

The New International Financial Map for LAC

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- More competition for financing due to higher indebtedness in developed economies
- But still emerging markets should benefit due to:
 - Much improved perception of their economies
 - Idea of core and periphery is disappearing: more South to South flows
- However, some risks ahead:
 - China will become a large capita exporter but Latin America not in such great position. Furthermore, China is sitting on a time bomb
 - Foreign bank financing could shrink (host countries may be instrumental)

1. DEVELOPED COUNTRIES: Risk Reward Considerations

- a. Risk perceptions have increased
- b. Returns are revised downwards

2. EMERGING ECONOMIES: Risk Reward Considerations

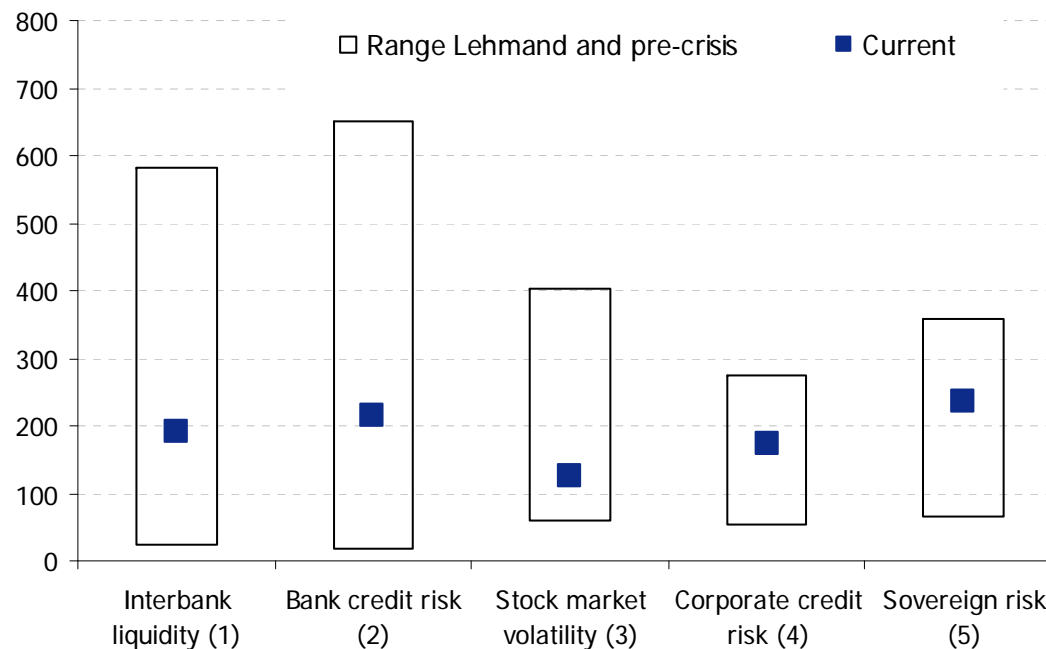
- a. Risk has not increased in generally
- b. Returns should, thus be revised downwards as long as the demand is there

