



Are the BRIC(M)s shaken?

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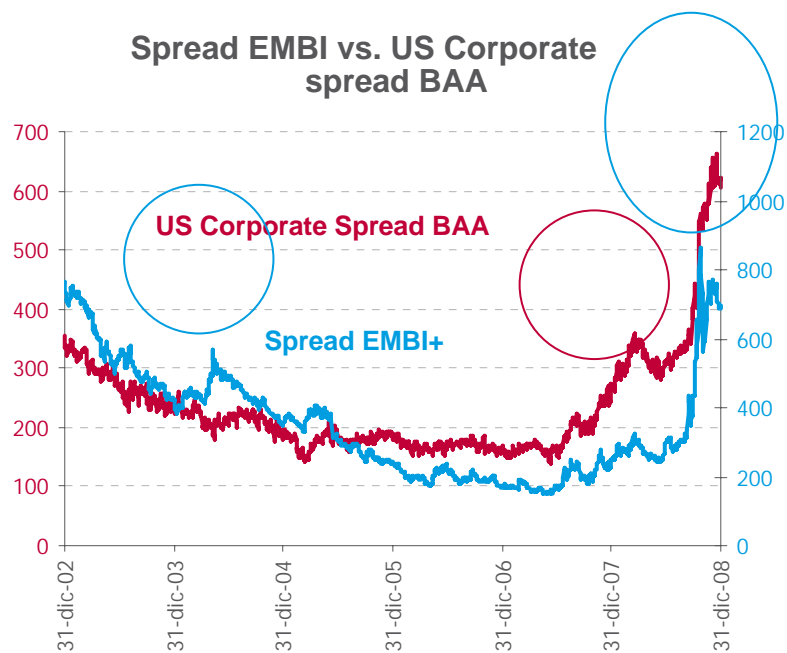
Emerging markets

—— From the decoupling dream to the contagion

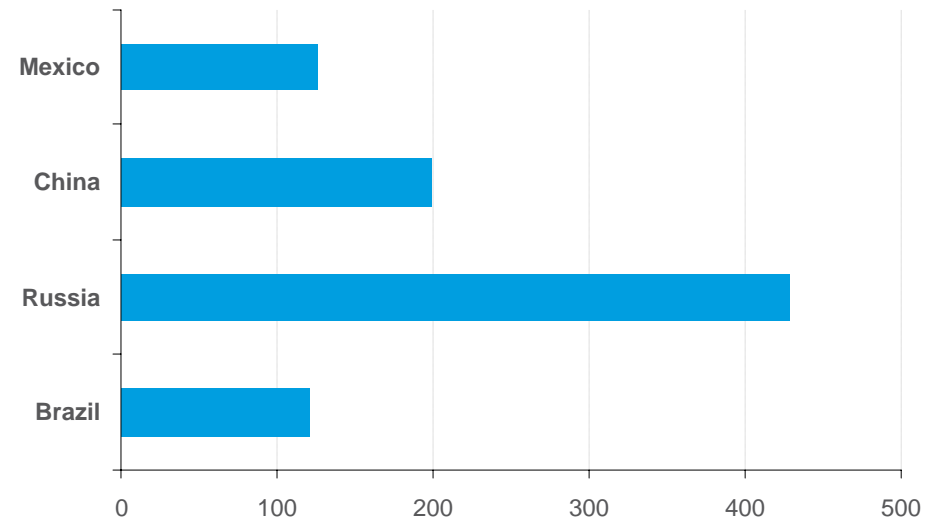
—— What are the main issues for BRIC(M)'s looking forward

From the decoupling dream to the contagion

- Sovereign risk has increased but less than that of similar US corporates

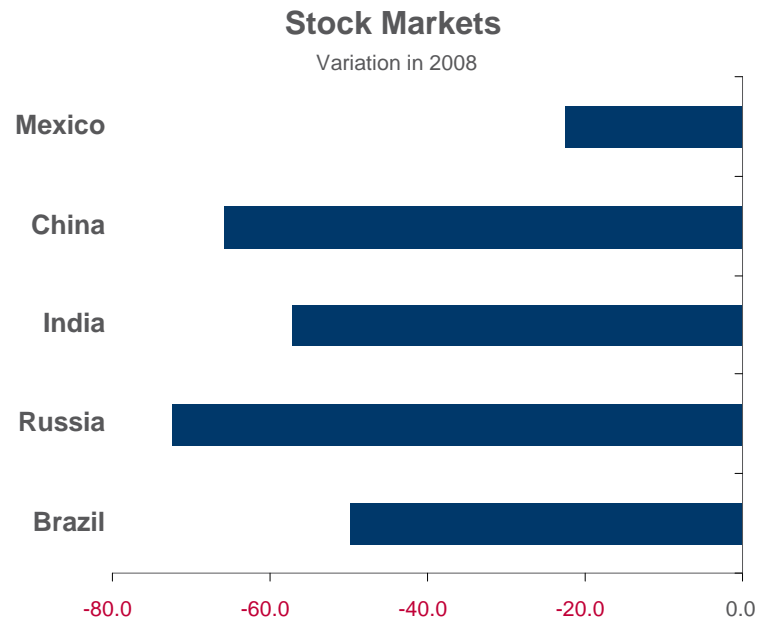


Spread EMBI increase since LB (bp)

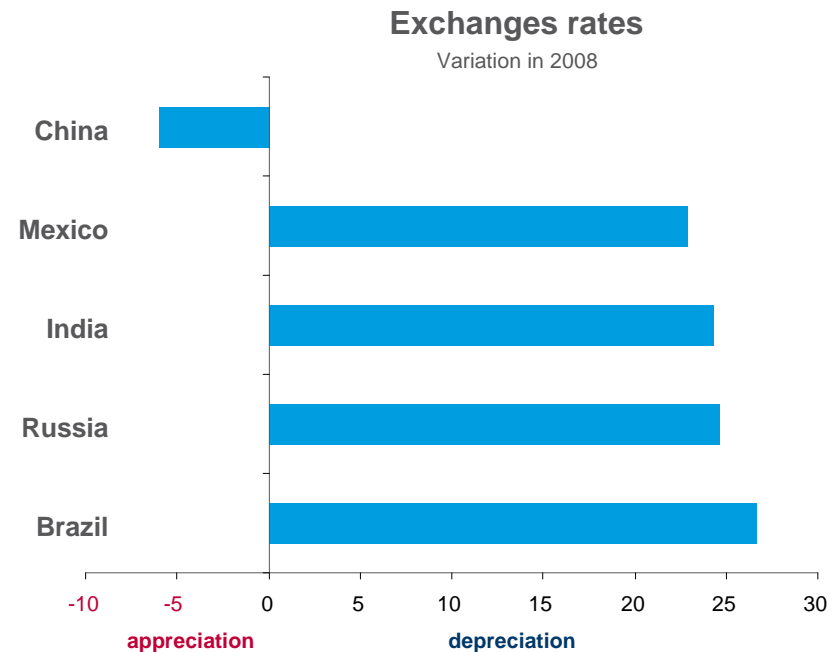


- Russia's sovereign risk has been the most affected among the BRICMs

From the decoupling dream to the contagion



Source: Bloomberg



Source: Bloomberg

- Stock markets have fallen substantially and exchange rates have depreciated, except for China

