

# Europe and China

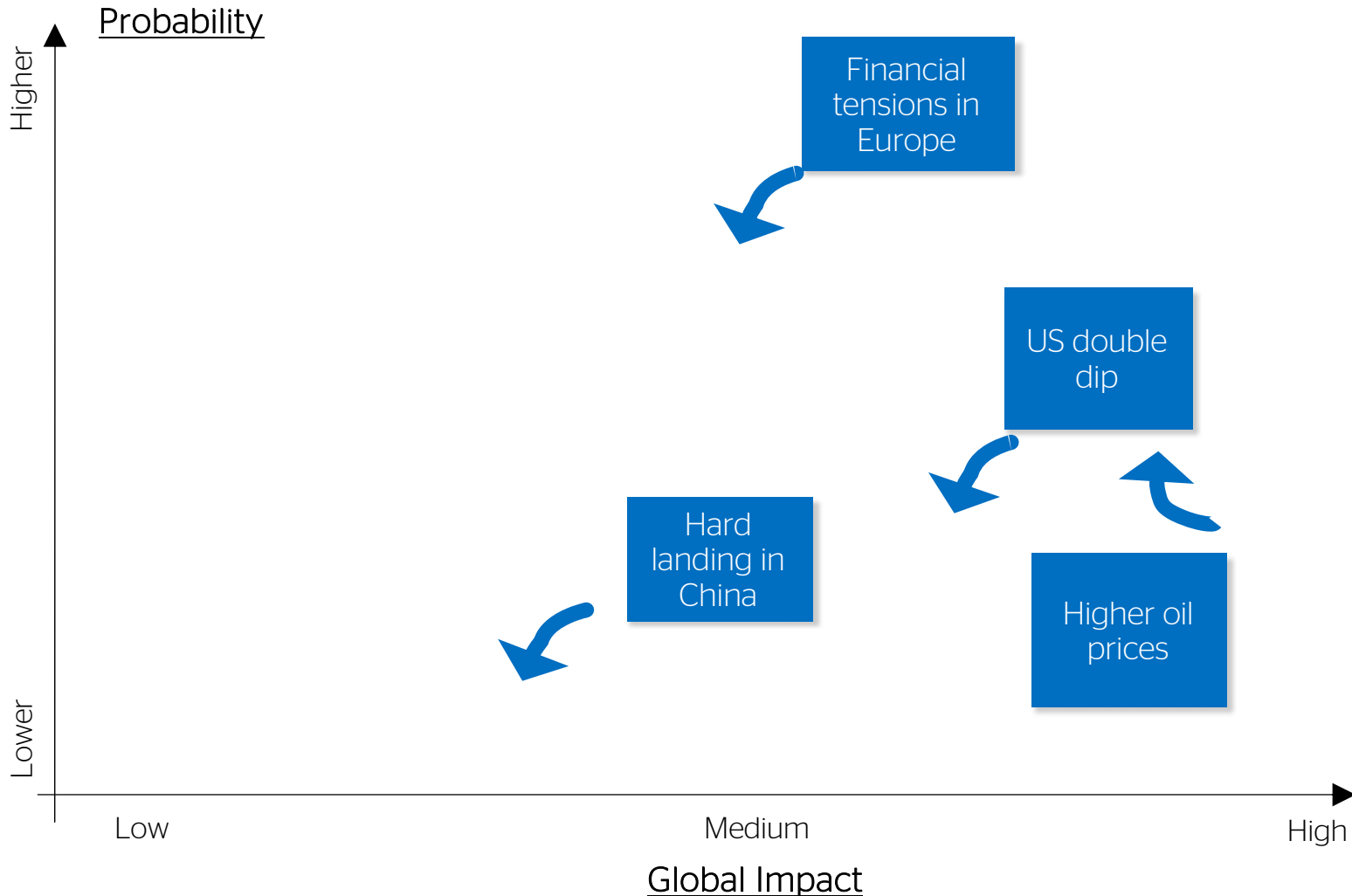
## How does it look from Latin America?

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**Chief Economist Emerging Markets BBVA**

Rio de Janeiro, IIF Meeting, 7-8 March 2012

# Global risks are coming down except for a oil-related geopolitical risk



# Roadmap to presentation

**We pick up 2 of those risks:**

Risk 1. Most likely: “Accident” in Europe

Risk 2. Most feared in South America: Hard landing in China

**Key take aways:**

Risk 1 Increasingly less relevant (except in a mass destruction scenario)

Risk 2: Less likely than we think

On that basis key issues for Latin America

1. What about exchange rate appreciation?
2. What about macroeconomic imbalances?

# Risk 1

**Europe's looming risk**

**So persistent but still changing  
dynamically**

# An “event” in Europe less likely (specially mass destruction)

Good news coming from:

1. ECB larger and more predictable provision of liquidity
2. More –even if not full –clarity on Greece
3. Stricter fiscal surveillance at European level with the end goal of a fiscal union!
4. Progress on structural reforms