3. Will demand for emerging financial assets hold up? :

The role of China and foreign banks

A - Risk perceptions still higher than at pre-crisis levels

United States: financial tensions indicators

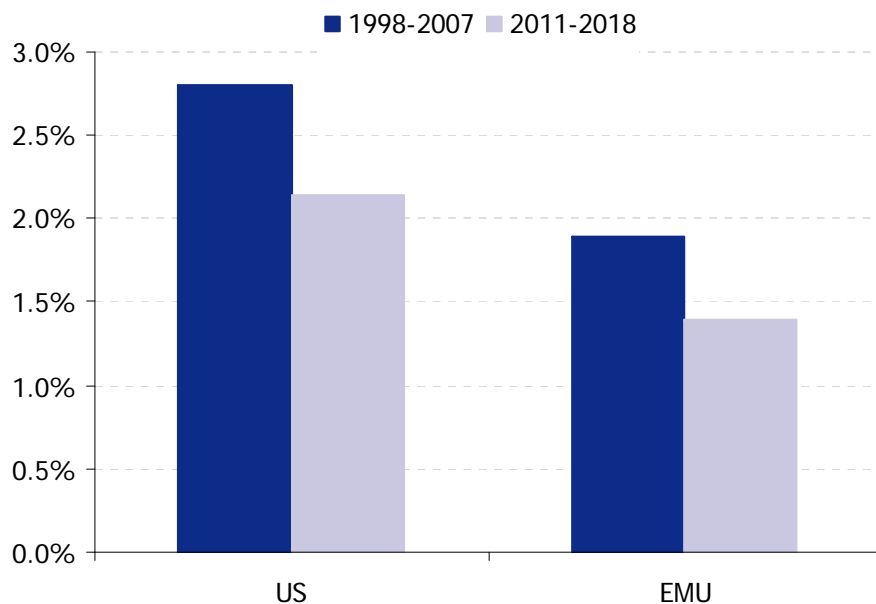


Source: BBVA ERD

B - Capity to create returns in developed markets **are revised downward**, due to:

1. Lower potential growth in the future

**US and EMU: Potential GDP growth
(avg. annual % var.)**



- Higher uncertainty,
- Probably higher structural unemployment (hysteresis effect).
- Crowding out of private sector

2. Regulatory constraints should make it harder to get financing in developed world

Regulatory changes

Beyond expectations, in terms of:

- Geographies
- Agents
- Homogeneity
- Areas:

Regulation and Supervision

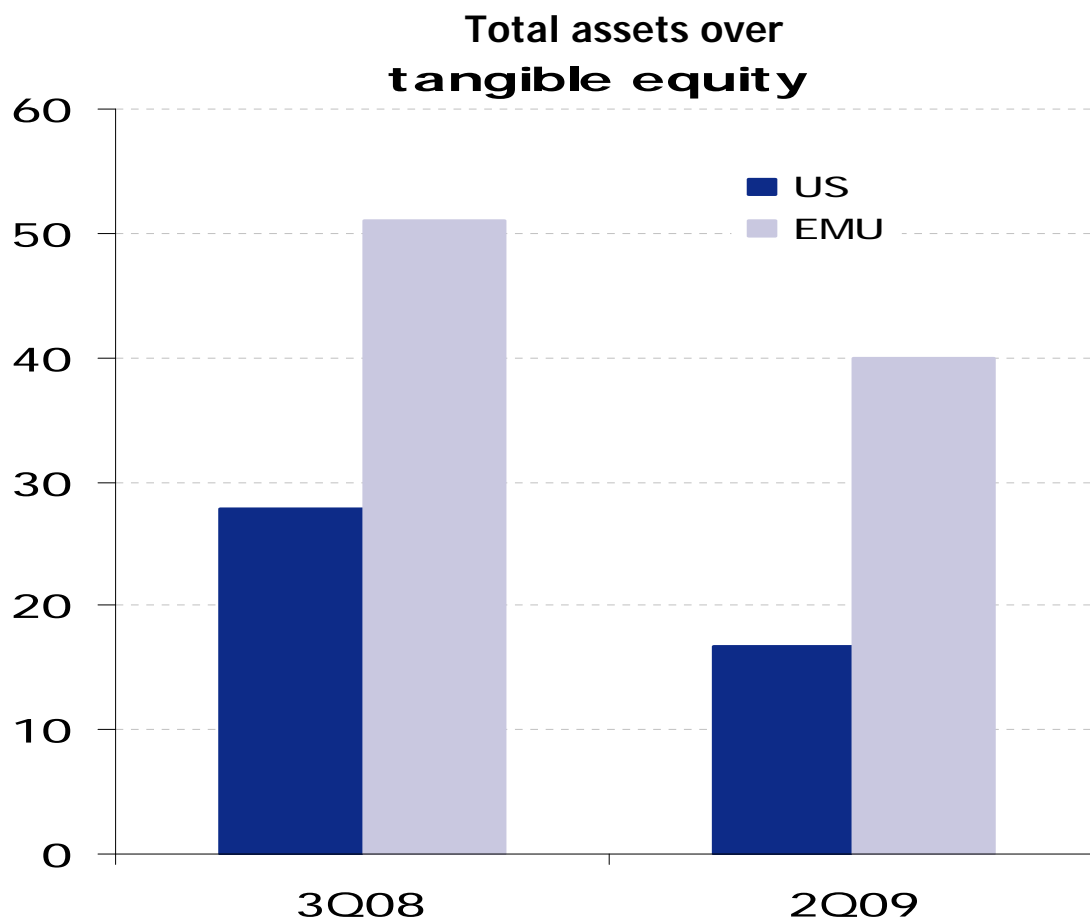
Capital and Liquidity

Counter-cyclicality

Consumer Protection

Compensation, perimeter....

