BBVA

EAGLEs

Annual Report 2015

Emerging and Growth Leading Economies

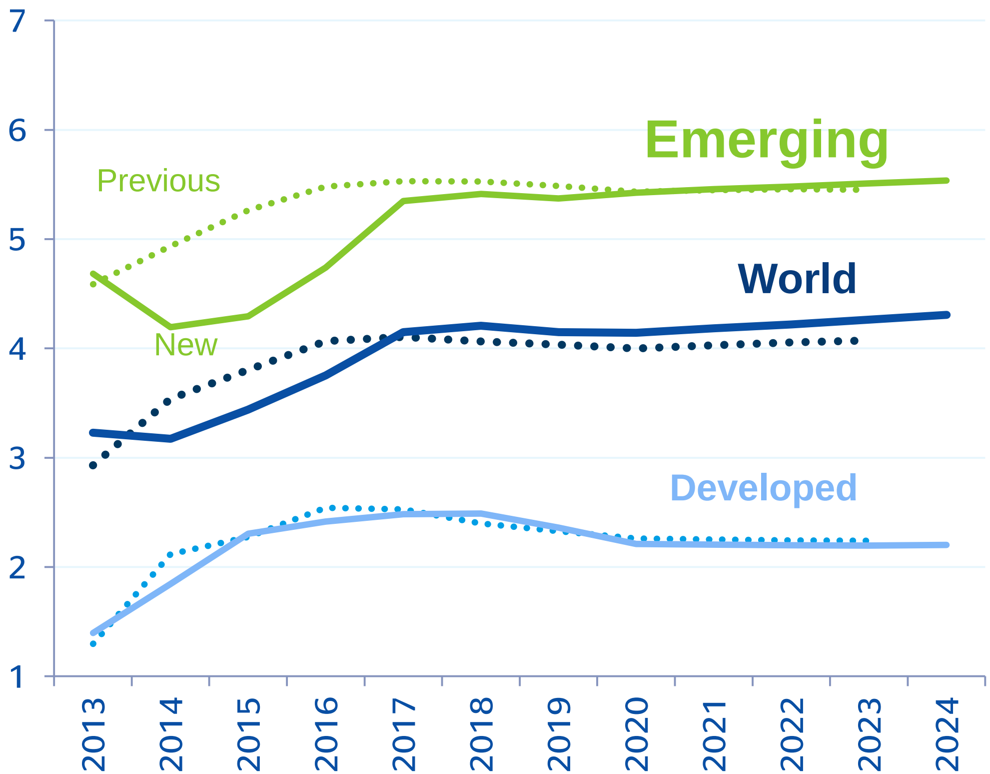
Economic Outlook

Index

- Update of forecasts for the 2014-2024 horizon
- The role of EAGLEs and Nest in the global economy
- Update of middle classes projections
- Inequality concerns
- Balance of risks

Short-term headwinds for emerging economies but long-term gap remains relative to developed markets

Real GDP growth (% YoY)



Source: BBVA Research, IMF

Emerging economies lost momentum in 2014, but **they will recover its growth's pace in the long run,** maintaining the gap with the developed world.

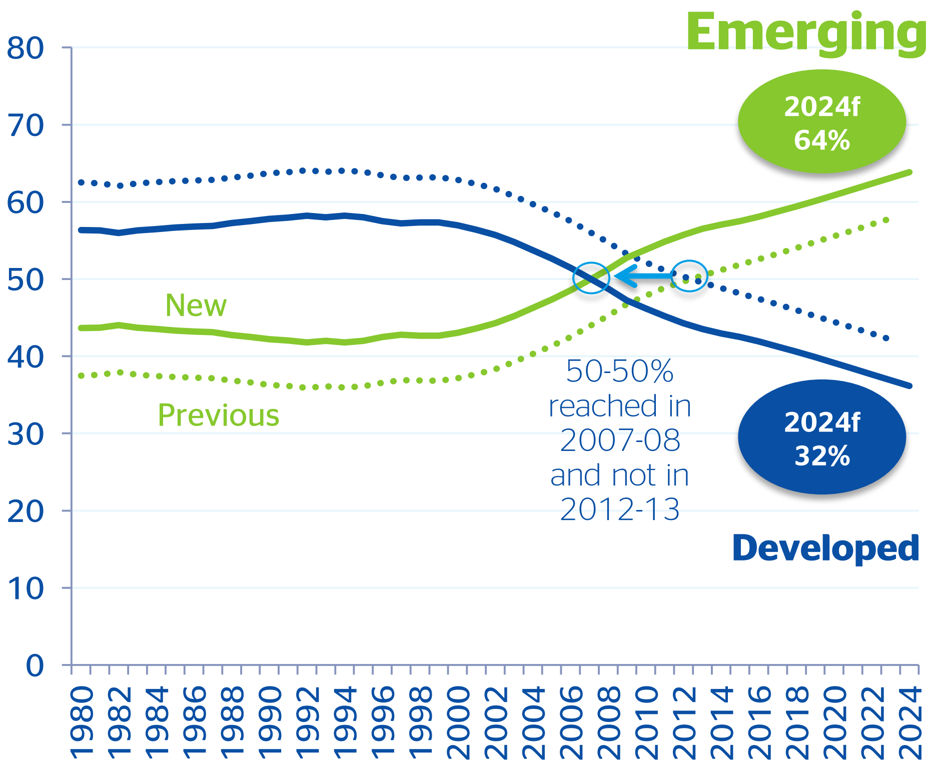
We expect **emerging countries to grow 5.5% YoY in 2024** from 4.2% yoy in 2014.

Developed economies will grow 2.2% YoY in 2024 from 1.8% YoY in 2014.

As a whole, **the world economy will grow 4.3% YoY in 2024** from 3.2% YoY in 2014.

The recent update of Purchasing Power Parities (PPPs) lifts further the share of the emerging world in world's GDP

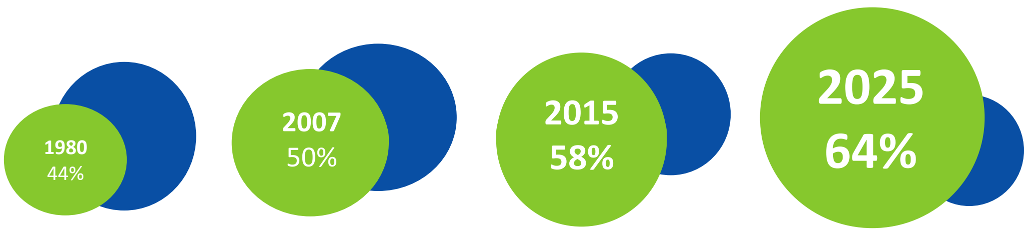
GDP share (% of total world GDP PPP)



Source: BBVA Research, IMF

Emerging countries GDP share

(% of total world GDP PPP)

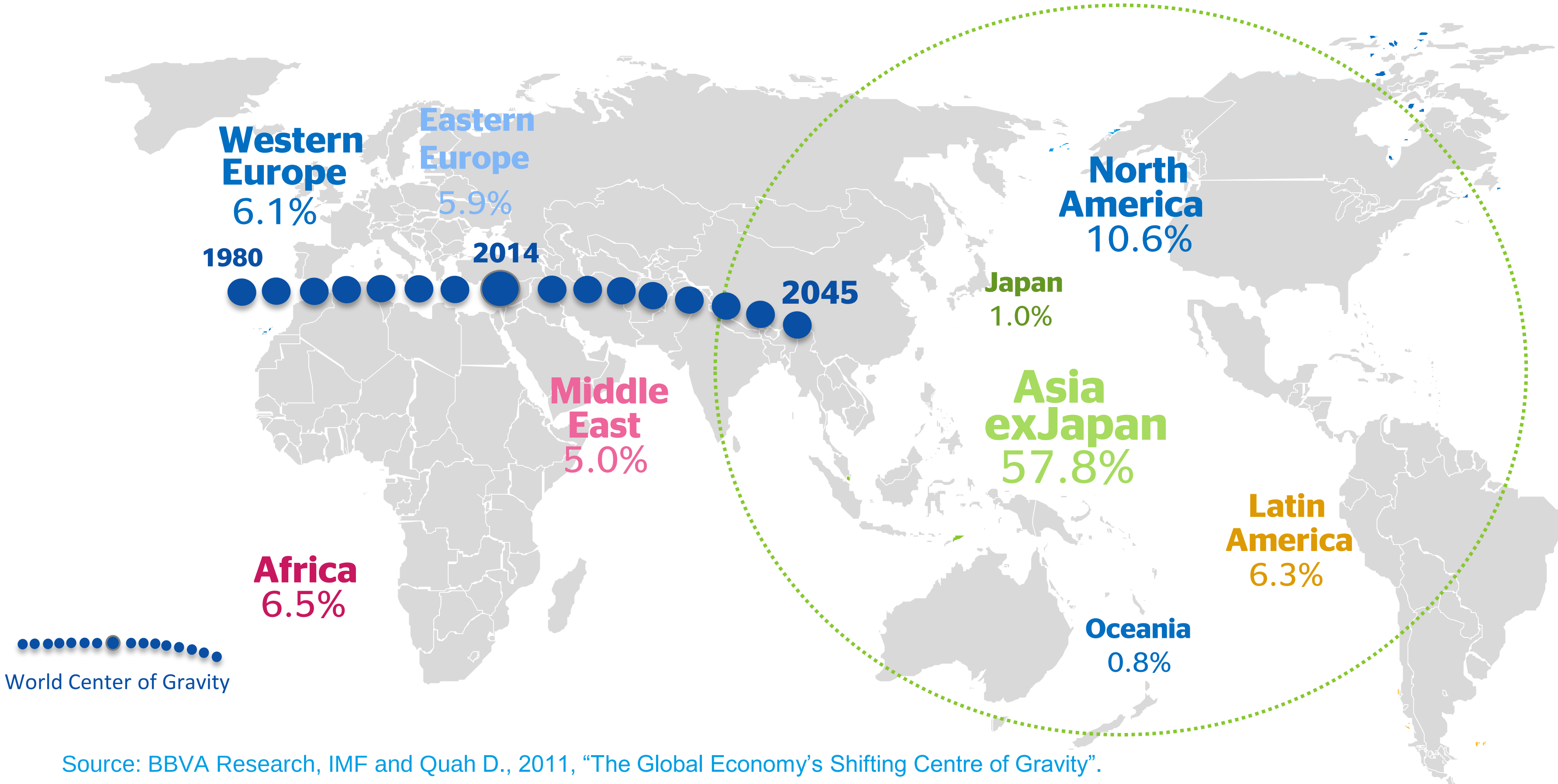


The new set of PPPs considered by the IMF has supposed a substantial increase in PPP-adjusted GDP levels for most of the emerging economies, while the figures remained almost unchanged in developed economies. Then, with the PPP revision, **emerging economies reached developed countries in terms of GDP share 5 years before than previously considered**.

The IMF updated its WEO database at the end of 2014 including a new set of PPPs computed in the 2011 round by the International Comparison Program (ICP), which imply significant revisions to those estimated in 2005. In particular, among emerging economies the PPP-adjusted GDP levels increased substantially for African and Asian countries and to a lesser extent in Latin America and Europe, while the figures remained almost unchanged in developed economies. See the annex for further information.

