

Global Slowdown and recession in Europe

Global Economic Outlook – First quarter, 2012

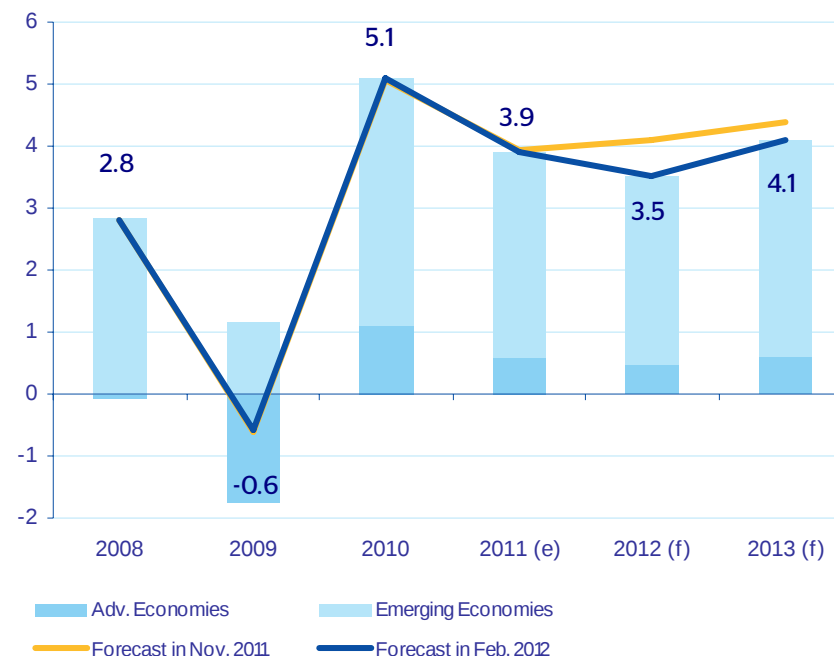
Madrid, 9 February 2012

Main messages

- 1 Global growth slows down, but will remain between 3,5% and 4% in 2012 and 2013.**
- 2 Downside risks to growth will diminish** as European policies dispel existing doubts
- 3 Europe has entered a recession, although with great heterogeneity by countries.** At the same time, it will decouple from other advanced economies, especially the US.
- 4 Emerging economies are on track for a soft landing,** buttressed by resilient domestic demand and policies that will turn into growth-supporting mode

Global growth (%)

Source BBVA Research





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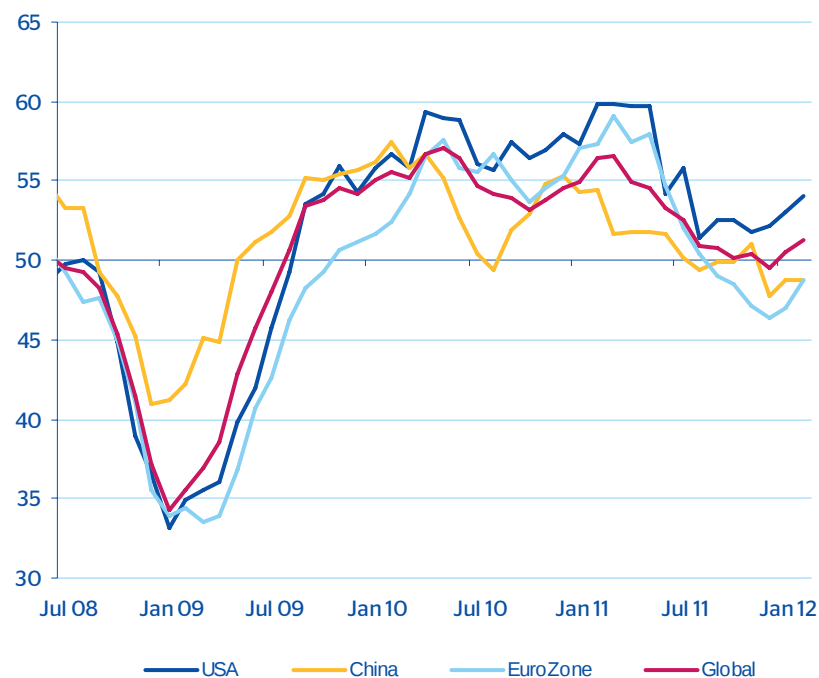
- 1 The global economy slows down temporarily**
- 2 The European crisis is the main risk to the projections
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The global economy slowed down in 2011

Global slowdown at the end of 2011 has been followed by some signals of stabilization and even rebound at the beginning of 2012, especially in the US and emerging economies.

Business confidence (PMI)

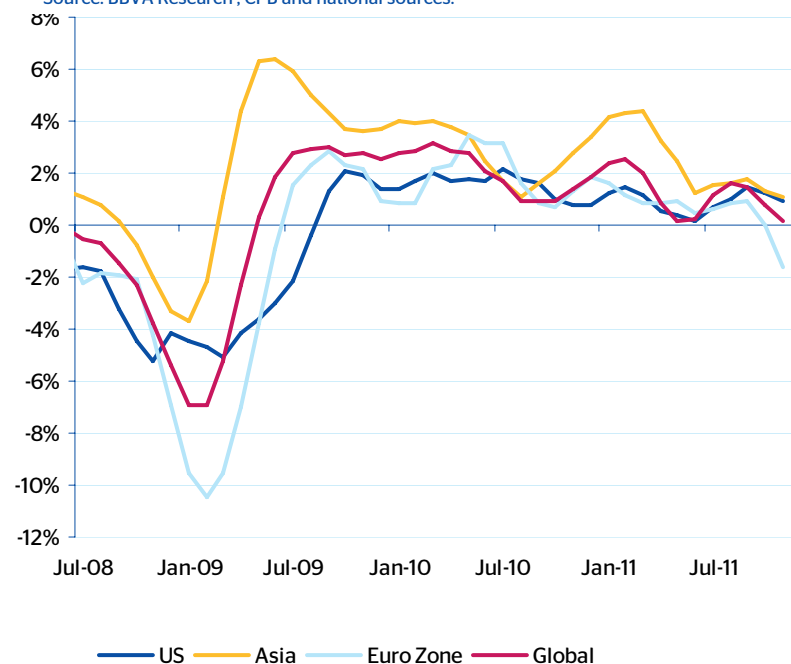
Source: BBVA Research and Bloomberg



Industrial Production

(%qoq of the 3-month moving average)

Source: BBVA Research, CPB and national sources.