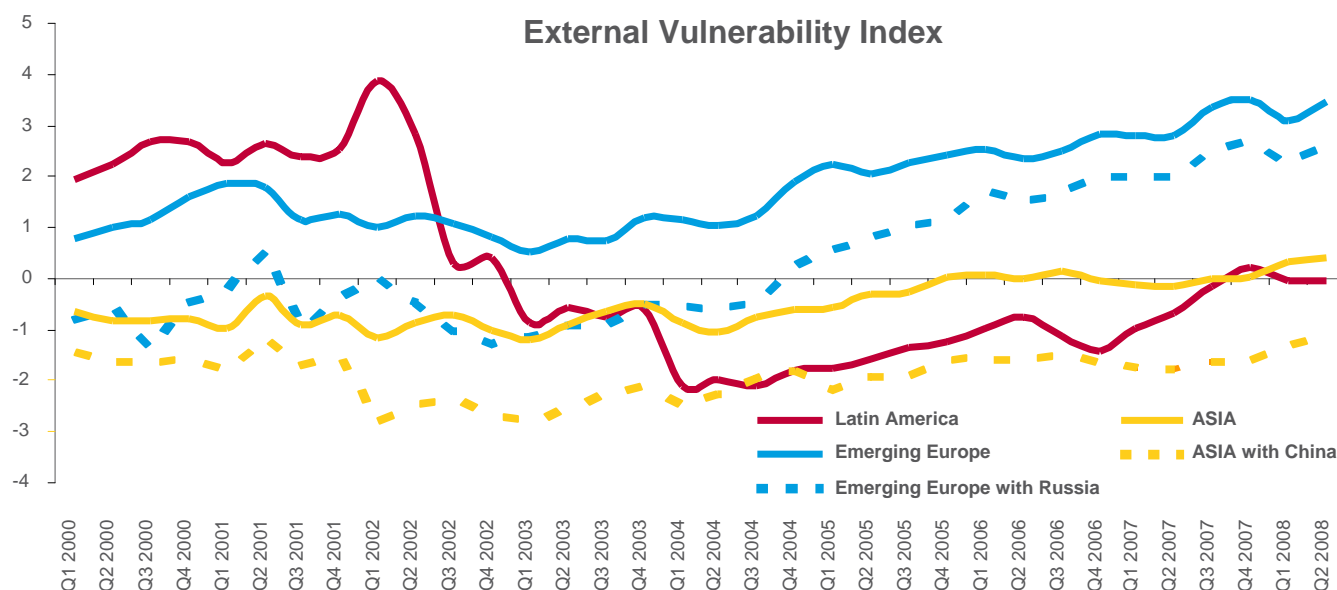
From the decoupling dream to the contagion

- A discriminating reaction from International Institutions

	Objective	Amount	Eligible countries
Fed, swap lines	To improve financing conditions in USD	USD 30 B x 4	Brazil, Mexico , Korea and Singapore (well-managed and systemically important economies)
New facility IMF (SLF)	Helping restore confidence, avoiding financial contagion	Total amount Approx. USD 100 B	Countries with a proven record of sound macroeconomic policies

From the decoupling dream to the contagion

- BBVA's measure of macroeconomic vulnerability: a historical perspective



Source: IMF, BIS, IFS and BBVA calculations

* Asia includes: India, Indonesia, Thailand, Malaysia, Philippines, Hong Kong, S. Korea, Japan and Singapore.

* Emerging Europe includes: Poland, Hungary, Czech Republic, Slovakia, Lithuania, Latvia, Romania, Bulgaria, Turkey and Estonia.

* Latin America includes: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.

- Although further aggravation of the crisis would leave no immune areas, so far emerging Asia and Latin America are significantly better positioned to weather the turmoil. Emerging Europe is the most vulnerable area

Emerging markets

—— From the decoupling dream to the contagion

—— What are the main issues for BRIC(M)'s looking forward

What are the main issues for BRIC(M)'s looking forward?

1. Size of the credit crunch: very difficult to evaluate...

- Strong in countries with large foreign liabilities, specially cross border bank
- Foreign banking liabilities
- Countries with large deposit base are safer

2. External demand (including commodity prices)

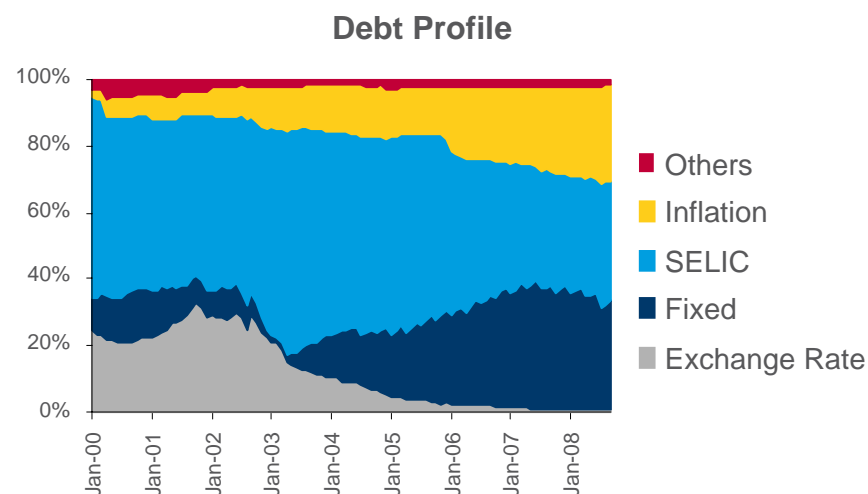
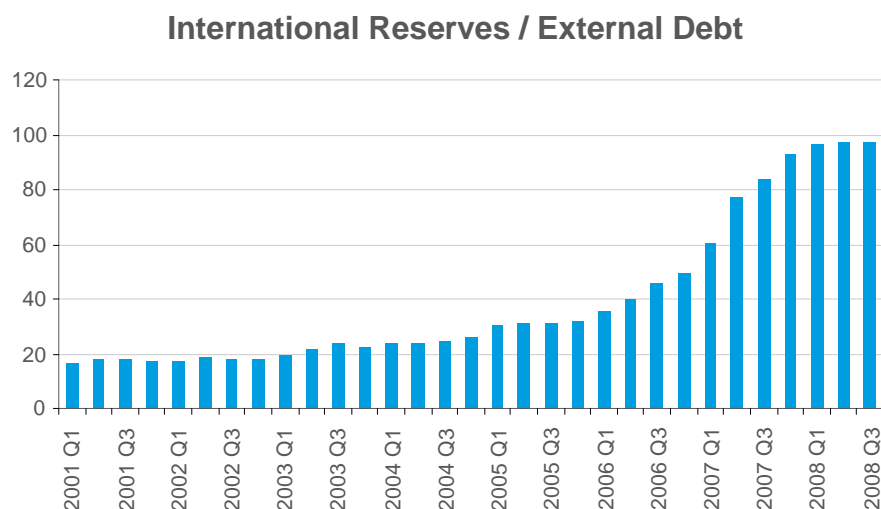
- Larger impact for countries very open to trade (CH and MX)
- Additional impact if commodity exporters (RU, MX and BR)

3. Room for demand policies

- Fiscal policy, specially in CH
- Monetary policy could be a tool for all as inflationary risks abate

