



What To Expect From Emerging Markets?

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Path to presentation

- What is our main scenario for emerging markets?
- The risk of too much: *Overheating*
- The risk of too little: *Contagion from Europe*

Main messages

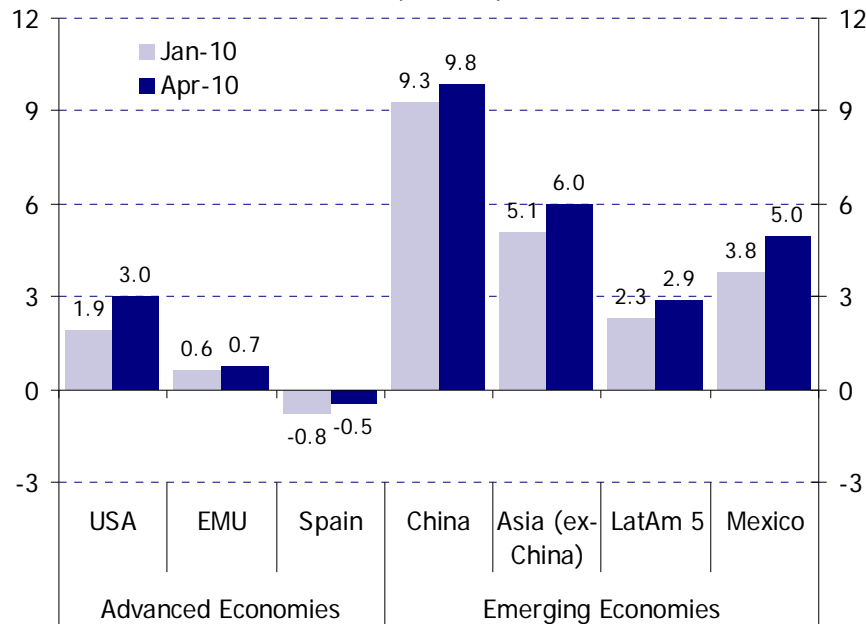
- The global scenario was improving, specially for the US (clearly less so for Europe even before Greece's situation deteriorated)
- Emerging economies, specially Asia followed by Latin America have been growing very fast (in some cases too fast).
- Before the European events, the risks clearly lied on the upward side:
 - Too slow an exit from very lax fiscal and monetary policies
 - Rapid appreciation and bubbles
- Europe's crisis should in principle mute those risks and not accelerate them
 - Very hard to think of continuous flight to quality to emerging markets when problems become systemic

Our global outlook : growth trends

Downward risks lower in 2010...

but more uncertainty on whether this impulse will continue in 2011

2010 GDP growth revision
(% Y-o-Y)



Source: BBVA ERD

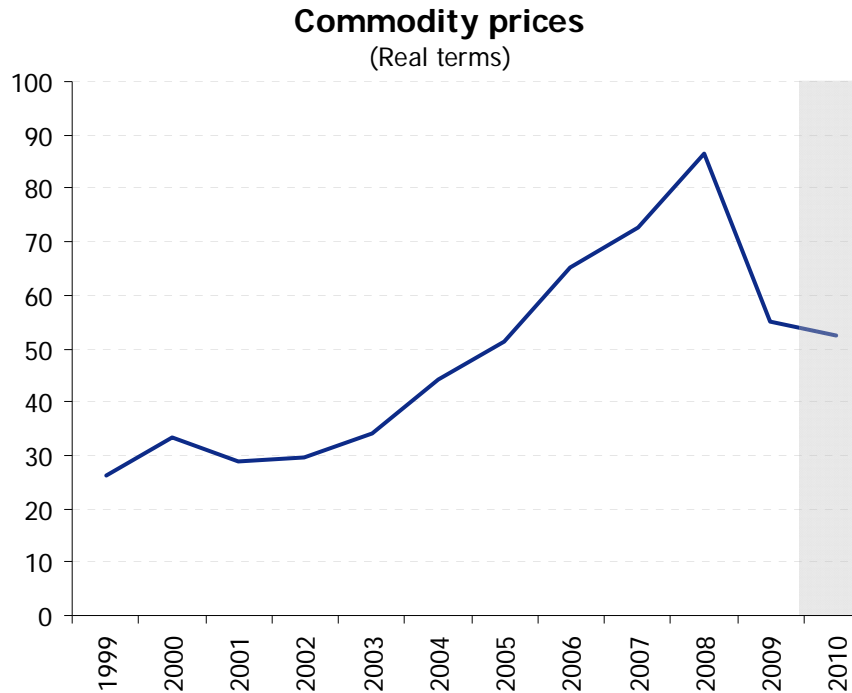
2010 GDP revision

- USA: Fiscal policy and inventory recovery provide further support than expected.
- EMU: No major changes since data confirms our scenario of weaker recovery than the US.
- China and Asia: Upward revision between 0.5 and 1pp, driven by somewhat stronger domestic demand and exports recovery.
- Latam-5: Upward revision of around 0.5 pp, supported by stronger domestic demand.
- Mexico: Upward revision of 1.2 pp only due to US recovery effect, since domestic demand remains subdued.