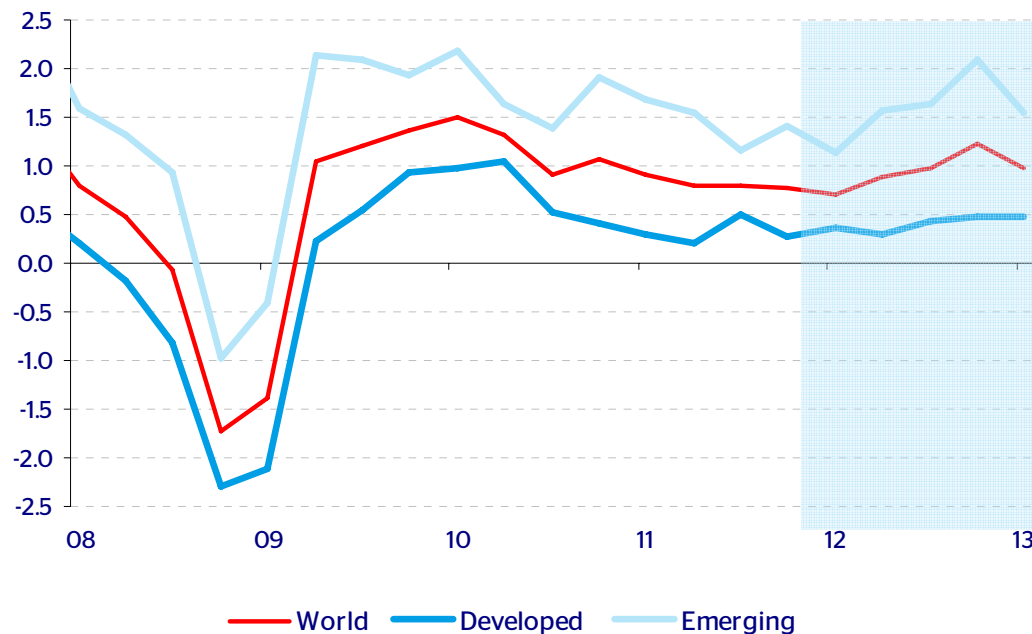


Emerging economies slow down in part due to external headwinds...

Growth heterogeneity will increase both between emerging and developed economies and within developed economies: US and Japan will grow more than Europe in 2012 and 2013. Emerging economies decelerated during 2011 because of external headwinds, both in external demand and global risk aversion. But a rebound is expected in mid-2012.

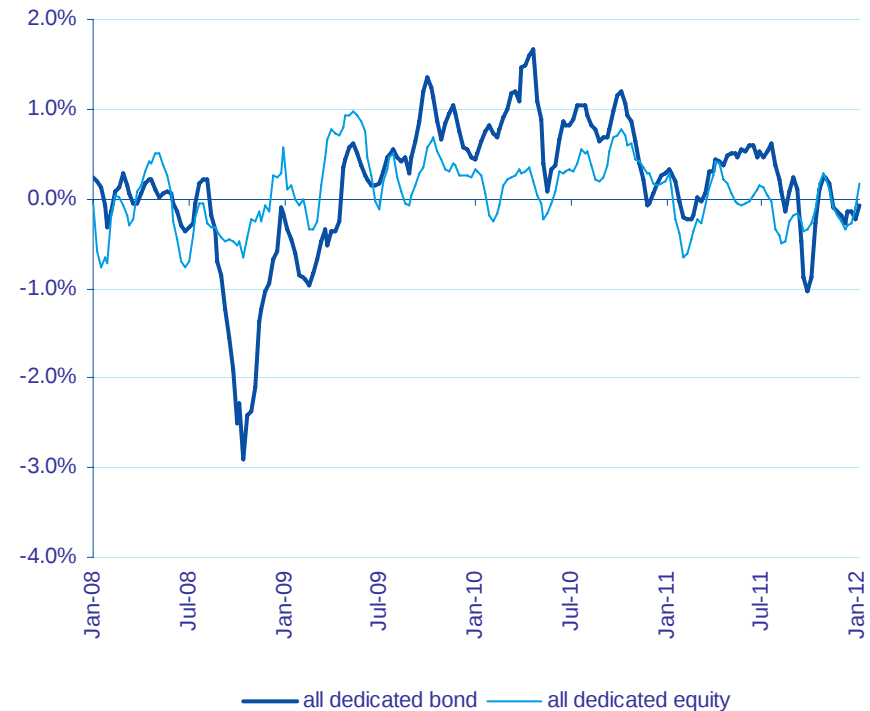
Global growth (%qoq)

Source: BBVA Research and Haver Analytics



Capital inflows to emerging economies (% of assets under management, 4-week avg.)

Source: BBVA Research and EPFR

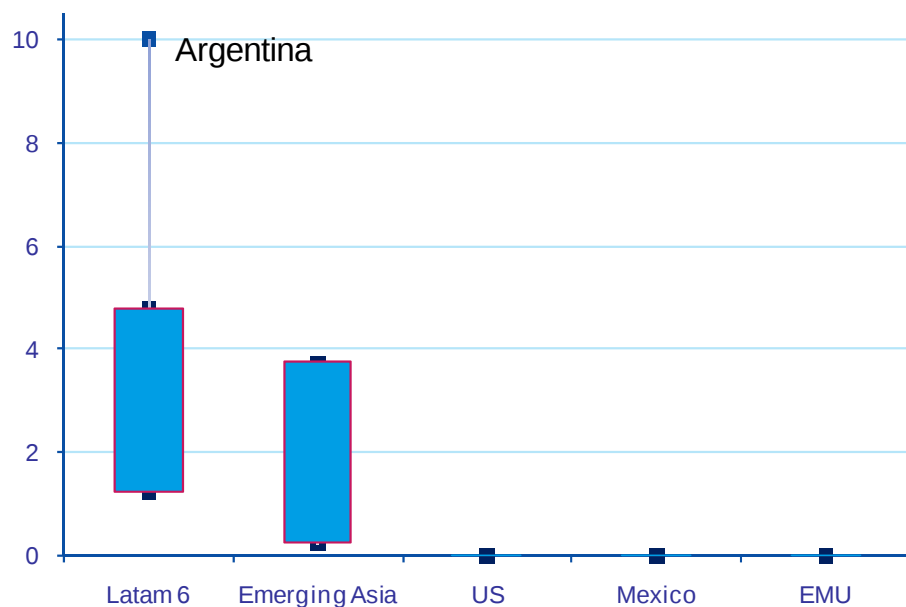


... but policies will turn more into growth-supporting mode

Restrictive policy measures were implemented until mid-2011 to contain overheating risks in emerging economies. They will be put on hold or, in some cases, partially reversed in response to weaker-than-expected growth and weak external demand, especially from developed countries.

