

Outlook for the Global Economy and for Spain

13 February 2013

Key themes

- 1 The perception regarding the prospects of the global economic scenario has improved as a result of a relaxation of financial tensions, particularly in Europe, and the last-minute agreement to side-step the fiscal cliff in the US.
- 2 To sustain the recovery, appropriate policies must be adopted in both the US and the euro area.
- 3 Without ruling out upside surprises, the risks remain tilted to the downside, although they appear less likely now and should have a smaller impact.
- 4 Spain: caution due to existing risks. In 2013, the economy should bottom out, paving the way for economic growth in 2014.
- 5 Therefore it is vital to take advantage of the window of opportunity that has opened up to push through reforms that shore up the improvement in confidence.

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Global economy: economic outlook improves

Section 2

Spain: will recovery start in 2013?

The perception of the global economic scenario improves

The ease in financial stress drives an improvement in global economic activity

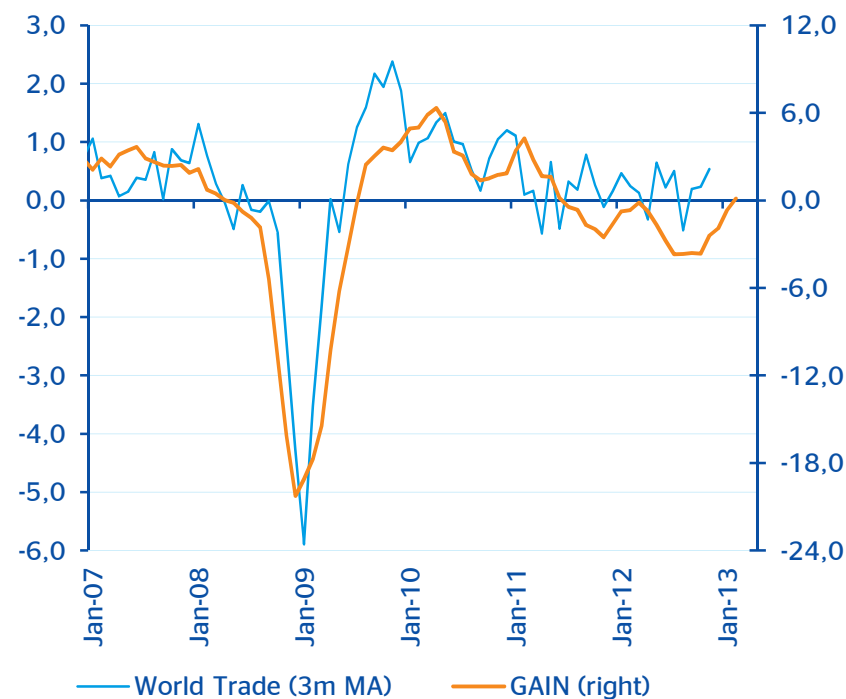
BBVA financial stress index

Source: BBVA Research



BBVA-GAIN and World Trade

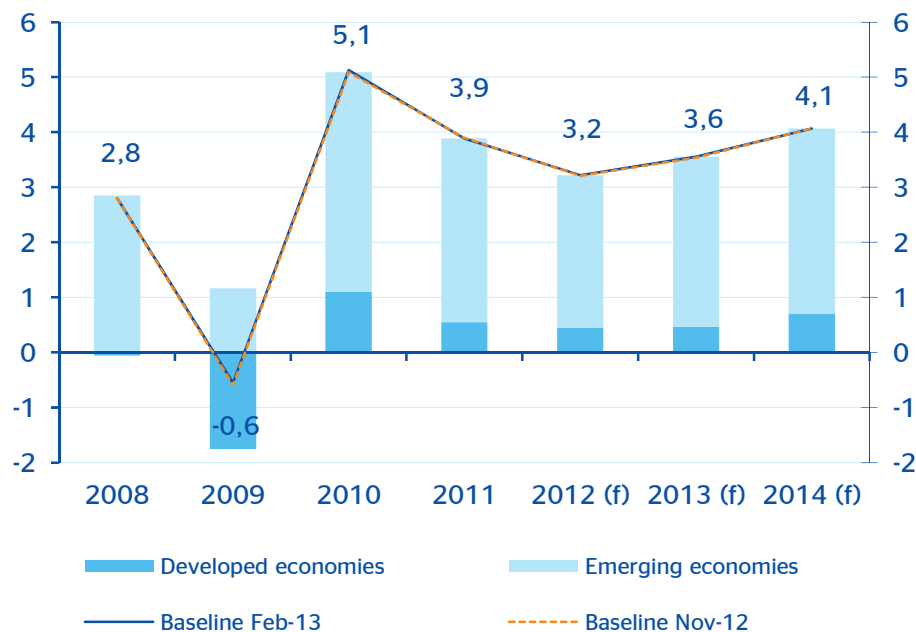
Source: BBVA Research based on CPB data



The perception of the global economic scenario improves

Global economic growth (%)

Source: BBVA Research



Improved confidence boosts activity

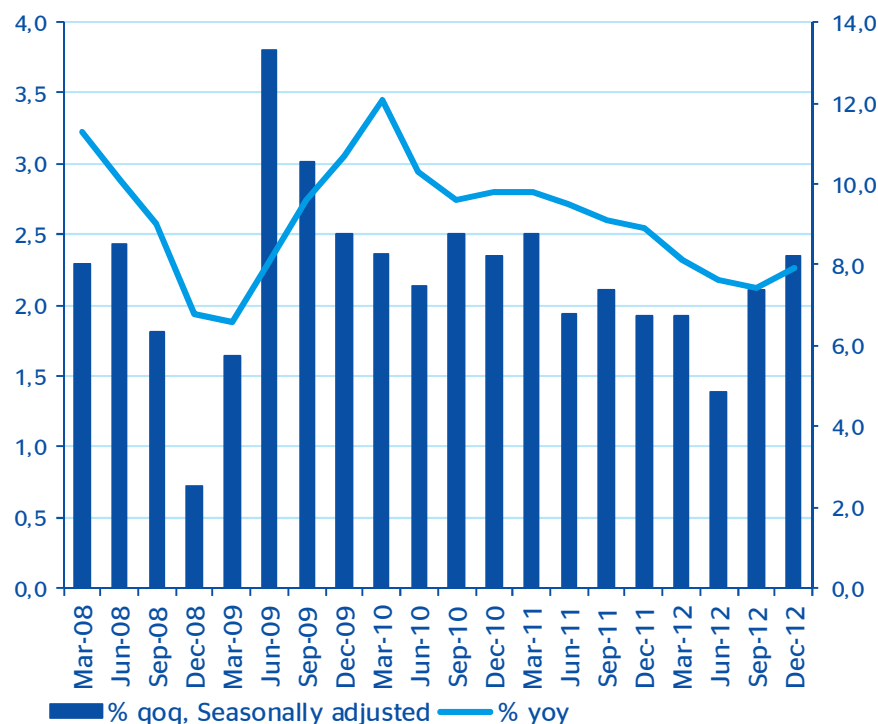
Progress in governance in Europe and further agreements on the US fiscal deficit are necessary conditions for recovery

The most extreme risk scenarios are less likely now thanks to the response by economic policies