BRICM: The dimensions of the crisis in Brazil

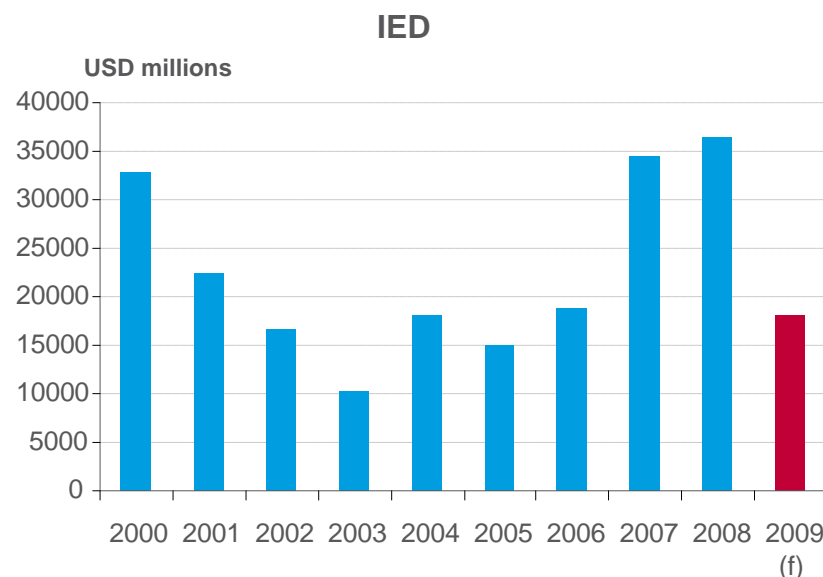
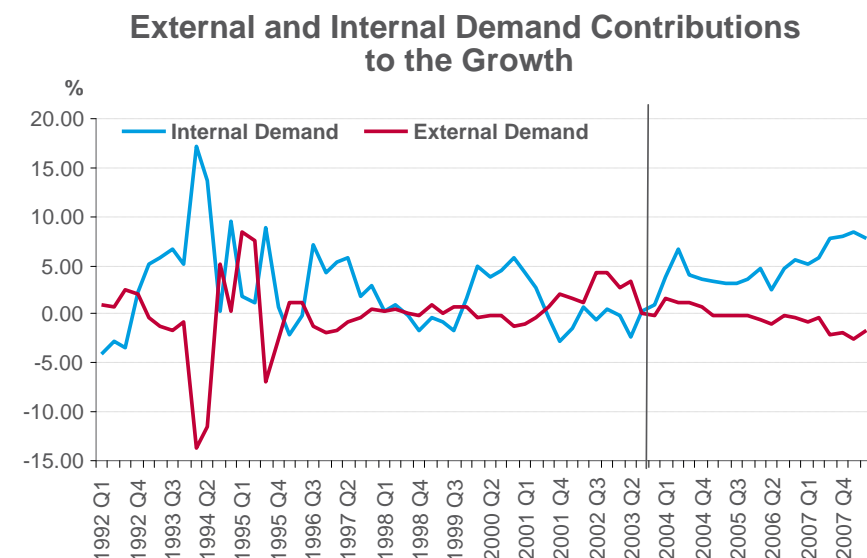
1. External finance dependence and liquidity



- Brazil is in a much sounder situation to face the crisis than in the past
 - Reserves fully cover external debt. The debt profile has also improved substantially
- The real depreciation has been good news in fiscal terms
 - A currency depreciation of 10% reduces the public debt / GDP relation by around 1%
 - In 2002, the same depreciation increased this relation by more than 3%
- But not for some parts of the private sector (several bets against the USD have brought up forex losses)

BRICM: The dimensions of the crisis in Brazil

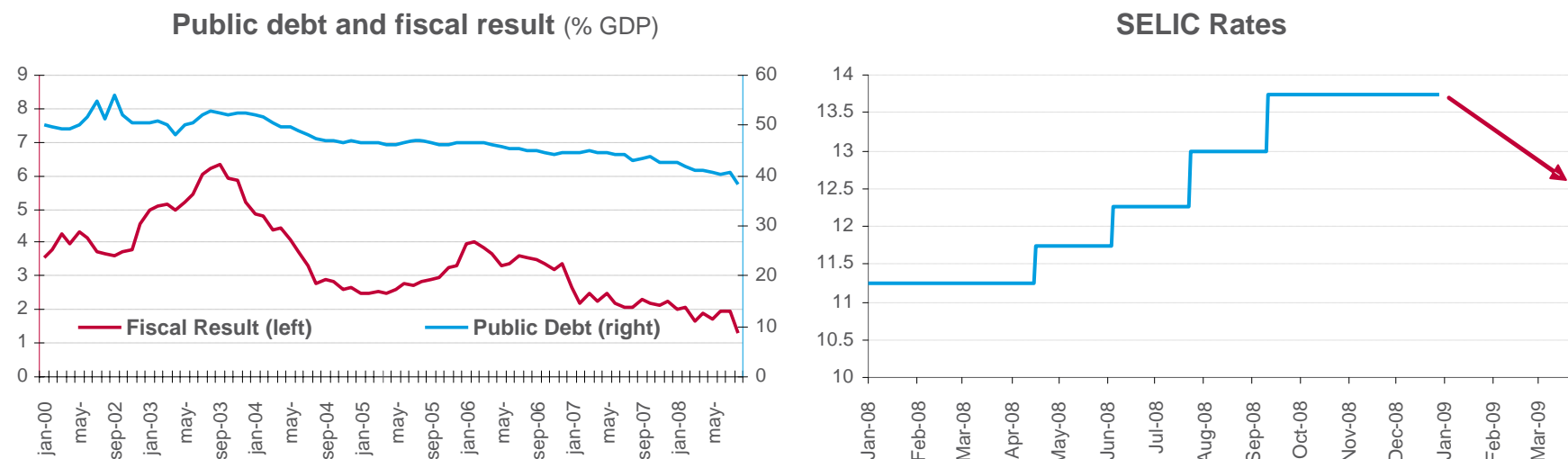
2. External demand dependence and Commodity prices impact



- Lower global growth will limit Brazilian exports and will reduce FDI flows to the country. Reduction in commodities prices will also impact the country negatively
- However, a weaker external demand will have only a limited impact on GDP growth as the main source of the recent growth is the internal demand. The effects of lower commodities prices will be partially offset by a more depreciated exchange rate

BRICM: The dimensions of the crisis in Brazil

3. Room for countercyclical policies

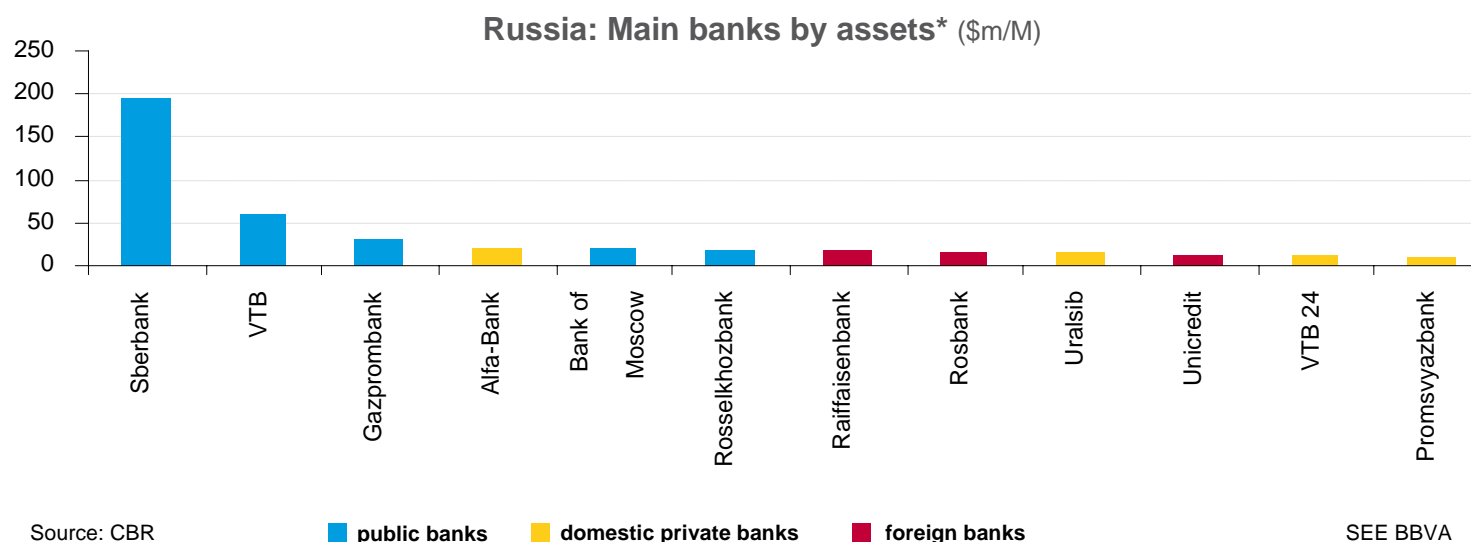


Source: Bloomberg

- The favorable external position and the improvement in fiscal results during last years allow the government to implement a countercyclical fiscal policy which will, however, be limited by lower revenues
- High interest rates and reserve requirements leave room for supportive monetary policies. The Central Bank has already started cutting reserve requirements (injecting around USD 60 billions in the economy) and will start to cut rates in the beginning of 2009