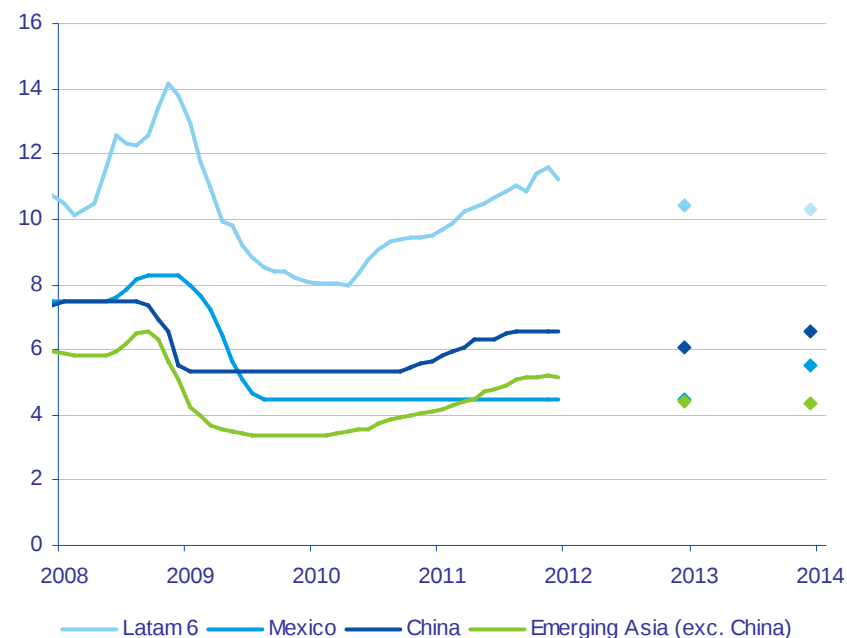
Range of official interest rate increases since January 2010 (pp)

Source: BBVA Research and Bloomberg



Official interest rate in emerging economies (%)

Source: BBVA Research and Bloomberg

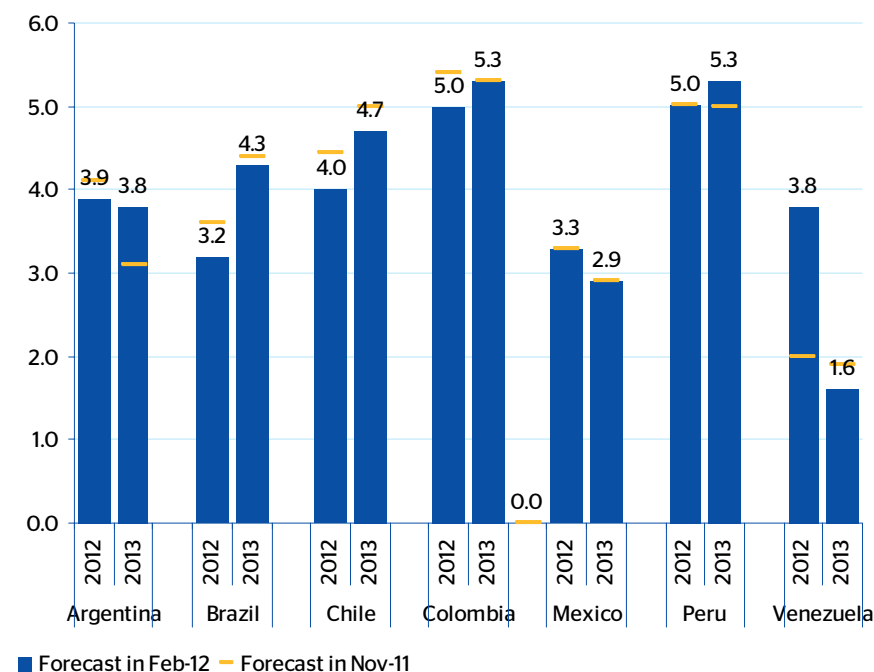


Latin America: slow convergence to potential growth

In Latam, forecasts are basically unchanged from November. Growth in 2012 will slowdown closer to its potential due to the withdrawal of policy stimulus in 2011 and weaker external demand. Domestic demand will remain resilient even with heightened global uncertainty. The “slow motion” nature of the crisis has kept confidence indicators elevated in the region.

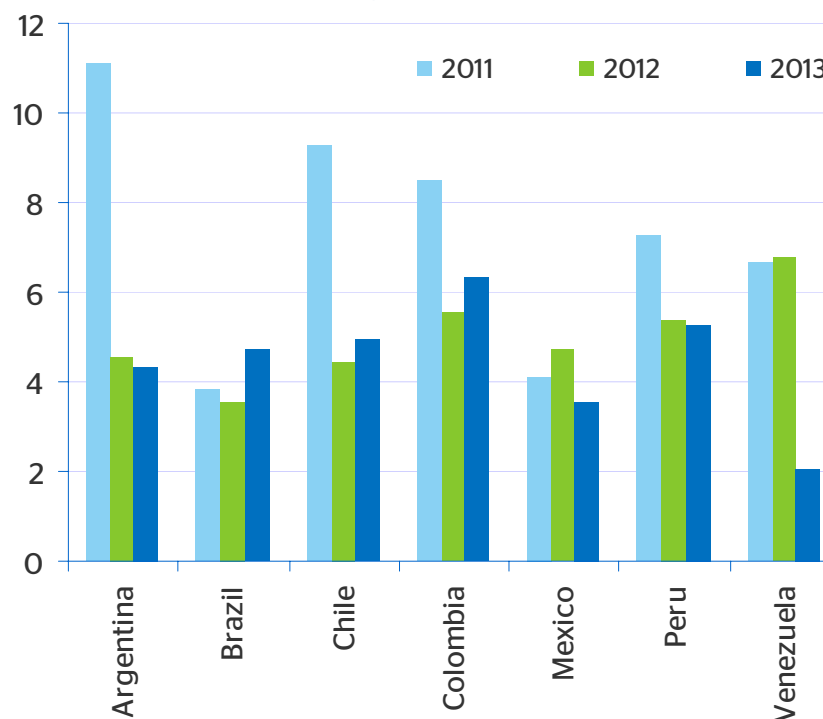
Latam: GDP growth

Source: BBVA Research



Latam: Domestic demand growth (%)