# But important milestones still pending which will make Europe's recovery long and painful

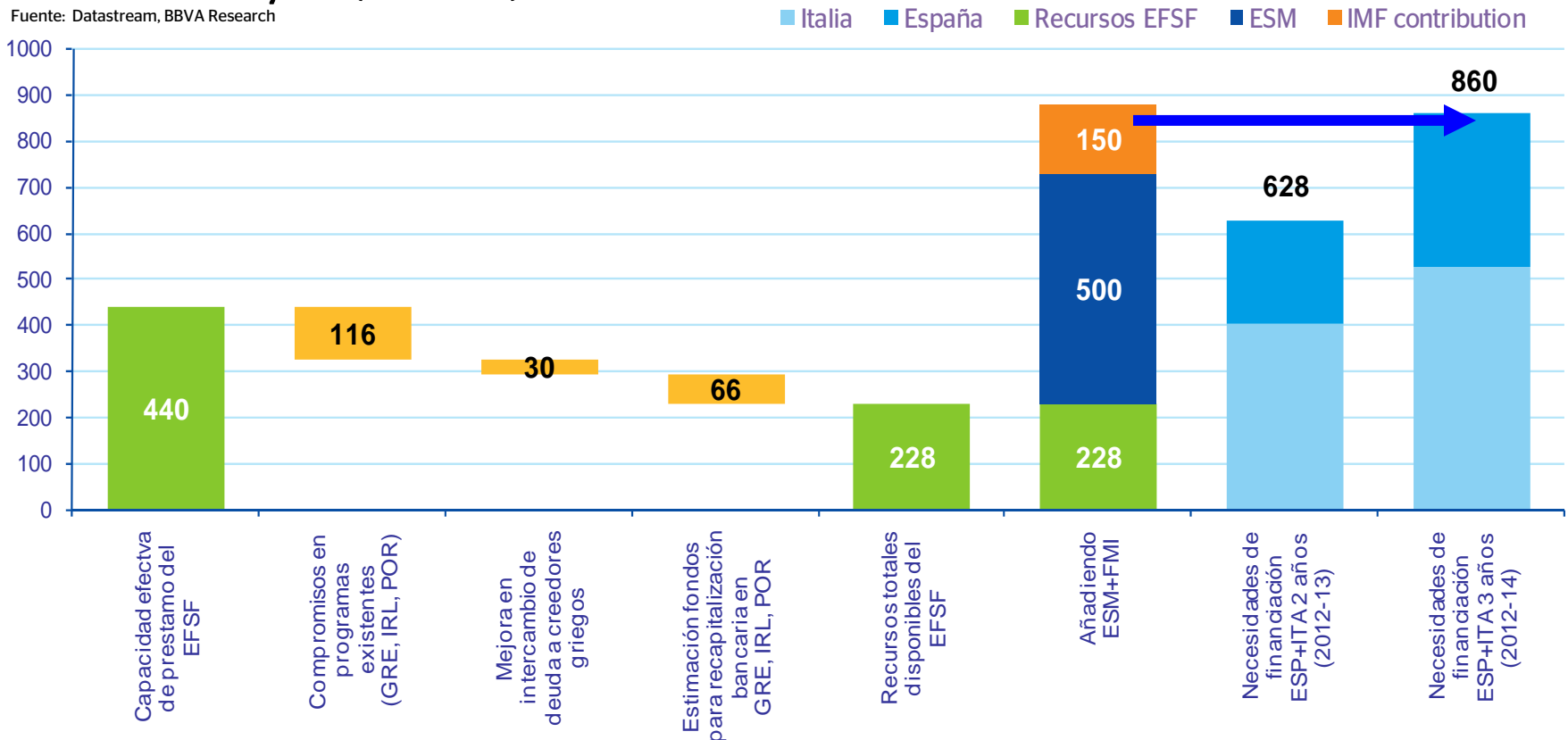
- Reforms have been legislated but need to be implemented!
- In the medium term some kind of Eurobonds needed while heading towards fiscal union
- In the short term, enough ammunition for countries at risk
- Try EFSF with Ireland first so as to have a success case
- Then avoid Portugal going to the market in 2013

# More countries at risk so funds available for insurance should increase

Germany seems ready to put EFSF and ESM together for a total of 730 billion EUR. Topping this up with IMF contribution should be enough to cover Spain and Italy as well. The key hurdle is parliamentary approval for ESM

## Resources of EFSF y ESM (billion EUR)

Fuente: Datastream, BBVA Research



# Risk 2

**China's risk of a hard landing  
obviously systemic but less likely than  
people think**



# No signs of sharp slowdown

- **Real economy data still points to a soft landing.**
  - Government GDP revision could well be another negotiating tool given mounting pressure to be a responsible stakeholder in the global arena
- **Exports have softened, not plummeted**
  - As one could have expected being Europe its major trading partner
- **Exchange rate helping as it is now depreciating in real terms**
  - Thanks to Euro strength and sudden stop in RMB/USD appreciation trend
- **Investment will not suffer much either**
  - Infrastructure and high end housing construction to be substituted by a frontloaded social housing program
- **Even if there were a European “event”, room for monetary and fiscal policies.**
  - Not as much as in 2008-09, specially on the fiscal side but still relevant

