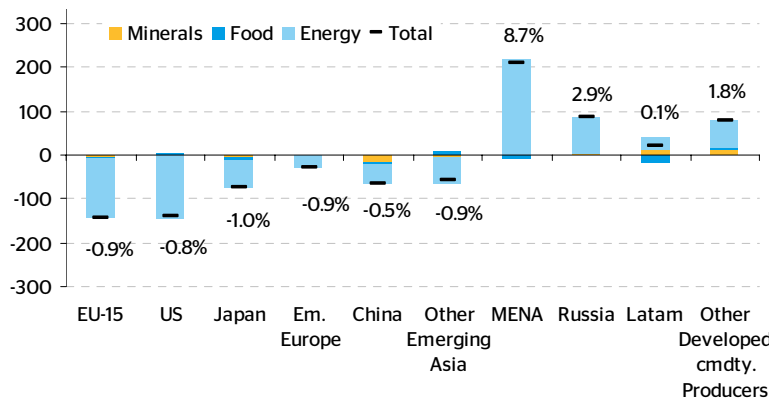
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## Oil prices and global growth

Higher commodity prices will imply an increase in net income transfers from commodity importers to exporters.

### Change in net transfers due to commodity prices (2011 vs. 2010, USD bn and % of own GDP)

Source: BBVA Research



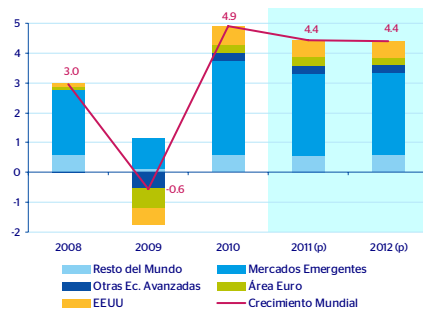
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## Oil prices and global growth

Overall, the global economy will be able to absorb higher oil prices without much impact on growth. Global growth will continue strongly, propelled by emerging economies. Among developed economies, the strength of the recovery will differ markedly.

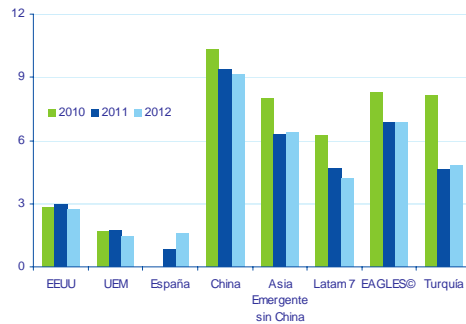
**Contributions to global growth (%)**

Source: BBVA Research



**Growth forecasts (%)**

Source: BBVA Research



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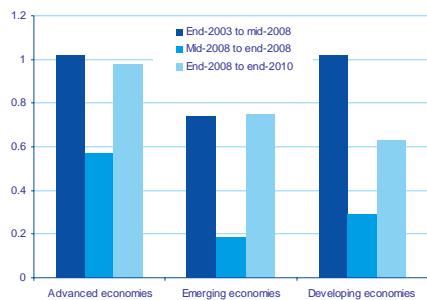
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## Oil prices and inflation

The main effect of higher oil prices will be higher headline inflation in most economies in 2011, though the effect will be temporary. Emerging economies with fiscal space will try to limit the pass-through of commodity prices to domestic prices, as in the previous cycle.

### Pass-through of international to domestic oil prices\*

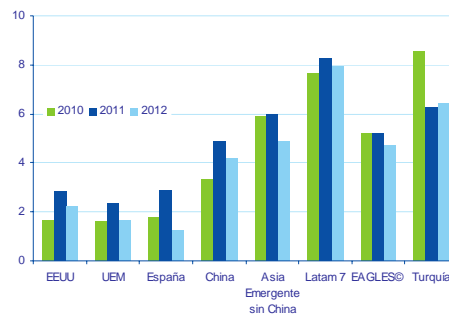
Source: BBVA Research and IMF



\* Ratio of change in domestic price of hydrocarbons to the international spot price index, measured both in local currency

### Inflation forecasts (%)

Source: BBVA Research



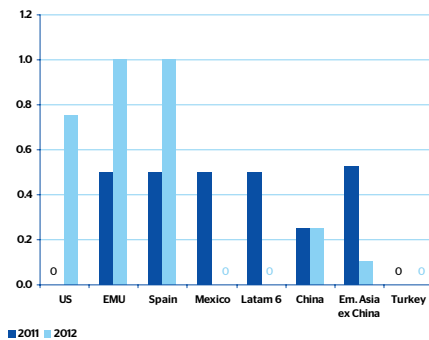
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## Monetary policy response

The rise in headline inflation and the risks of second-round effects will prompt central banks to bring forward in time their expected interest rate hikes, but with wide heterogeneity across countries. In particular, the Fed is in no hurry to raise interest rates.

### Change in year-end forecast for central bank rates compared to February projections

Source: BBVA Research



### Policy interest rates

	ECB	Fed
Today	1.25	0.25
April 2012	2.00	0.50

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## March European summits and sovereign debt tensions

European summits in March have agreed useful reforms for the long run (Euro Plus Pact) but have not address solvency concerns.