Source: BBVA Research and Haver Analytics



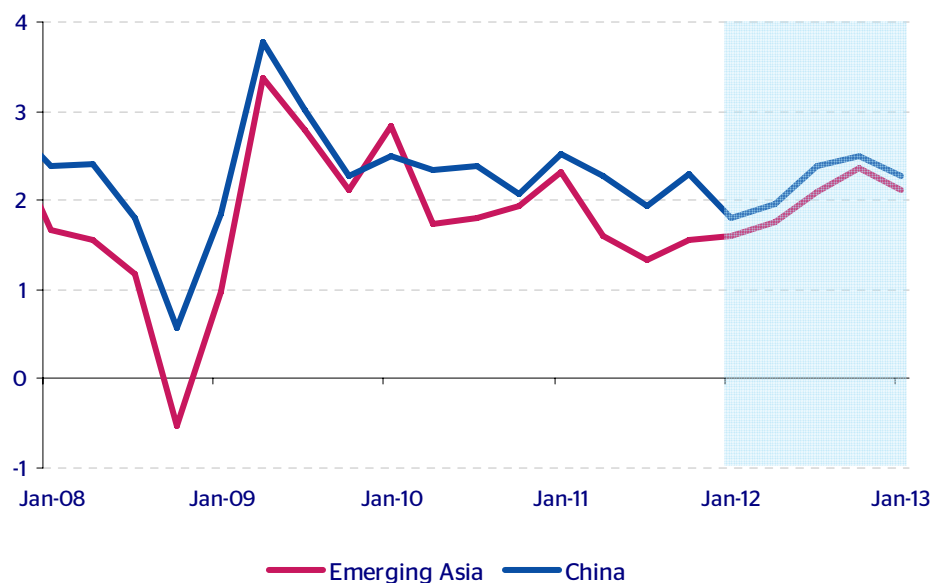
Asia will reaccelerate in the second half of 2012

Growth slows due to weaker external demand, but domestic demand remains resilient. Limited transmission of tensions from the European crisis.

A gradual acceleration of activity is expected in the second half of 2012, due in part to policies turning to support growth. Lower expected inflation in Asia will open up more room for support from monetary policy.

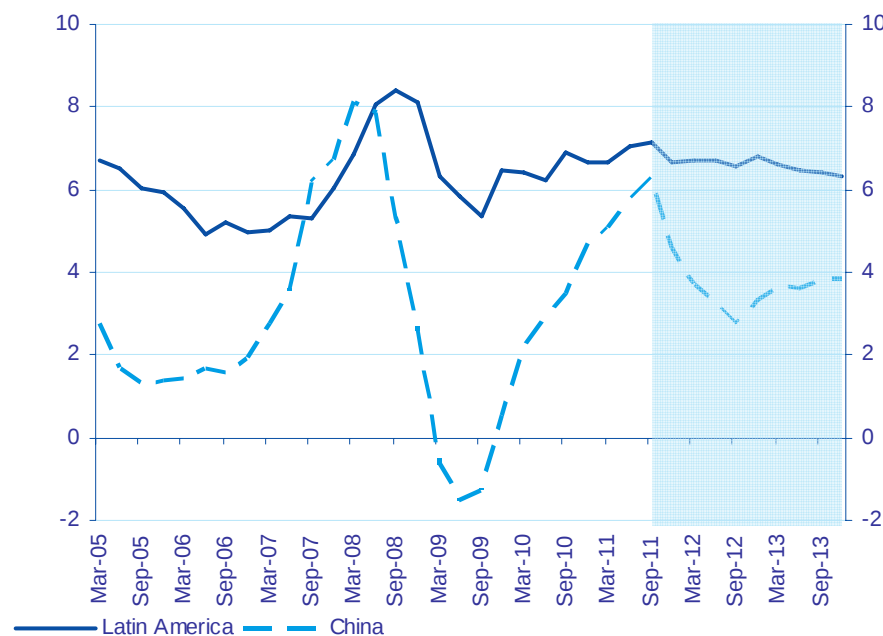
Emerging Asia: GDP growth (%qoq)

Source: BBVA Research



Inflation in emerging Asia and Latam

Source: BBVA Research



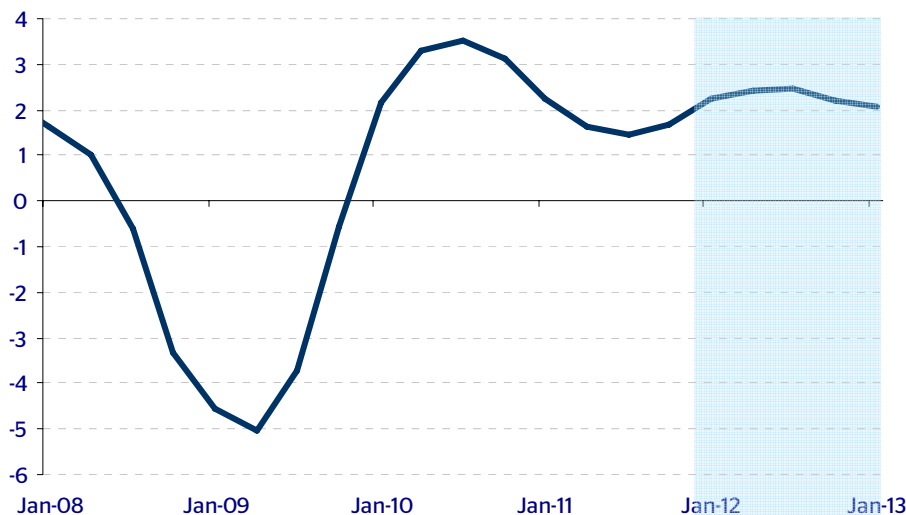
US: improved outlook after the risks of a double dip in 2011

Recent data suggests resilient growth in 2012, but still limited by ongoing deleverage. In addition, uncertainty about policies (fiscal, regulatory) is high.

In particular, fiscal policy could deliver a massive tightening in 2013 (expiration of tax breaks and automatic spending cuts), but without a credible long-run fiscal consolidation plan.