Shifting the economic centre of gravity from the Atlantic to the Pacific area

Regional contribution to world growth in the next ten years (%)



Source: BBVA Research, IMF and Quah D., 2011, "The Global Economy's Shifting Centre of Gravity".

Global growth will be concentrated in the Asia-Pacific region, which will account for **76.5%** of the increase in GDP between 2014 and 2024.


The role of
EAGLEs & Nest
in the global economy

BBVA EAGLEs: a reminder of the methodology

Step 1: Estimating GDP level in the next decade

Developed Economies

Emerging Economies

Current GDP level

Current size
("initial size matters")

X

BBVA Research & IMF forecasts

Growth rate
(10 years)

Potential Growth
("long run dynamics")

Labor | Capital
Institutions | Technology

=

GDP level In 10 years

Final size

Step 2: Calculating incremental GDP

GDP level In 10 years

-

Current GDP level

=

Incremental GDP

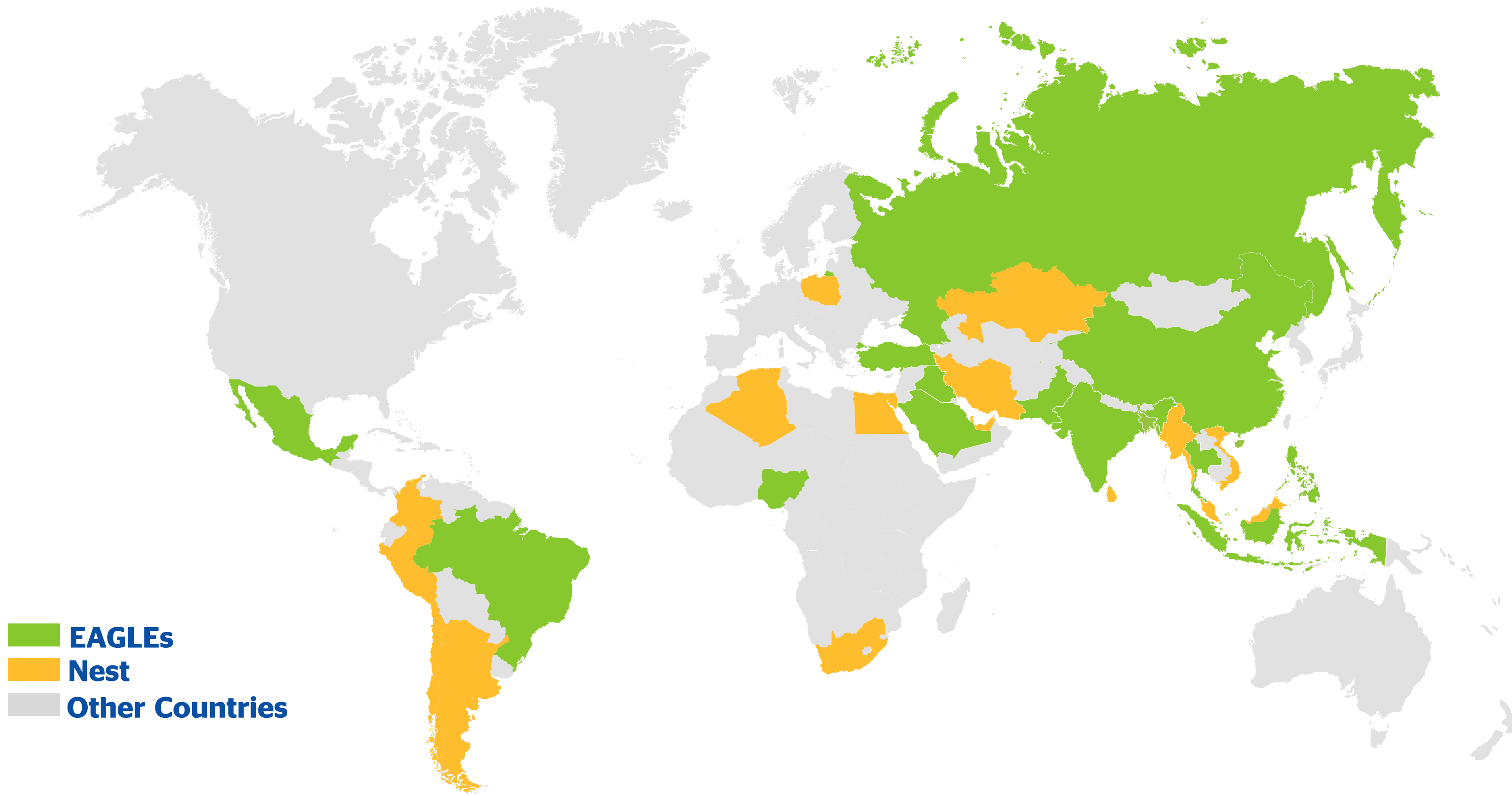
See the annex for further information.

BBVA EAGLEs and Nest 2015 membership

EAGLEs (14)	China, India, Indonesia, Russia, Mexico, **Nigeria**, **Saudi Arabia**, Brazil, Turkey, **Philippines**, **Pakistan**, **Iraq**, **Bangladesh**, **Thailand**
EAGLEs threshold	G6 average **Incremental GDP 2014-24 = USD 475bn**
Nest (16)	Malaysia, Egypt, Colombia, Vietnam, Poland, **UAE**, Iran, **Myanmar**, Kazakhstan, Qatar, **Algeria**, Peru, Argentina, South Africa, Chile, **Sri lanka**
Nest threshold	Non-G7 DMs >USD100bn **Incremental GDP 2014-24 = USD 168bn**
Rest of emerging economies	**Rest of emerging economies**

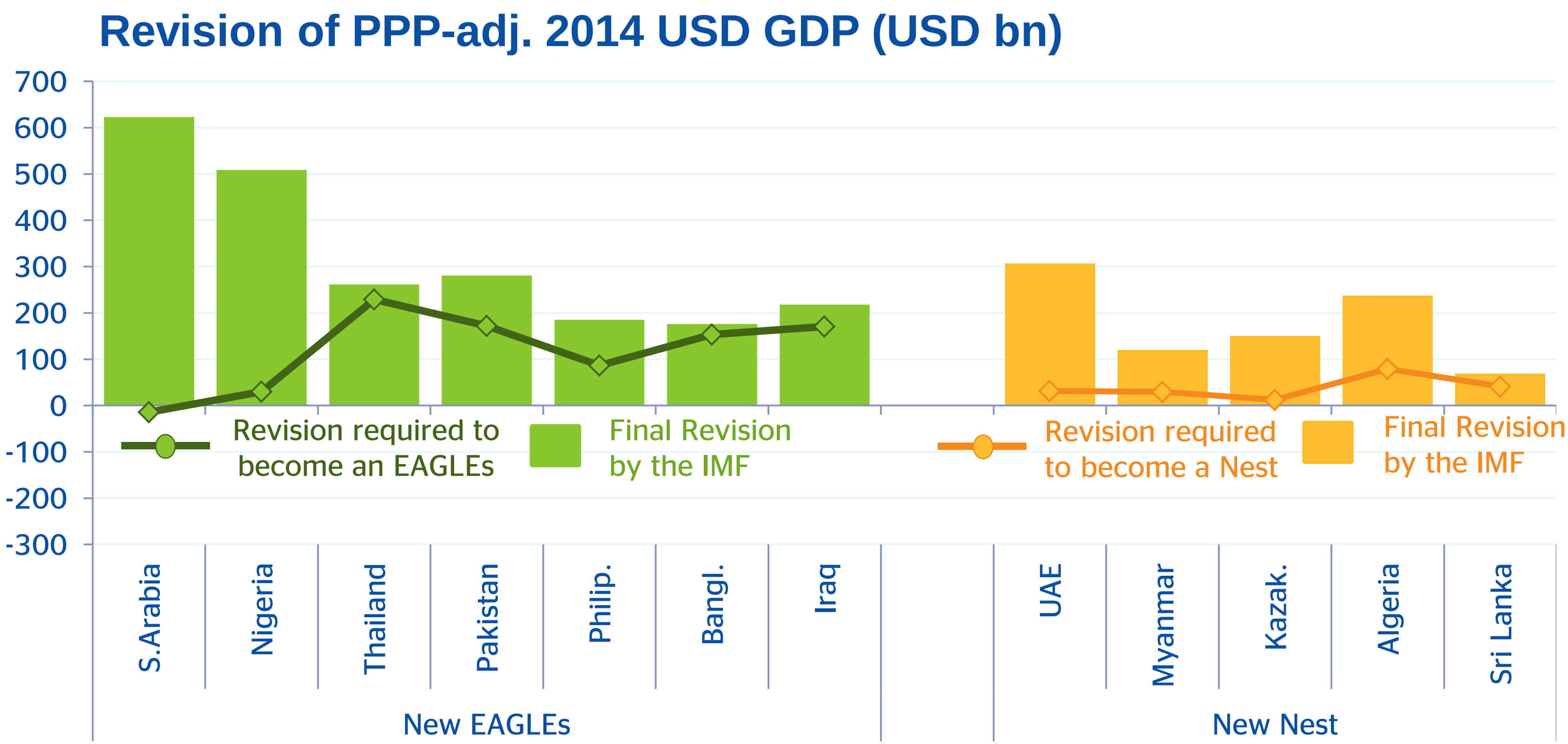
See the annex for further information.

BBVA EAGLEs and Nest 2015 membership are balanced across the globe



Emerging markets will account for 78% of global growth between 2014 and 2024, with **EAGLEs** contributing up to **62%**, the **Nest** group **9%** and other emerging countries another 7%.