Brighter prospects for emerging economies

China: GDP growth

Source: BBVA Research



Improved prospects for the Chinese economy provide support to the global economy

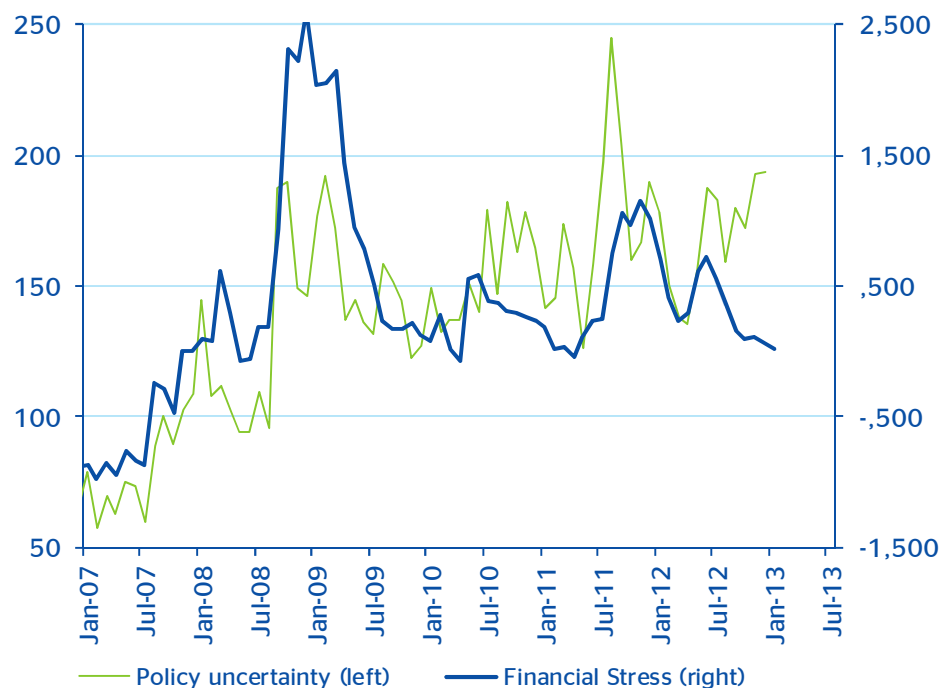
Investment, backed by stimulus measures, and exports to the rest of Asia and the US are behind China's renewed growth

Mid term, consumption must take over as a growth driver in China

The US weathers the impact of fiscal uncertainty

US: economic policy uncertainty index

Source: BBVA Research based on data from PolicyUncertainty.com



Economic policy uncertainty has not prevented financial stress from easing...

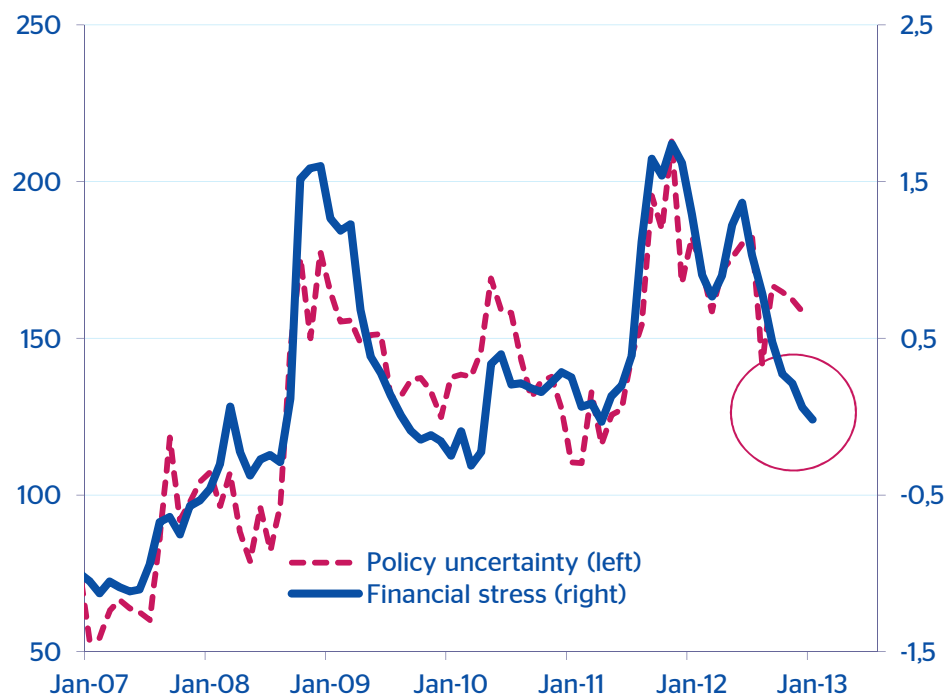
...enabling private consumption to continue growing at near pre-crisis levels

Extraordinary monetary expansion counterbalances the potential impact of fiscal uncertainty on economic performance

EMU: lower perception of risk with progress towards a banking union

Euro area: economic policy uncertainty index

Source: BBVA Research based on data from PolicyUncertainty.com



What has happened since last summer?

1. The ECB says it is “ready to do whatever it takes” to preserve the euro

2. Second Greek bailout: a decisive movement against euro break-up risks

3. EU council: decisive and continuous steps towards a banking union

-> capital flows back to Europe, and not only to peripheral countries; financial stress eases

EMU: lower perception of risk with progress towards a banking union

Fiscal union

Since the December summit, progress towards a fiscal union has been delayed

The "Treaty on Stability" and the "Six pack" appear to be sufficient for now...

...without debt mutualisation commitments or additional budget controls

Banking union

Single regulator and supervisory body in 2014

Single resolution mechanism and direct recapitalisation to be developed in 2013...

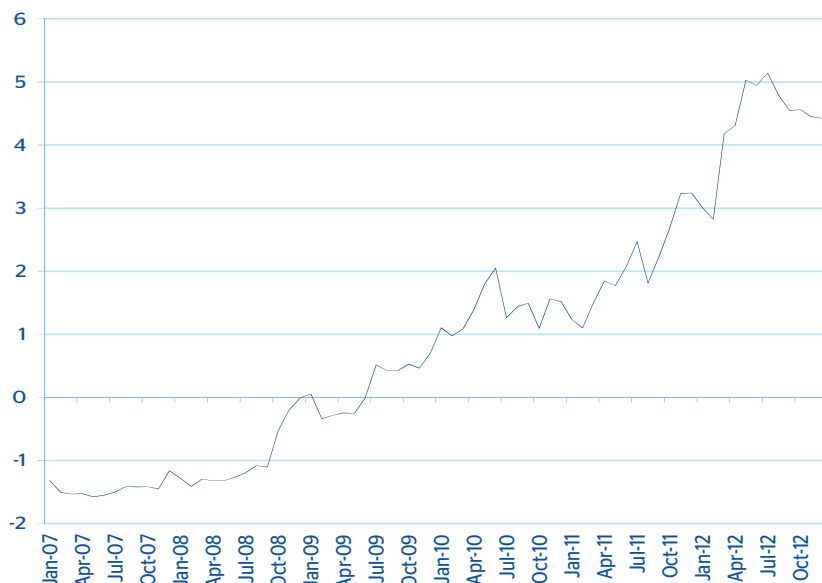
...without commitments to implement an European deposit guarantee fund