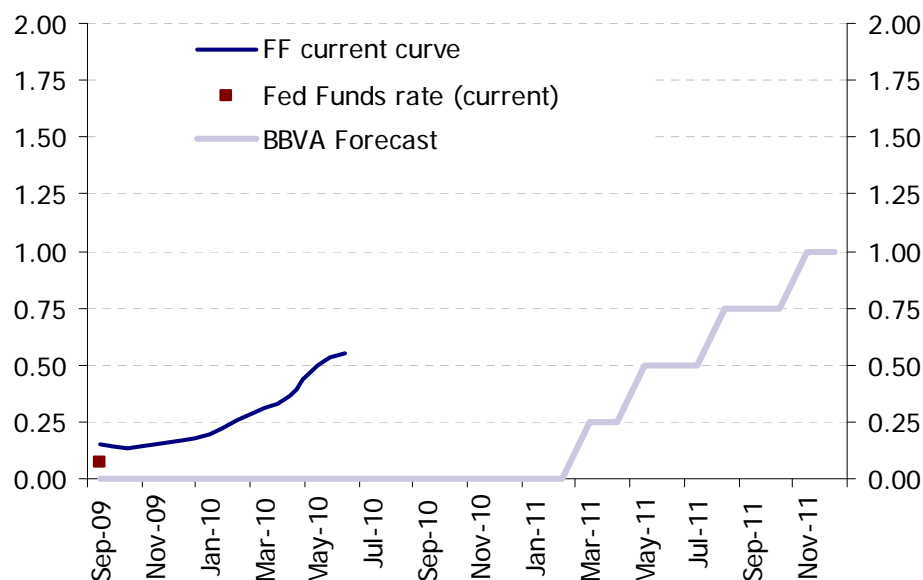
3. Deleveraging of financial system: much more needs to come from Europe



4. Low interest rates for quite some time

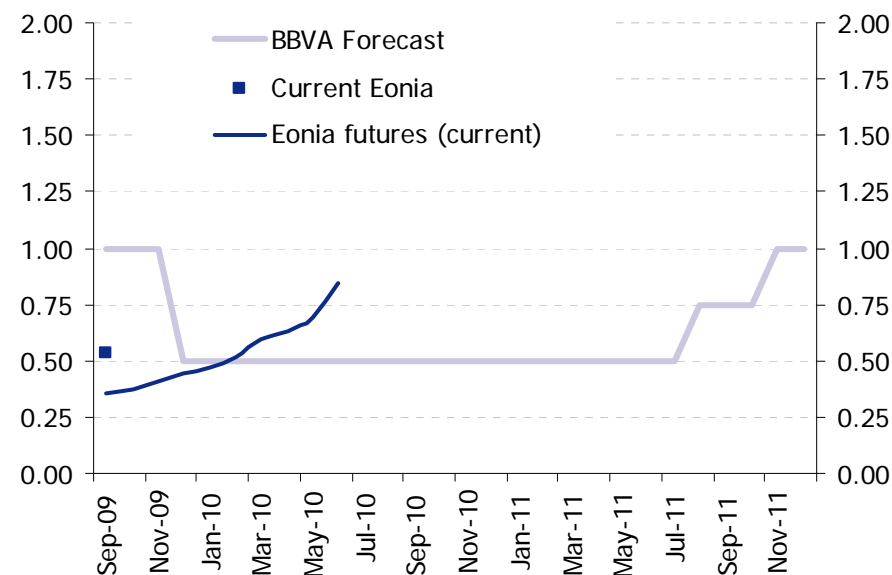
We project hikes will resume in 1Q11 for US and 3Q11 for Euro area)