BRICM: The dimensions of the crisis in Russia

1. External finance dependence and liquidity

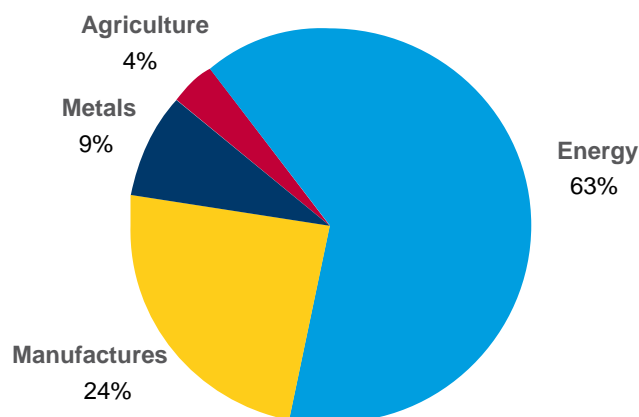


- Financial vulnerability is high in Russia. Credit growth has been founded on large volumes of external borrowing, and against low deposit base
- Yet, the banking sector faces no systemic risks: market dominance of public institutions (with access to the large State financial resources, public funds) leave small-size private domestic banks as the only suitable candidates to face bankruptcy in the current scenario

BRICM: The dimensions of the crisis in Russia

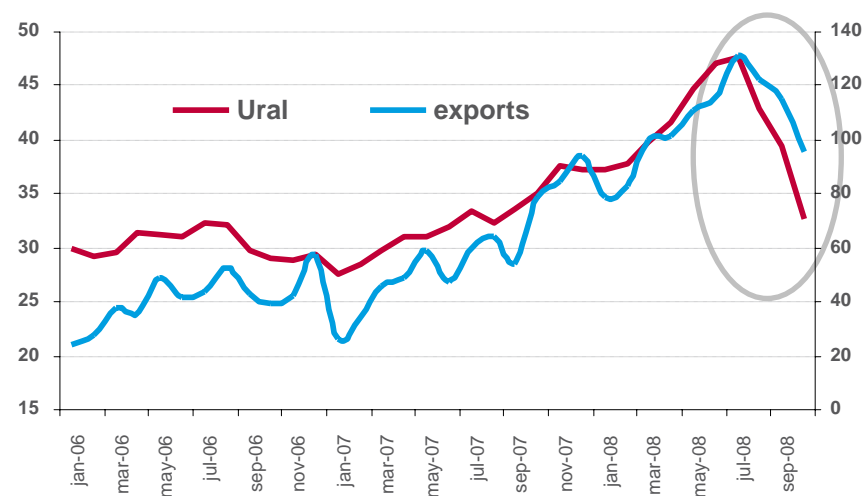
2. External demand dependence and Commodity prices impact

Russia: Export Concentration (2006)



Source: WB

Russia: Exports (USD B) vs. Ural oil price



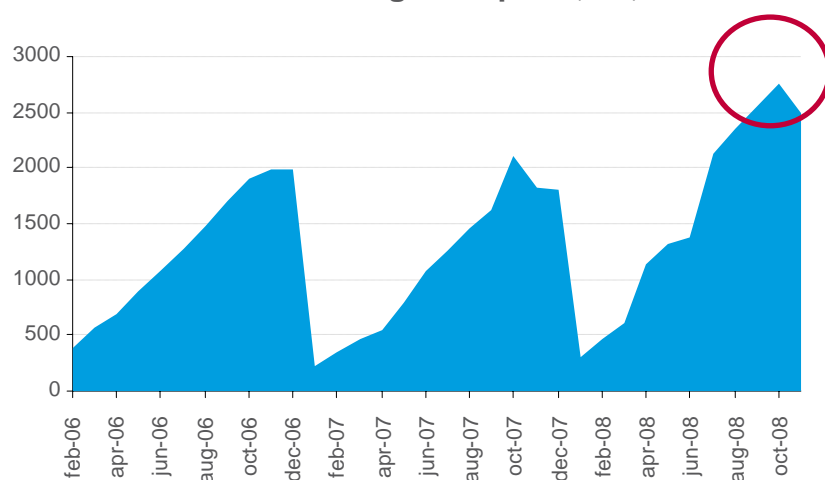
Source: Bloomberg

- Export dependence on energy commodities is high and commodity prices are critical for public finances, which exacerbates Russia's vulnerability given the sharp correction in oil prices since July

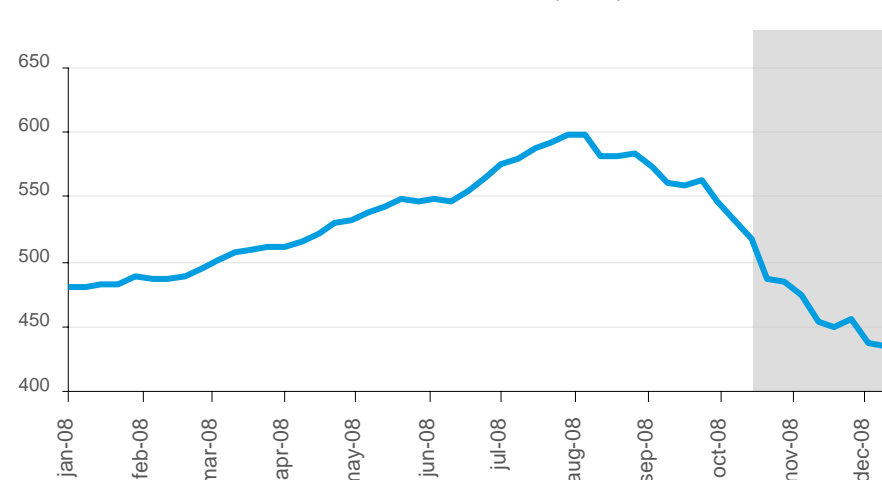
BRICM: The dimensions of the crisis in Russia

3. Room for countercyclical policies

Russia: Budget Surplus (\$bln)



Russia: Reserves (\$ bln)