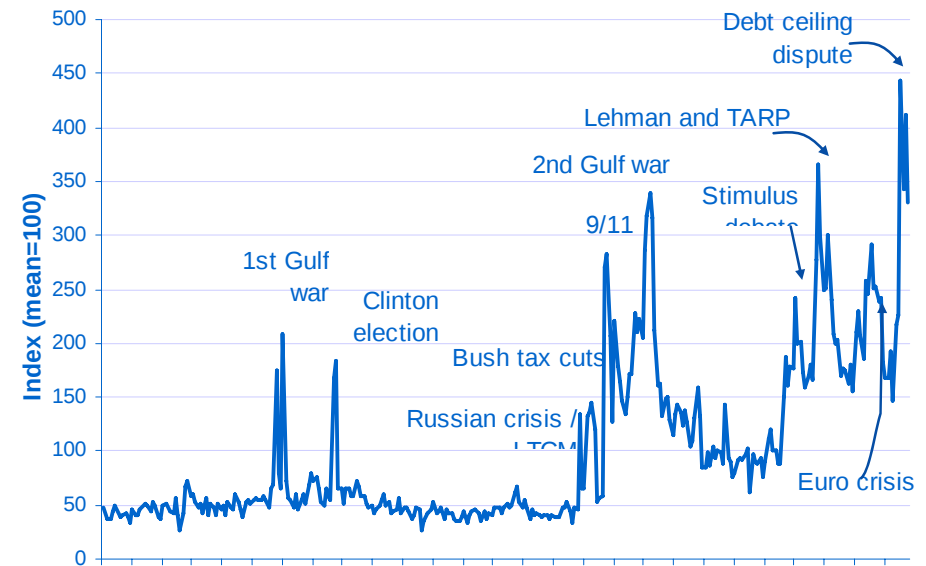
US: GDP growth (%yoy)

Source: BBVA Research



US: Index of economic policy uncertainty

Source: BBVA Research based on Baker et al (2011)



85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11
Monthly number of news articles containing "uncertainty" or "uncertain", "economy" or "economic", as well as policy relevant terms ("policy", "tax", "spending", "regulation", "federal reserve", "budget" or "deficit"). Scaled by number of articles containing "to day". Series normalized to average 100 in the sample period.



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European crisis needs to be tackled in three fronts

1

Clear sovereign solvency concerns (Greece) and avoid contagion to illiquid but solvent countries

2

Advance reforms to increase growth

3

Advance changes in Euro area governance, to strengthen the monetary union and prevent future crisis

There have been just partial advances in the three fronts to end the crisis

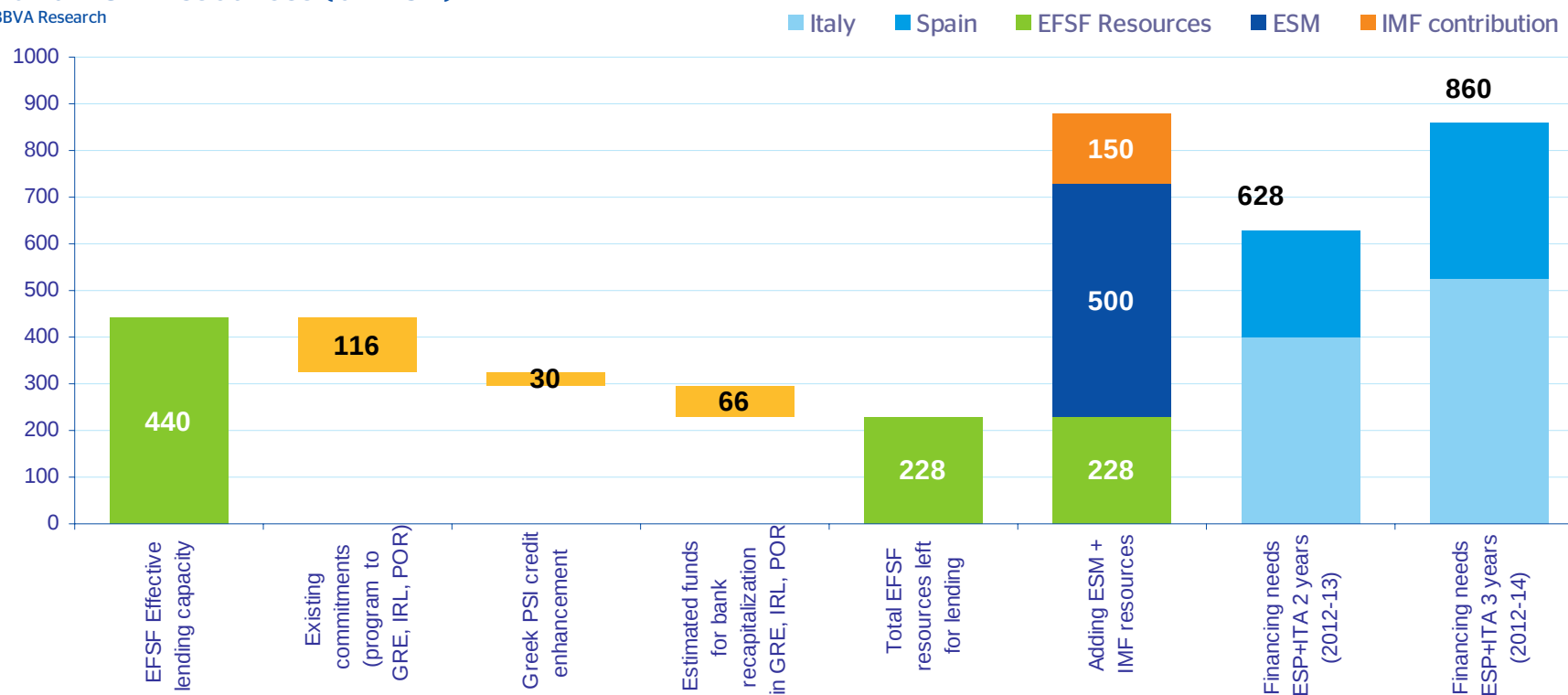
	Issue	October summit	December	January
1	Greek debt sustainability	Increase in PSI to 50%. Doubts continue to exist. ✗	PSI negotiations unfinished. Haircut increased to 60% ✗	PSI negotiations stalled. Haircut above 70% ✗
	EMU sovereign firewalls	EFSF to be leveraged, but fails afterwards ✗	ESM brought forward to 2012 + IMF funds. No ECB backstop ✗	ESM+EFSF coexisting ✗
	Further reforms	More economic reforms ✓	Implementation under way ✓	Pro-growth agenda, but few aid. No talk of struc. deficit targets ✓
2	Strengthen financial system	Broad-based, inefficient recapitalization ✗	ECB provides long-term liquidity ✓	No advances ✓
	Euro area governance	No clear roadmap to a fiscal union ✗	Fiscal compact. No mention of eurobonds ✗	Fiscal compact to be approved. No eurobonds ✗

Avoiding contagion: EFSF and ESM might not be enough

Core Europe seems ready to add up EFSF and ESM, for a total of about 730 bn EUR. But ESM will require parliamentary approval and may take time to be implemented afterwards. Even 730 bn EUR is short of long-term debt refinancing needs of Italy and Spain for 3 years