United States: implicit official rate in Fed Funds futures and BBVA Forecast



Source: Bloomberg and BBVA ERD

Euro area: implicit official rate in EONIA futures and BBVA Forecast



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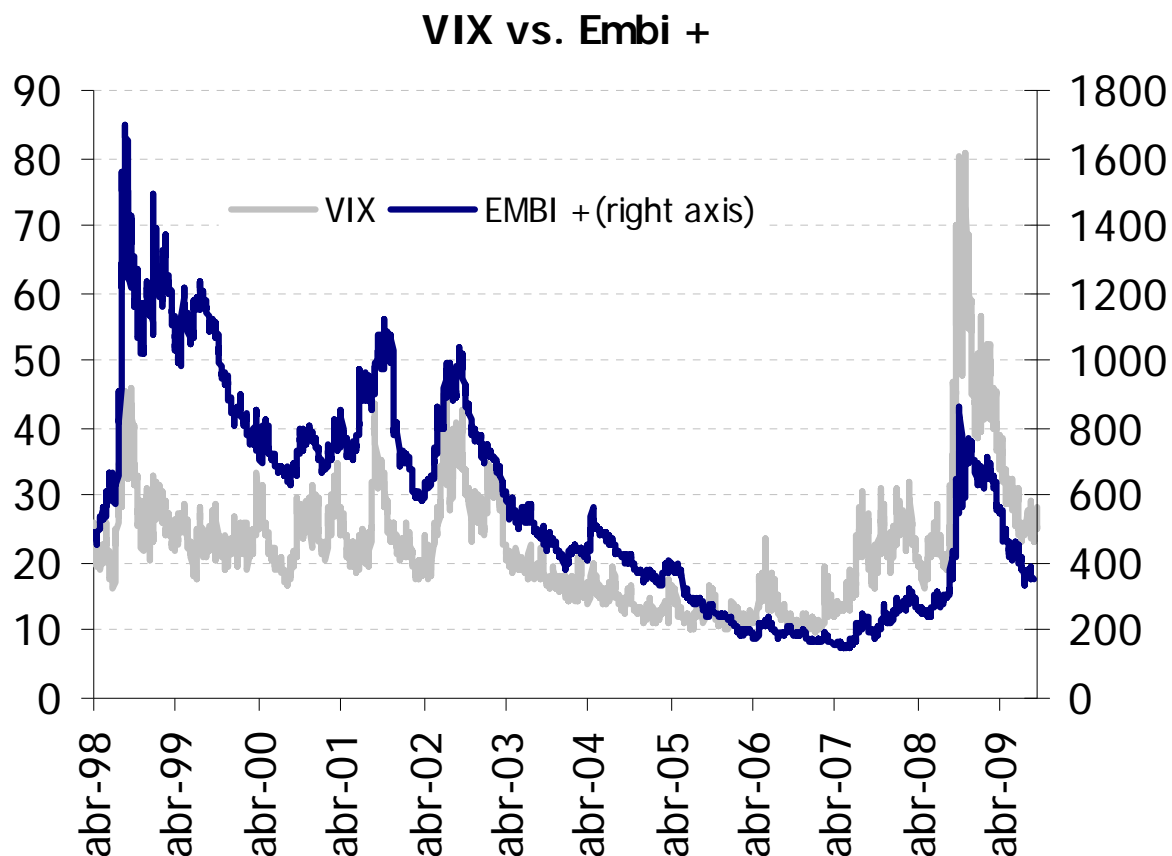
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Risk perception of emerging countries has not increased in a structural way

Still lower than its average in the past: much smaller spike that global risk aversion