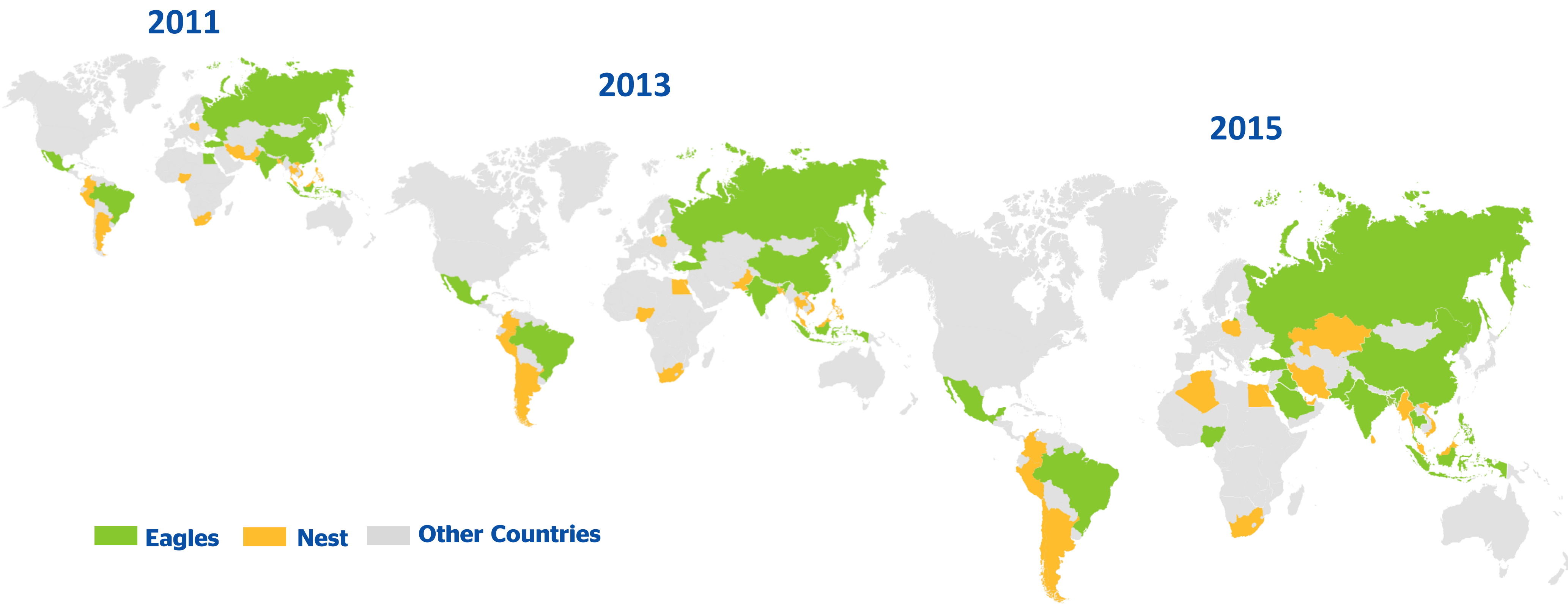
BBVA EAGLEs and Nest 2015 membership: significant impact of new estimates



Source: BBVA Research, IMF

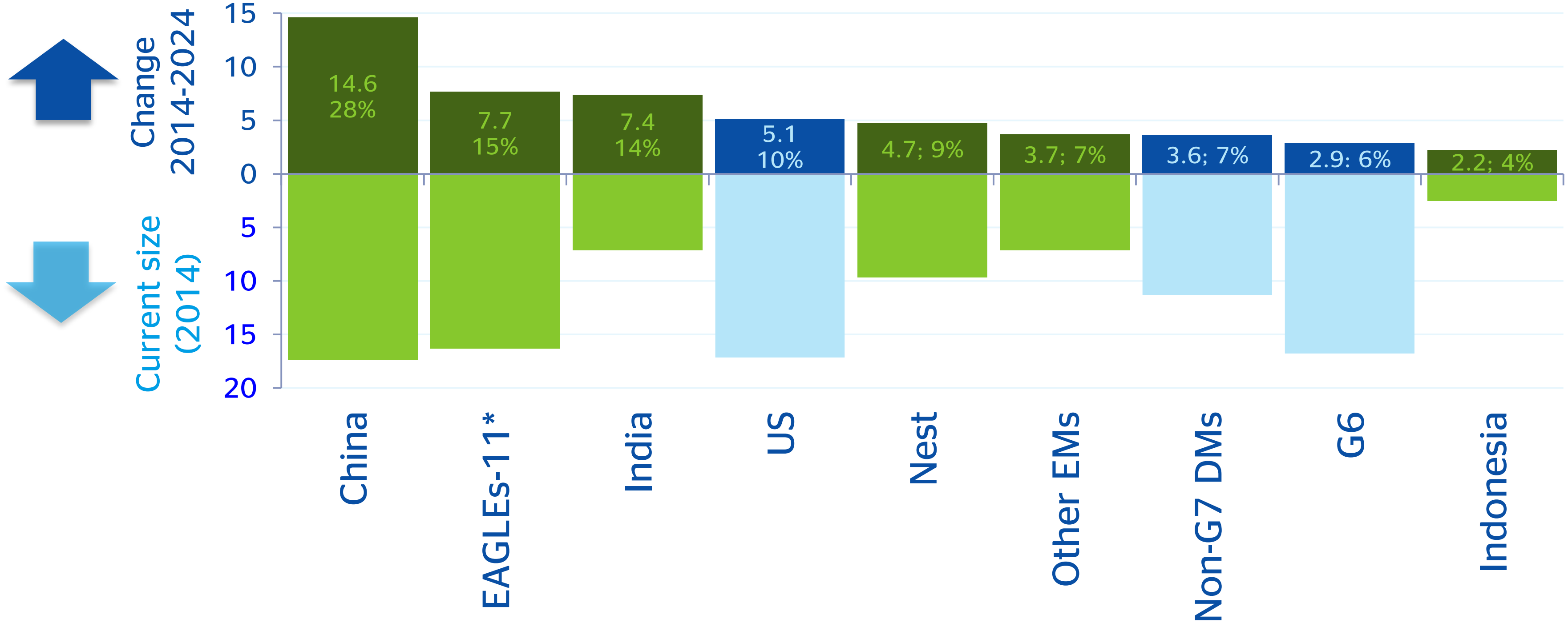
Saudi Arabia would have become **an EAGLE in 2014 regardless of the PPP revision. Thailand, Bangladesh and Iraq** also became **EAGLEs** members **in 2014,** but they **rank at the bottom** very close to the EAGLEs threshold.

Evolution of EAGLEs and Nest membership over time



New PPP projections have significantly increase the EAGLEs group in 2014, while the Nest group's size remains almost unchanged.

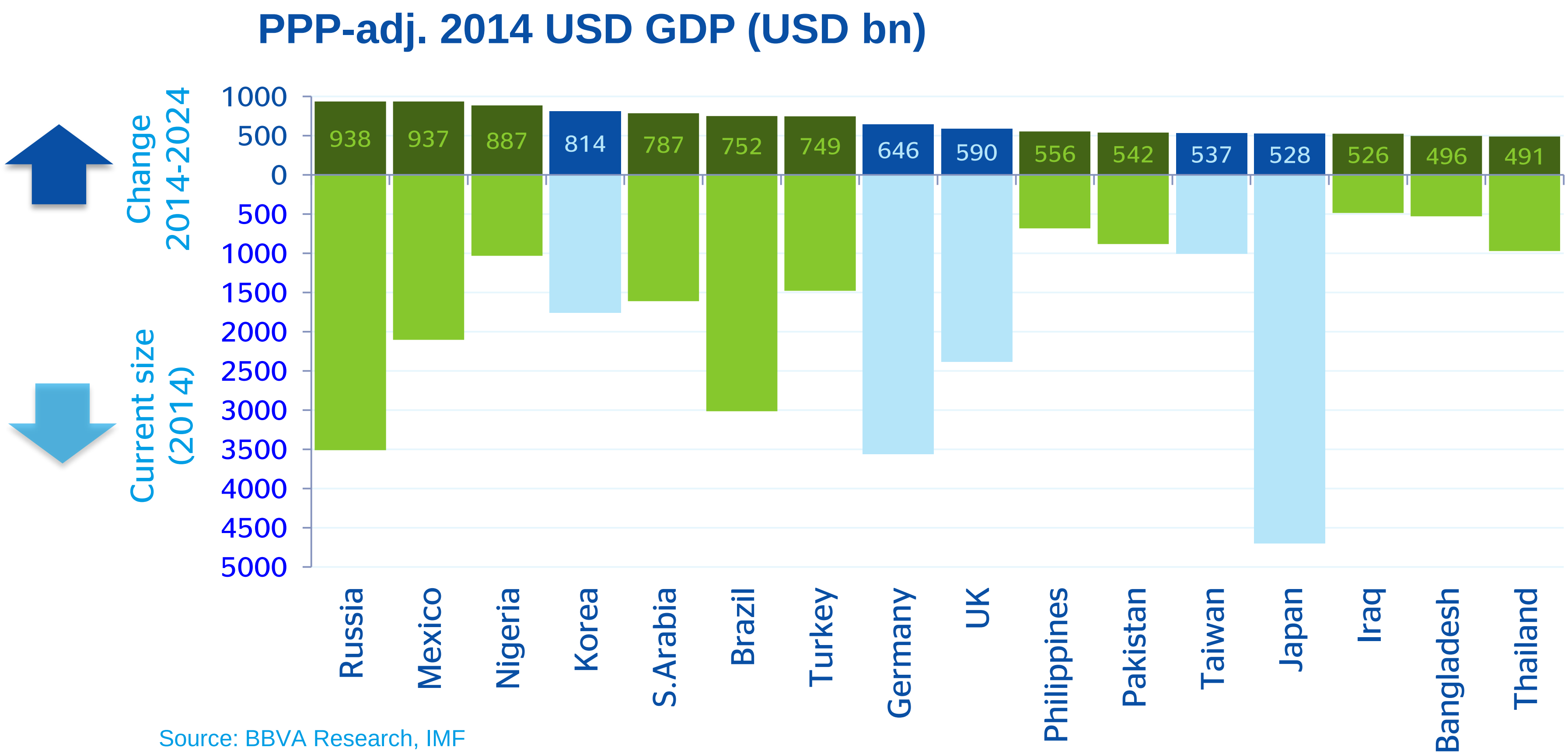
Contribution to world growth 2014-24



NB: *EAGLEs ex China, India and Indonesia
Source: BBVA Research, IMF

China and India will lead global growth contributing 28% and 14% respectively between 2014 and 2024. Their **rapid growth** is behind the **boom of the middle classes** in the emerging world.