What are the drivers behind the outlook?

Emerging markets

Commodity prices remain at high levels, supporting income in some emerging markets (specially Middle East and Latin America)



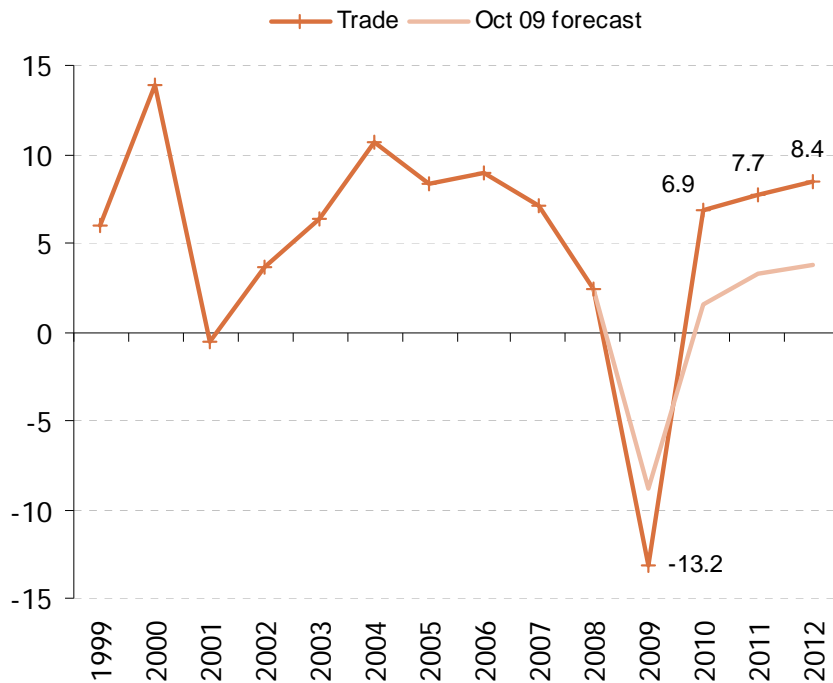
Source: BBVA ERD using CPB data

What are the drivers behind the outlook?

Emerging markets

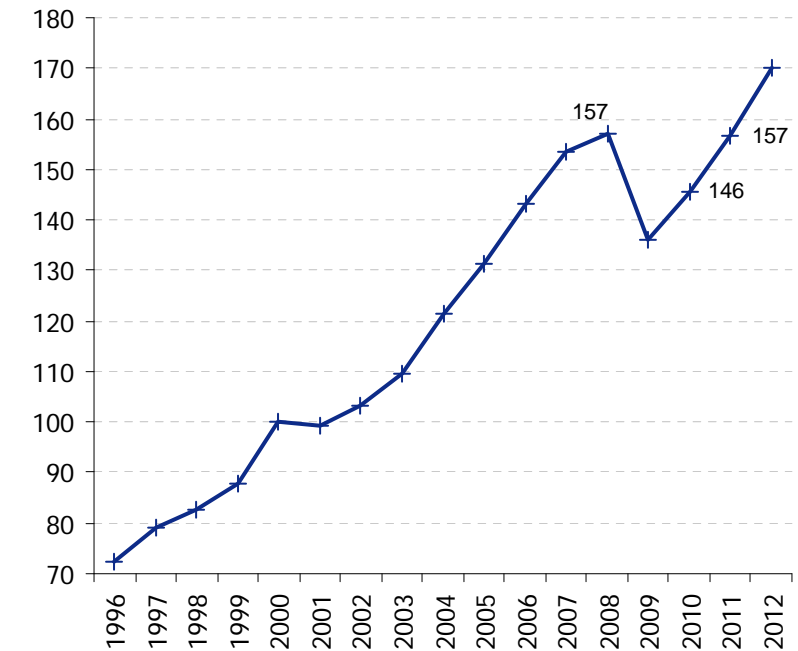
Trade is recovering very rapidly and surprisingly supportive. This trend is expected to continue.