- Banking sector seems to be sound

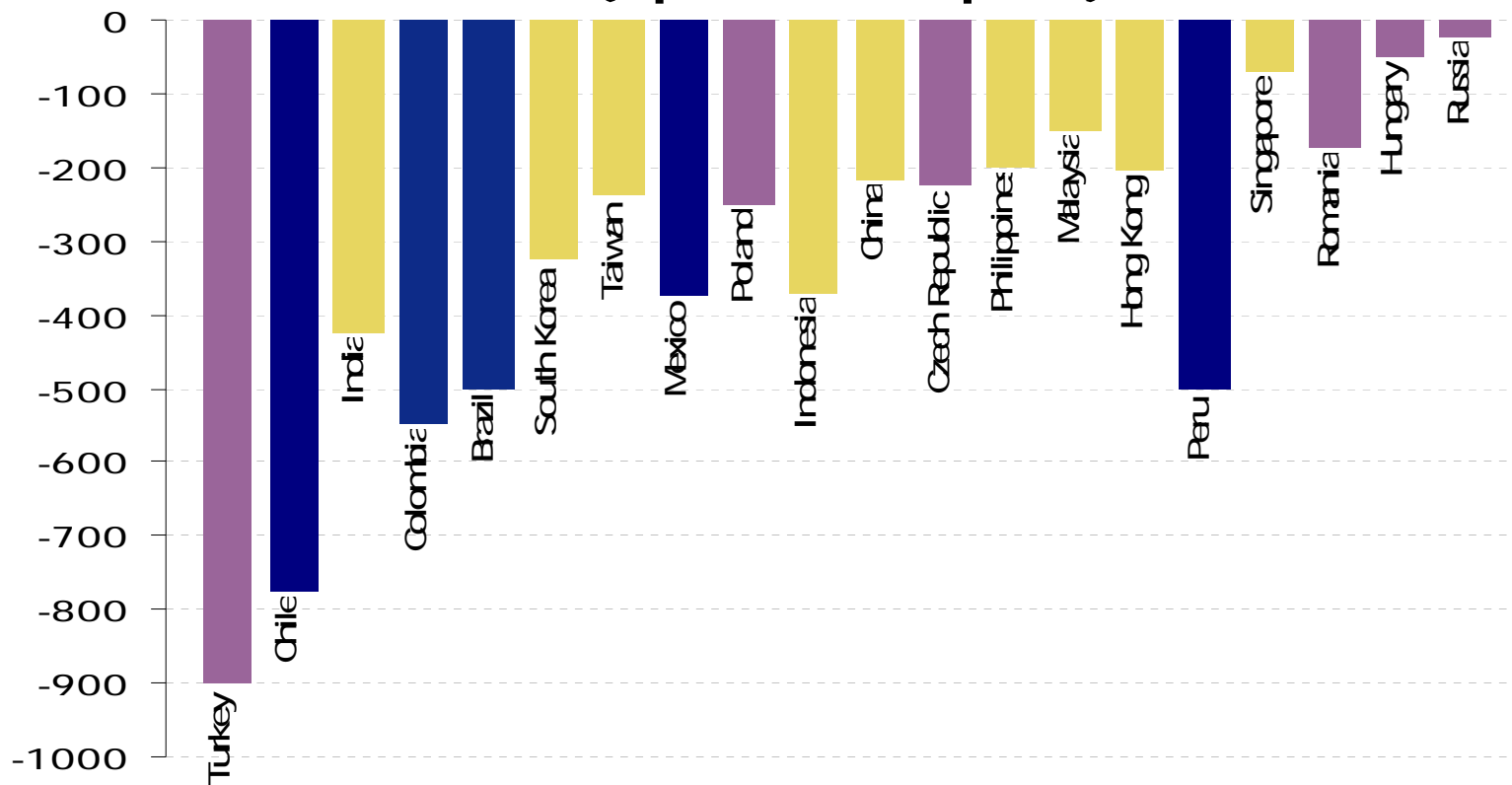
- 1 - Marginal exposure to toxic assets

- 2 - Prudential and solvency ratios have not deteriorated.

- 3 - Collapse of credit markets led to a successful substitution for domestic sources of funds in some cases (particularly in Latin America), along with the appearance of new financing sources (i.e., China).

- Monetary authorities have been very active both through orthodox and heterodox measures (reserve requirements, etc)

EMERGING MARKETS: Change in Official Rates (Bps since Sep.08)