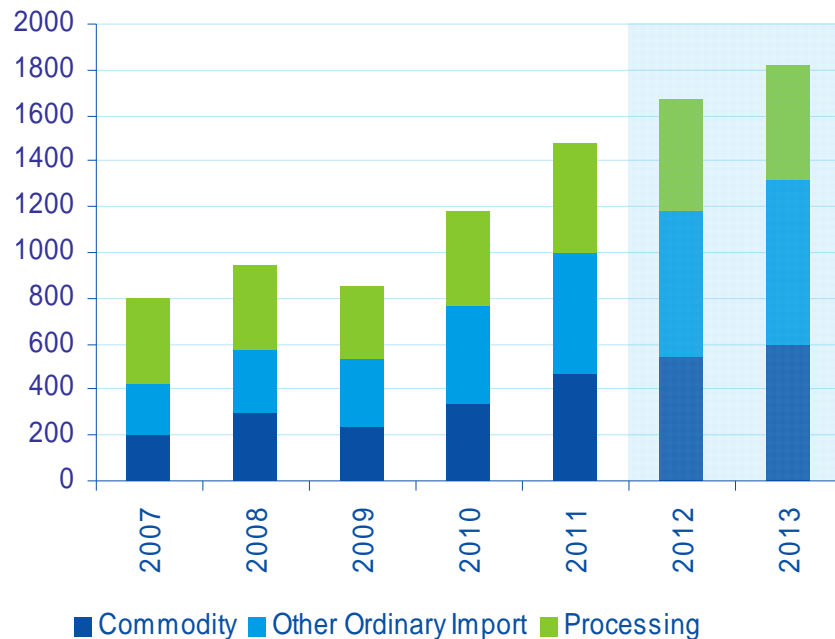
# China has the size and openness to be a growth engine

- Quota in global imports growing: 10% in 2010 right after EU=12.9%, US=12.8% .
- According to IMF's network analysis, China actually stands first in terms of centrality in trade
- In the current juncture – as in 2009 - processing imports (mainly from Asia) growing more slowly than commodities and rest

## Breakdown in Chinese imports

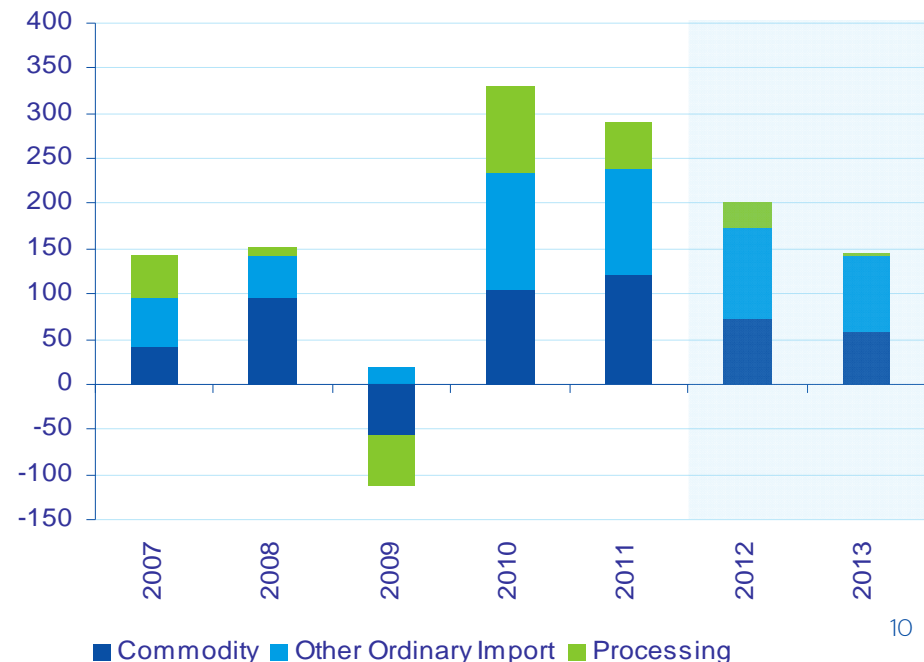
Source: CEIC and BBVA Research estimates