EMU: lower perception of risk with progress towards a banking union

Despite advances, Europe's banking markets remain highly fragmented

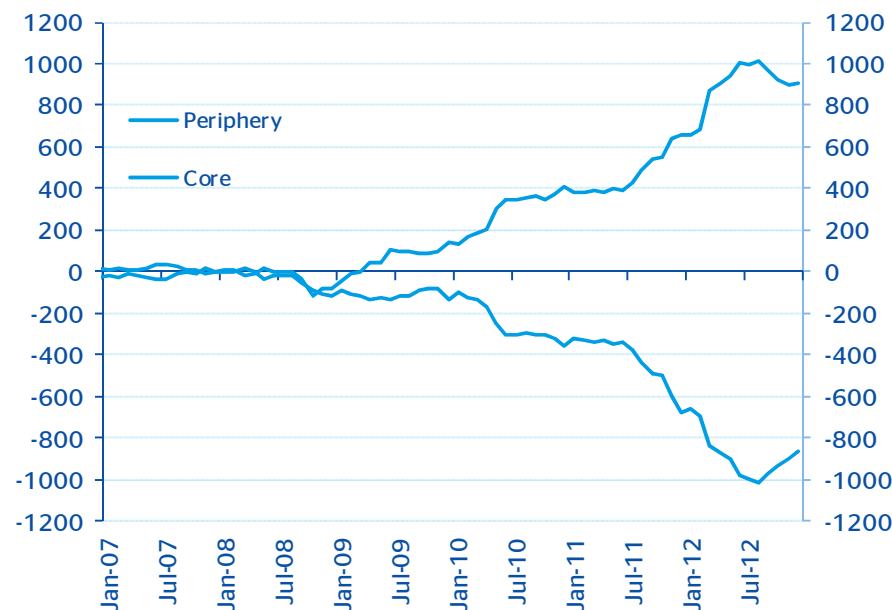
BBVA composite bank fragmentation index

Source: BBVA Research



Net balance with the Eurosystem (€ Bn)

Source: BBVA Research based on Bloomberg data



* Components: (i) coefficient of variation across countries on the interest rate of loans to businesses and households (average) (ii) TARGET2 balance (iii) Eurosystem liquidity as a percentage of bank assets, (iv) interquartile range of 2-year bond yields. To combine the indicators, we normalise and estimate each based on principal components.

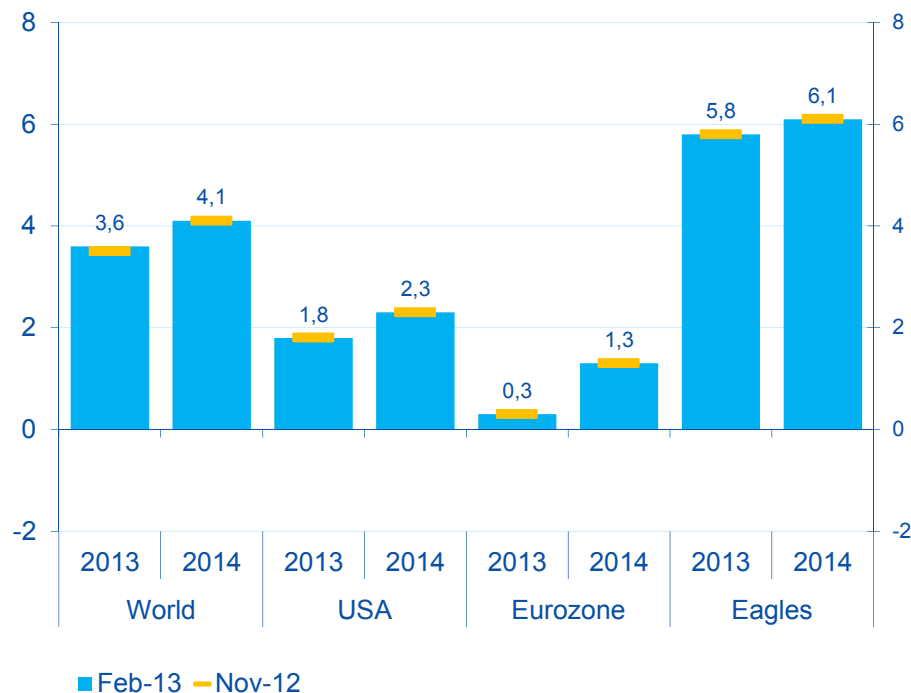
Risk factors to the global scenario

Eurozone	Achievement of budget deficit targets
	Adoption of banking union and Cyprus bailout agreements
	Election uncertainties
US	Agreements pending: automatic public spending cuts and debt ceiling
Other global risks	Geopolitical pressure, especially in North Africa and the Near East
	Slowdown in China and other emerging economies

Growth looks set to remain uneven

GDP growth (% yoy)

Source: BBVA Research



A three-speed world

There is still a high dispersion in growth rates

The EAGLEs have proven to be crisis-resistant, reinforcing the "new normal" paradigm

Euro area: brighter prospects, but recovery will be slow, uneven and vulnerable

Contents

Section 1

Global economy:
economic scenario improves

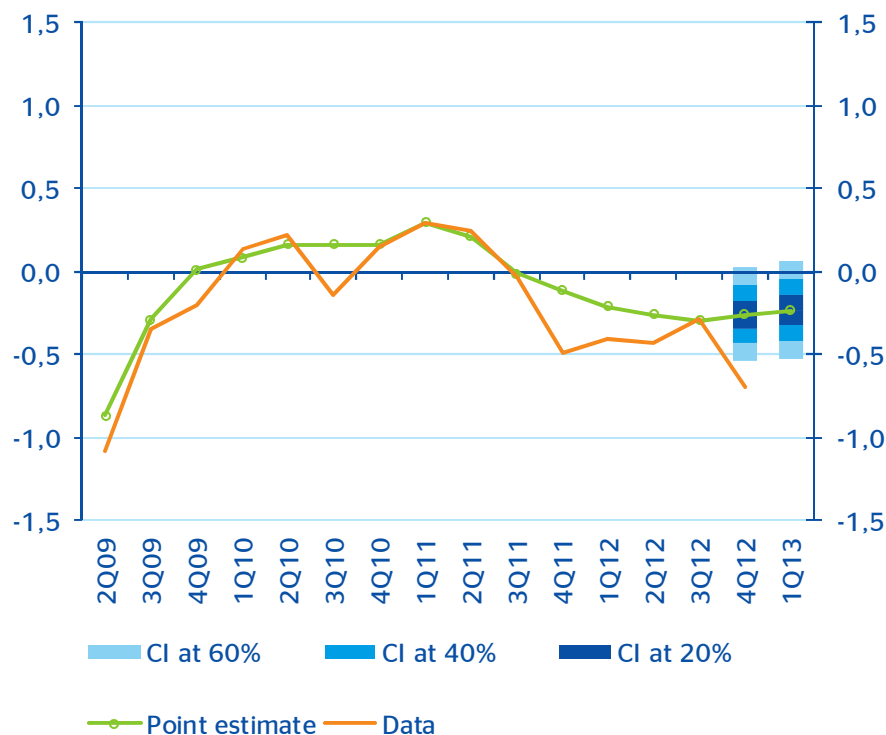
Section 2

Spain: will recovery start in 2013?

