

The Global Economic Outlook and the Spanish Economy

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IADS FINANCIAL DIRECTORS MEETING

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Section 1

Global economy: a more balanced contribution to growth between developed and emerging economies

Section 2

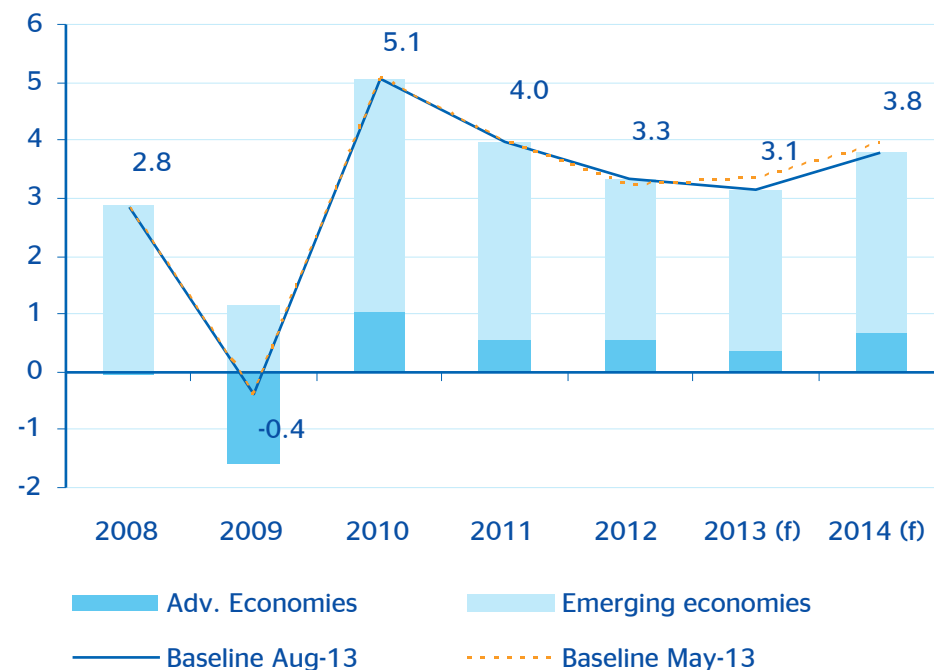
Spain: the Spanish economy will bottom out in 2013. Growth will resume in 2014

The global economy is growing but below its potential

- 1 Global growth has slowed down slightly** due to incoming adjustment in emerging economies
- 2 Financial conditions have tightened in some countries** as consequence of FED announcement on the QE exit strategy and the emerging economies adjustment

World GDP growth (%)

Source: BBVA Research



Progress in the global economic situation...

US: sustained recovery (albeit below potential), strength in private demand. A careful exit strategy by the Federal Reserve is a must (*forward guidance*)

Emerging economies: resiliency and macroeconomic stability during a prolonged period of crisis in developed economies, but heterogeneity between countries

EMU: recovery although with differences among countries. Fiscal targets delayed, advances towards the Banking Union and financial stress reduction

Spain: improving outlook and international confidence, lower risk premium, current account surplus and macroeconomic stabilization

... with significant uncertainties

Worldwide: risk of abrupt deceleration in some emerging countries and doubts on their ability to rebalance the economic pattern, effects on capital flows of the monetary normalization in the US and geopolitical risks in the Middle East.

US: debt ceiling agreement, long term fiscal uncertainty and risks regarding the exit strategy of the Federal Reserve

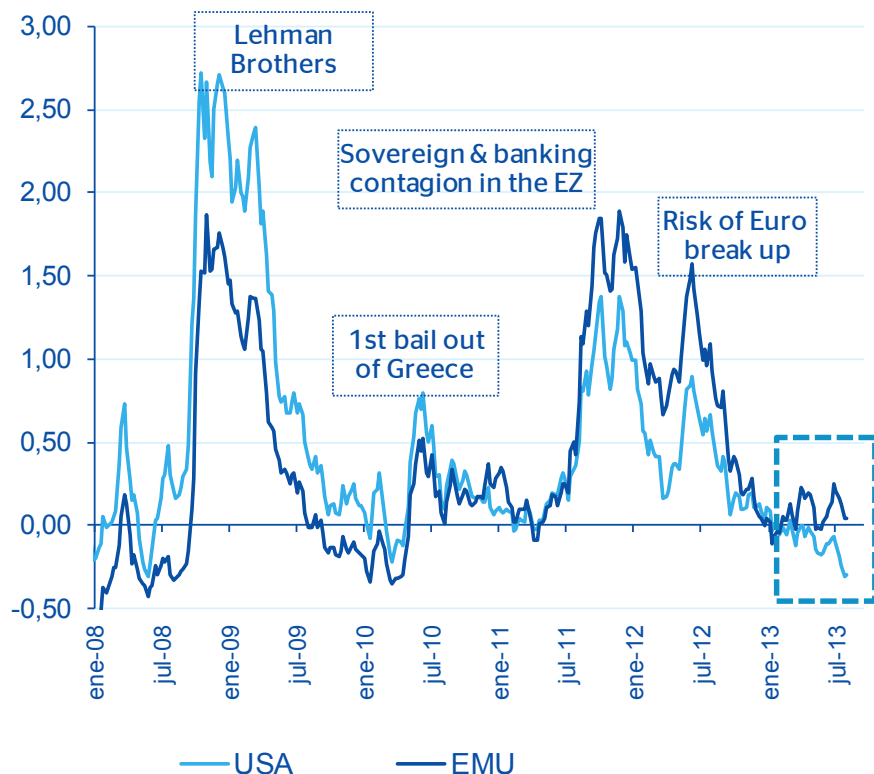
EMU: political uncertainties in Italy and Spain, new financial assistance to Greece and Portugal, AQR results of European banks, sovereign risk persistence and financial fragmentation

Spain: uncertainty about the scope and intensity of structural reforms, potential growth, fiscal consolidation and completion of bank restructuring

Developed markets remained resilient to risk events

BBVA financial tensions index

Source: BBVA Research



Eurozone: political gridlock in Italy; bail-out in Cyprus; Portugal's Constitutional Court rejection of austerity measures