USD bn



## Change compared to last year

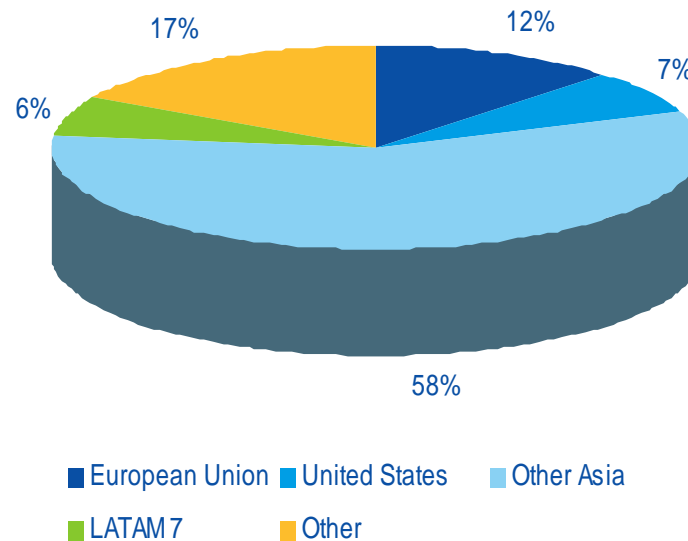
USD bn



# Even if Latam has a smaller share of Chinas' imports, it will benefit more than East Asia in current juncture

## Imports by region (2011)

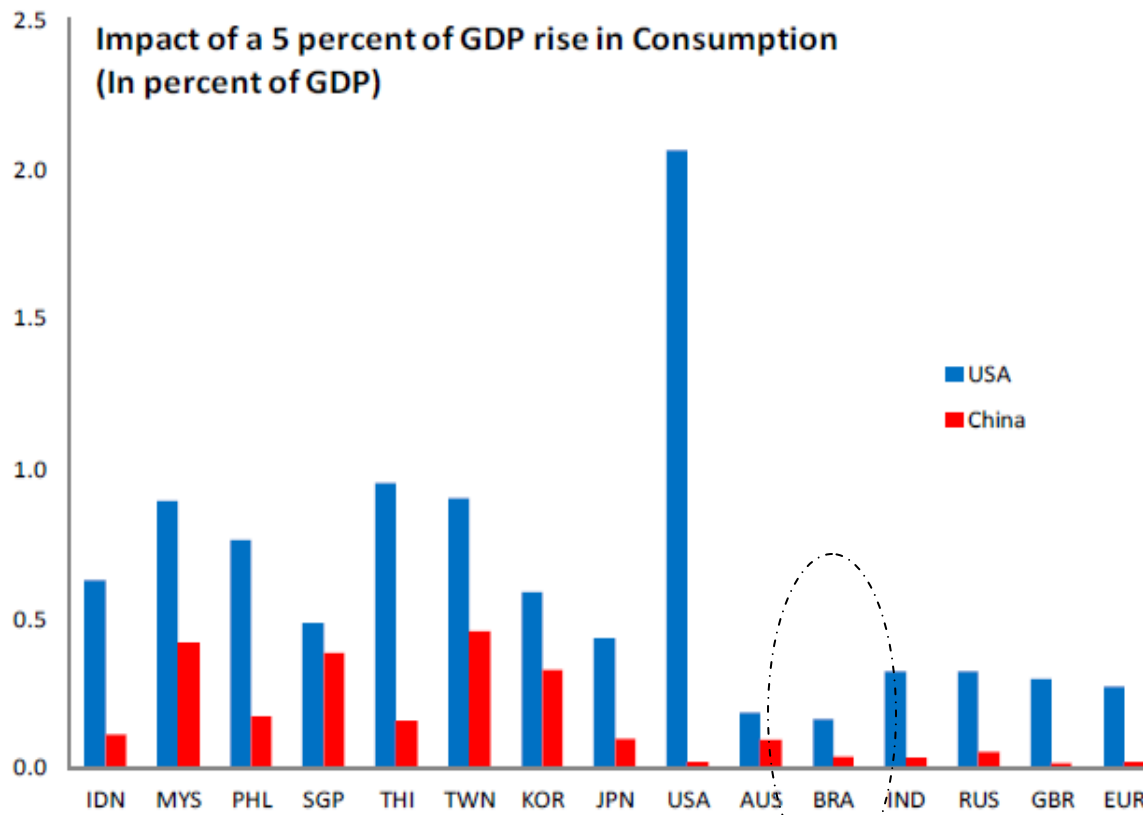
Source: CEIC and BBVA Research



# In the medium term, with China's rebalancing towards consumption, Asia will clearly benefit more

## Impact of a 5 percent of GDP Rise in China's and US's Consumption

Source: IMF



# Still, China relevant for commodities but US relevant for commodities and the rest!

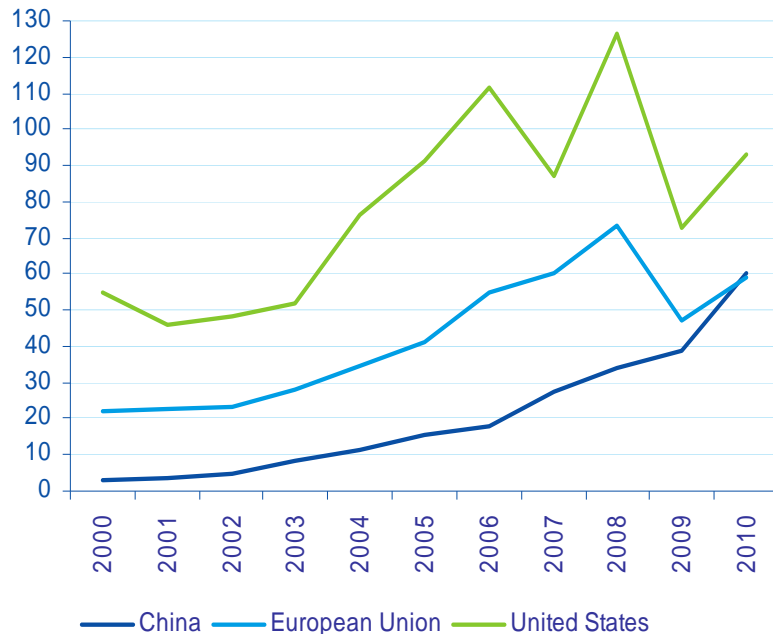
**A double dip in the US would still be more of a problem than China**