EFSF and ESM resources (bn EUR)

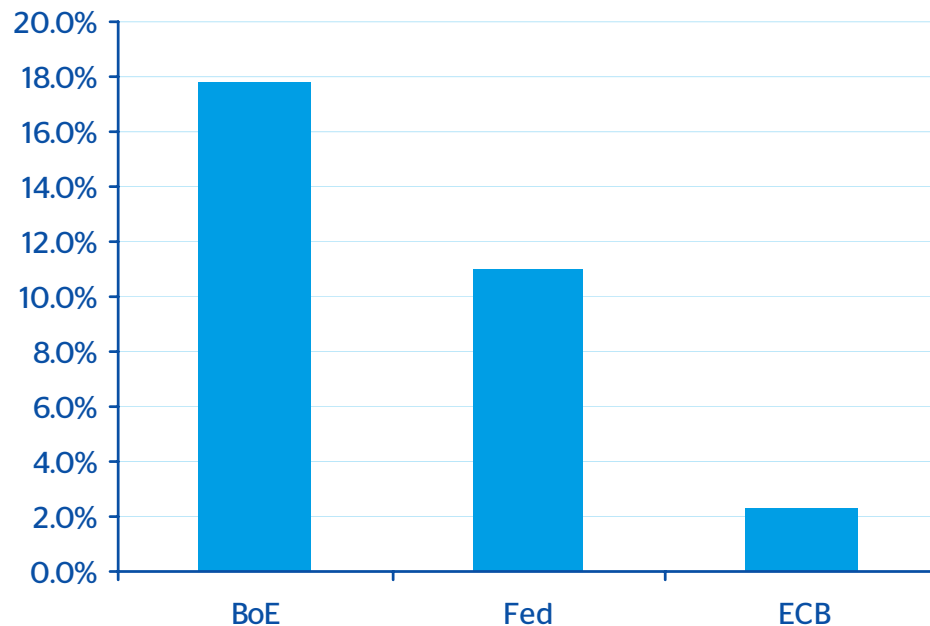
Source: BBVA Research



Liquidity provision by the ECB has been crucial, but has only bought more time.

Central banks' purchases of public debt (% GDP)

Source: Datastream, BBVA Research



Potential role of the ECB

ECB has significantly increased bank liquidity ...

... contributing to a reduction in risk premia.

The new fiscal compact and economic reforms may allow the ECB to take more decisive actions

Closer monitoring of imbalances, but still no roadmap to a fiscal union

European Governance

Monitoring of public and private imbalances (“six pack”).



No strong enforcement

Fiscal compact



In line with fiscal austerity asked by Germany and the ECB. Still waiting for the final agreement

Roadmap to Fiscal union



Just discussion of Eurobond alternatives by the European Commission

¿What is needed now? Reforms, fiscal compact and ECB support in the short run

Preventing a Euro area breakup

Key takeaway from December EU summit:
Core Europe wants to enforce reforms on the periphery, but will do what is needed to prevent a break-up.

ECB is the only backstop in the short run.

So far mostly indirect support to sovereigns through provision of long-term bank liquidity.

Roadmap to exit the crisis

Implement reforms to push growth (mostly) in peripheral countries, and revamp the financial system.

Key for long-term success of eurozone

Approve and implement fiscal compact.
Fiscal compact as the seed of a fiscal union

Fast increase in resources for a sovereign firewall, perhaps with more decisive action by the ECB

Turn discussion about fiscal consolidation to take into account both cyclical and structural part of the adjustment



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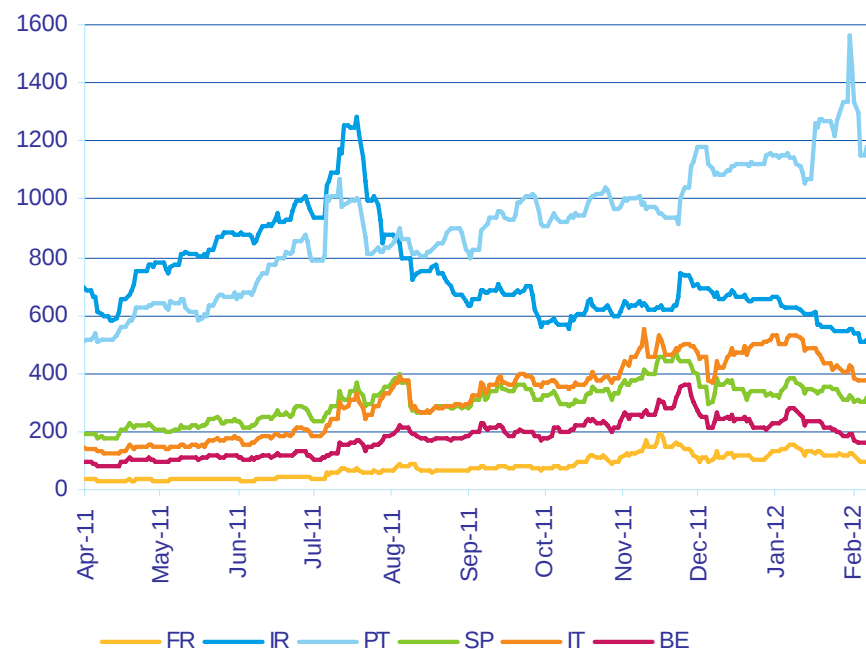
Sovereign and financial tensions in Europe remain very high...

Sovereign risk premia remain very high. Portugal is now the big uncertainty, given the possibility of contagion from Greece.

Even after the provision of long-term liquidity by the ECB, financial stress in Europe remains elevated and wholesale funding markets are still impaired, especially for the European periphery.