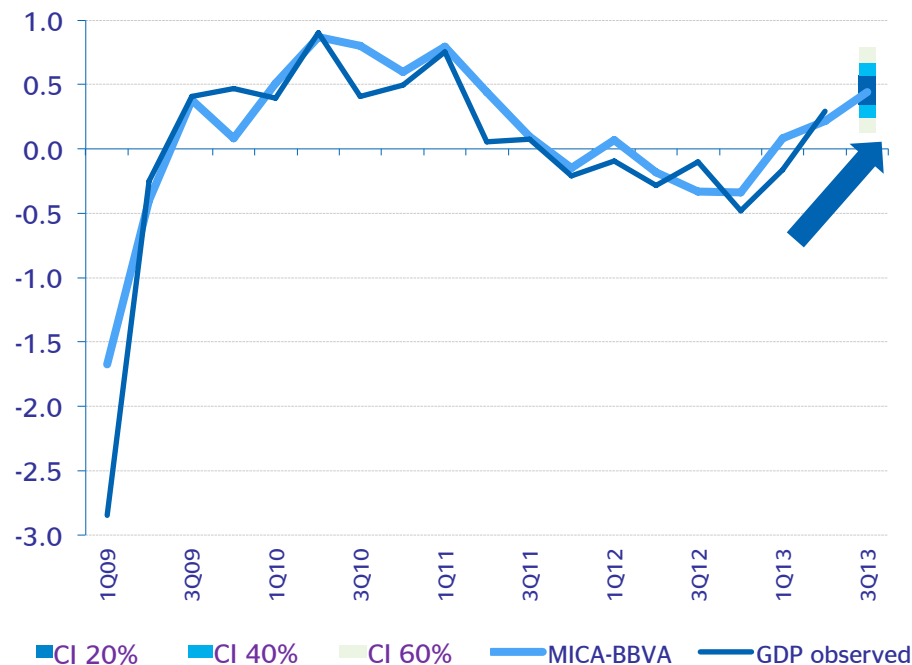
USA: political deadlock over long-term fiscal policy

China: deeper-than-expected slowdown and increasing risks of local public debt and shadow banking

EMU recovery is underway but behind the USA

EMU: MICA BBVA and GDP growth, % QoQ

Fuente: BBVA Research



EMU: GDP growth forecast

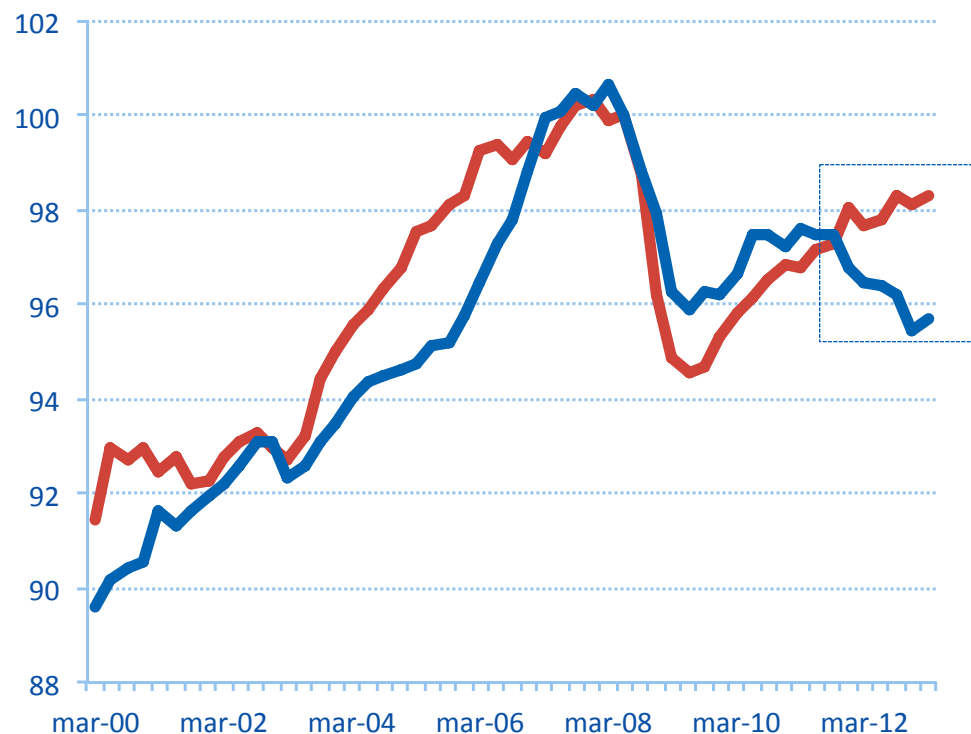
Source: BBVA Research

Country	2013	2014
Germany	0.5%	1.8%
France	-0.1%	1.1%
Italy	-1.8%	0.8%
Spain	-1.4%	0.9%

EMU recovery is underway but behind the USA ...

GDP per working-age population (2Q2008=100)

Source: BBVA Research



The USA has recovered 2/3 of the fall in GDP per working-age population

The sovereign debt crisis in EMU put an end to the recovery of 2010 and 1H2011 ...

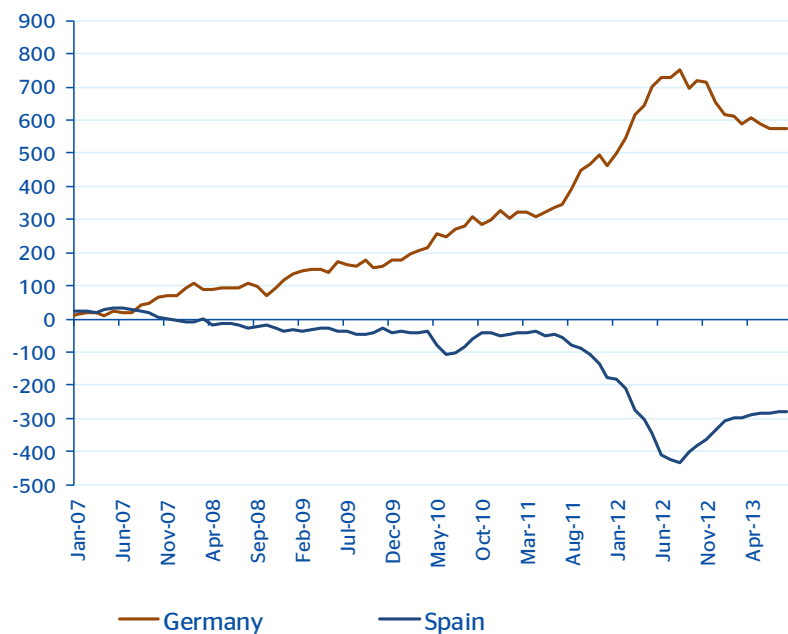
... such that the current level of GDP per working-age population is slightly lower than in 2009