Source: Bloomberg and BBVA

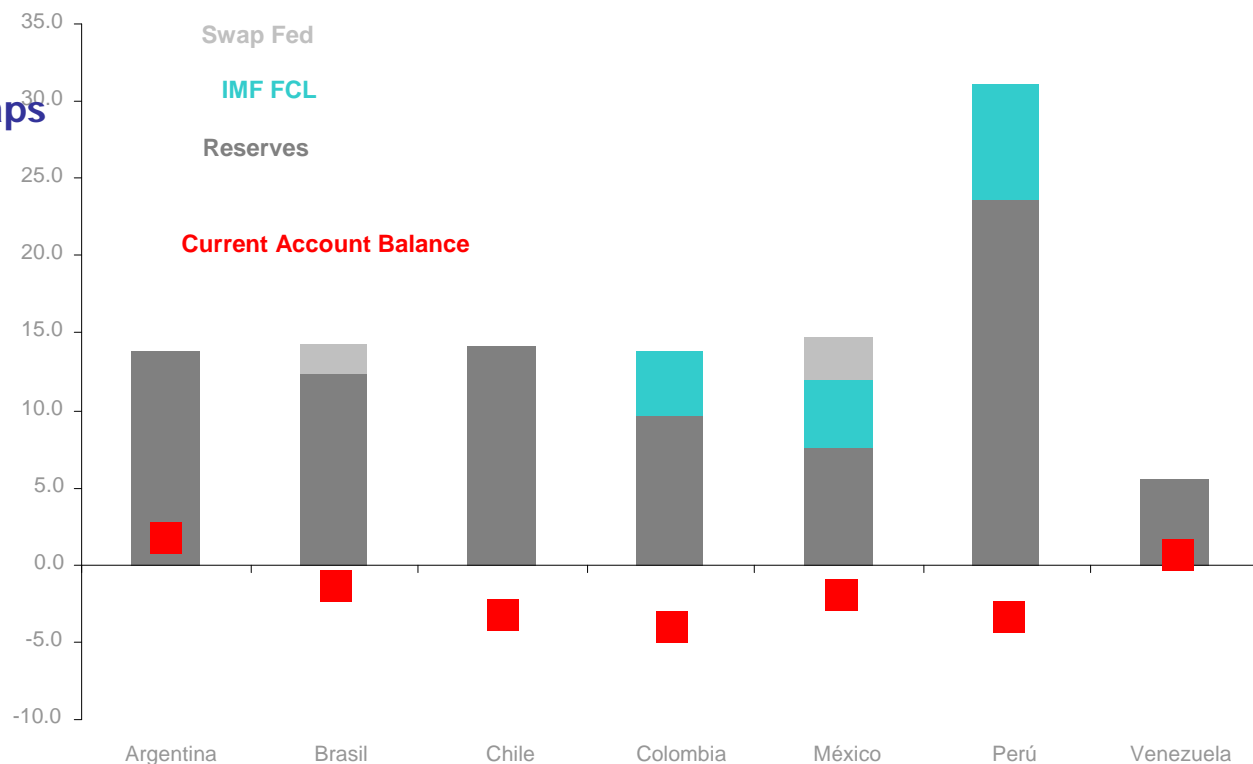
- Multilateral/bilateral support has been more flexible and timely

Latin America: Reserves and Financing Facilities (%GDP)

- IMF FCL

- FED swaps to “systemic” countries

- Increased in currency swaps in Asia (120 billion USD)



- Foreign banks have generally maintained their commitment

	Agreements reached by foreign banks operating in EE hosts (Vienna Group)		market share of participating banks
Hungary	explicit statement to remain in the market	willingness to conduct stress test exercises under the supervision of the national monetary authority	50%
Serbia			50%
Romania			70%
Bosnia			81%
Latvia			70%
		increase the risk-weighted capital ratio	