¿What was needed to end sovereign debt concerns?

¿Done?

Improve the EFSF and approve a permanent rescue fund, ESM

Limited flexibility and higher lending capacity still pending to be approved (June).



Address solvency concerns

March summits have not addressed solvency concerns. Action has been delayed further down the road



Reforms to strengthen macro surveillance

Euro Plus Pact was approved. Together with the ongoing reform of the SGP will help prevent future crises

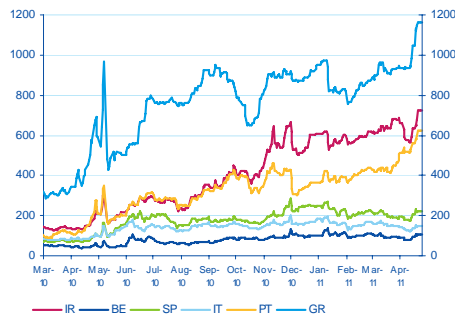


## Financial tensions in Europe continue

Markets are getting impatient with partial solutions to possible solvency problems. Sovereign spreads in Greece, Portugal and Ireland will remain high given lack of comprehensive solutions.

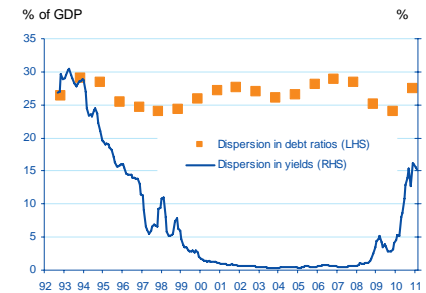
10y sovereign bond spreads to Germany

Source: BBVA Research.



Dispersion of yields and debt levels in the Euro zone

Source: BBVA Research.



\* Standard deviation of debt ratios and yields for Germany, France, Italy, Spain, Portugal, Ireland and Greece.

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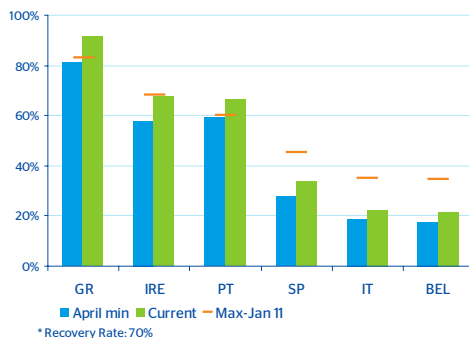
## Europe: solvency concerns arise

Declarations in favor of Greek debt restructuring by European officials and rumours that the IMF would also support this measure, have spooked markets in late April. Markets increasingly view as insufficient a mere extension of deadlines for official debt.

Given very high Greek banks' exposure to its own sovereign debt and also cross border exposures by European banks a strong restructuring, with haircuts for private investors, would have very harmful effects and a high potential worse financial market tensions than in 2010.

Probability of default implied by 5y CDS\*

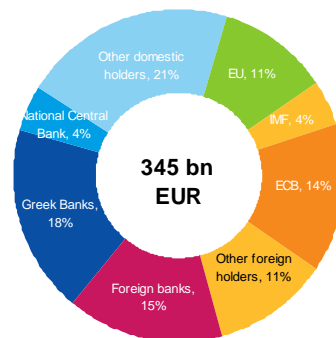
Source: BBVA Research, and Bloomberg



\* Recovery Rate: 70%

Holders of Greek sovereign debt (EUR bn)

Source: BBVA Research, IMF, BIS and national authorities



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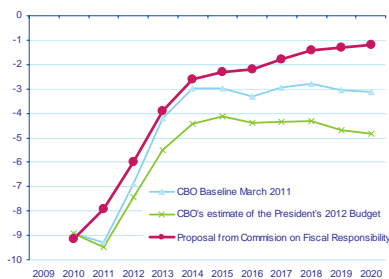
## US: on track for fiscal consolidation?

**In the US, negotiations for a fiscal deficit reduction will likely end in a true fiscal consolidation plan, but the political noise around the debate will likely add to uncertainty in the markets.**

We expect the debate will gravitate towards cuts probably in line with the proposal by the National Commission on Fiscal Responsibility and Reform and that the final outcome will be a reduction in deficits and a more sustainable debt path.