... and financial fragmentation is still high

Net balance with the Eurosystem

(EUR bn)

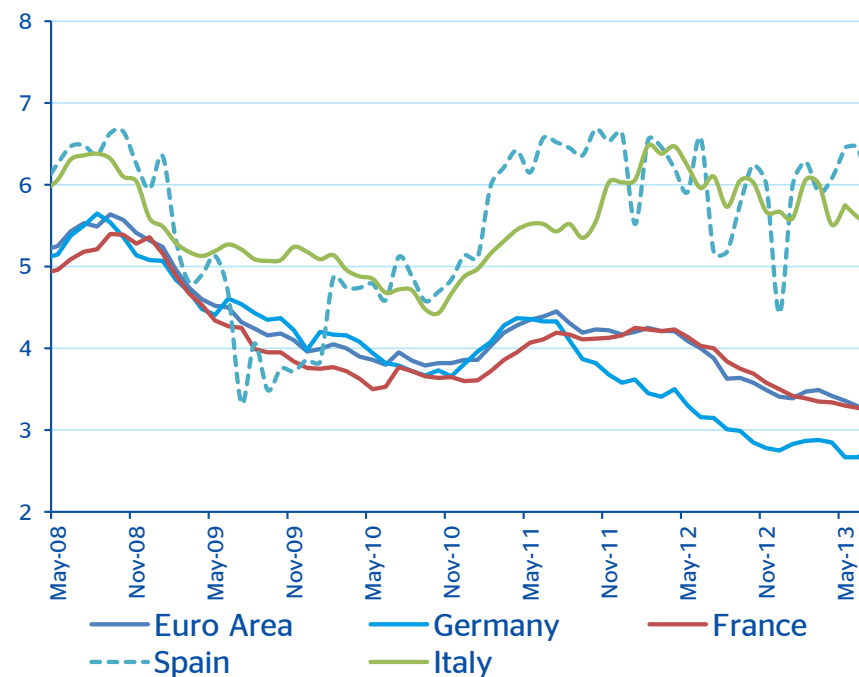
Source: BBVA Research based on Bloomberg



Interest rate of new loans to businesses

(Up to one million un euros, more than 5 years)

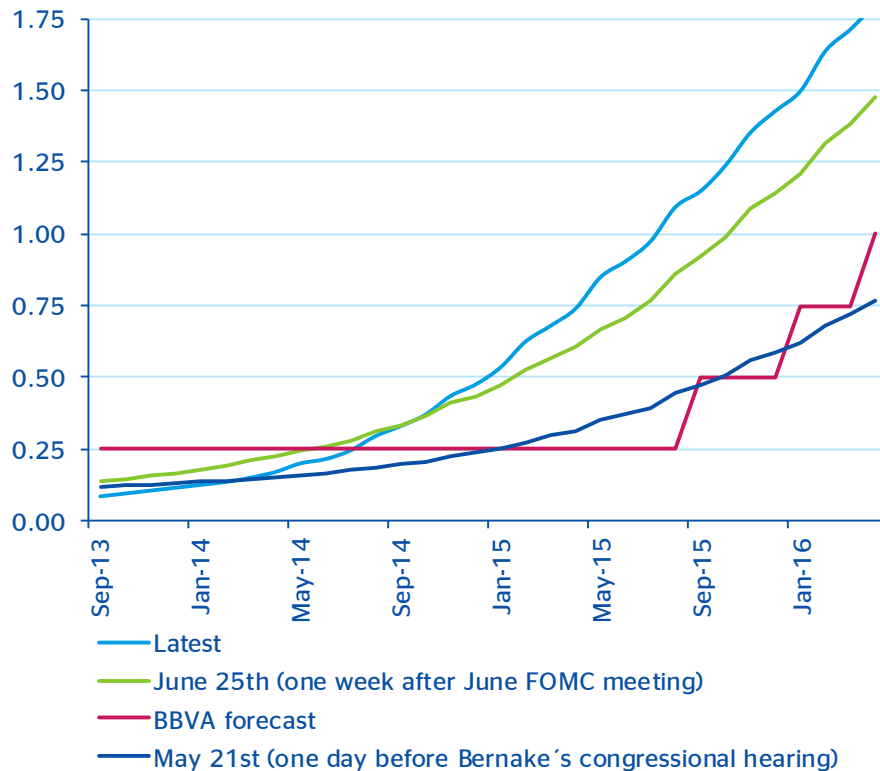
Source: ECB



FED's tapering expectations roiled markets ...