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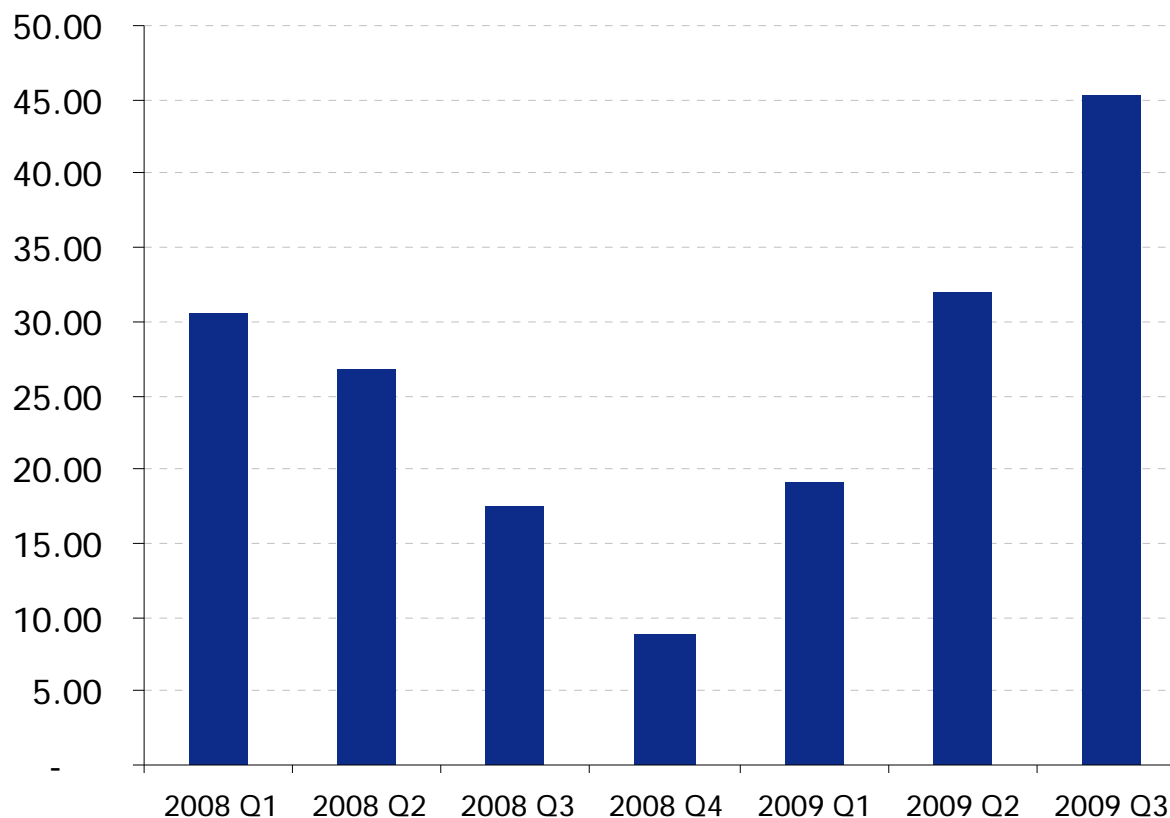
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The role of foreign banks and China

- Emerging countries' borrowers may abandon their periphery position: bond issuance are higher than they were at the beginning of the crisis

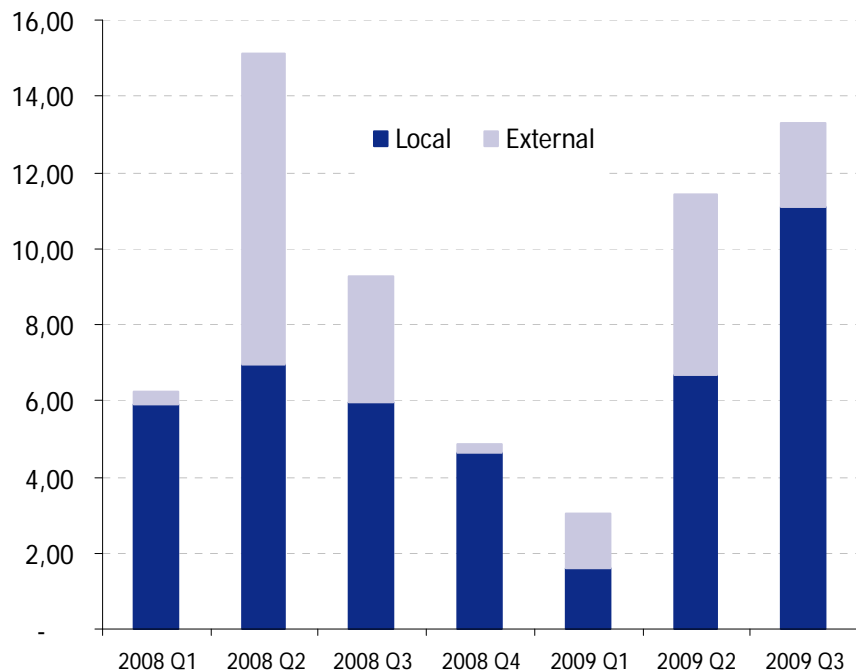
Selected Emerging Economies: Bond Issuance*
(billions of euros)



* Brazil, Indonesia, Mexico, Phillipines, Russia and Turkey. Source: Dealogic.