World Trade: Real Growth (%)



Source: BBVA/SEE using CPB data.

Real world trade levels (2000=100)

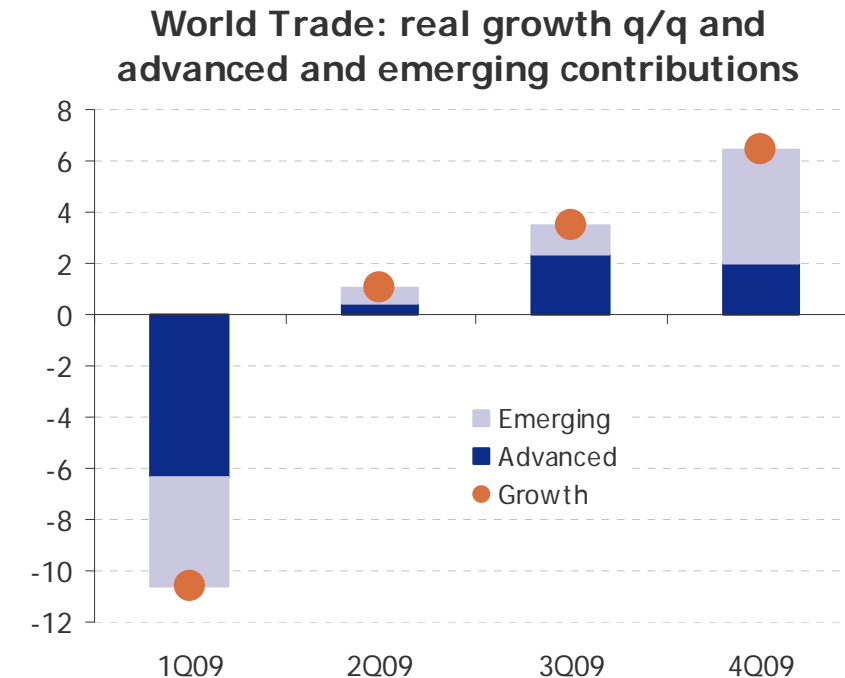


Source: ERD/BBVA.

What are the drivers behind the outlook?

Emerging markets

Emerging economies should benefit from it. This reinforces the key trend observed during the past decade: EM are the major actors in world trade.



Source: BBVA/SEE using CPB data.

Global Outlook: main risks

1

Some upward revisions, mostly cyclical and not across the board

2

However, some issues still remain jeopardizing recovery in some economies may emerge...

Advanced economies

- The sluggish restructuring in the financial system will lead advanced economies to a **creditless recovery**, with a potential drag on economic growth, more significant in EMU

- Europe: Markets' concerns are pushing governments towards **greater consolidation**, which implies a downward pressure on short-term growth. However, consolidation turns out to be essential to guarantee sustained growth in the medium term.

Emerging markets

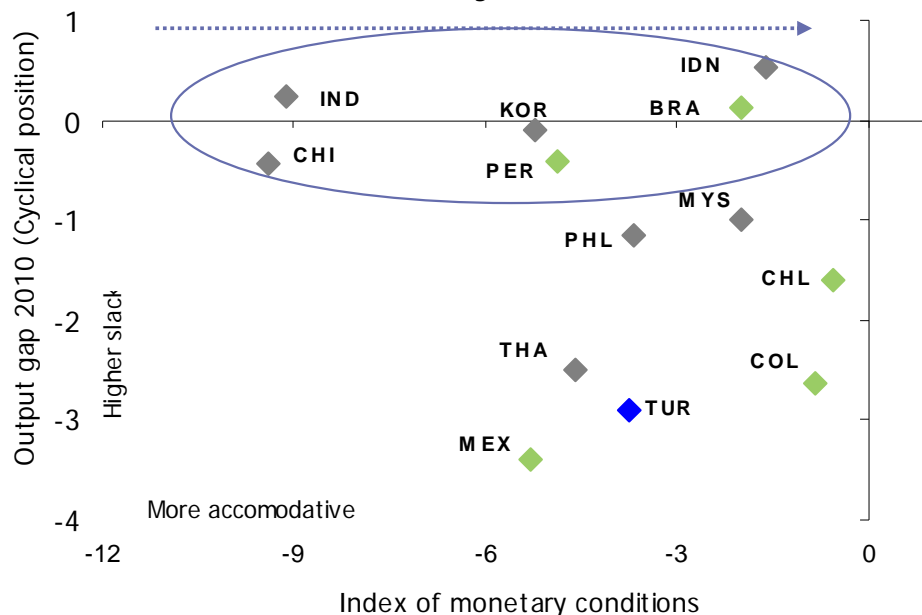
- Accommodative policies might bring about harmful effects if they are not removed in a timely manner (overheating, inflation, bubbles...)