Implicit policy rates in fed funds futures

Source: Bloomberg and BBVA Research



US: 10 y Treasury, yield (%)

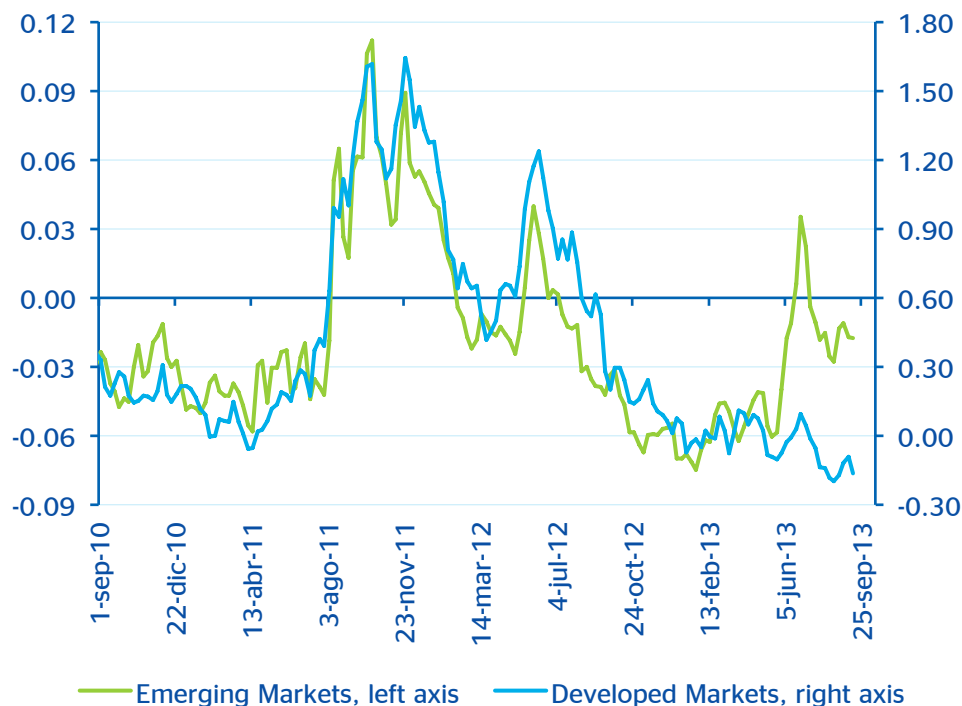
Source: Bloomberg



... impacting especially in emerging economies

BBVA's Financial Stress Index

Fuente: BBVA Research



Capital outflow from emerging countries,...

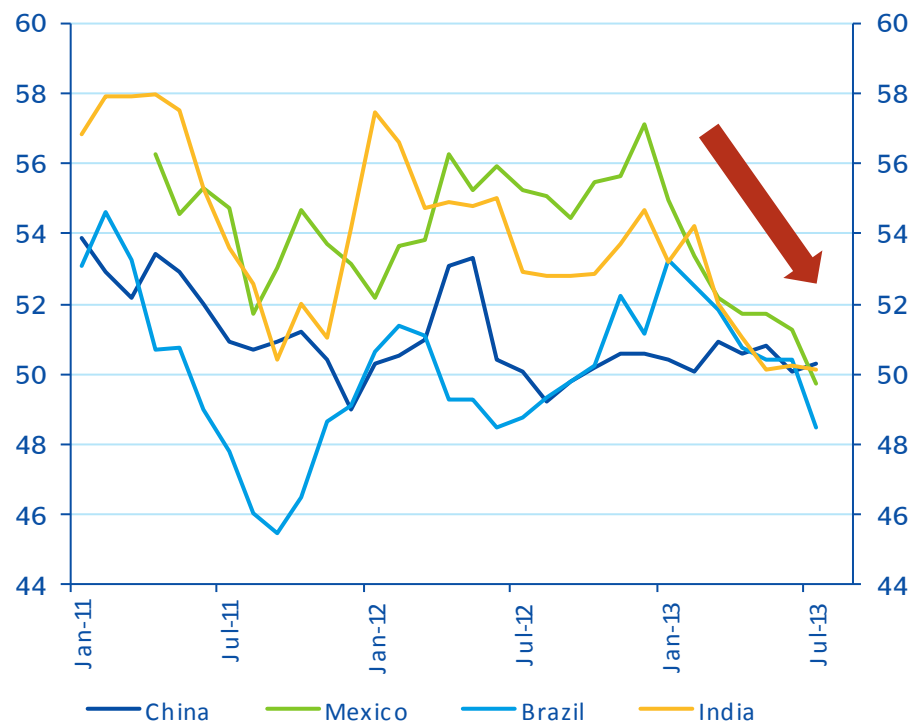
..., due to idiosyncratic reasons,...

..., which could impact growth prospects if persistent in time.

Transitory global slowdown due to emerging countries?

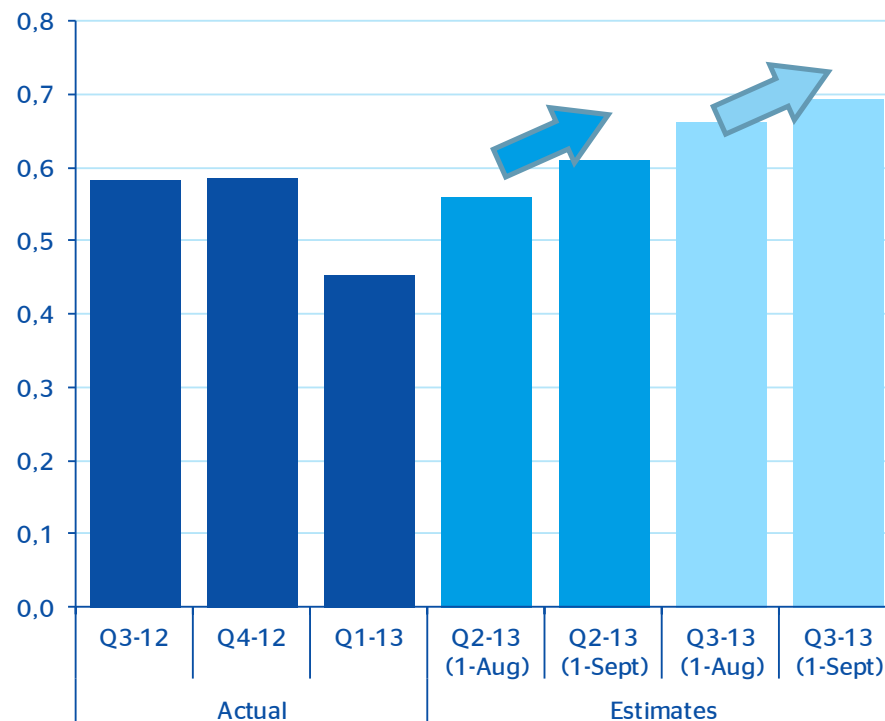
Emerging economies: PMIs manufacturing

Source: Haver, BBVA Research



Global GDP growth based on BBVA-GAIN (%q/q)