2012 topped forecasts in spring

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

Source: BBVA Research based on INE data



In spring, 28.6% of analysts polled expected Spanish GDP to contract more than 2.1% in 2012 (50% between 1.4% and 1.8%)

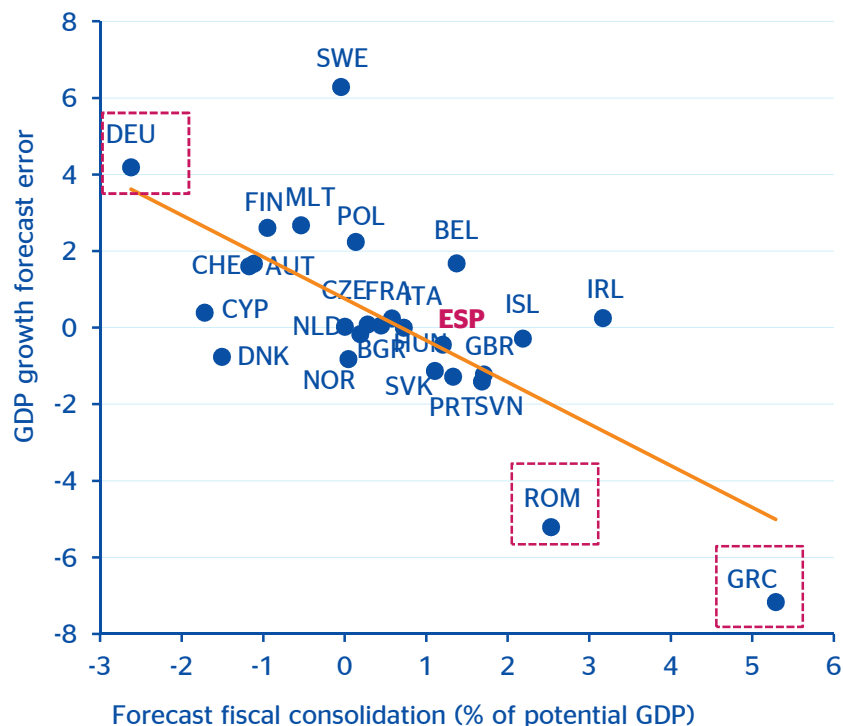
Although the pace of decline accelerated in 4Q12, the second half of 2012 beat expectations

Available data point to a negative growth in 1Q13, but not as severe as in 4Q12

2012 topped forecasts in spring

Fiscal adjustment and economic growth

Source: BBVA Research based on IMF data



1. Lower-than-expected multiplier (I)

Fiscal adjustment has been considerable, but GDP has not responded as expected. Potential reasons:

1. Spending has been cut with a low multiplier at times of financial stress

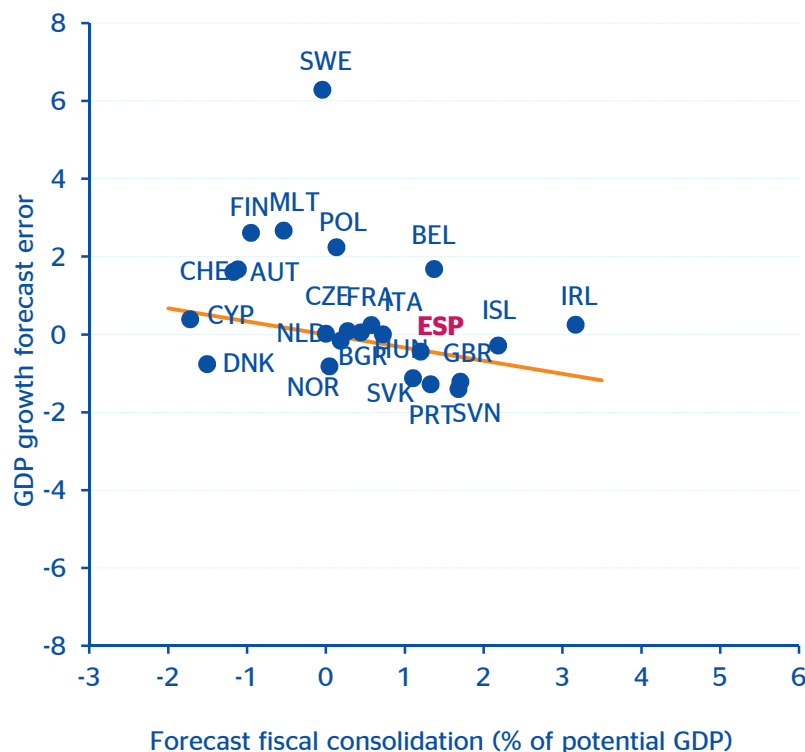
2. Certain measures have been construed as being temporary

3. Fiscal adjustment has come alongside compensatory measures (supplier payment plan)

2012 topped forecasts in spring

Fiscal adjustment and economic growth

Source: BBVA Research based on IMF data



1. Lower-than-expected multiplier (II)

Fiscal adjustment has been considerable, but GDP has not responded as expected. Potential reasons:

1. Spending has been cut with a low multiplier at times of financial stress

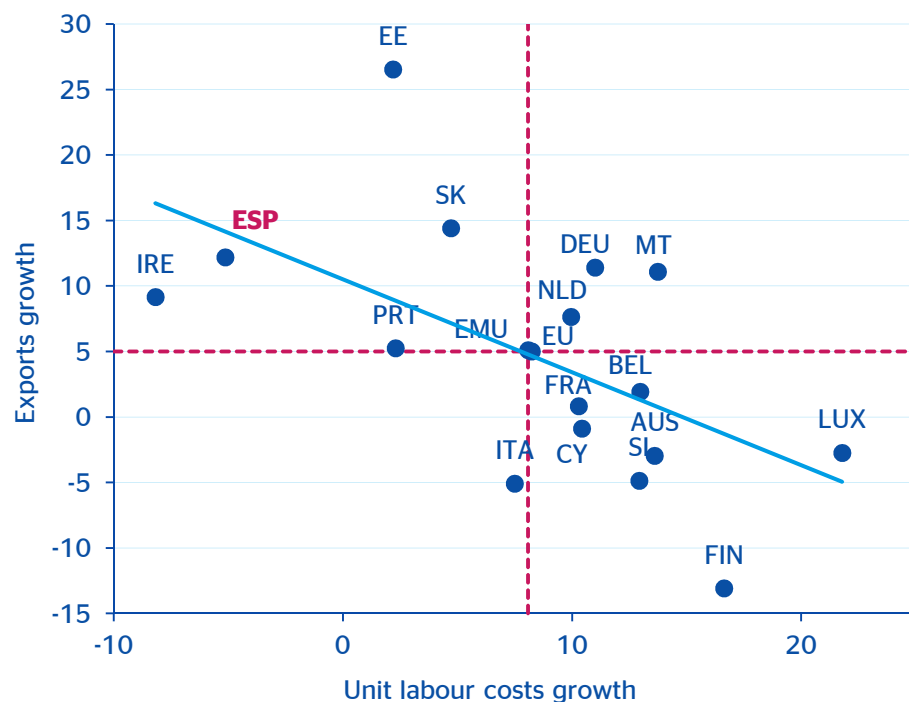
2. Certain measures have been construed as being temporary