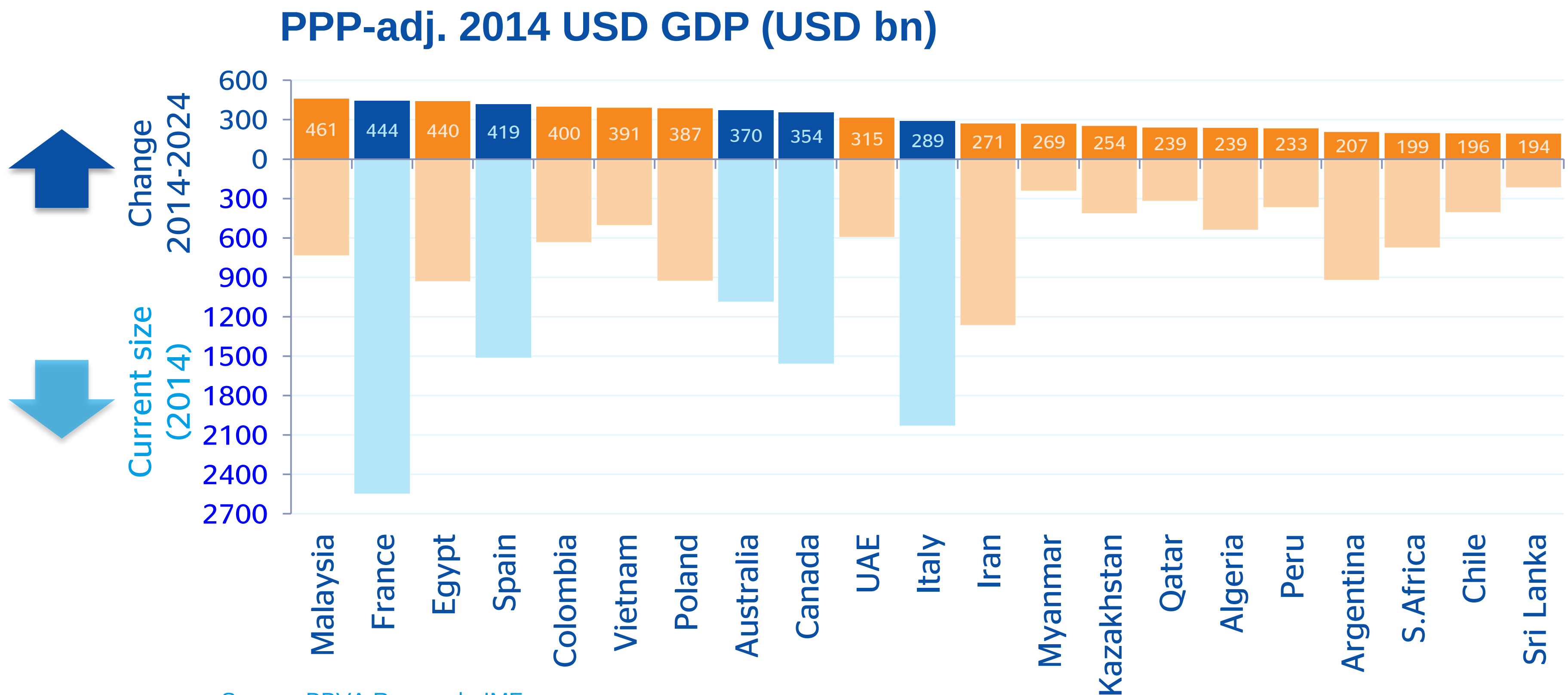
Contribution to world growth 2014-24



Source: BBVA Research, IMF

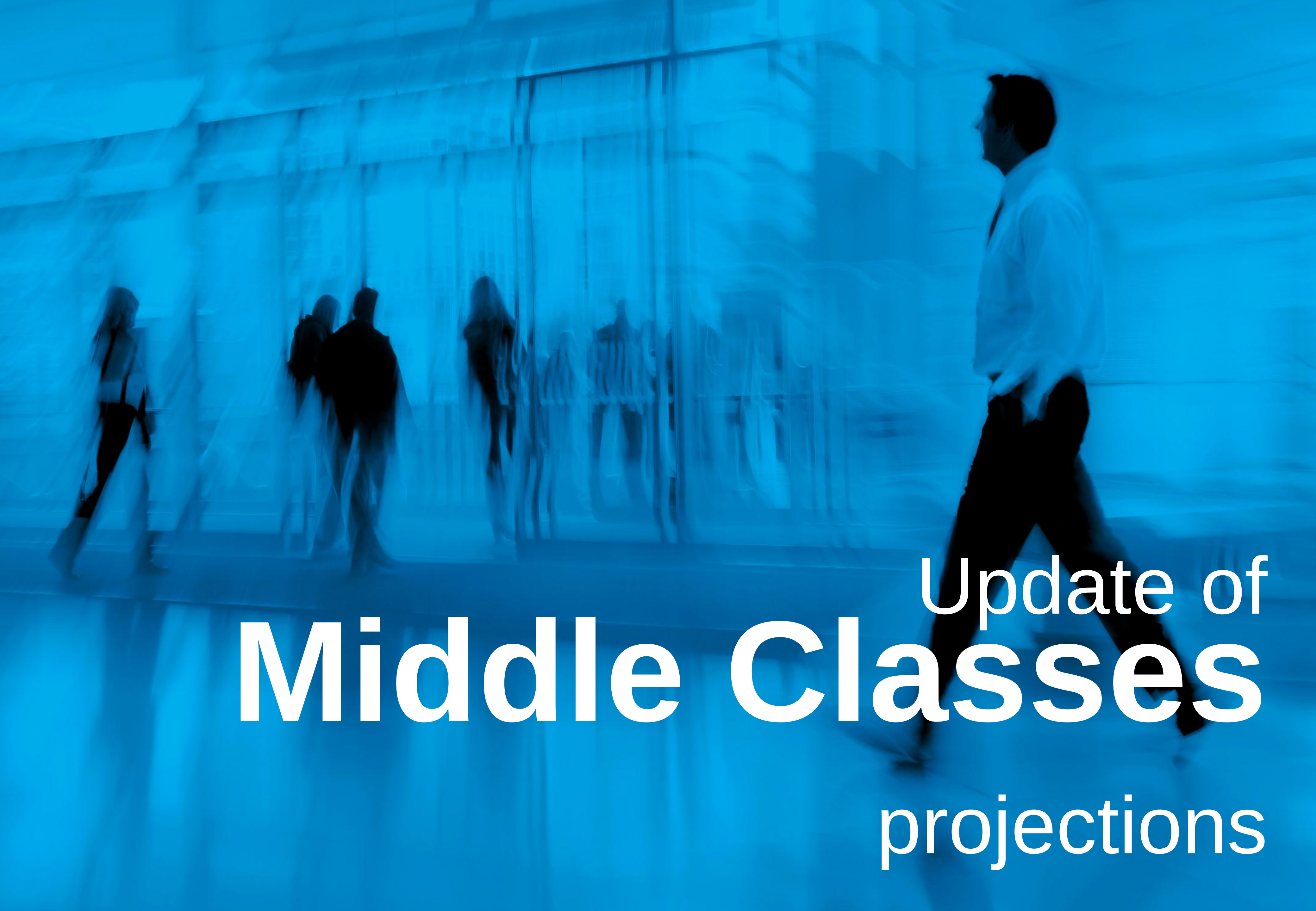
Russia, Mexico and Nigeria will contribute more than any developed country. **Saudi Arabia, Brazil and Turkey** will add more to the increase of world GDP than Germany and UK.

Contribution to world growth 2014-24



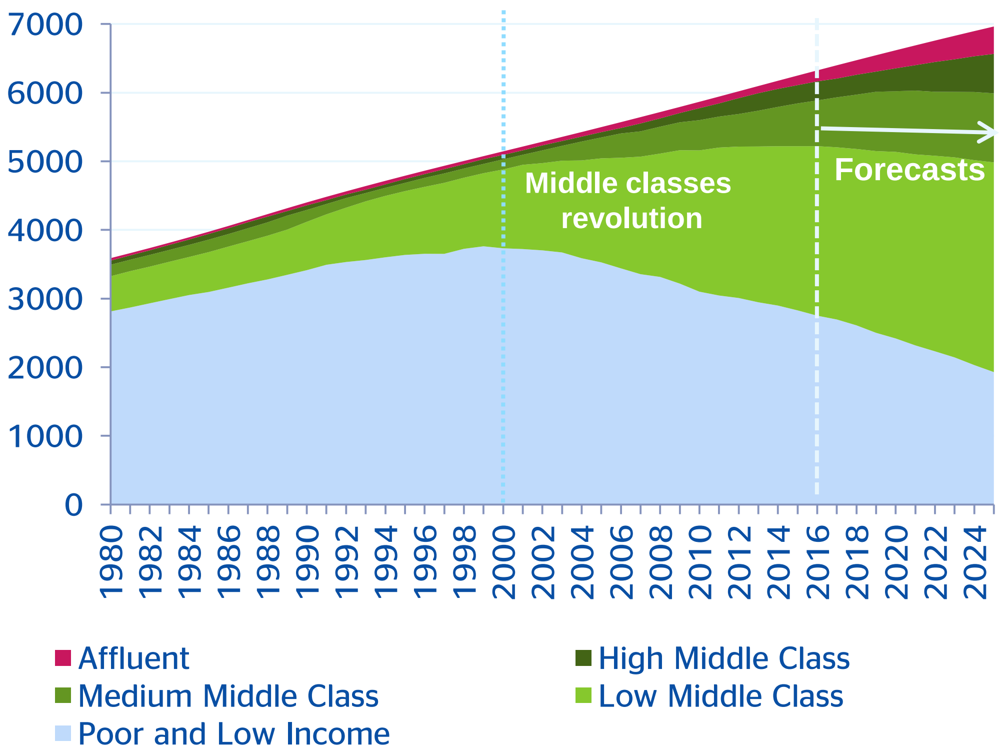
Source: BBVA Research, IMF

Malaysia ranks at the top of the Nest group. **Egypt, Colombia, Vietnam and Poland** show contributions to global growth comparable to those from large developed economies.


Update of
Middle Classes
projections

The Emerging Middle Classes revolution will accelerate

Emerging countries' middle classes (1980-2025)
(millions)



NB: Based on PPP-adjusted 2010 USD; Poor and Low Income (<USD5,000), Low Middle Class (USD5,000-15,000), Medium Middle Class (USD15,000-25,000), High Middle Class (USD25,000-40,000), Affluent (>USD40,000).

Source: BBVA Research, UN, WB, IMF

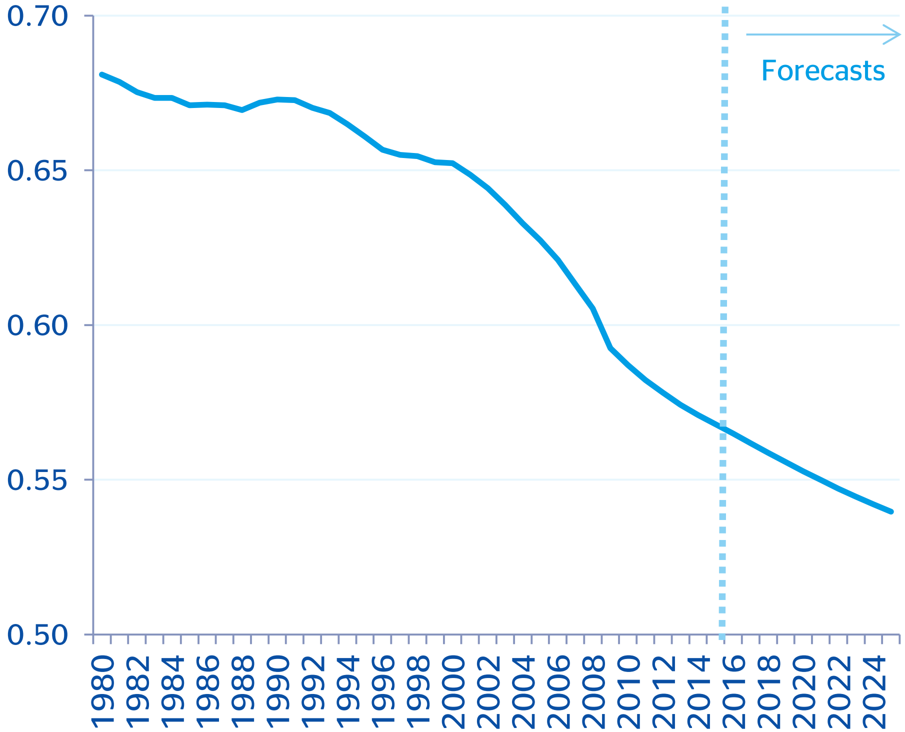
There has been **a dramatic reshaping of global income distribution since 2000 led by an unprecedented reduction in poverty rates** as well as by the **rapidly growing middle classes in the emerging economies. This will continue in the coming years.**

We expect **emerging countries to increase** their share of the global **medium-high middle classes and affluent segments from 24% in 2000 to 67% by 2025.**

See "Flourishing middle classes in the emerging world to keep driving reductions in global inequality", BBVA Research. See the annex for further information.