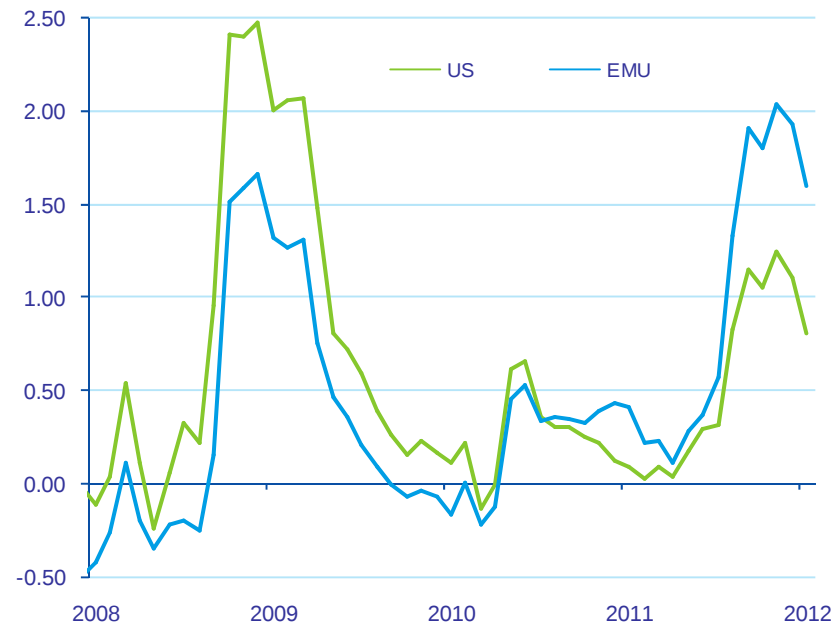
10y sovereign bond spreads to Germany

Source: BBVA Research and Bloomberg



BBVA Financial Stress Index

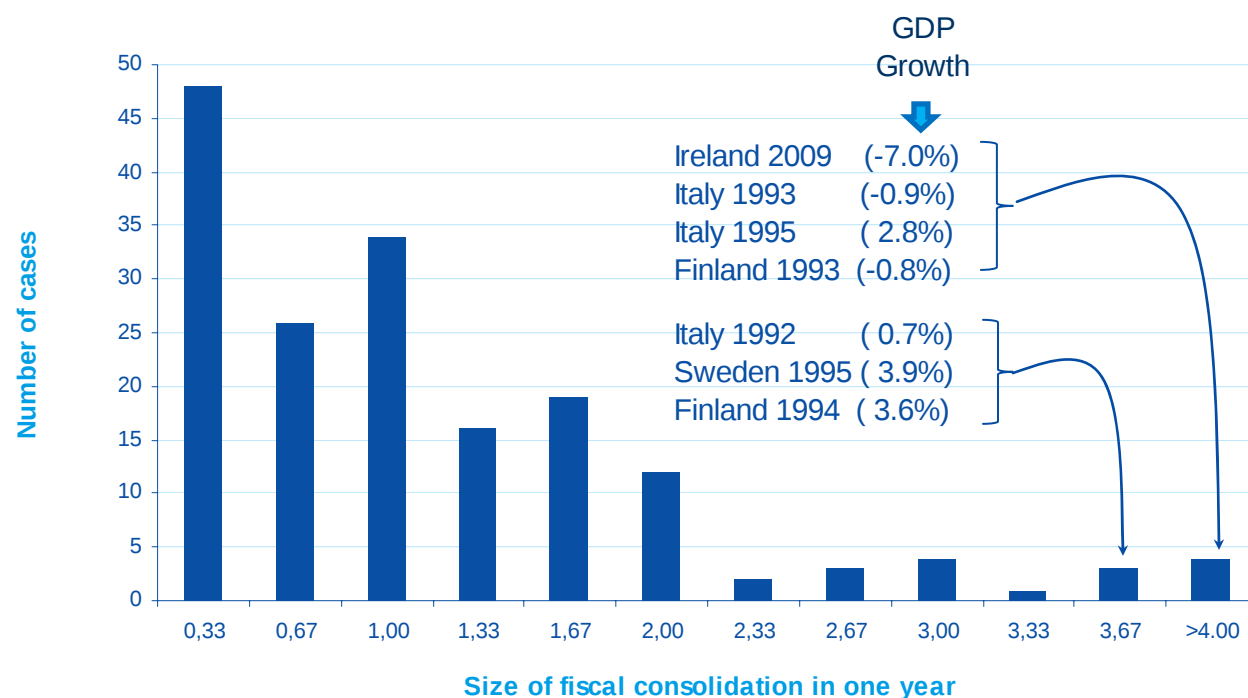
Source: BBVA Research



... and fiscal consolidation also represents a drag on growth

Size distribution of annual fiscal consolidations in OECD countries aimed at reducing the deficit

Source_ BBVA Research a based on Devries et al (2011)



Very few deficit reductions in one year have been bigger than 3% of GDP

Based on 173 cases of action-based fiscal consolidation in 1978-2009 for 17 OECD countries (Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, Portugal, Spain, Sweden, UK and US).

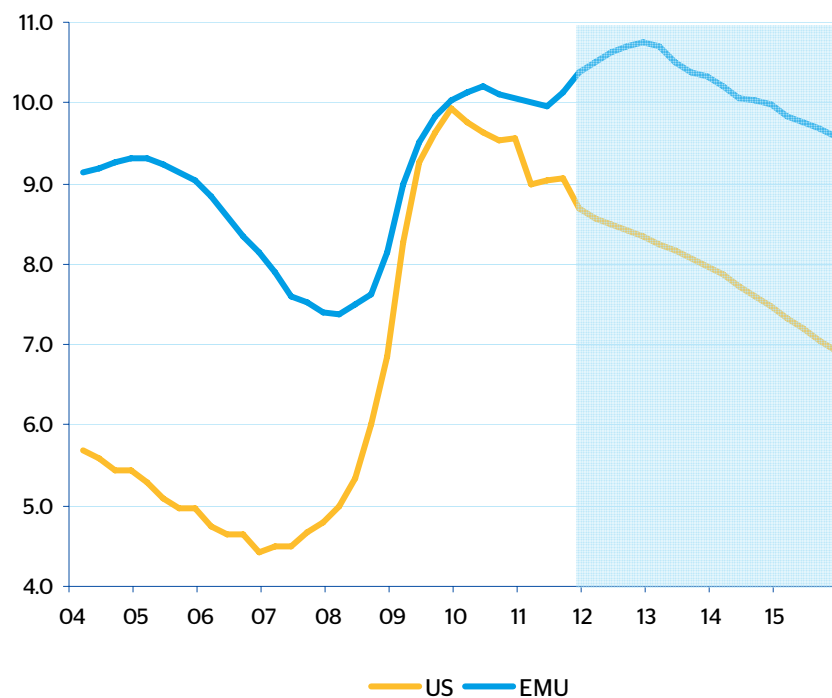
Activity in Europe will be the most affected by the crisis: decoupling and recession in 2012

In the central scenario, we anticipate an orderly restructuring of Greek debt. At the same time the EFSF and ESM avoid contagion to other countries. The ECB provides ample liquidity and wholesale funding markets reopen. Later on, the approval of the fiscal compact and economic reforms induce a reduction of risk premia.

All in all, growth in Europe will be slow compared with other developed economies such as the US.