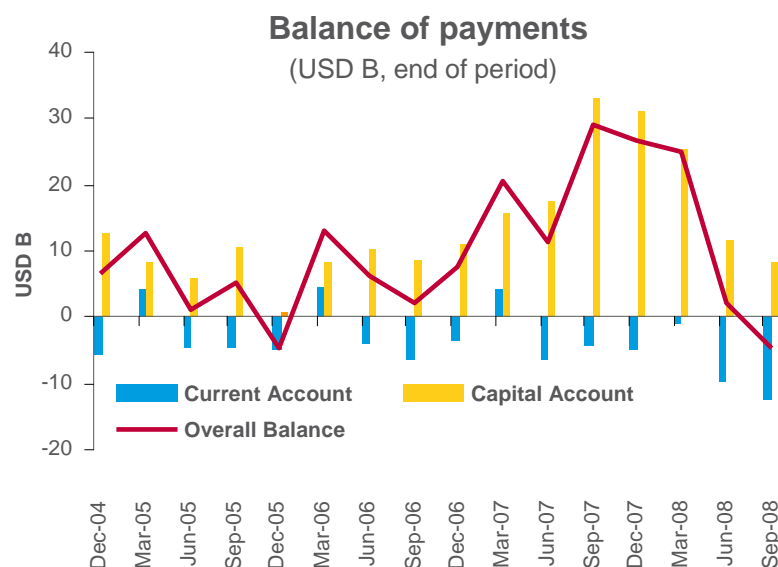
Source: Bloomberg

- Fiscal balances already register a narrowing fiscal surplus, mainly due to lower tax revenues. Although there are significant room for demand policies, this will take place with the return of fiscal deficits (between 1%-2.5% of GDP)

- Although internal reserves are an important buffer, they are being depleted very rapidly during the last couple of months, due to the government's standing behind the debt of large corporations and the defense of the rouble

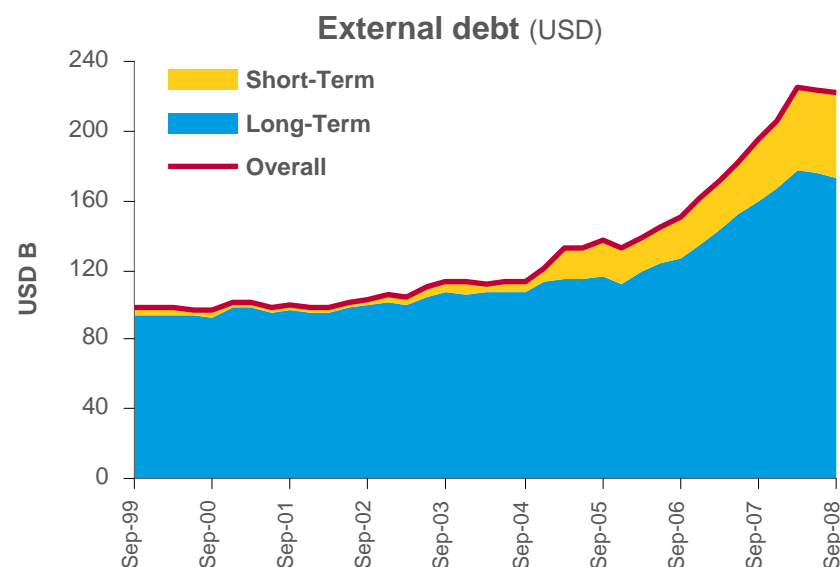
BRICM: The dimensions of the crisis in India

1. External finance dependence and liquidity



Source: CEIC

ERD BBVA



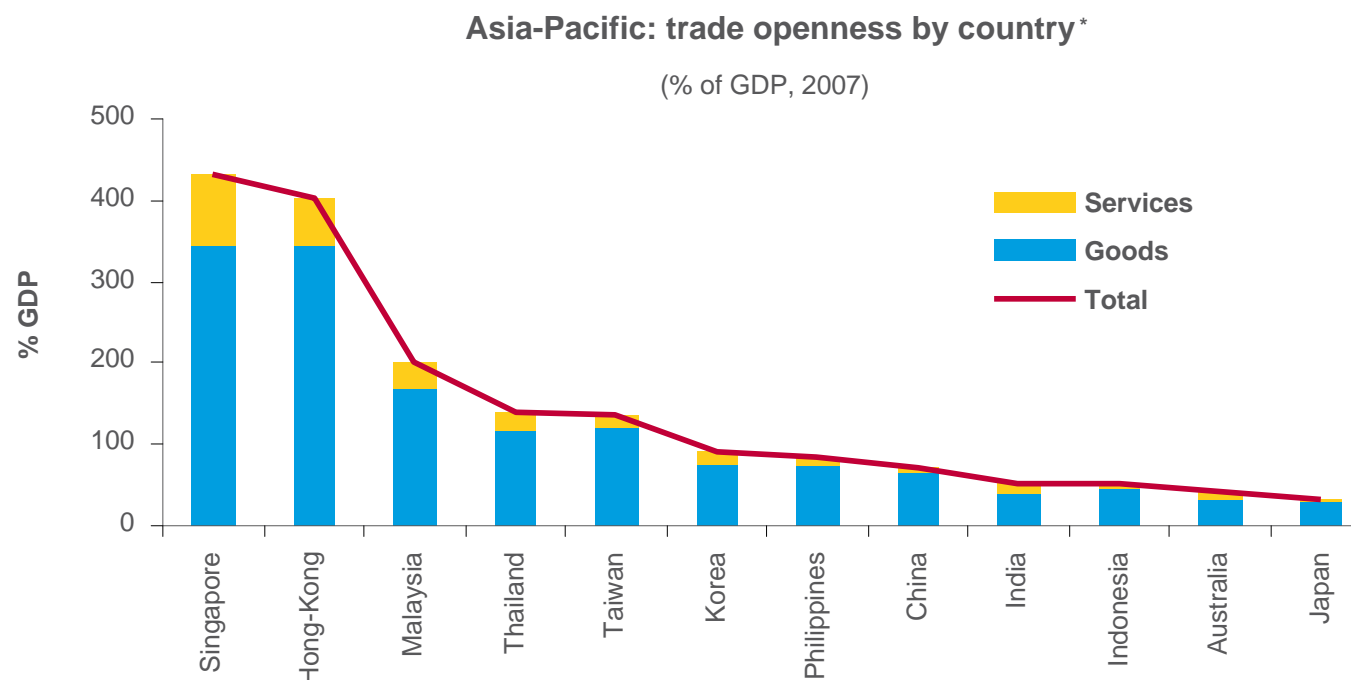
Source: CEIC

ERD BBVA

- India is not in a very strong position
- Its built up of reserves mainly stem from portfolio flows and not from current account surpluses
- India remains a net international debtor country