Flourishing middle classes in the emerging world are reducing global inequality

Global GINI index (1980-2025f)



NB: The GINI index is calculated with percentile GDP per capita including data for 90 countries covering over 90% of the world population.

Source: BBVA Research, UN, WB, IMF

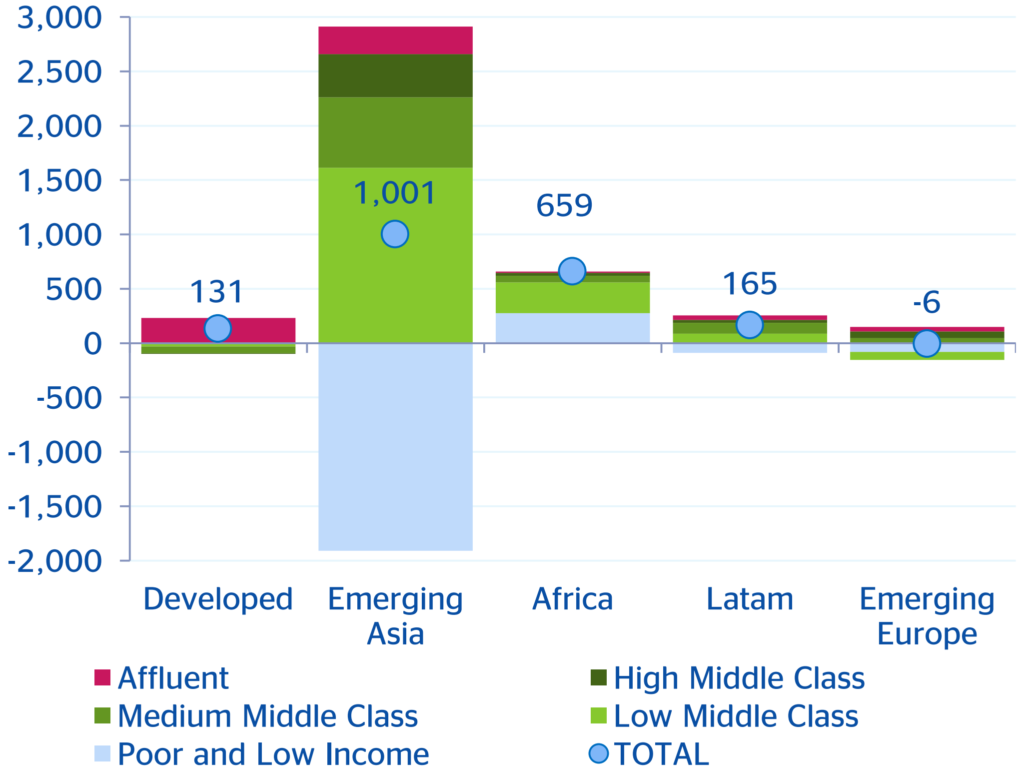
The expansion of the middle classes has contributed to a rapid decline in global inequality, which will reduce further even assuming no changes in domestic income distributions.

However, **levels of GINI index will remain high on cross-country standards**, with a GINI index similar to those recorded today in Africa and Latin America.

See “Flourishing middle classes in the emerging world to keep driving reductions in global inequality“, BBVA Research. See the annex for further information.

Asia leads the reshaping of global income distribution…

Change of population (mn) by GDP per capita and region (2000 to 2025f)



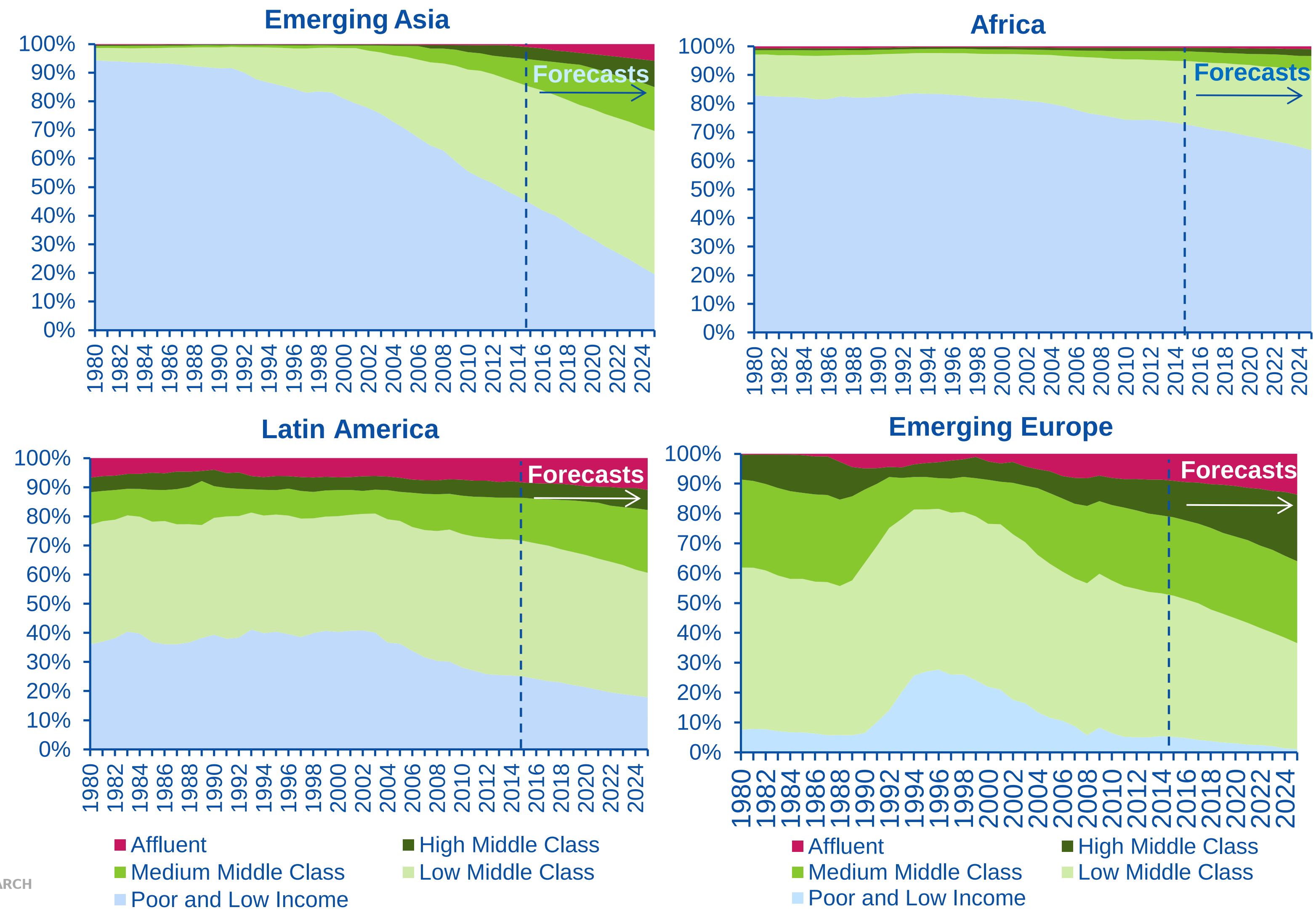
Source: BBVA Research, UN, WB, IMF

Medium-high middle classes and **affluent segments** will increase from 24% in 2000 to **67% in 2025** in **Emerging Countries**

Emerging Asia is the largest contributor to this reshaping of the world's income distribution with a new **middle class of 2658 mln** living there

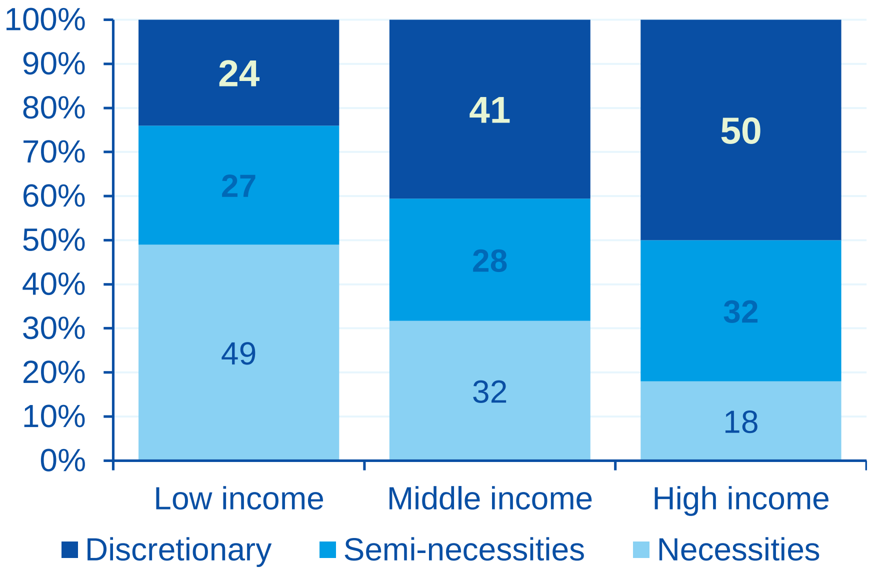
The share of the **wealthier segments** is **on the rise** in **Africa, Latin America and Emerging Europe**

…leading creation of the Middle Classes with pro-poor growth. Latam growth has been more inclusive



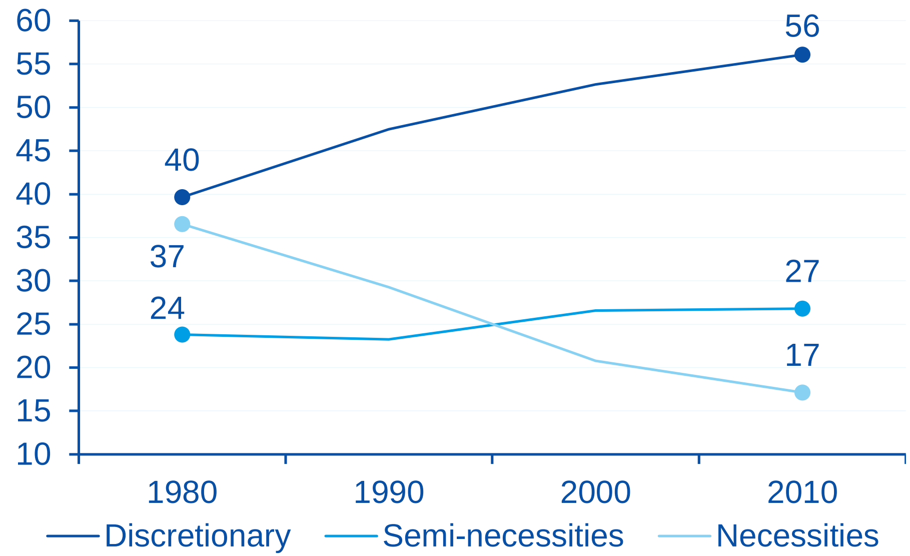
Income transition drives significant changes in consumption expenditure

Consumption basket according to GDP per capita
(average CPI weights by broad group) (c.2012)



Source: BBVA Research, Haver, IMF

Consumption basket in Korea
(% CPI weight by broad group) (1980-2010)



Source: BBVA Research, Haver

As **countries develop from low income to middle and high income levels,** the relative **demand for basic products declines** substantially, while the opposite happens with discretionary products.