## Commodity exports from LATAM 7

Source: Comtrade and BBVA Research

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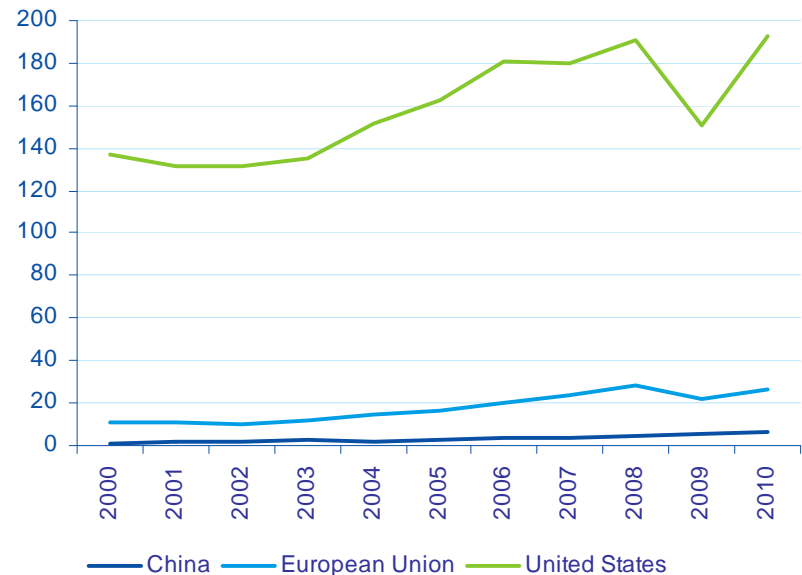
USD bn



## Non-Commodity exports from LATAM 7

Source: Comtrade and BBVA Research

USD bn



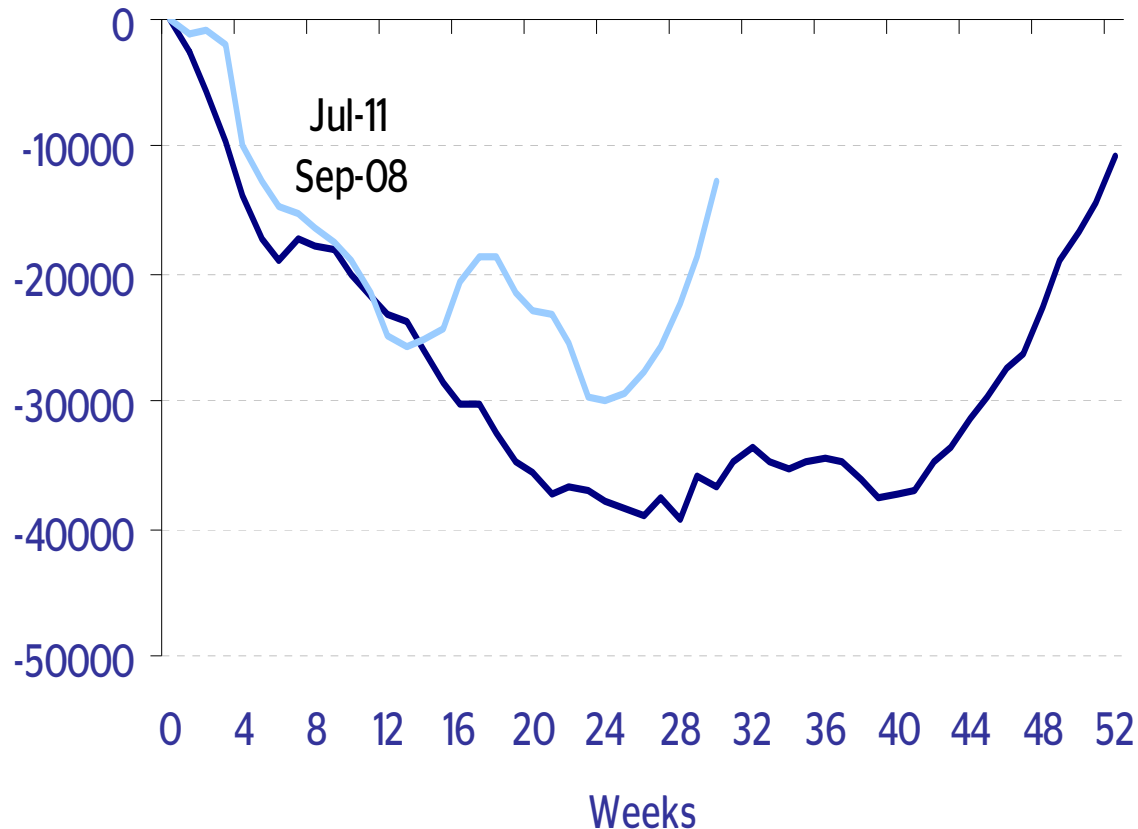
# The world from Latam perspective

## **1. What about exchange rate appreciation?**

# Capital inflows to return to the forefront

Further accommodative global monetary policy measures in the developed world (LTRO, etc) will bring new capital inflows in the emerging world