The risk of too much ...but also the risk of too little

EM: the risk of *too much*, overheating

Strong recovery

Emerging markets: cyclical position Vs. monetary conditions



Note: Countries within the circle show excessively accommodative monetary conditions given their OG levels. A more restrictive stance is advised particularly on these cases.

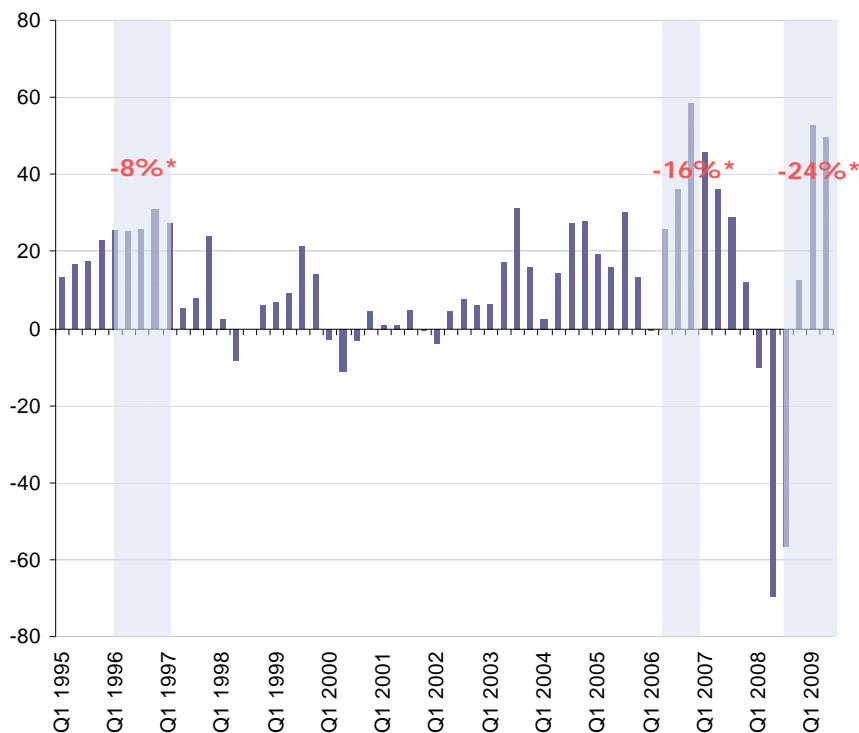
The monetary policy stance has been near a “emergency” mode, mainly due to very low real interest rates. Some economies show significant FX undervaluation

Rapid and robust rebound leaves many economies converging to potential, and some will be closing their output gaps in 2010. This suggests the need for a withdrawal of the monetary stimulus (towards a more neutral stance)

EM: the risk of *too much*, overheating

Surge in capital inflows

EMERGING MARKETS: Portfolio inflows
bn USD



Source: IFS and ERD BBVA

* The value is the maximum appreciation registered during the flow surge period (simple average between key emerging countries: Argentina, Brazil, Mexico, Colombia, Chile, Peru, Venezuela, China, India, Indonesia, Malaysia, Korea, Thailand, Poland, Russian and Turkey).

Emerging markets are facing (once again): 1) a surge in capital inflows, especially portfolio flows and 2) growing appreciation pressures.

During this episode the appreciation process seems more intense in magnitude and affects a wider range of countries.

To prevent such pressures, FX intervention or reserve accumulation (particularly in Asia) are widespread. Will intervention be sustainable if capital flows prove to be more persistent over the time?