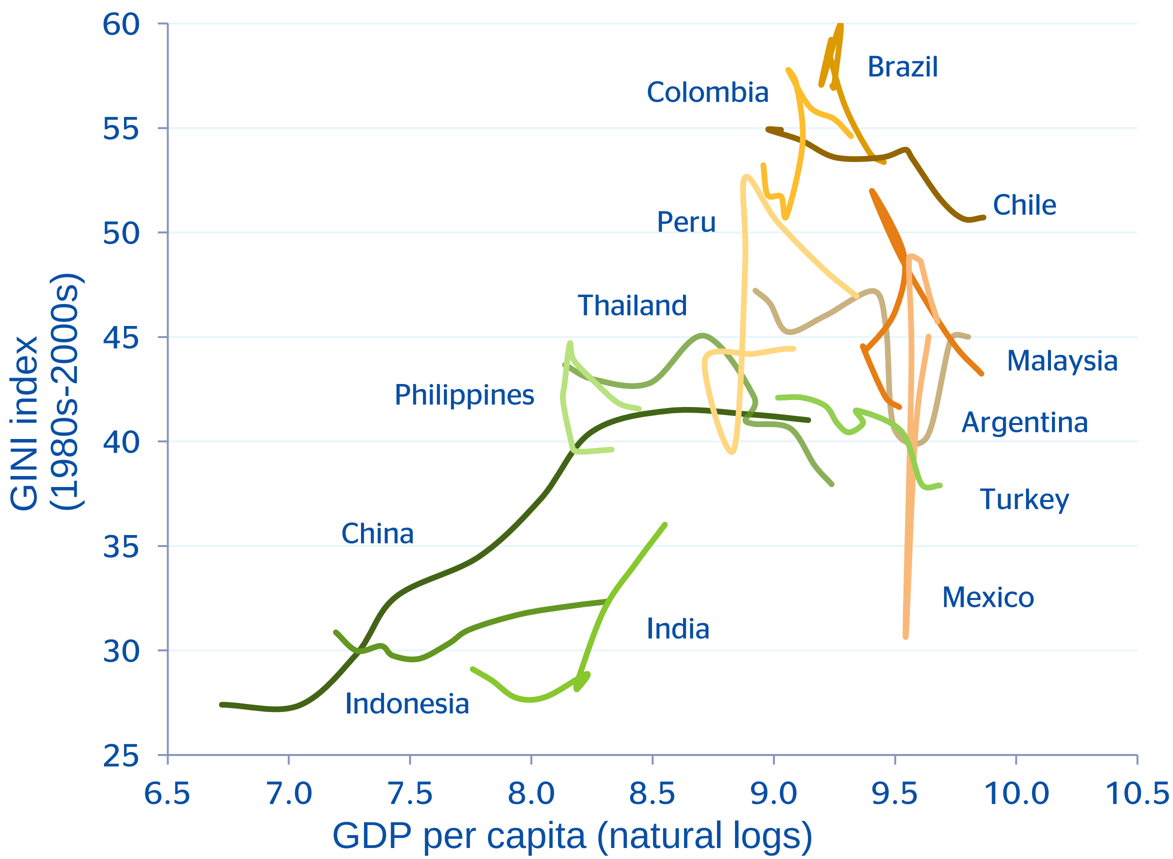
Korea is a good example of this. The country **has developed extraordinarily rapidly**, increasing its GDP per capita five-fold between 1980 and 2010 and transitioning from low to high income levels.

Inequality

concerns

Inequality as a by-product of the development process (Kuznets Inverted U curve)

Kuznets curve: income inequality and GDP per capita to relate in the form of an inverted U



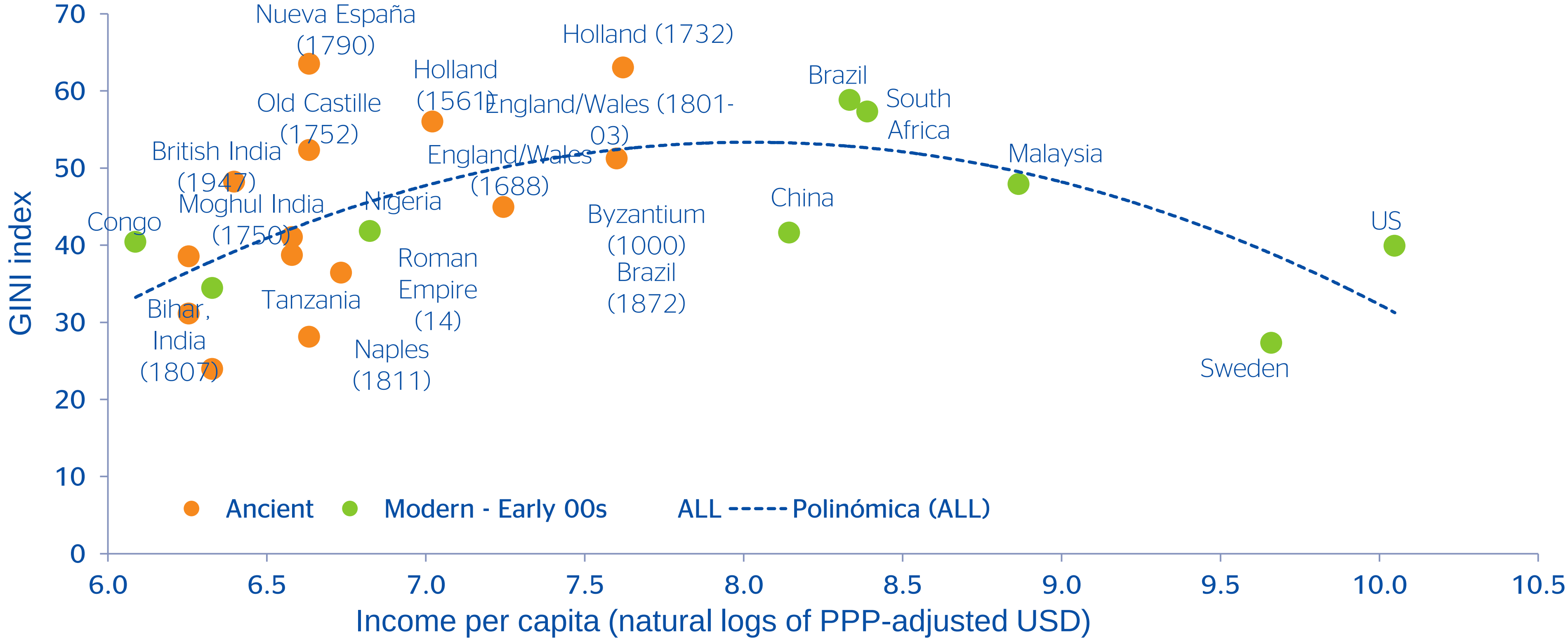
Unprecedented growth in emerging economies during the last 15 years has brought an impressive reduction of poverty and a boom in the middle classes.

However, the decline in global inequality has taken place at the expense of more uneven income distributions in large Asian economies and only a slight smoothing of high inequality in Latin America.

Source: BBVA Research, WIID, IMF

Note: see "Tackling excessive inequality as a critical ingredient for sustainable development in the emerging world", BBVA Research.

The Kuznets curve seems to hold from a historical perspective



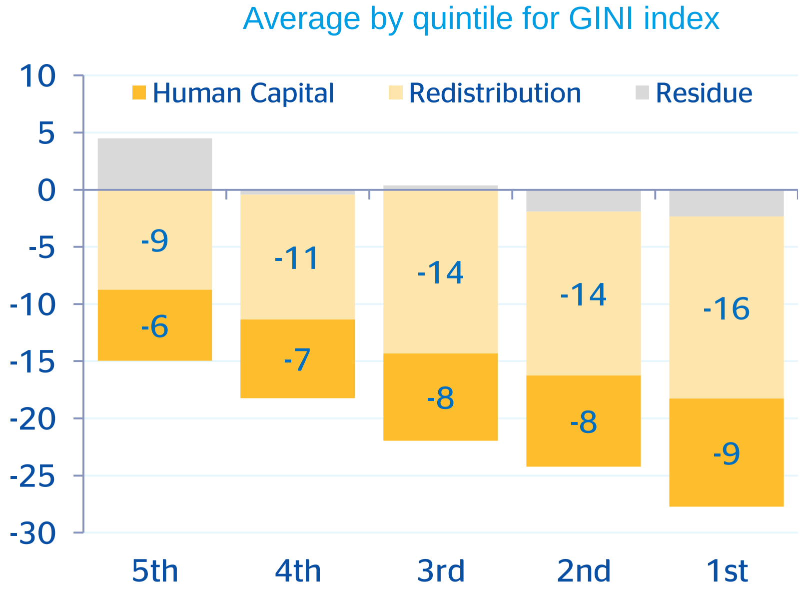
Source: Milanovic, Branko, Lindert, Peter H., and Williamson, Jeffrey G., 2007, "Measuring ancient inequality", NBER Working Paper No.13550

The **global economy's development** over time **shows the inverted-U relationship between economic development and inequality** (Kuznets curve) from the Roman Empire to US and China.

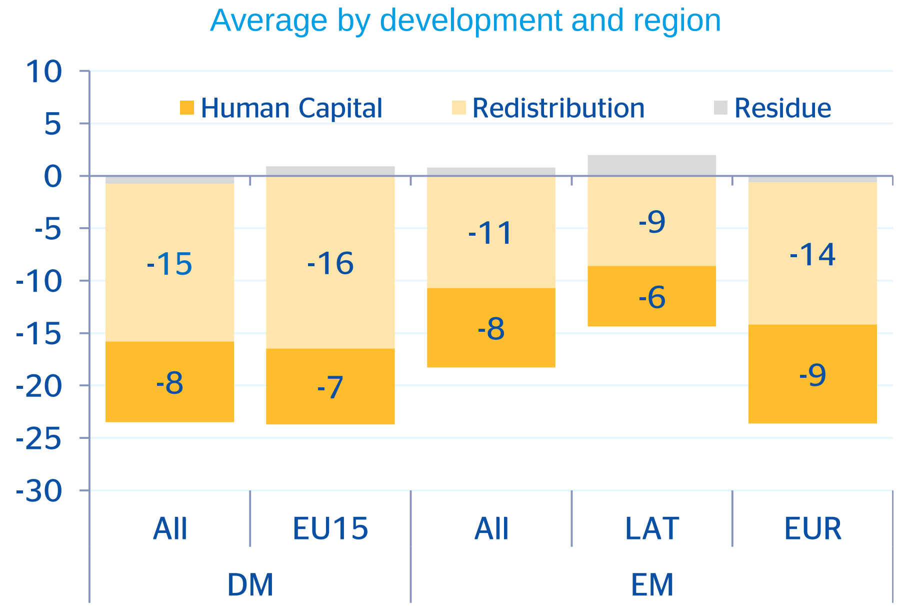
Note: According to Kuznets curve theory, income inequality would be a by-product of growth in early stages of development as urbanisation and the shift to more productive activities increase the gap with rural areas, and the capital share rises. Thereafter, this upward trend is stabilised and eventually reversed at some point, following transition to medium-high income levels. See "Tackling excessive inequality as a critical ingredient for sustainable development in the emerging world ", BBVA Research

