International Outlook

Expansion continues at a global level

During 2007, economic activity will maintain its notable strength, although its growth will be slightly moderated. Currently, the world economy is immersed in its greatest cyclical expansion since the oil crisis of the seventies, expanding for the fifth consecutive year at rates higher than 4.0%. However, what is most characteristic of this cycle is the vast geographic base that is backing global growth. Thus, the main driving force for growth will continue to be the developing countries, with Asia, and particularly China, as the leading actors. As for the developed countries, the euro zone continues to accumulate positive surprises in activity, and our growth expectations, which already surpass the potential, indicate GDP growth of 2.5%. Japan, the second largest economy of the world, is consolidating its economic recovery, after a decade of having been submerged in deflation.

However, it is the United States, one of the main reference points at a global level, where the greatest uncertainties fall. In addition to the concern regarding the adjustment of the real-estate sector, made more acute by uncertainties forthcoming from the sub-prime market (the riskiest segment of the mortgage market), is the transitory weakness of non-residential investment. Nevertheless, taking into account the strength of the fundamentals of the entrepreneurial sector that sustain investment, as well as the solidity of employment and consumption, the economy will recover its strength in the second half of the year. Despite this, risks, derived from a deeper adjustment of the non-residential investment or of the real-estate sector in the U.S., continue to take on a major role, together with the impact that the geopolitical risk could have on the oil risk, the main risks at a global level.

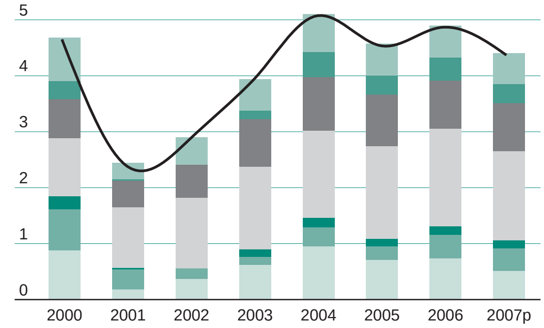
The U.S.: the main source of uncertainties

Until several months ago, the main factors of uncertainty came mainly from the war conflict with Iran, which eventually could lead to an escalation in oil prices and to a strong slowdown of the U.S. economy, as a result of an abrupt adjustment of its real estate sector. Both factors continue to be in force, although the second one with new elements. On the one hand, surging strongly is the concern surrounding the problems which certain of the riskier segments of the mortgage market are going through, the so-called sub-prime segment, and its potential impact on private consumption and contagion of the financial market in general (credit crunch) that could end up having a very negative impact on the real economy. Nevertheless, the little relative importance of the sub-prime on the mortgage loan market (7%), the growing diversification of the risks and the growth of the revenues which contribute to maintaining family solvency, delimit the risk of contagion throughout the rest of the economy.

On the other hand, the most important risk now would be the slowdown of non-residential investment in the U.S. economy that started to materialize at the end of 2006, which if long-lasting, would cause a strong setback to activity, in view of a greater weakness in employment and a marked slowdown in consumption, currently the main supports of the U.S. economy. However, given the strength of the fundamentals of the entrepreneurial sector that sustain investment