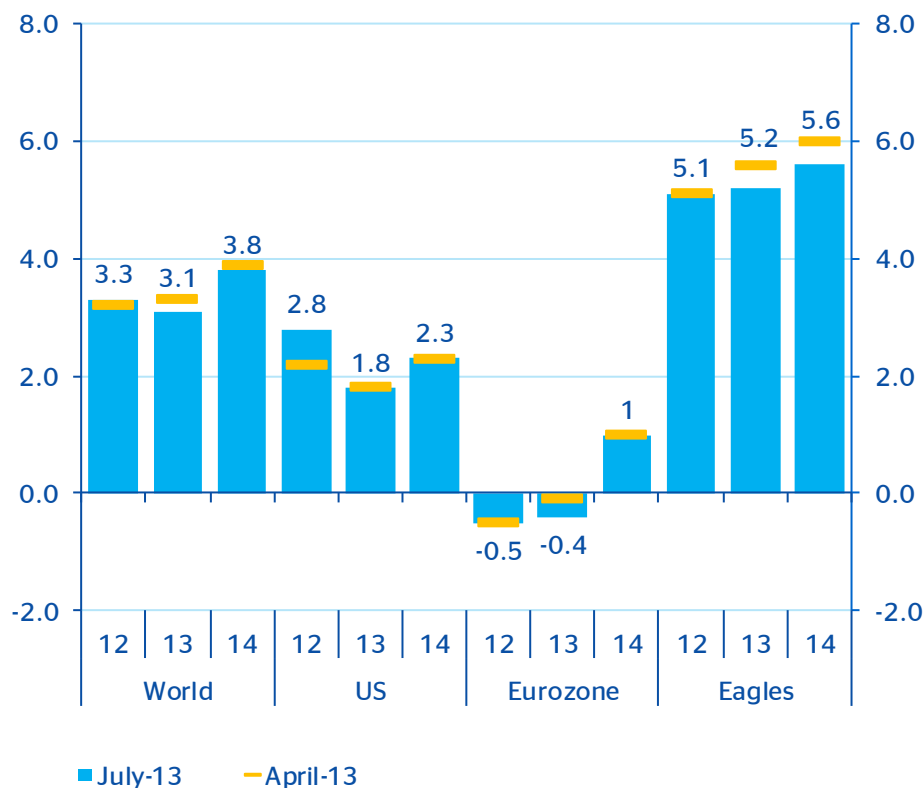
Source: BBVA Research



Global growth slows down slightly and resets across areas

Economic growth (%)

Source: BBVA Research, Haver



The global economy shows a cyclical downturn, especially in emerging countries, and faces a tightening of financial conditions

Developed economies: the US and the Euro Area keep a slightly better outlook for 2014

Emerging economies, growth in BBVA Eagles remains, although somewhat lower due to downward revisions in **China** and **Latam**

Section 1

Global economy: a more balanced contribution to growth between developed and emerging economies

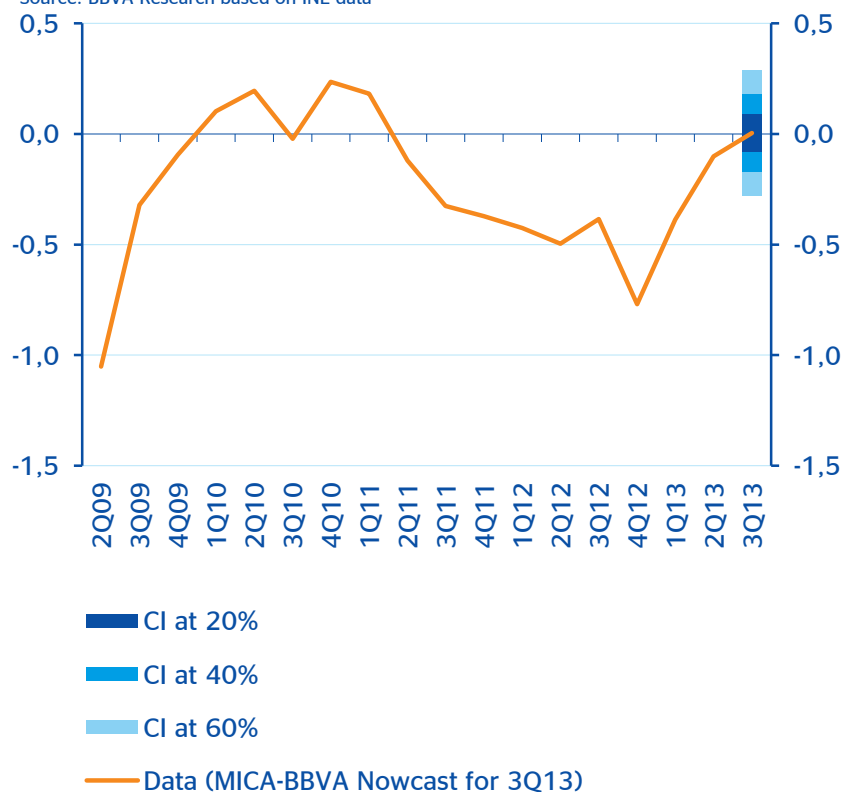
Section 2

Spain: the economy is bottoming out in 2013 and growth will resume in 2014

The Spanish economy is bottoming out in 2013 ...

Spain: GDP growth and MICA-BBVA forecasts (% QoQ)

Source: BBVA Research based on INE data



A more protracted economic recession in Europe, financial fragmentation and the intensification of the fiscal consolidation ...

... were responsible for a higher-than-expected economic decline in 4Q12 and 1Q13...