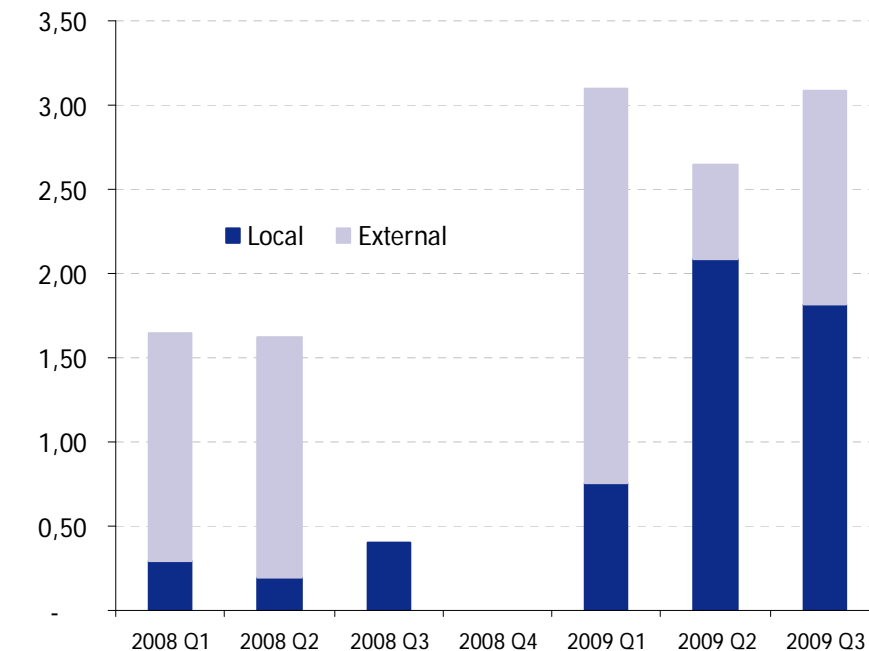
- Will it continue?
- As for bond issuance, a great deal is domestically financed

Russia: Bond Issuance
(billions of euros)



Source: Dealogic

Indonesia: Bond Issuance
(billions of euros)



Source: Dealogic

- Whatever is foreign financed will be affected by stronger competition from the developed world (more similar returns for more similar risks): no more core and periphery
- Growing role of Asian investors
 - Japan is already there but China could follow
 - Increased share of QDII is to be expected but Latin America will be one of the last places to consider (developed world first and then Asia)

- For FDI, in 2008 China for the first time exported more capital than it imported. More to come but Latin America is, again , not high in the list (big announcements but less so in reality)
 - US is now very cheap
 - Asia is better known and some countries are commodity abundant (Australia but also Indonesia)
 - Middle East (Iran) and Russia are also considered closer
- Furthermore, big risk is looming in China which may derail the export of capital : the bust of the credit boom

Impact of the loan financing of the stimulus package

(RMB tn, otherwise indicated)

Data

Legacy of NPLs	3.5
Capital (dec-08)	4.4
Profits (dec-08)	0.6
Nominal GDP 2008	30.1
Loans issued Jan08-Aug09	12.3

	Scenario A Optimistic	Scenario B Neutral 1	Scenario C Neutral 2	Scenario D Pesimistic
<i>Assumptions</i>				
Loans Issued (2008-2010)	17	20	20	25
Default rate (after recoveries)	10%	15%	20%	25%
Nominal GDP growth (2009-2020)	15%	10%	10%	7%

Results

Loan default	1.7	3.0	4.0	6.3
New NPLs (% 2008 Capital)	38.4	67.8	90.4	141.3
New NPLs (% 2008 Profit)	291.4	514.3	685.7	1071.4
New NPLs (% 2008 GDP)	5.7	10.0	13.3	20.8
New NPLs (% 2020 GDP)	1.2	3.5	4.7	9.9

Source: Authors' calculations

Garcia Herrero and Santabarbara (2009) work in progress

- Chinese NPL problem could be large but even bigger problems have been solved before (with fewer resources)
- China cleaned up its banking system before for a cost equivalent to 25% of GDP ...
 - In reality cost disappeared hidden in asset management companies balance sheets and through high nominal growth

Another important issue is foreign bank financing – a very important share of foreign financial for many emerging markets (specially Emerging Europe) may not come back. Why?

1. Some of the foreign banks are still in trouble and may be forced to operate at home:

This risk looks smaller now

2. Those which will continue to operate will clearly do it based on subsidiaries with full financial independence
3. Financial protectionism in emerging countries: promoting national champions

Domestic (specially state-owned banks) have proven to be an important source of self insurance in several emerging countries (Brazil, Korea, etc.)

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