Beyond Kuznets curve, redistribution and human capital play key roles

Estimate of GINI index (DIS) and decomposition of non-Kuznets determinants (average for country groups)



Source: BBVA Research

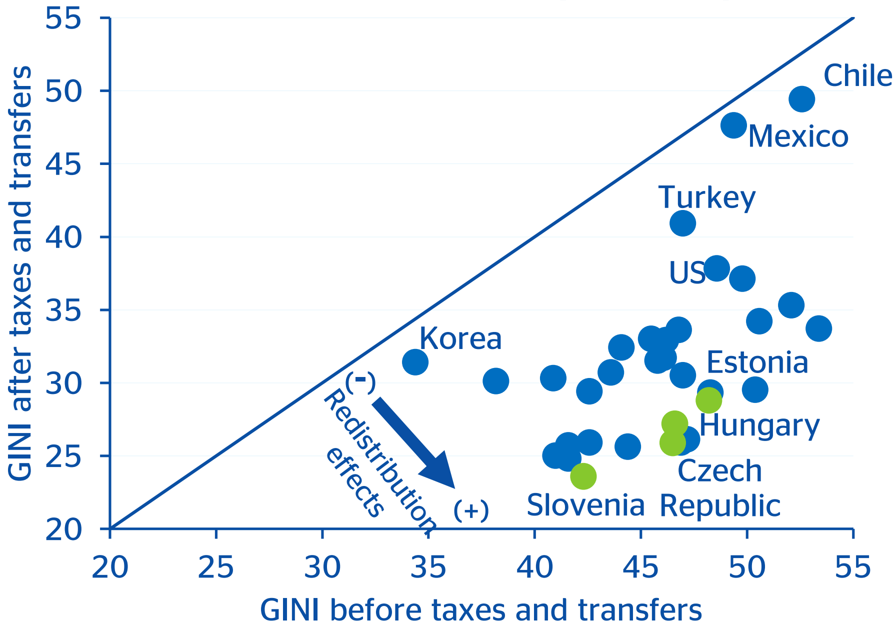


Source: BBVA Research

Our cross-country analysis exercise shows that redistribution policies and labour market dynamics are key determinants in tackling inequality. This relationship appears more intense in developed countries, which present lower GINI indices.

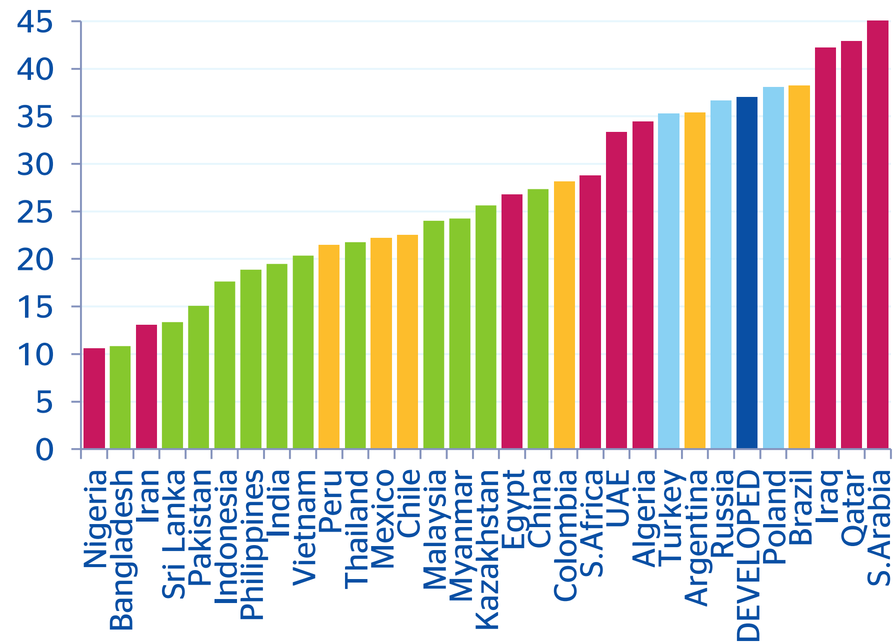
Redistribution requires stable and adequate fiscal revenues

GINI index in OECD countries before and after taxes and transfers (late 00s)



Source: OECD

General government revenue (% GDP) (2014)



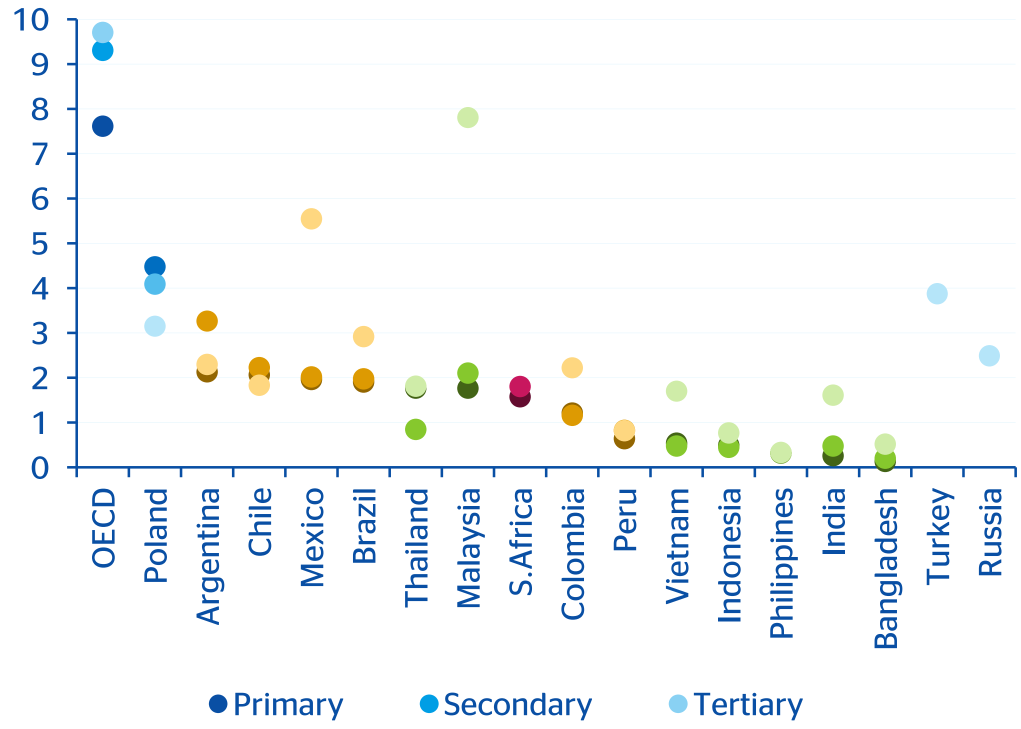
Source: IMF

Redistribution policies in developed countries have proved to be **effective in reducing inequality**. To use redistribution policies, **emerging countries need to increase fiscal revenues**, especially in South-east Asia, Mexico and the Andean countries in Latin America, where fiscal revenues are around 20% of GDP compared to 40% in G7 economies.

Education is also crucial to guarantee equality of opportunities… Spending on education will discriminate between and within countries

Public expenditure by educational level

(‘000s of PPP-adjusted USD per student) (2006-10 avg)



Source: BBVA Research, WB and IMF

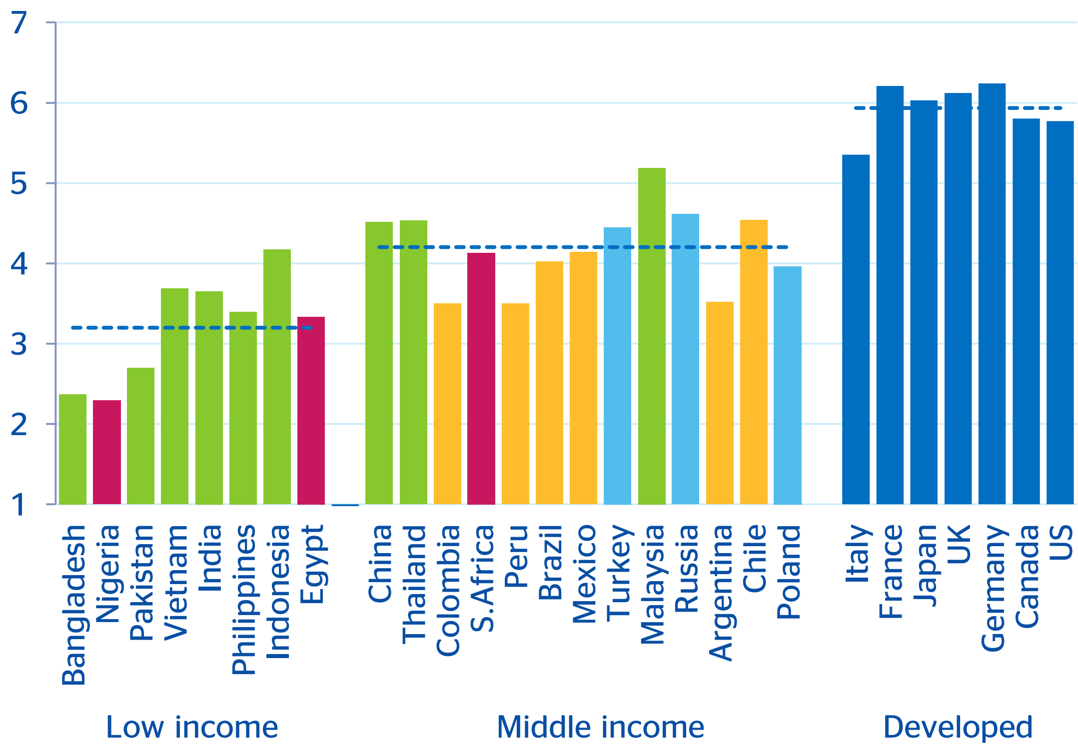
Educational gaps are crucial determinants to fight inequality. Large gaps remain between countries.

Public expenditure on education in emerging countries is very low compared with developed standards.

Reducing these gaps will be important in tackling inequality.