BRICM: The dimensions of the crisis in India

2. External demand dependence and Commodity prices impact



Source: CEIC

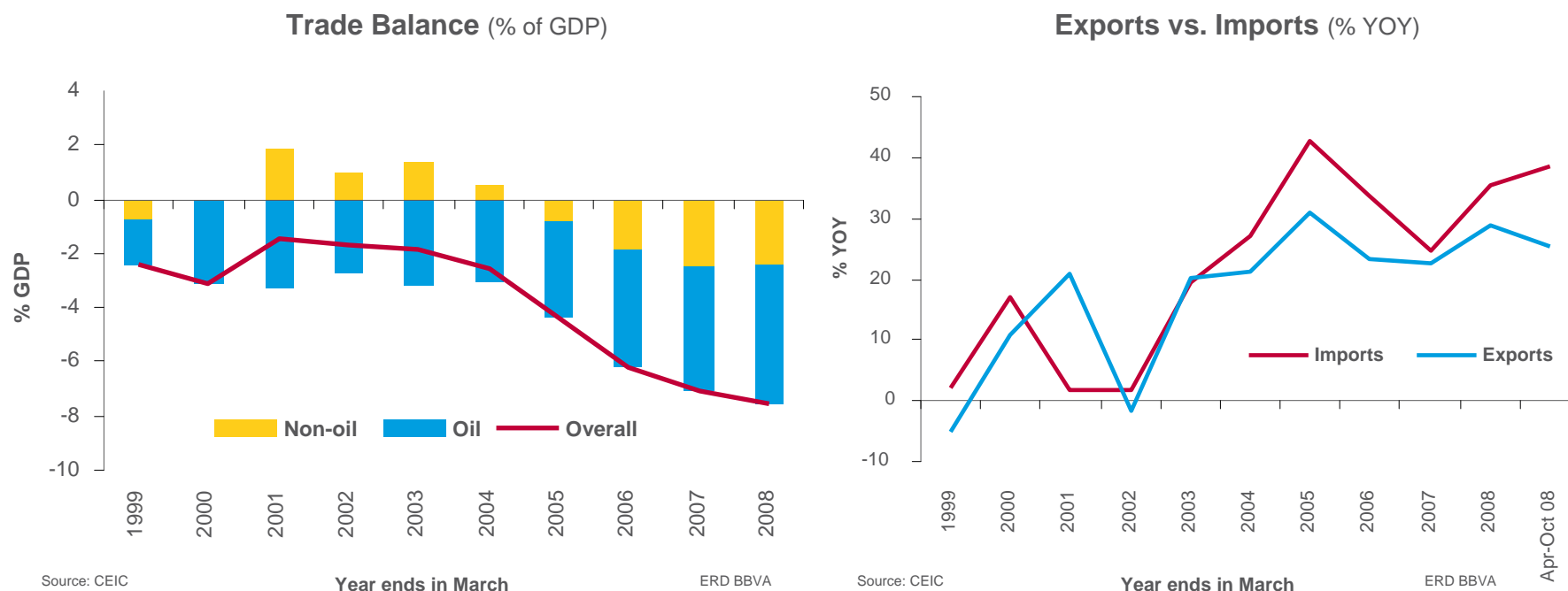
*Balance of payments data

ERD BBVA

- India is in a relatively better position than China (or MX) since it is a closer economy, although the difference is not as large when services are included

BRICM: The dimensions of the crisis in India

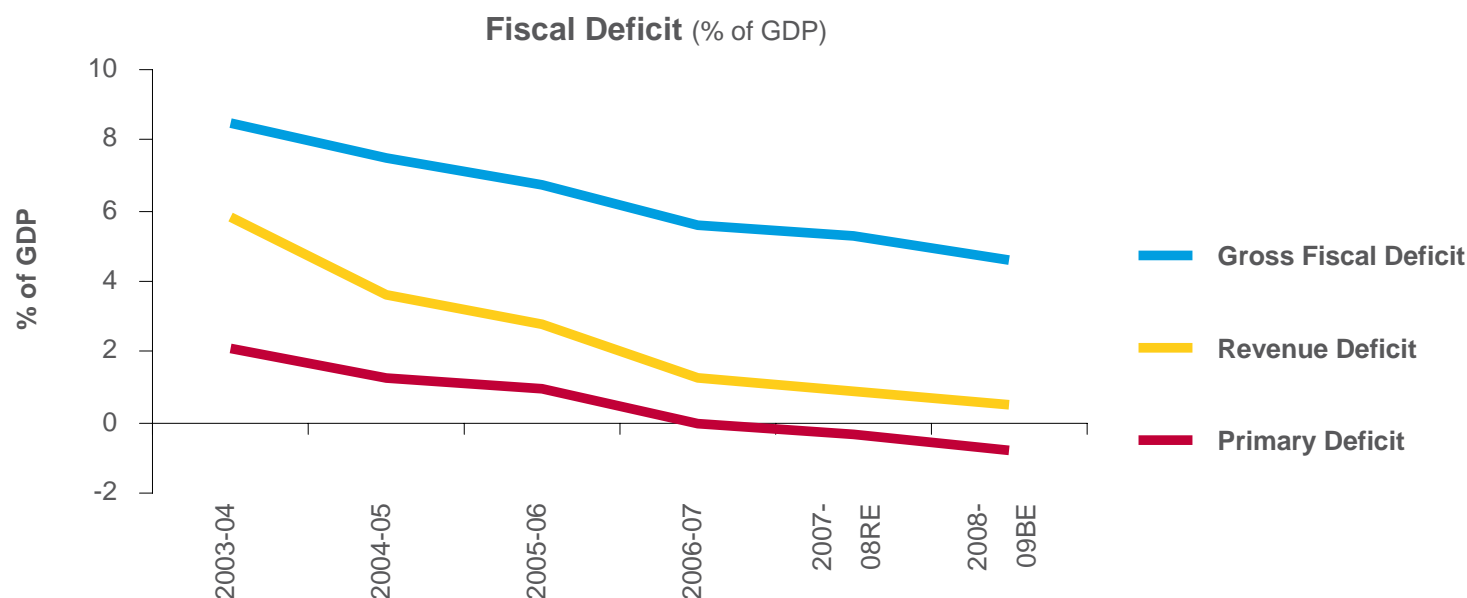
2. External demand dependence and Commodity prices impact



- To add to the problem of a large trade deficit, exports have decelerated since 2008 while imports have not.
This is at odds with the sharp fall in oil prices.
We should expect imports to fall in the new future and the trade deficit to stabilize although still at dangerous levels

BRICM: The dimensions of the crisis in India

3. Room for countercyclical policies



Source: Reserve Bank of India

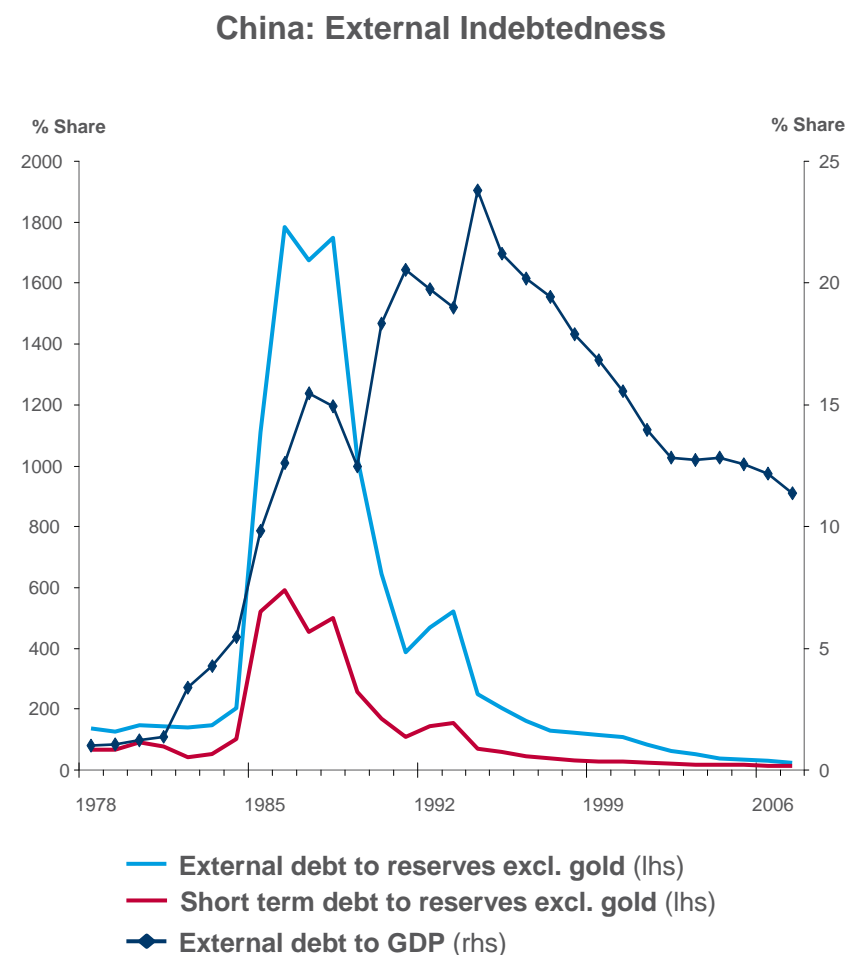
ERD BBVA

- Although the fiscal deficit has been reduced in the last few years, its size is sizable so that no room is left for fiscal policy. This is more of a problem if one considers India's strong need for infrastructure and had helpful it would be to push for it if it could be financed