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2012 topped forecasts in spring

EU: cumulative growth of exports and unit labour costs, 1Q08-3Q12 (%)

Source: BBVA Research based on Eurostat data



2. Higher external demand (I)

Exports show increasing diversification of destinations and products

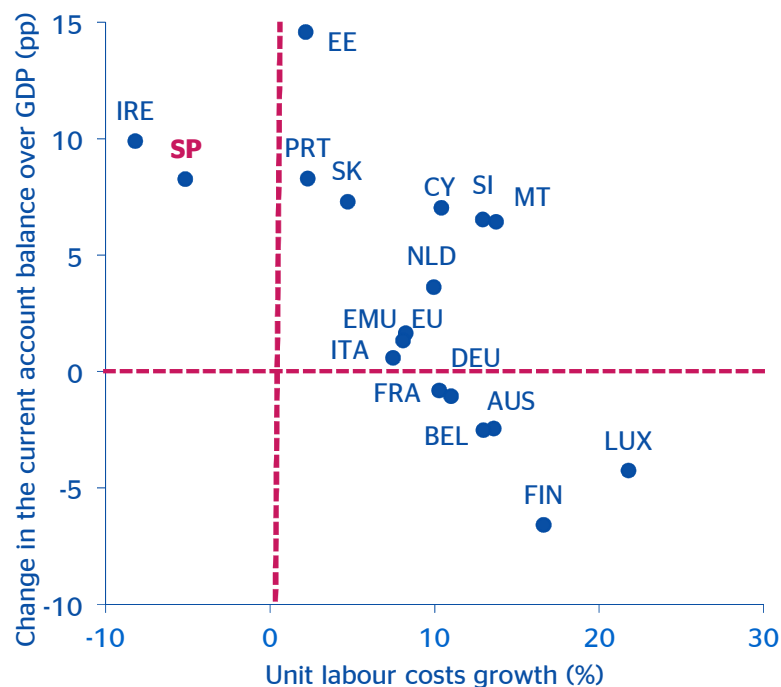
Better price competitiveness explains part of this trend, but other determinants are more important

The rise in exports has not been accompanied by any increase in imports, unlike at other times in the past

2012 topped forecasts in spring

Spain: current account and ULCs, 1Q08-3Q12

Source: BBVA Research based on Eurostat data



2. Higher external demand (II)

Higher exports and lower imports have produced a sharp improvement in the external imbalance

Lower ULCs make Spanish products more competitive vis-à-vis imports

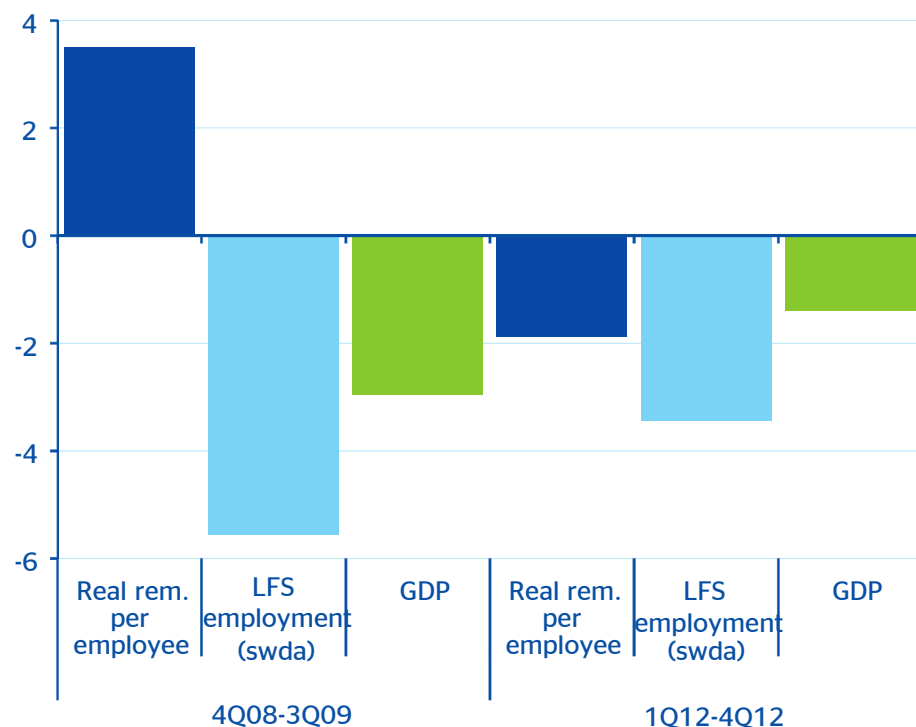
Reinforce the feedback factor: improvement in price competitiveness and the other determinants

2012 topped forecasts in spring

Spain: real wages, employment and GDP

(cumulative % change, SWDA data, %)

Source: BBVA Research



3. A more efficient labour market?

Labour market reform and the 2nd Agreement on Employment and Collective Bargaining have prevented further job destruction

While more data are needed to identify the factors undermining employment and GDP...

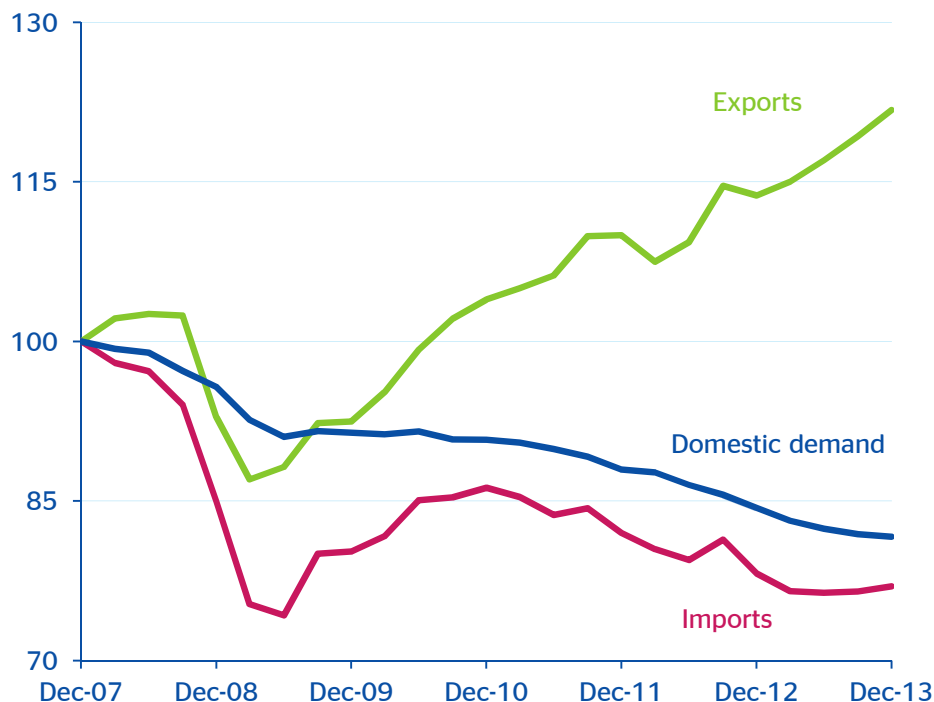
...trends in real wages and other variables are consistent with a more efficient labour market