..., but trends in activity improved in 2Q13 and are pointing to slight growth in 2H13

... following previous business cycle stylised facts

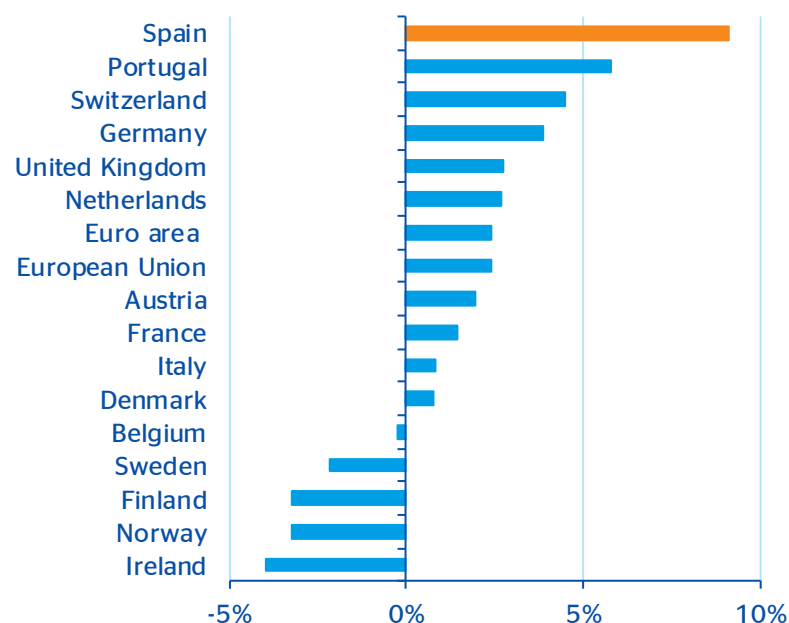
Leading	Exports growth	✓
	Gross operating surplus	✓
	Investment in machinery and equipment	✓
=	New credit operations (flow)	Stabilized
	GDP growth	Stabilized
	Employment growth	Stabilizing
Lagging	Growth of the stock of credit	Falling

Exports growth: great performance compared to EMU

Exports (% change, 1Q12-2Q13)

*) Data until 1Q13

Source: BBVA Research based on INE



In spite of the recession experienced within the EMU in the last year (50% of total Spanish exports), Spanish exports have grown

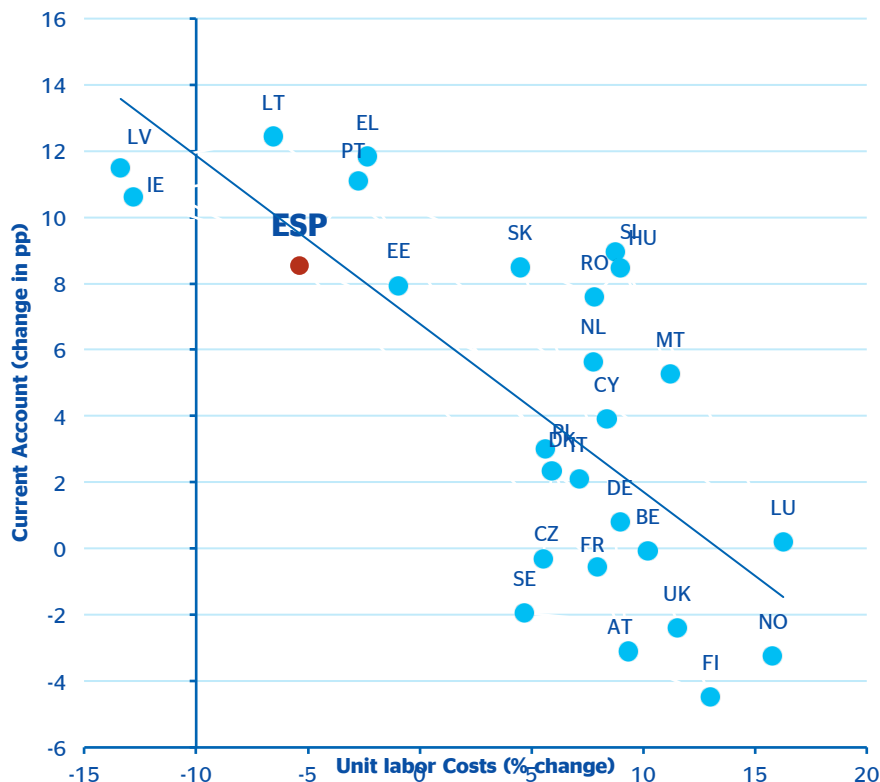
The increase was partly a result of higher exports to countries in the BBVA-EAGLEs area and other developed economies,...

..., but also of the higher competitiveness of Spanish exports, in terms of both price and quality

The current account balance: from deficit to surplus

EU: cumulative change in Current Account and unit labour costs, 1Q08-4Q12 (%)

Source: BBVA Research based on Eurostat data



Productivity gains have been large since the beginning of the crisis (12%)

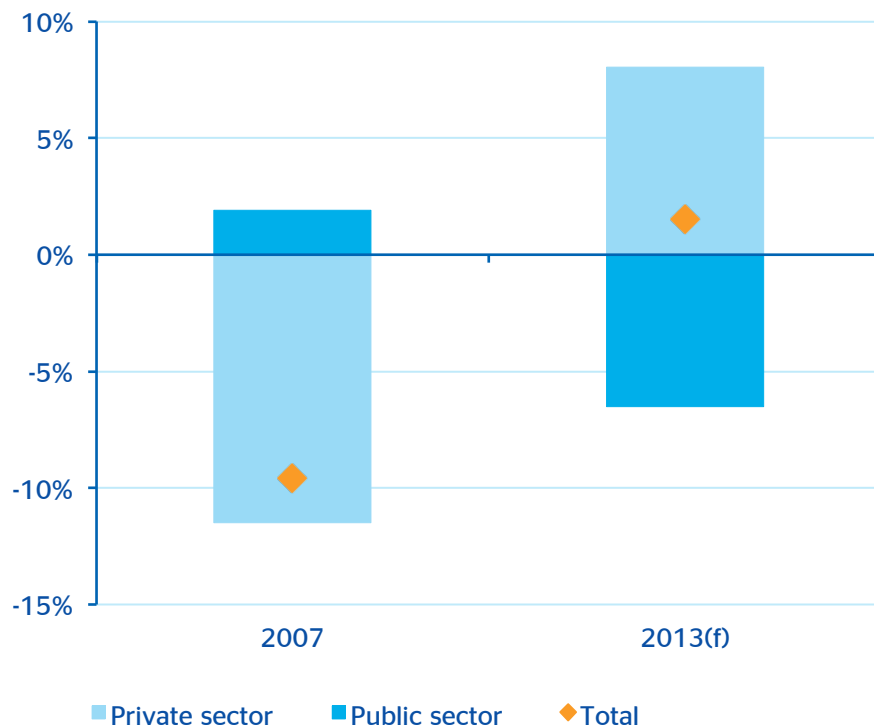
They have been widespread and not concentrated in residential construction

Tradeables like manufacturing and industry have had gains above 20%

The current account balance: from deficit to surplus

Spain: Financing Capacity (+) / Needs (-) with the rest of the world (% of GDP)

Source: BBVA Research



A stable private saving rate and the reduction in the investment rate...