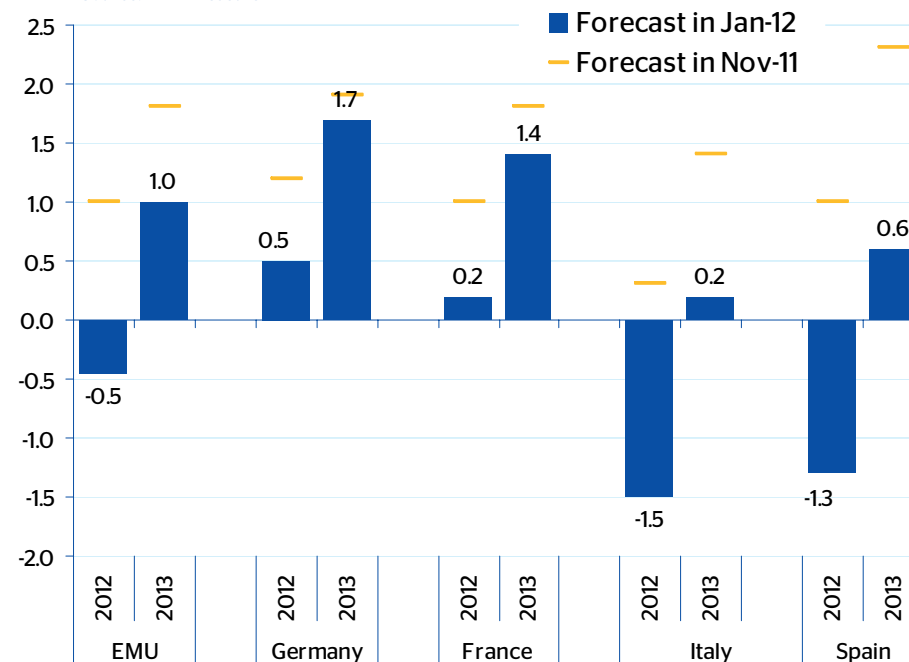
Unemployment rate in US and EMU (%)

Source: BBVA Research



Europe: GDP growth

Source: BBVA Research





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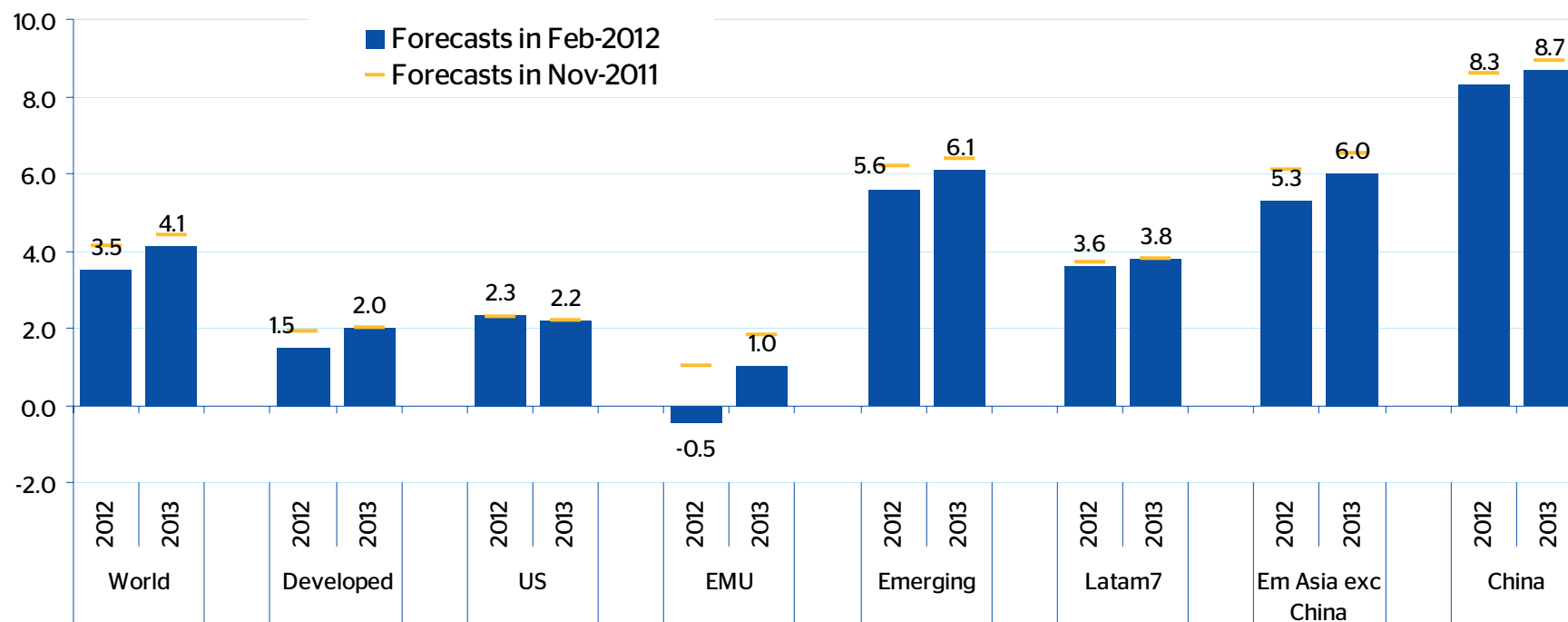
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Summary: decoupling in advanced economies and soft landing in emerging countries.

The main changes to the projections relative to November are centered in Europe, which undergoes a recession in 2012. There will be a clear decoupling with the US. Our baseline scenario points to a soft landing in emerging economies, buttressed by domestic demand.

Global growth (%)

Source: BBVA Research



GDP growth forecasts

	2011	2012	2013
World	3.9	3.5	4.1
Developed	1.7	1.5	2.0
US	1.7	2.3	2.2
EMU	1.6	-0.5	1.0
Spain	0.7	-1.3	0.6
Emerging	6.2	5.6	6.1
LatAm 7	4.3	3.6	3.8
Mexico	3.8	3.3	2.9
LatAm 6	4.5	3.7	4.1
Brazil	2.8	3.2	4.3
LatAm 5	6.6	4.2	4.0
Argentina	9.0	3.9	3.8
Chile	6.2	4.0	4.7
Colombia	5.5	5.0	5.3
Peru	6.7	5.0	5.3
Venezuela	4.0	3.8	1.6
EAGLES	6.7	5.9	6.5
Turkey	8.5	1.9	4.2
Asia Pacific	5.8	5.8	6.1
Emerging Asia	7.4	6.8	7.4
China	9.2	8.3	8.7
Emerging Asia ex China	5.6	5.3	6.0

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Madrid, 9 February 2012