Growth and Contribution by Areas

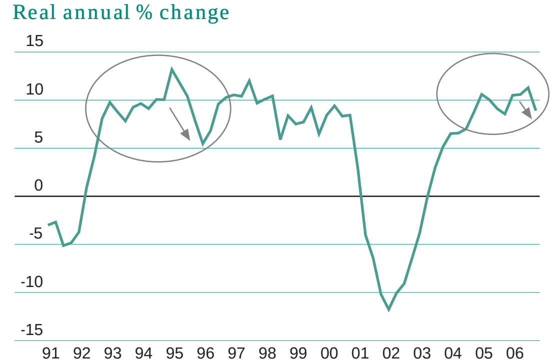
Percentages



Source: BBVA

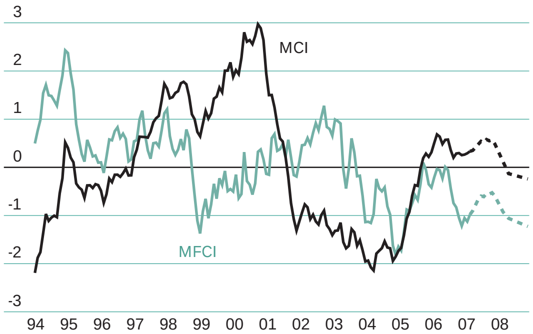
Non-Residential Investment

Real annual % change



Source: BBVA

U.S.: MFCI and MCI



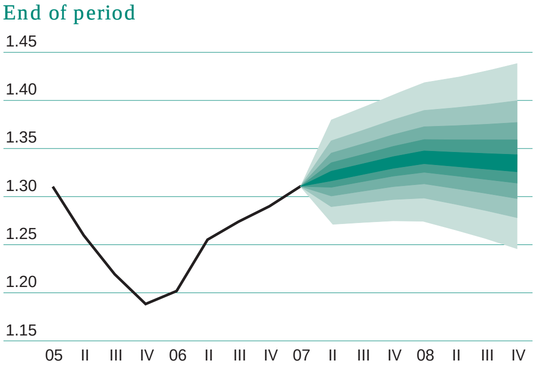
* Using core inflation
Note: Forecasts as of April 2007
Source: BBVA

Financial Forecasts
End of year

	2005	2006	2007f
Official rates			
U.S.	4.25	5.25	**5.25**
EMU	2.25	3.50	**4.25**
10-year rates			
U.S.	4.5	4.7	**4.8**
EMU	3.4	3.9	**4.3**
Dollar/euro	1.19	1.32	**1.33**

f forecast
Source: BBVA

Dollar / Euro
End of period



Note: Forecasts as of 2nd. Quarter 2007
Source: BBVA

and the positive outlook for entrepreneurial investment, everything indicates that the most recent performance can be qualified as a soft-patch, a readjustment in mid cycle. Therefore, our forecasts indicate that the economy will recover its strength in the second half of the year, although with a lower growth than what initially was expected for this year (from 2.8% to 2.3%), which later will lean toward its potential in 2008 (2.8%).

De-coupling of Monetary Policies

In the current situation of a divergent cyclical position of the economies, the various routes to be followed by the central banks are understandable. In the U.S., the Fed will maintain official interest rates stable at the current 5.25% for a prolonged period of time, since joining them are, on the one hand, core inflation that is moderating although close to the upper part of the Fed's tolerance range, and, on the other, a transitory weakness of activity and still lax financial conditions. In fact, these conditions, which incorporate the performance of the stock market and of the currency, as well as of short-term rates and long-term bonds, are currently in a more relaxed zone than when rates were at 1% in the middle of 2003.

The above contrasts with areas such as Japan and Europe, where the monetary policy continues to normalize. In the former, the official rates will stand at around 1% at the end of the year, even though the movements will come about very gradually and in terms of the performance of activity and of inflation. In the latter, the Central European Bank (CEB) will increase the "refi" rate up to 4.25%, supported by the strength of European growth and by inflationary risks that continue to rise. Even though the monetary tone in the main economies will continue to be restrictive, it is foreseeable that low market volatility and high liquidity will continue, sustained by the fact that the accumulation of reserves on the part of the developing economies and the limitations of long-term rates will continue to be seen in this cycle, all of it supported by stock market valuations and solid profit expectations. Within this context, a slight rally in long-term bonds is expected, although more limited in the U.S. due to strong demand for U.S. debt by foreign investors. Thus, our forecast for the ten-year rates is of 4.3% for Europe and of 4.8% for the U.S.

The dollar, in turn, continues to weaken against the euro since the end of 2006. Structural factors have been operating against the currency, such as mergers and acquisitions of companies and the recent news on the diversification of reserves. With respect to this, worth mentioning is the creation in China of a state agency of reserves for their management. Relatively similar plans in Japan and Russia will follow. Nevertheless, the recent weakness of the currency seems to be exacerbated, which is due to the fact that the market ponders a less benign scenario for the U.S. economy. Thus, in the same measure in which the market adjusts its outlook in line with our base scenario, the dollar should return to more appreciated levels, at about 1.32-1.33$/€.

In any case, as has been mentioned, the balance of risks inherent to the world economy ponders more concentrated impacts on the U.S. economy, setting a clearly depreciating bias on the dollar, at the same time that it affects long-term bonds downward.