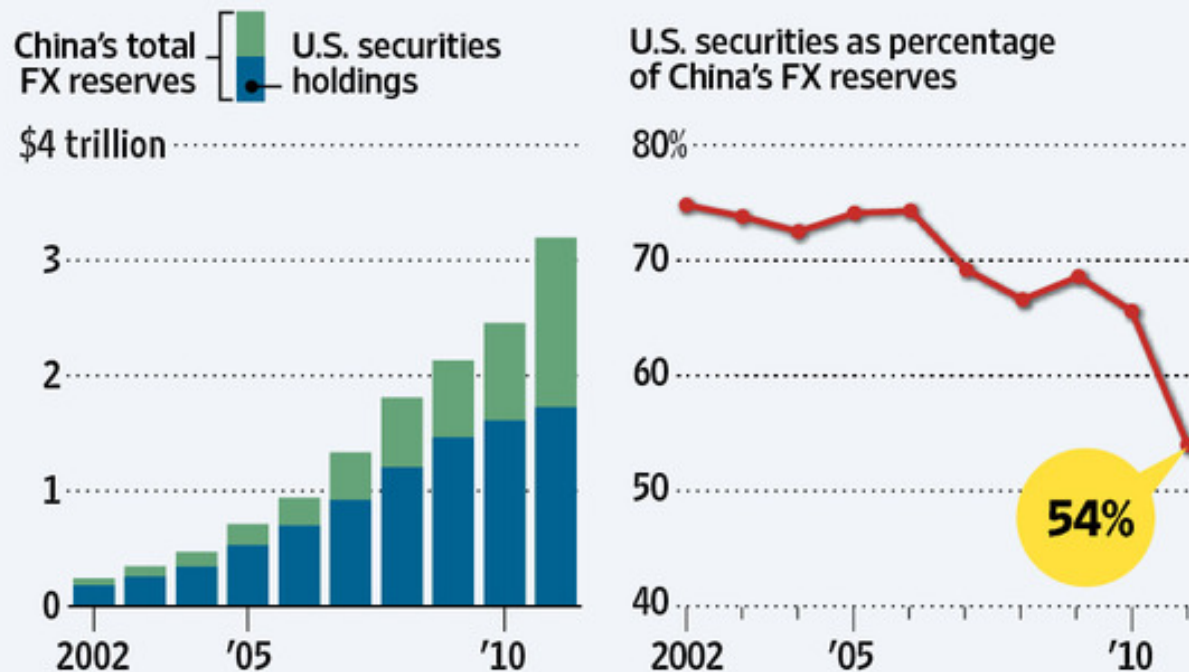
**Emerging markets: Net Portfolio outflows during the Lehman's episode and recent European debt crisis, Cumulative bn USD**  
Source: EPFR and BBVA Research



# China's exchange rate diversification to include emerging (and Latam) currencies

## Easing Off on Dollars

U.S. dollar holdings have become a smaller share of China's total foreign-exchange reserves.



Note: Figures as of June each year

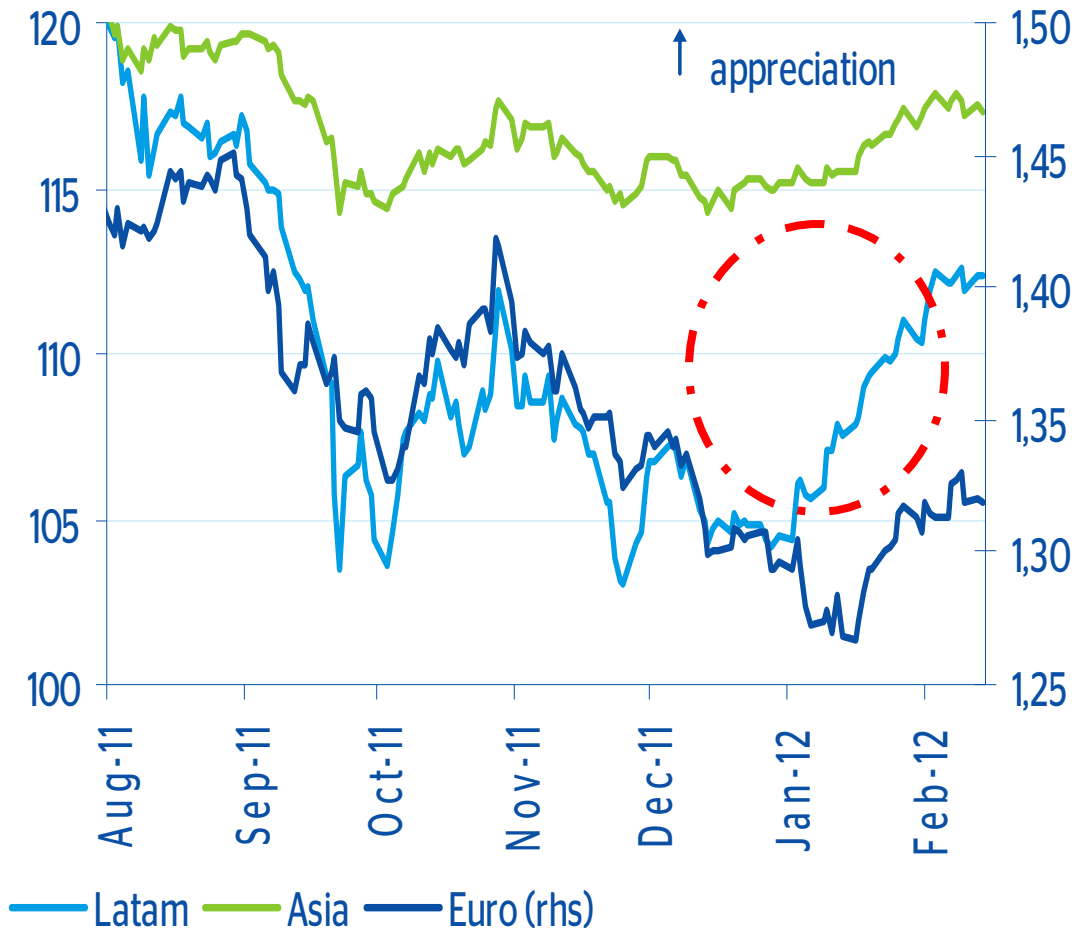
Sources: People's Bank of China; U.S. Treasury; WSJ calculations