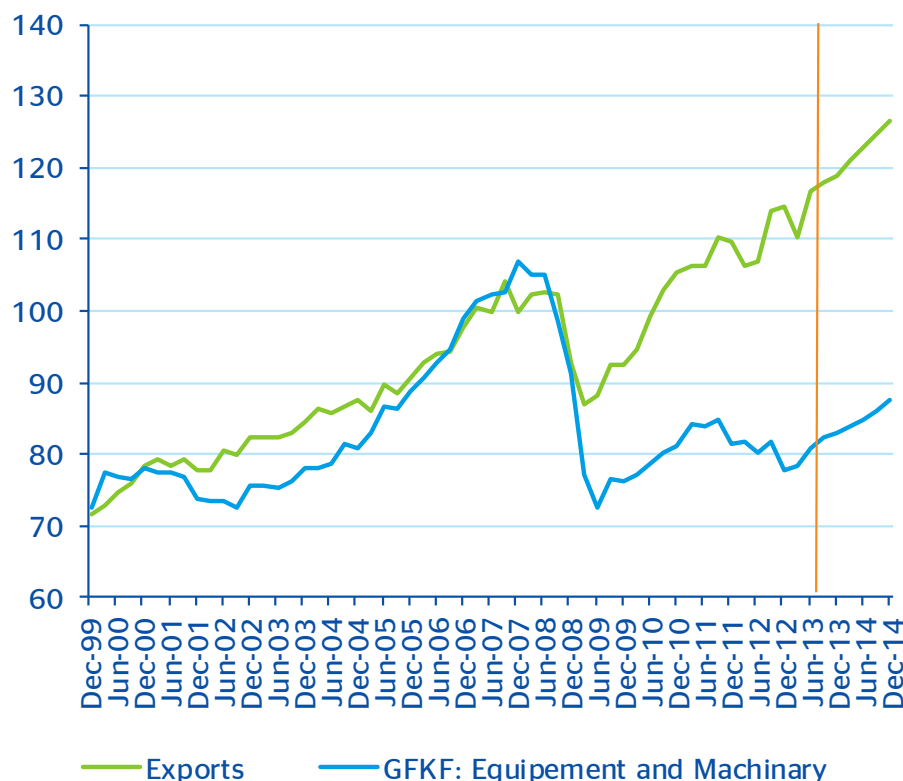
...have allowed firms to increase their financial capacity, fuelling a deleveraging process that is now hitting its fifth year

This has improved their balance sheets, placing them in a better position to resume investments

Investment in equipment and machinery recovering

Spain: exports and investment in equipment and machinery (2008=100)

Source: BBVA Research based on INE data



Brighter prospects for the EMU and sustained growth in exports...

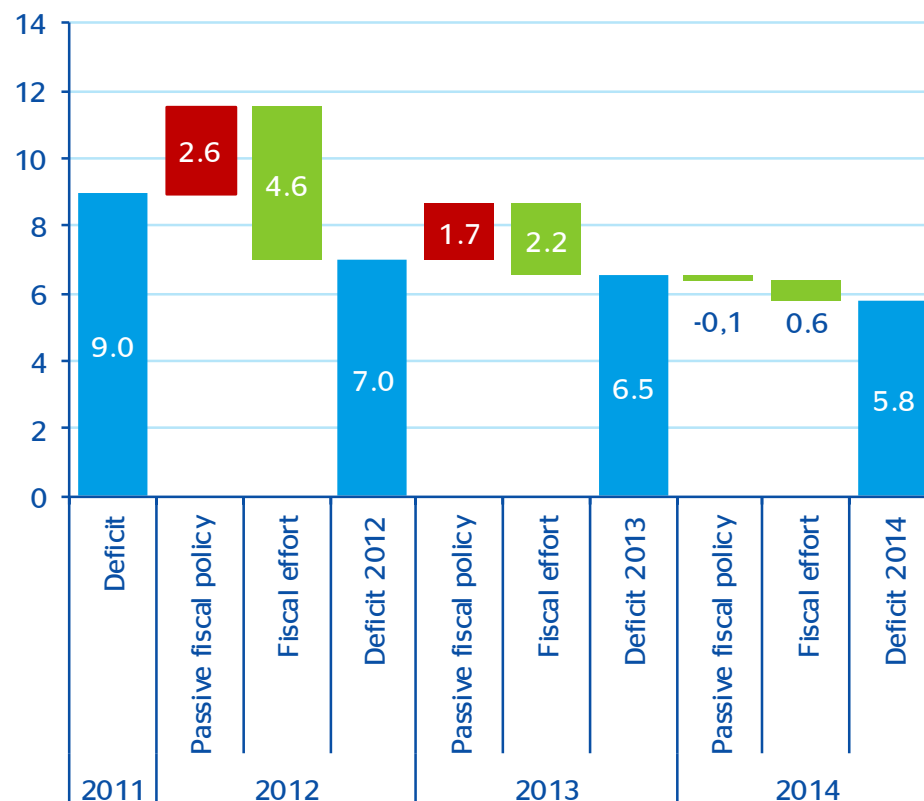
... should drive higher private investment

Indeed, in 1H13 investment grew 8% yoy

Fiscal consolidation will require smaller efforts

Public administrations: budget deficit breakdown excluding financial sector aid (% of GDP)