2013: the year the economy should bottom out

Spain: domestic demand, exports and imports

(4Q2007=100)

Source: BBVA Research based on INE data



Slight improvement in forecast GDP for 2013, with a 1.1% contraction, due to the knock-on effect of 2012

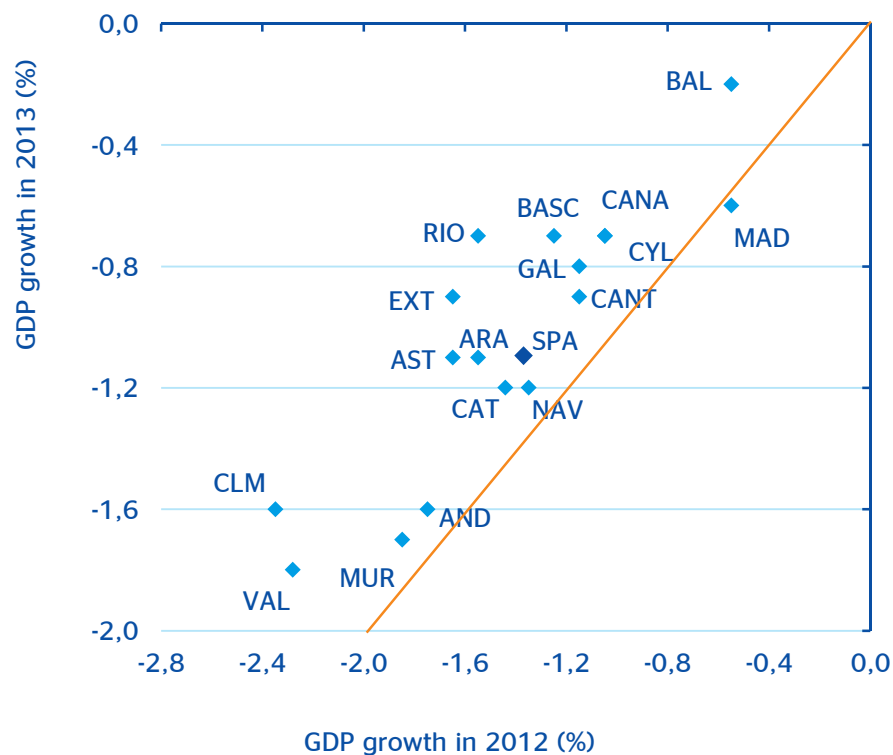
Highly mixed performances by exports, domestic demand and imports
-> a dual economy for firms

Significant reduction in the current account deficit

2013: the year the economy should bottom out

Regional growth forecasts for 2013 (%)

Source: BBVA Research based on INE data



Growth across Spain's regions should also remain uneven

Differences in regional growth marked by fiscal adjustment and net trade...

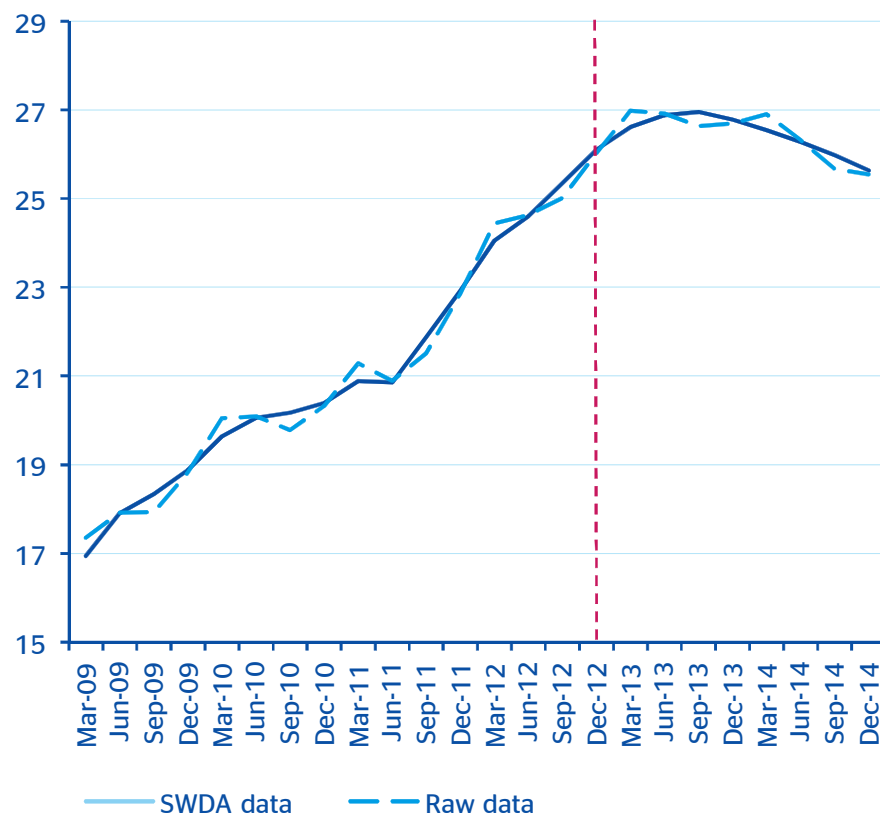
...although adjustment in the northern and central regions of Spain is approaching to the end

(*) The 45° line indicates the same growth in 2012 and 2013

2013: the year the economy should bottom out

Spain: unemployment rate (%)

Source: BBVA Research



The unemployment rate should peak during 2013

A smaller active population and improved GDP should allow the unemployment rate to ease slightly in 2014

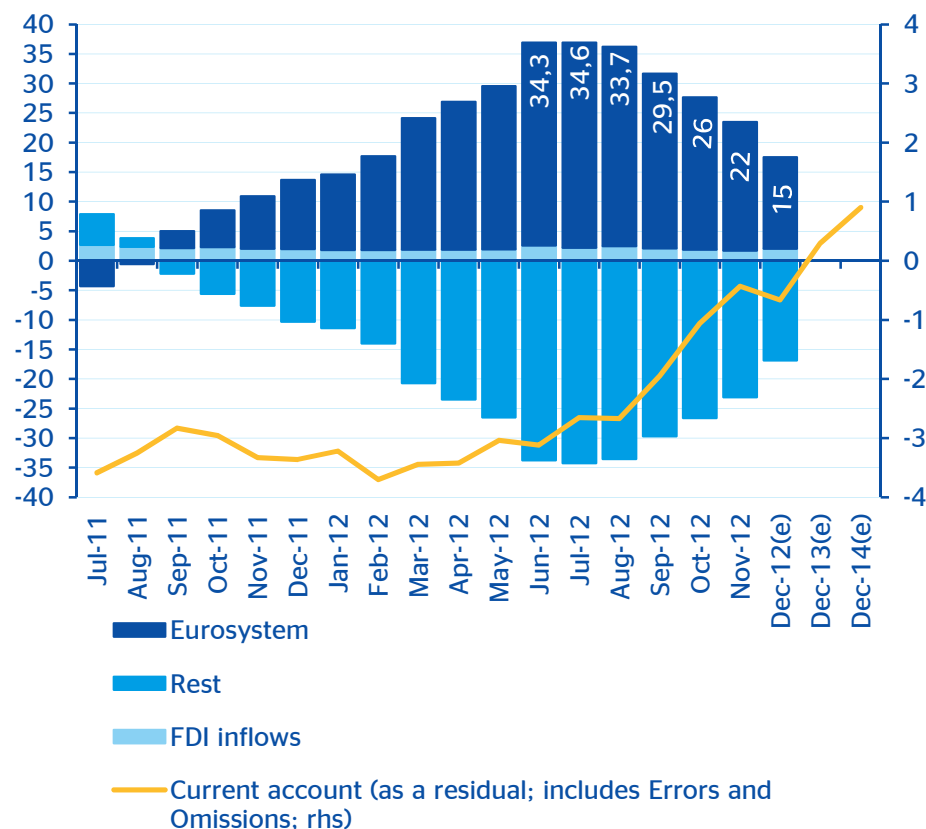
Additional measures and reforms are needed to reduce unemployment faster

2014: the start of recovery

Spain: balance of payments and capital flows

(Cumulative 12-month, % of GDP)

Source: BBVA Research, based on Bank of Spain data



1. Gradual improvement in foreign confidence in the Spanish economy

A better current account balance reduces the need for external borrowing...