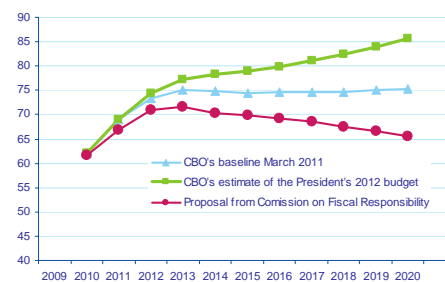
**US Fiscal deficit (% of GDP)**

Source: BBVA Research, CBO and Commission on Fiscal Responsibility and Reform



**US debt held by the public (% of GDP)**

Source: BBVA Research, CBO and Commission on Fiscal Responsibility and Reform



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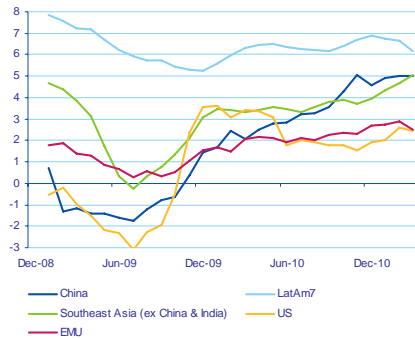


## Inflation and growth in emerging economies

Inflation in emerging economies has continued rising, and economic activity in the first quarter has generally surprised to the upside, both in Asia and Latam, although we still project a deceleration of activity in 2011.

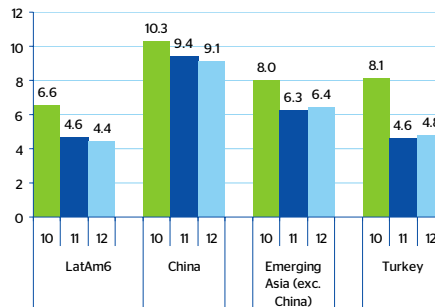
**Inflation (% yoy)**

Source: BBVA Research and Haver Analytics



**GDP growth**

Source: BBVA Research



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## Emerging Economies: differing risks of overheating

- Emerging economies continue to show risks of overheating, given strong outturns in first quarter, but with marked heterogeneity.
- Countries are starting to confront those risks with policy decisions, but higher commodity prices and smaller current account buffers make situation more dire for Latam

**Overheating indicators for emerging economies and policy stance**

Source: BBVA Research and IMF

		Policy stance	
		Fiscal Balance	Real policy Interest Rate
		Overheating indicator	
Latam	Argentina		
	Brazil		
	Chile		
	Colombia		
	Peru		
	Venezuela		
	Mexico		
Emerging Asia	China		
	Hong Kong		
	India		
	Indonesia		
	Korea		
	Philippines		
	Malaysia		
	Thailand		
	Turkey		

more overheating | easier policy stance

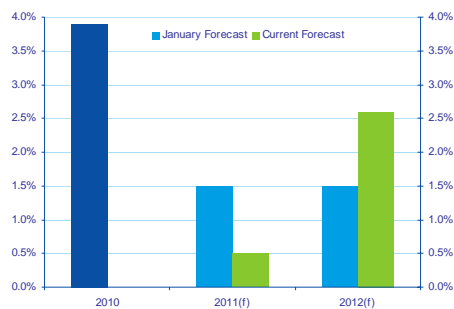
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## Some factors limit risk of overheating in Asia

Overheating risks in Asia might be limited by headwinds coming from higher commodity prices (they, on the other hand, represent a tailwind in Latam) and the effect of the East Japan earthquake. Moreover, the region has ample current account surplus to prevent a hard landing in case of overheating.

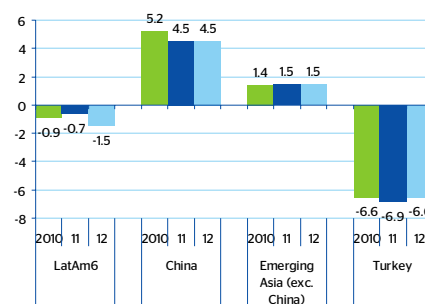
Japan: GDP growth forecast

Source: BBVA Research



Current account balances

Source: BBVA Research



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## Annex: Growth forecasts

Europe: recovery at different speeds. Core vs peripheral countries.

US: recovery with risks to the downside given soft patch in 2011Q1.

Upward revisions in Mexico and South America.

Asia on track for a soft landing.

	GDP growth forecasts				
	2009	2010 (e)	2011 (f)	2012 (f)	2013
<b>US</b>	-2.6	2.9	3.0	2.7	2.4
<b>EMU</b>	-4.0	1.7	1.7	1.5	1.9
<b>Spain</b>	-3.7	-0.1	0.9	1.6	2.4
<b>LatAm 7</b>	-2.4	6.2	4.7	4.2	3.6
<b>Argentina</b>	-2.1	8.7	5.5	4.0	1.2
<b>Brazil</b>	-0.2	7.6	4.0	4.4	4.3
<b>Chile</b>	-1.5	5.2	6.2	5.1	5.1
<b>Colombia</b>	0.8	4.3	5.0	5.5	5.3
<b>Mexico</b>	-6.6	5.5	4.7	3.8	3.0
<b>Peru</b>	0.9	8.8	7.1	6.3	6.0
<b>Venezuela</b>	-3.3	-1.6	4.2	2.5	2.0
<b>EAGLES</b>	3.5	8.3	6.9	6.9	6.8
<b>Turkey</b>	-4.7	8.1	4.6	4.8	4.4
<b>China</b>	9.1	10.3	9.4	9.1	8.9
<b>Emerging Asia</b>	5.2	9.2	7.9	7.8	7.7