The Wall Street Journal



# Appreciation already happening in Latam much faster than in Asia: Where is the limit?

LATAM, Asian currencies\* & EUR vs. USD1  
1 JP Morgan LACI and ADXY trade-weighted indexes



# Even more relevant reasons in the medium term

- Based on the convergence with the rest of the world
- The more so the more undervalued the currencies now
  - More for Asian currencies but still

The world from Latam perspective

**2. Should we be worried about  
exchange rate appreciation?**

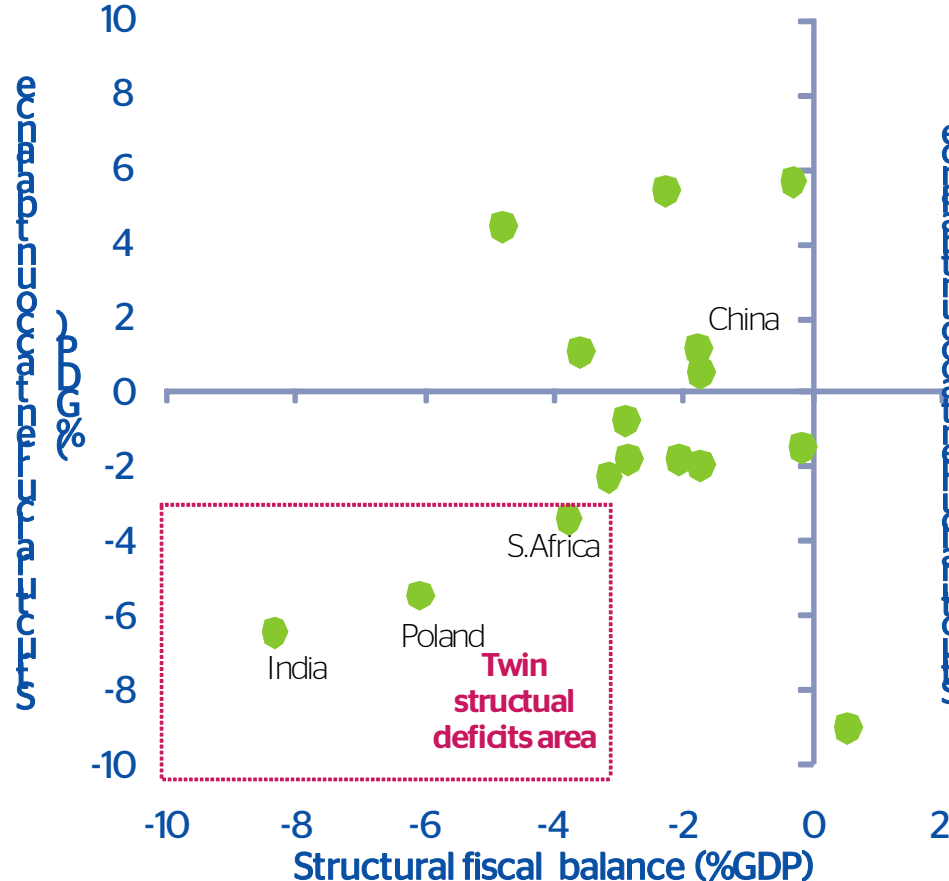
**What about macroeconomic  
imbalances?**

# Structural imbalances not so relevant for emerging economies than developed ones and exceptions not in Latam

## Structural Balances 2011 : Dev Economies

(% GDP)