BRICM: The dimensions of the crisis in China

1. External finance dependence and liquidity

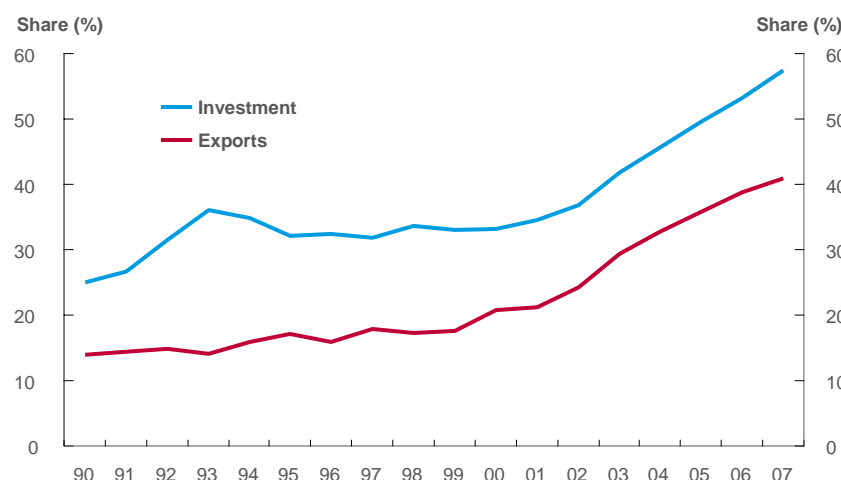
- China is clearly the soundest of all countries given its massive reserves and the very low levels of external debt
- The latest IMF figures suggest total external debt and short term debt as shares of FX reserves is at 24% and 13%, respectively
- Cross-border liabilities from international banks are also very low.
The BIS statistics show that China's short-term cross-border bank loans (maturity within one year) are less than 9% of its FX reserves in June 2008



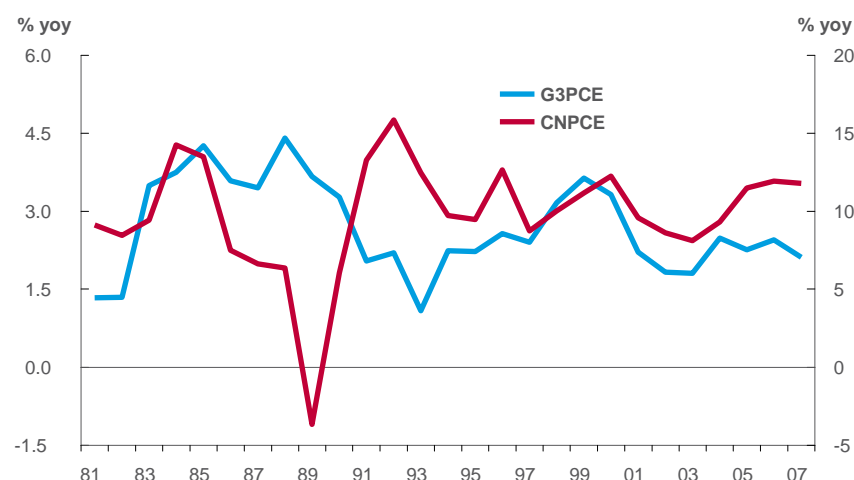
BRICM: The dimensions of the crisis in China

2. External demand dependence and Commodity prices impact

China's investment and export share



Growth in private consumption more synchronized

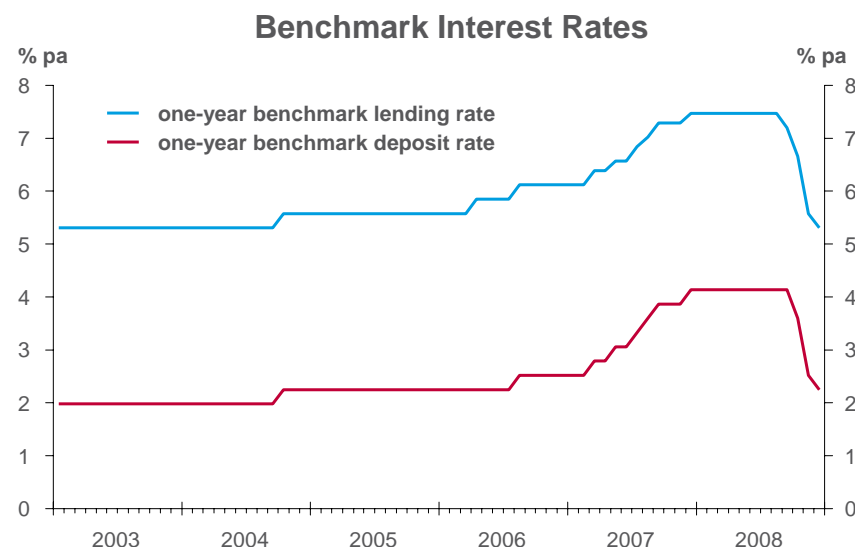


- However, China's large trade dependence on the G-3 makes it very vulnerable to their slowdown
- A slowdown in external demand will also pull down investment, particularly that in machinery and equipment
- Meanwhile, consumption growth in both China and G-3 has shown signs of increased synchronization
- In terms of real GDP growth rate, we find that a simultaneous G-3 economic slowdown by one percentage point will lead to a Chinese economic slowdown by 0.7 percentage point one year later

BRICM: The dimensions of the crisis in China

3. Room for countercyclical policies

- **The room for fiscal stimulus is large and, more importantly, it has been used**
- The package plans to spend RMB 4 trillion (USD 586 billion, 16% of 2007 nominal GDP) through 2010 to boost the Chinese economy
- 70% of the funds in the package will be allocated to the investment in transportation network and the Sichuan post-earthquake reconstruction
- Low income population will get more affordable housing and the rural sector will also benefit from the massive fiscal stimulus
- The package is moderately positive for commodity demand.
However, the world should not believe that this package is designed to maintain their exports to China: most of the effect might stay at home



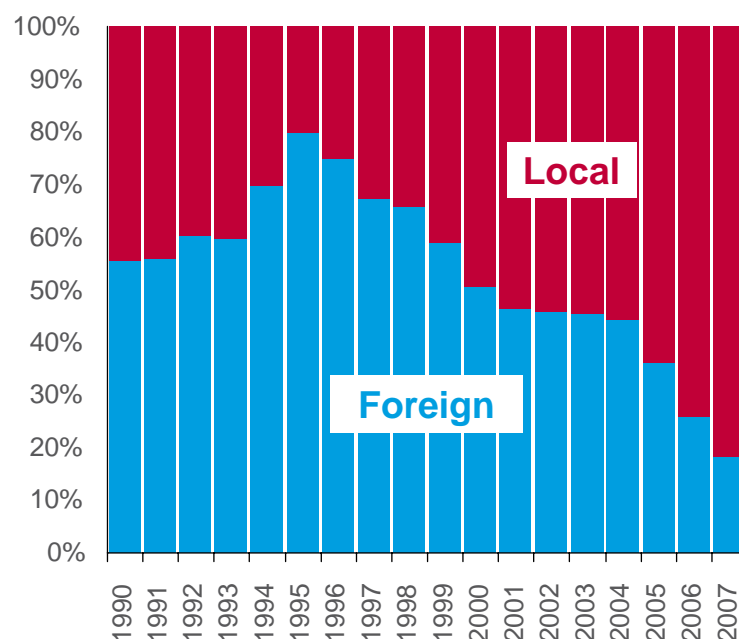
- The monetary policy has become aggressively accommodative. The PBOC has cut the one-year benchmark lending and deposit rate by 135 basis points (27bps*5) and the required reserve ratio (RRR) to 14% for 6 largest banks was lowered to 14%, from peak at 17.5% (0.5 p.p. for smaller banks)
- **More room exist to cut rates/RR further**