Source: BBVA Research, based on MINHAP data



Fiscal consolidation is working: budget effort in 2012 was above 4pp of GDP

2014 will not require as great an effort as in 2013 and 2012

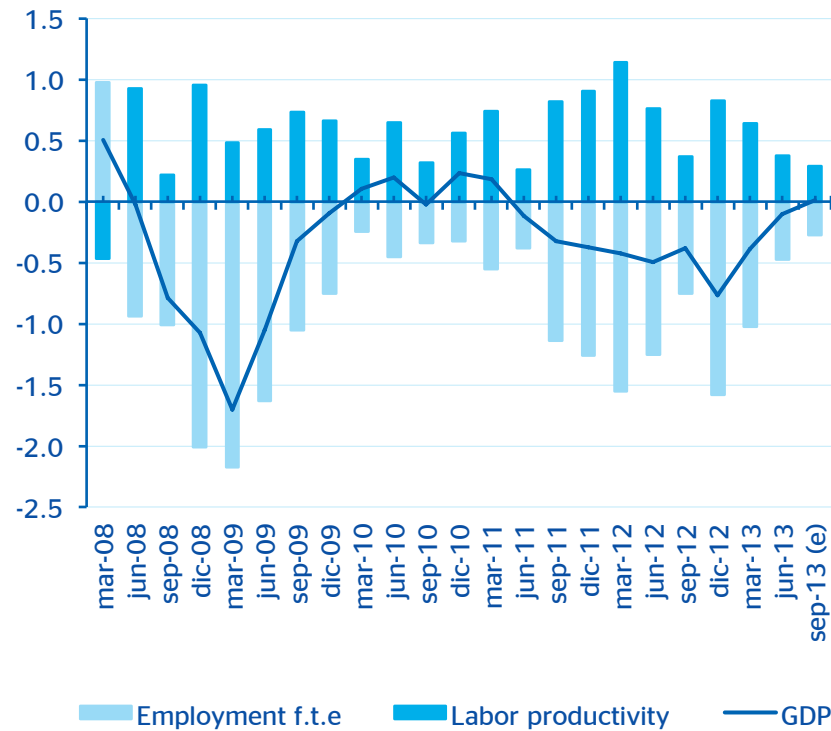
Overall, there are still major reforms to be undertaken (pensions, local corporations, PES), that would increase the efficiency of the public administrations

The labour market is stabilising

Spain: GDP, employment and productivity

(% qoq)

Source: BBVA Research based on INE



Job destruction has slowed down in the last few quarters...

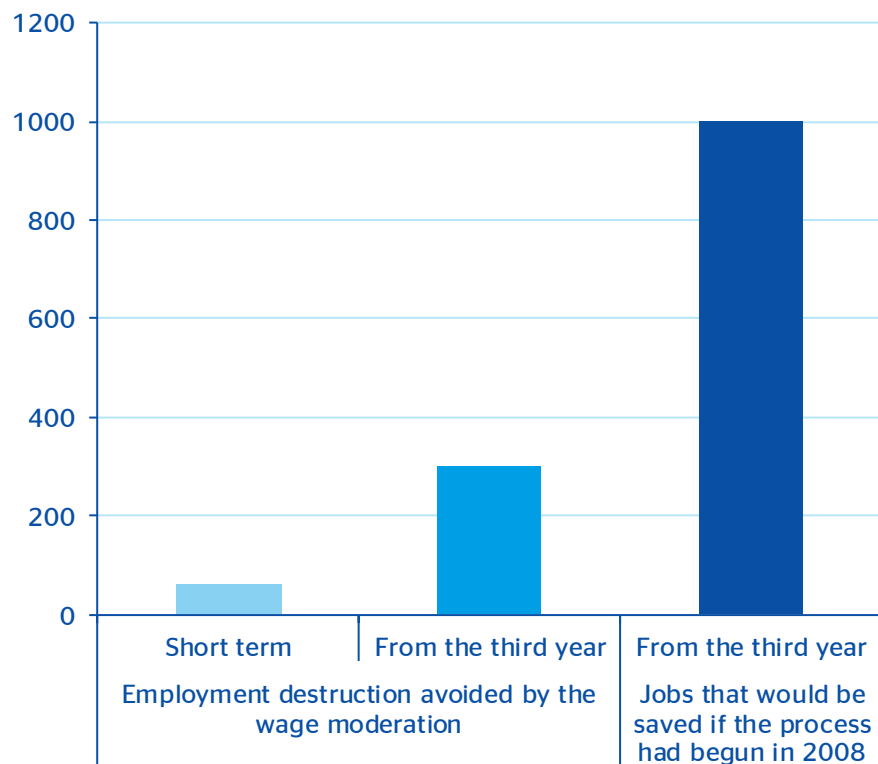
..., partly thanks to wage moderation

Should Spain have had better labor institutions at the beginning of the crisis, job destruction would have been lower

The labour market is stabilising

Spain: impact of wage moderation in 2012 on employment (thousands of jobs)

Source: BBVA Research



Labour market reform and the 2nd Agreement on Employment and Collective Bargaining prevented greater job destruction in 2012

Without the wage moderation of 2012, an additional 60 thousand jobs would have been lost in the short term (300 thousand in the medium and long term)

The existence of better employment institutions at the onset of the crisis might have prevented the destruction of around one million jobs

A window of opportunity that must be seized

The baseline scenario is highly sensitive to financial conditions in international markets, while numerous risks persist

Efforts to achieve permanent improvement of markets and take advantage of it, unlike previous recovery in the past

Europe should progress towards a more genuine EMU. For this, progress towards the banking union in 2013 and European policies to promote growth are crucial

Spain must strengthen efforts with the ongoing adjustments and structural reforms required to boost the competitiveness of its economy

A window of opportunity that must be seized

The **ECB** is serving as a bridge until the new institutional framework is established

The new fiscal and imbalances detection framework should serve to deliver a better balance between **fiscal consolidation and structural reforms in EMU members**

Banking union is key to tackling market fragmentation.
Any delay implies risks

The **medium term** goal of configuring some form of **fiscal union** requires significant pre-requisite steps

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