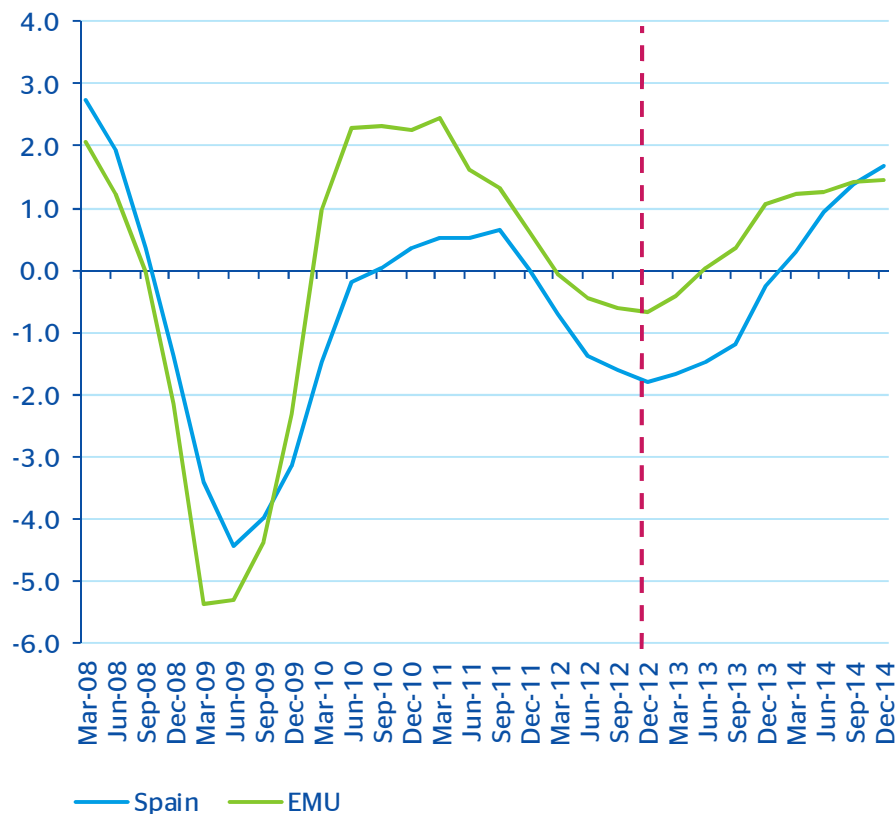
...which should reduce the dependence on ECB finance...

...and improve foreign perception of the Spanish economy, driving down risk premiums

2014: the start of recovery

Spain and the EMU: GDP growth (% yoy)

Source: BBVA Research based on Eurostat and INE data



2. Higher growth in the EMU

Brighter prospects for the EMU also bode well for Spain:

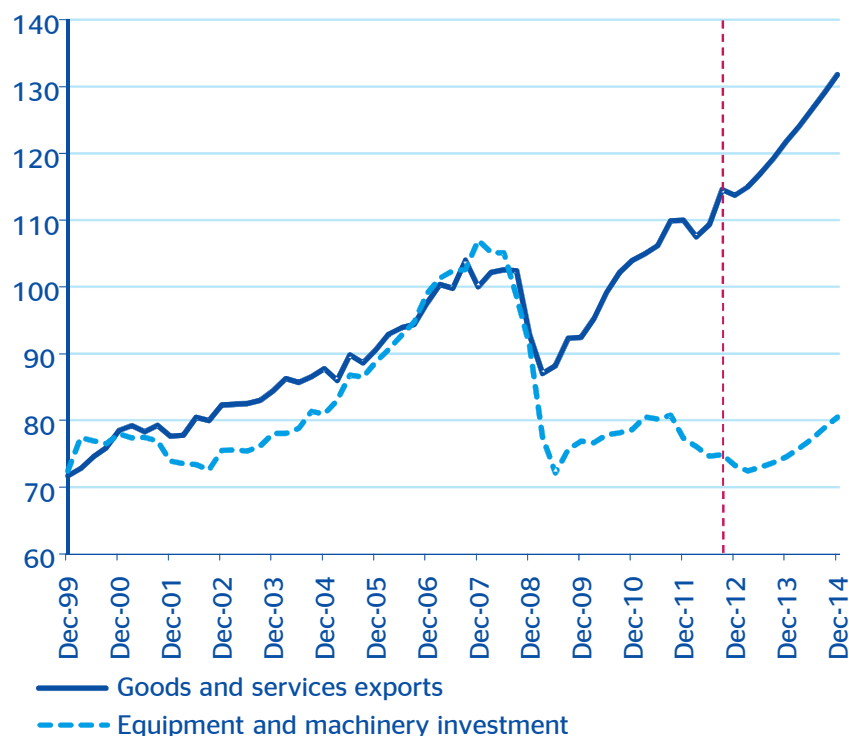
1. Higher confidence and lower financial stress

2. Higher external demand

2014: the start of recovery

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

Source: BBVA Research based on INE data



3. Improvement in private investment

Brighter prospects for the EMU, continued growth in exports...

...and reduced financial stress...

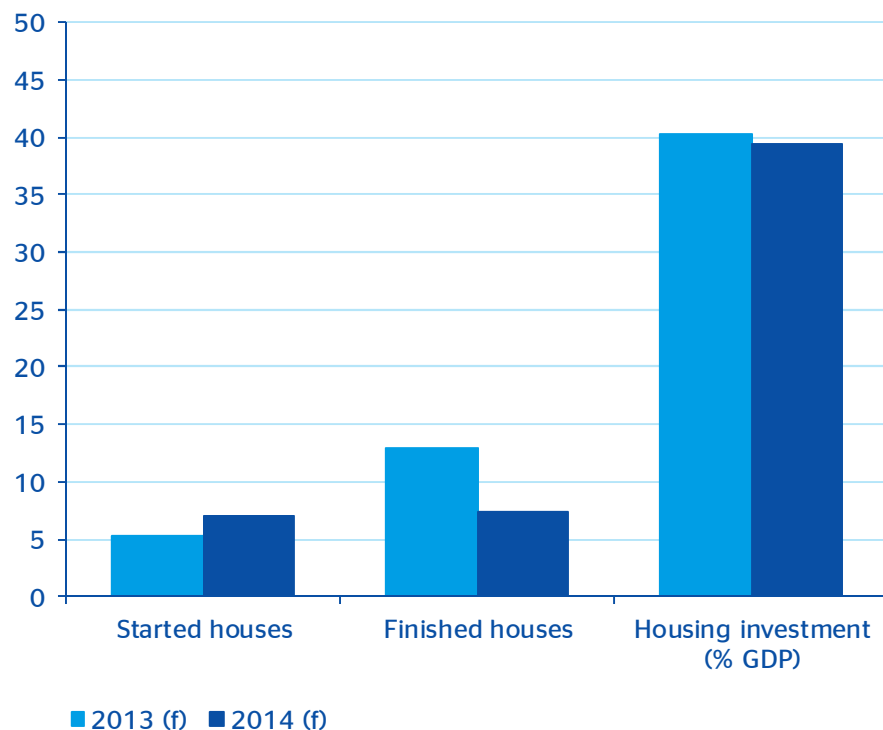
...should feed through to a recovery in private sector investment