BRICM: The dimensions of the crisis in Mexico

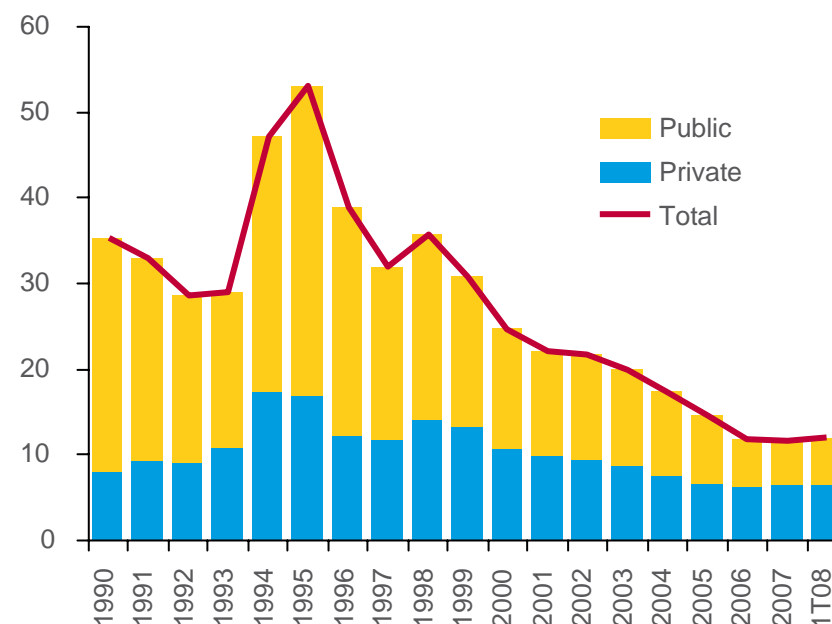
1. External finance dependence

- Mexico is a much sounder country today since both public and external debt are much lower and is increasingly issued locally

Net public debt: Local vs. Foreign currency
(% of Total)



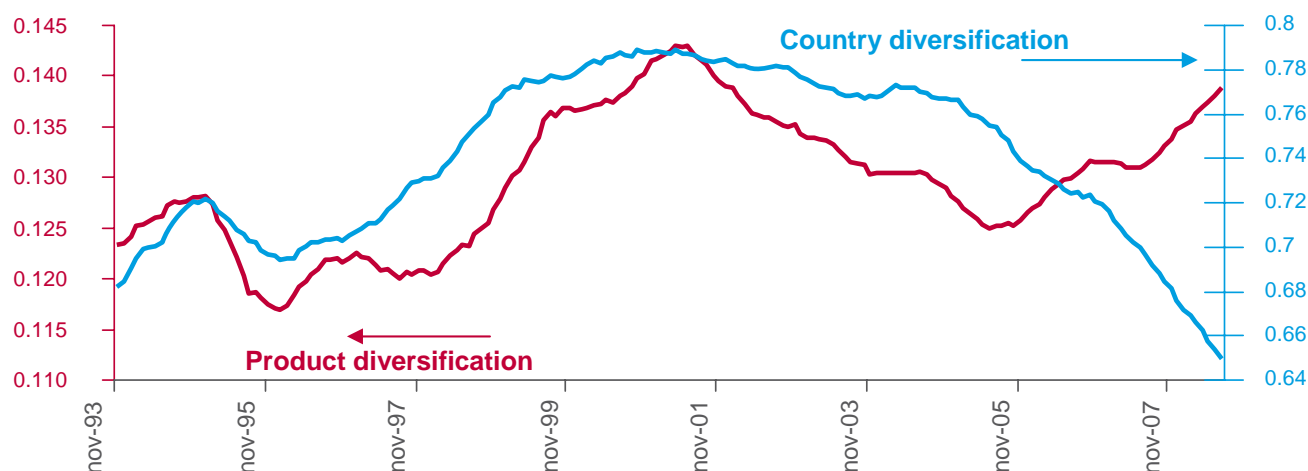
External Debt: Public & Private
(% of GDP)



BRICM: The dimensions of the crisis in Mexico

2. External demand dependence and Commodity prices impact

Export Concentration Index: Goods & Services and Countries
(Hirschman-Herfindahl Index, total concentration= 1)



- Mexican exports are concentrated on USA and in some key sectors
- Trade balance points to a higher deficit explained by an output growth gap in favor to Mexico

Local

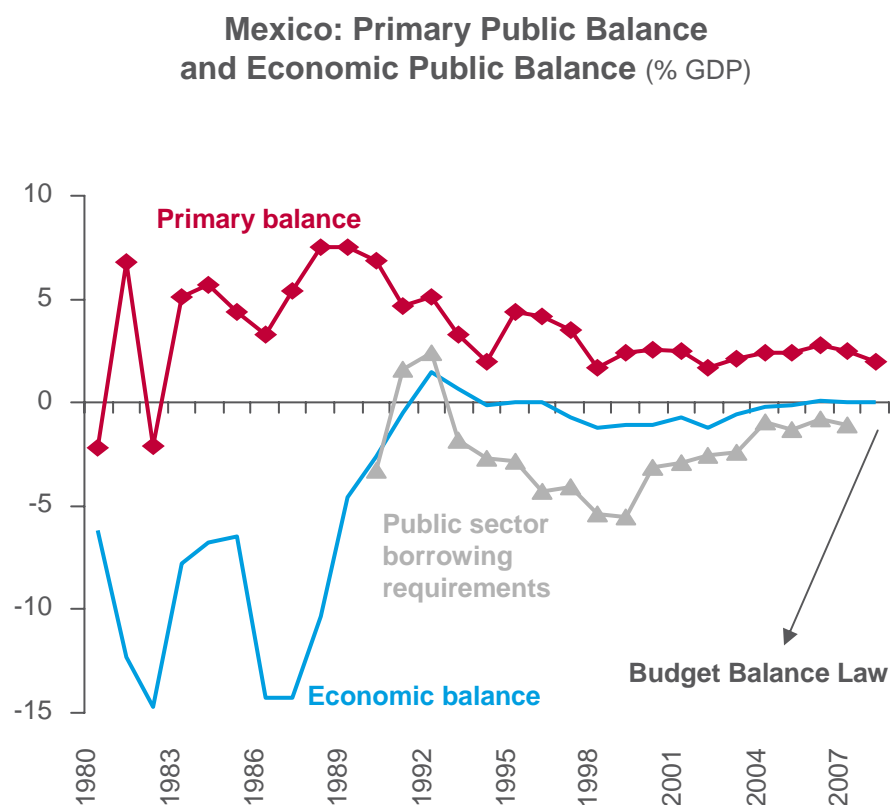
1. Lower oil net exports

2. Lower car net exports

3. Remittances deceleration

BRICM: The dimensions of the crisis in Mexico

3. Room for demand policies



- The contained public sector deficit and the lower public debt make room to implement countercyclical fiscal policy in Mexico for 2009
 - Federal Government could have a higher temporary fiscal deficit according to the Budget Balance Law
 - However, the room of higher disbursements is limited by tax revenue (oil, VAT, IRS) and a potential squeeze in international markets
 - Current multiyear infrastructure plans should help boost public spending

Conclusions



- China is the least vulnerable BRIC due to strong external reserves, high current account surplus, very low external and fiscal deficit and room for fiscal and monetary policies
- Brazil and Mexico both maintain a relatively favorable position
- India and, even more so, Russia, are clearly more vulnerable

Thank you