EM: the risk of *too much*, overheating

As a result, risks are tilted toward overheating, especially in Asia

A map of risks

	Output Gap	Domestic Demand	Inflation	Credit	Assets bubbles
China	Yellow	Red	Yellow	Red	Red
India	Red	Red	Red	Yellow	Yellow
Indonesia	Red	Red	Red	Yellow	Blue
Korea	Red	Yellow	Yellow	Yellow	Yellow
Malaysia	Yellow	Yellow	Blue	Yellow	Blue
Philippines	Blue	Red	Red	Yellow	Blue
Thailand	Yellow	Blue	Yellow	Blue	Blue
Brazil	Red	Yellow	Red	Yellow	Blue
Chile	Blue	Blue	Yellow	Blue	Blue
Colombia	Blue	Yellow	Yellow	Blue	Blue
México	Blue	Blue	Yellow	Blue	Blue
Peru	Yellow	Yellow	Yellow	Blue	Blue
Turkey	Blue	Blue	Yellow	Blue	Blue

Source: ERD BBVA

Red color indicates overheating of the economy according to the respective indicator (exit should be near). Blue color indicates the economy is far from overheating according to the respective indicator (exit strategy could be delayed). Yellow color indicates an intermediate situation.

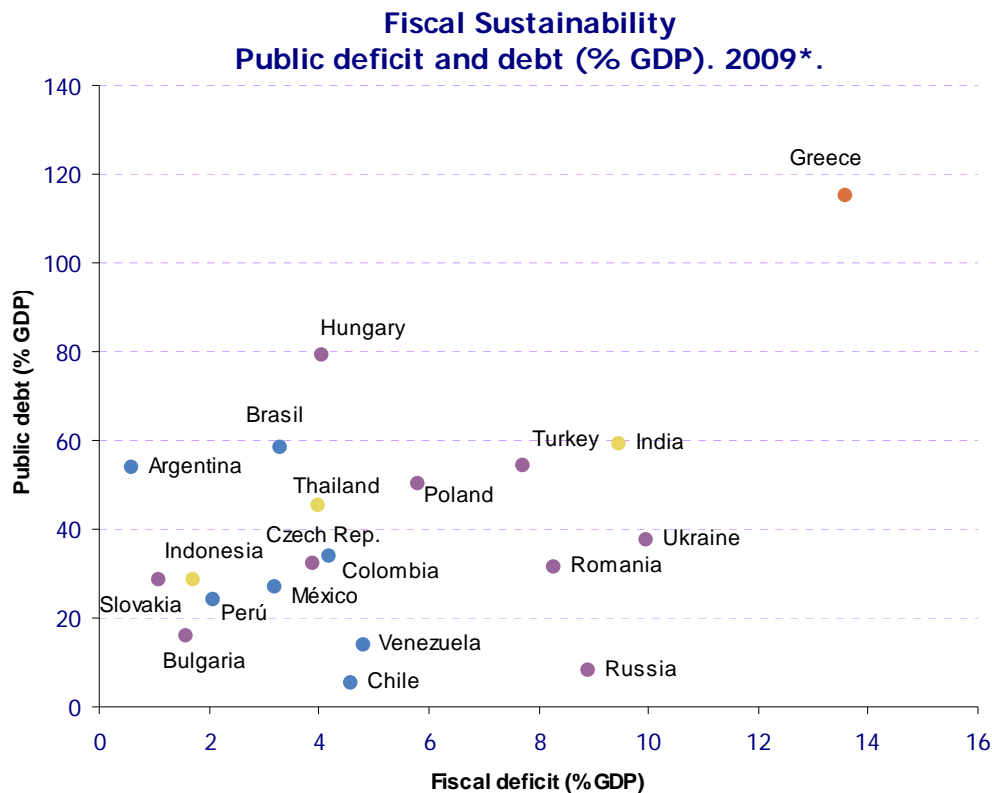
- **Asia** is leading the recovery, helped by an increasingly important contribution of domestic demand. It is in this region where the need for a timely exit is more imperative.

- In **Latam**, domestic demand is still contributing negatively to growth, with the exception of Brazil.

- Concern that emerging economies have shown for assuring growth might turn to be a very expensive insurance against a global double dip:
There is a increasing risk of overheating and inflation, beyond 2010

EM: The risk of too little, contagion from Europe

Greece's event can become a turning point at global level, also for emerging markets, even when fiscal standings in EM are by no means comparable to the standards in some EMU countries.



Source: IIF. 2008 data for: Arg, Bra, Chi, Col, Mex, Per and Ven.

All in All

- For the last months the balance of risks had turned towards overheating (with currencies across emerging countries expected to continue to appreciate)
- The European crisis is bringing back the ghost of a double dip
- If only a ghost, it could be good for emerging markets:
 - Less capital inflows and less overheating pressures
- However, the European crisis ends up being fully systemic, it could end up resembling more to the post Lehman period
 - Huge increase in risk aversion affecting financial markets in Emerging economies as well, including