2014: the start of recovery

Spain: forecasts for the real estate sector

(% versus average 2004-2007)

Source: BBVA Research based on Works Ministry and INE data



4. Smaller negative impact of ongoing adjustments (I):

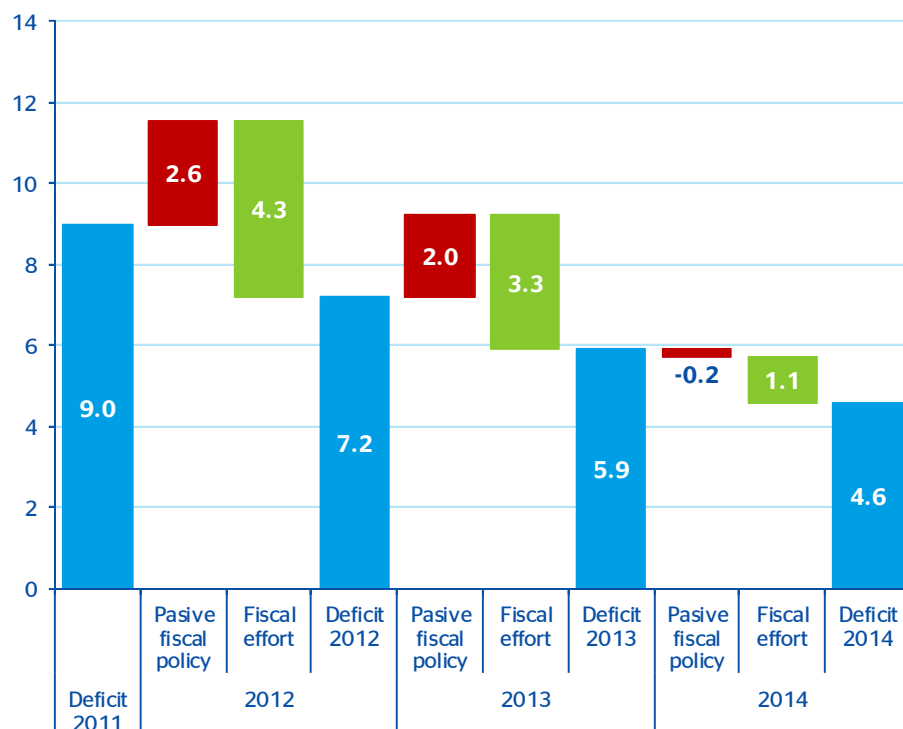
The supply-side correction in construction should end in 2014

Public sector cuts should be less severe than the undertaken in 2012 and the forecast for 2013

The banking sector restructuring will be further along

2014: the start of recovery

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



4. Smaller negative impact of ongoing adjustments (II):

Fiscal consolidation is working: budget cuts in 2012 will surpass 4pp of GDP

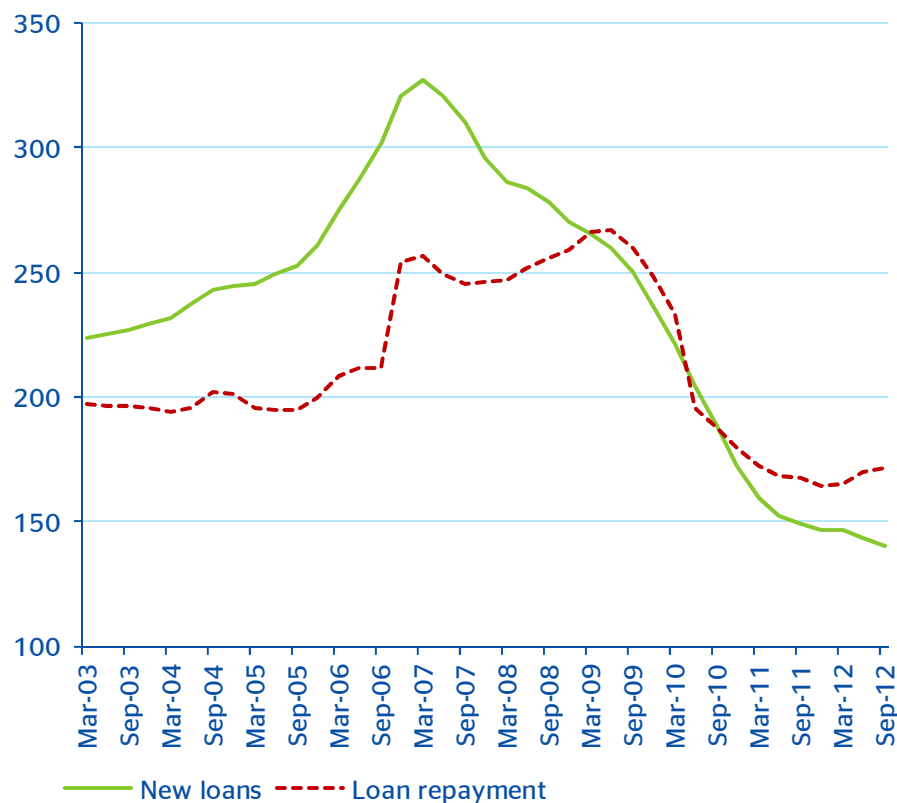
2014 will not require as great an effort as in 2013 and 2012

Overall, there are still major reforms to be undertaken, that would increase the efficiency of the public administrations

2014: the start of recovery

Spain: Private sector credit (€Bn, trend)

Source: BBVA Research, based on Bank of Spain data



4. Smaller negative impact of ongoing adjustments (III):

Assessment of the MoU: bank restructuring is well underway

Deleveraging and economic recovery: credit for productive investment and job creation

Areas for improvement: (1) lending to SMEs
(2) increased data on credit flows

A window of opportunity that must be seized

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

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

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

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

Key themes

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- 2 To sustain the recovery, appropriate policies must be adopted in both the US and the euro area.
- 3 Without ruling upside surprises, the risk of global uncertainty remains tilted to the downside, although the risks appear less likely now and with a smaller impact.
- 4 Spain: caution due to existing risks. In 2013, the economy should bottom out, paving the way to begin growing again in 2014.
- 5 Therefore it is vital to take advantage of the window of opportunity that has opened up to push through reforms that shore up the improvement in confidence.

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