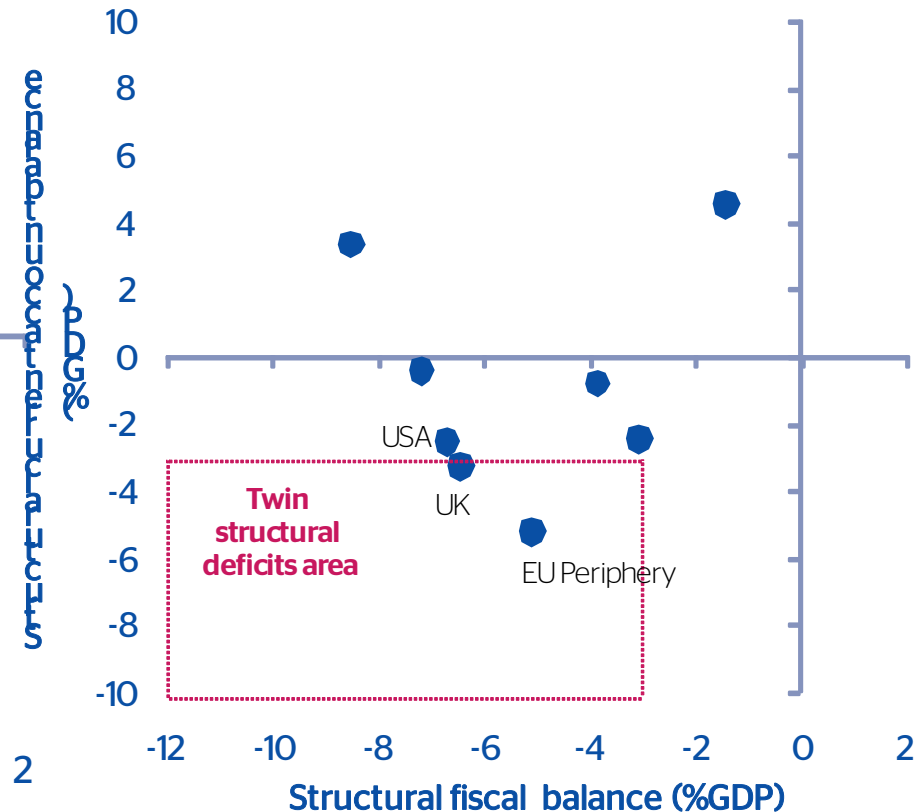
Source BBVA Research



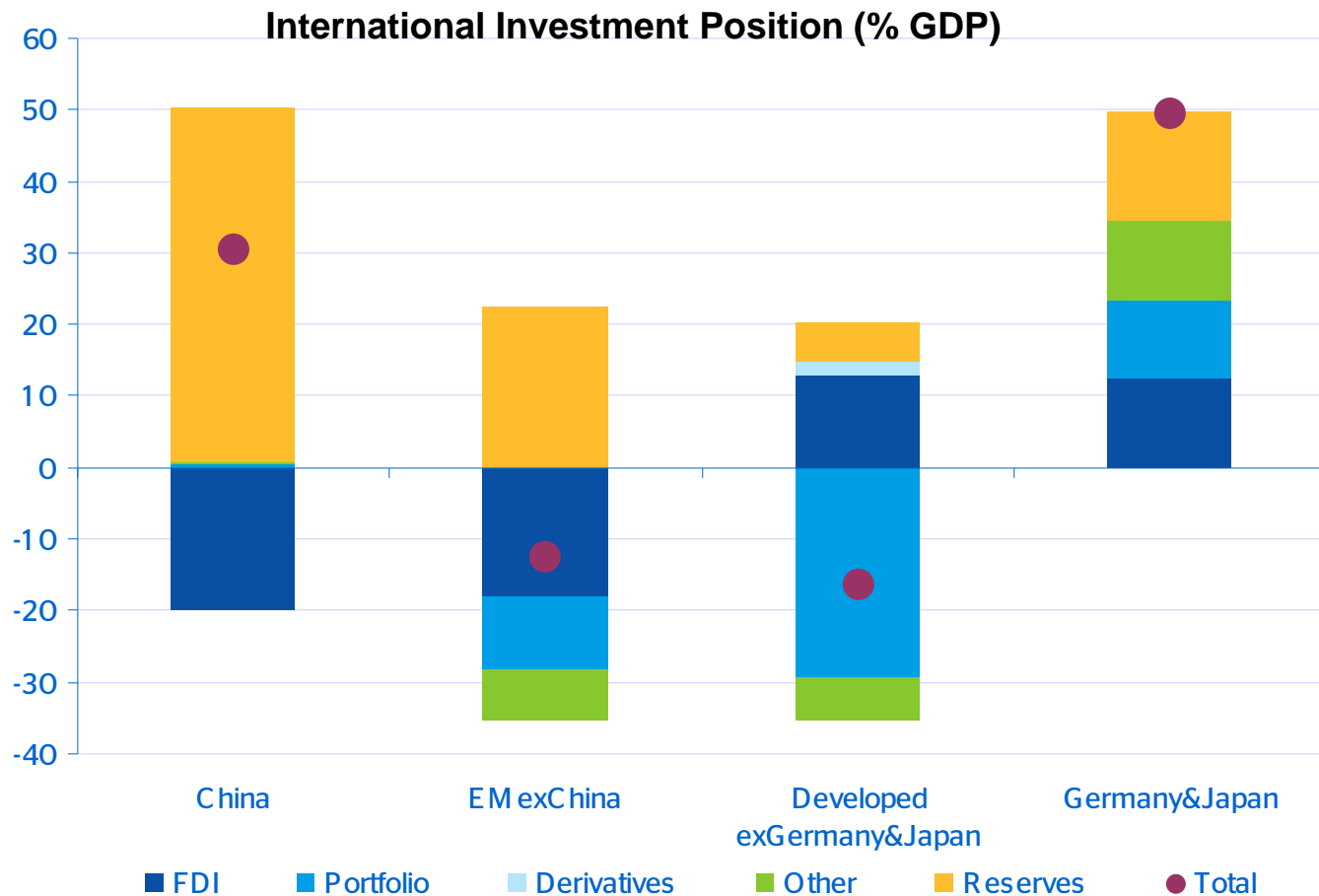
## Structural Balances 2011 : EM Economies

(% GDP)

Source BBVA Research



While China is the only large creditor among the emerging world, other emerging countries (also Latam) in less negative position than the developed world



# All in all

- Exchange rate appreciation is bound to happen
- But it should not be such a big problem in the medium term based on the relatively moderate structural imbalances in the region and the moderately negative external wealth
- However, when thinking about FUTURE structural imbalances productivity/competitiveness are key issue
- As for the external environment China clearly more relevant than Europe but US probably even more relevant than China for the region as a whole

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