…although it must be accompanied by good infrastructure

Quality of overall infrastructure (1-7)
(2013-14)



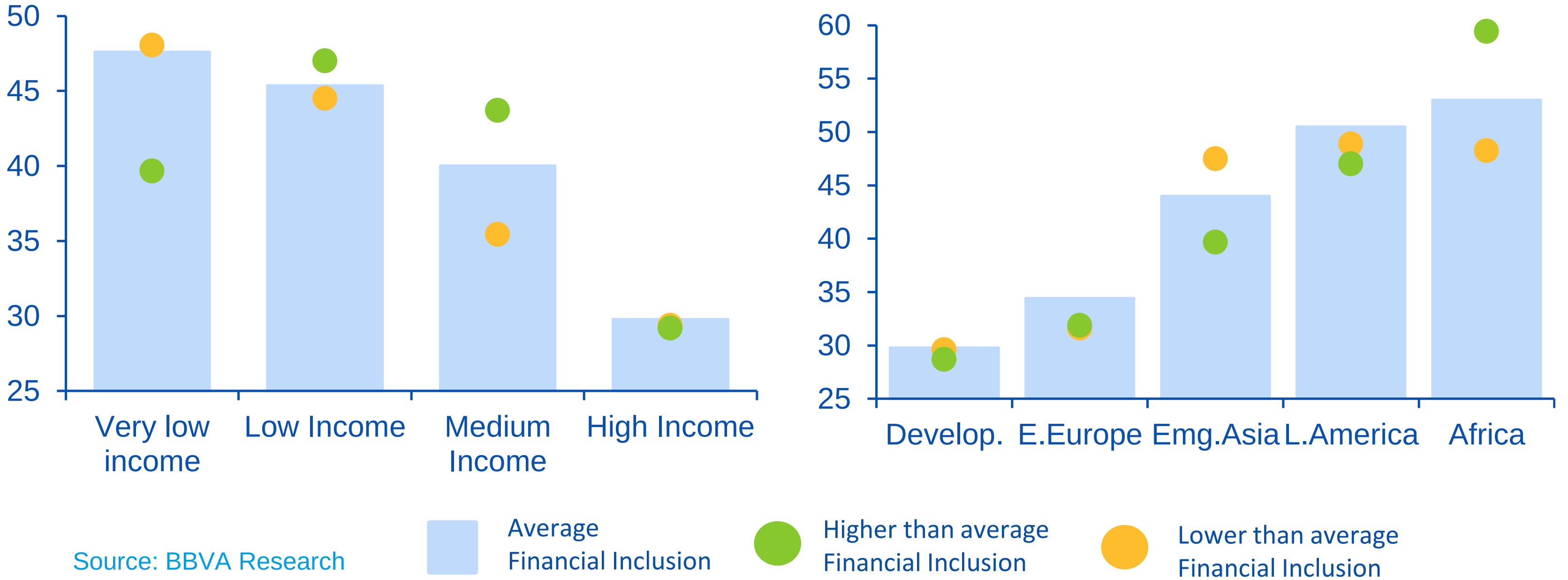
NB: Countries are ranked according to their real PPP-adjusted GDP per capita in 2013
Source: BBVA Research, WEF

Poor quality of infrastructure harms competitiveness and may eventually become a serious bottleneck for further growth.

The challenges to developing infrastructure are huge, given the low fiscal revenues, leading necessarily to consideration of alternative financing sources such as regional banks, private-public partnerships or portfolio diversification by global lenders.

Financial inclusion rather than size is a key factor in tackling income inequality…

Average of GINI index for income groups / regions and financial inclusion conditioned on GDP per capita



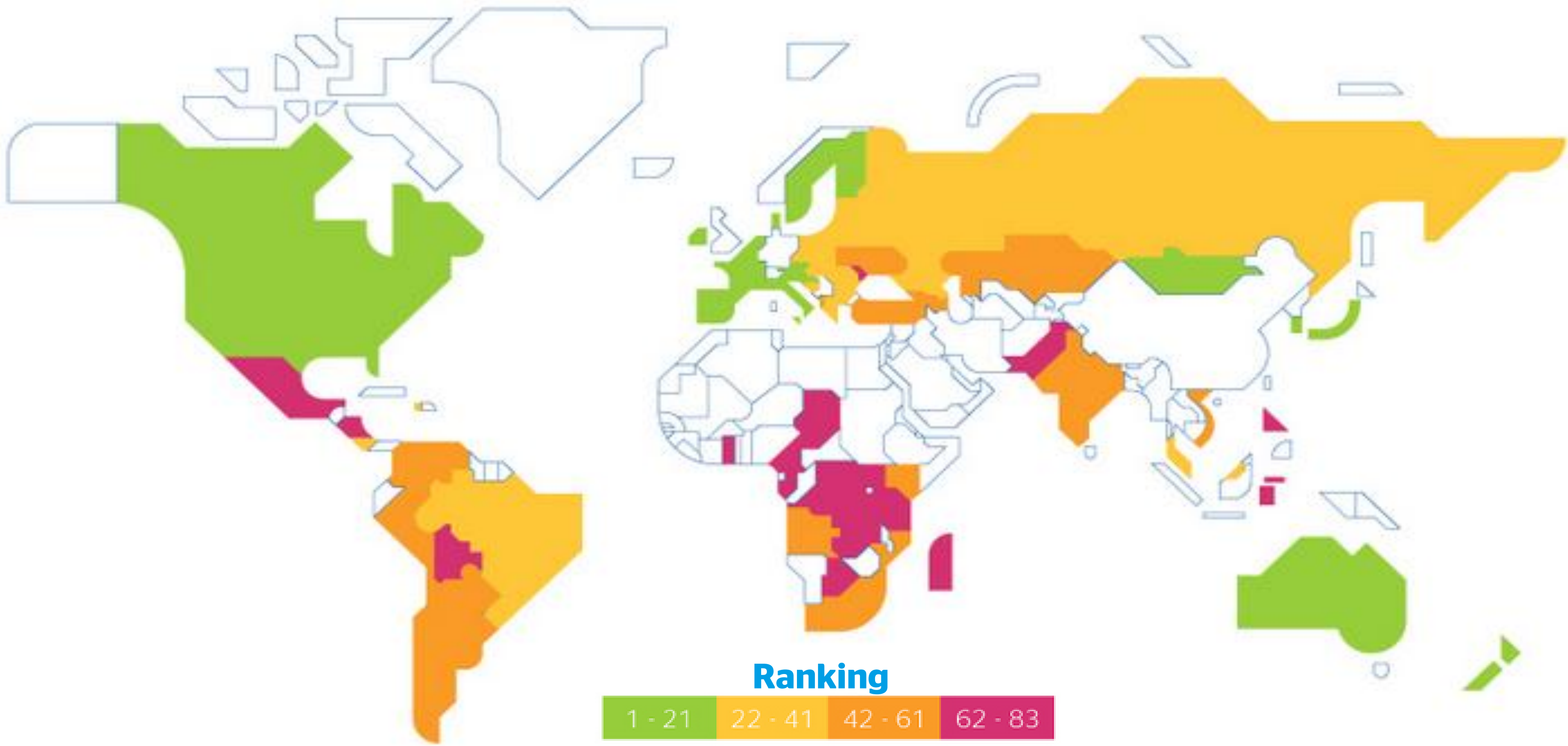
Source: BBVA Research

Financial inclusion contributes significantly to more equal income distribution, having a larger incidence in **low and medium-income countries**, particularly in **Emerging Asia and Africa**.

Note: Values above average correspond to residuals of regressions on GDP per capita (level and square values) that are one standard deviation above mean (0).
See García-Herrero A., Martínez Turégano D., 2015, "Financial inclusion, rather than size, is the key to tackling income inequality"

…and there is still plenty of room for improvement in emerging markets

BBVA Research Multidimensional Financial Inclusion Index



Countries ordered by the degree of financial inclusion.
Source: BBVA Researcha

Note: the degree of financial inclusion is determined by three dimensions: usage, barriers and access. These dimensions are, at the same time, determined by several demand-side individual level indicators for the cases of usage and barrier, and supply-side country level indicators for access. Weights assigned to the dimensions are determined endogenously. See Cámara N., Tuesta D., 2014. "Measuring Financial Inclusion: A Multidimensional Index", BBVA Research.


Balance of Risks

Geopolitics will dominate Eurasia and Middle East, but more hot spots need to be monitored

BBVA World Conflict Heatmap (from 2H 2014 to Mar 2015)
(Number of conflicts / Total events)

Source: www.gdelt.org & BBVA Research

Ukraine-Russia

A new ceasefire agreement was reached, but is still very fragile

Instability in Middle East

Fighting continues in Syria and Iraq and is now spreading to North Africa. Yemen conflict escalates

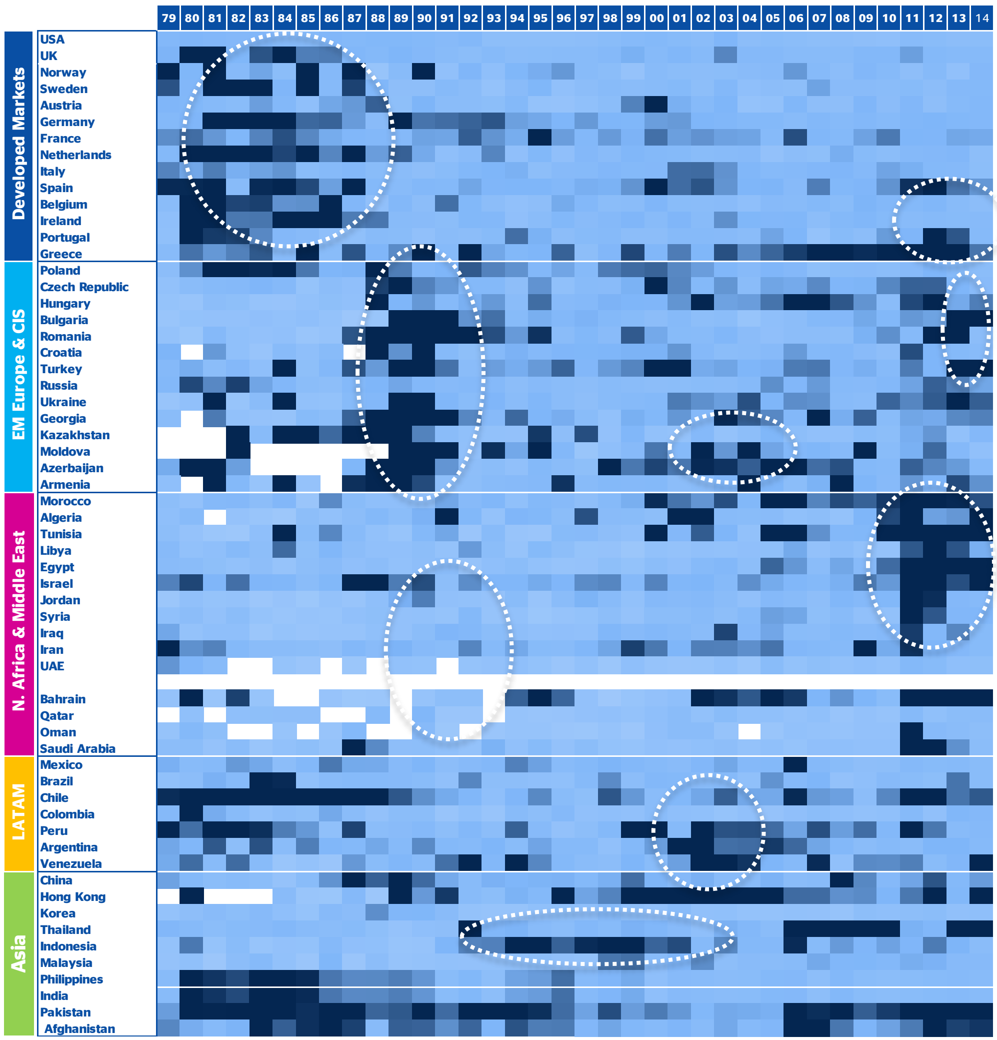
Some pressure in Asia

The risk of Social unrest in Hong Kong and territorial disputes in South East Asia Sea

The Global Awakening has spiked after years of calm

World Protest Intensity Map 1979- Mar 2015

(Number of protests / Total events. Dark Blue: high intensity)



Source: www.gdelt.org & BBVA Research

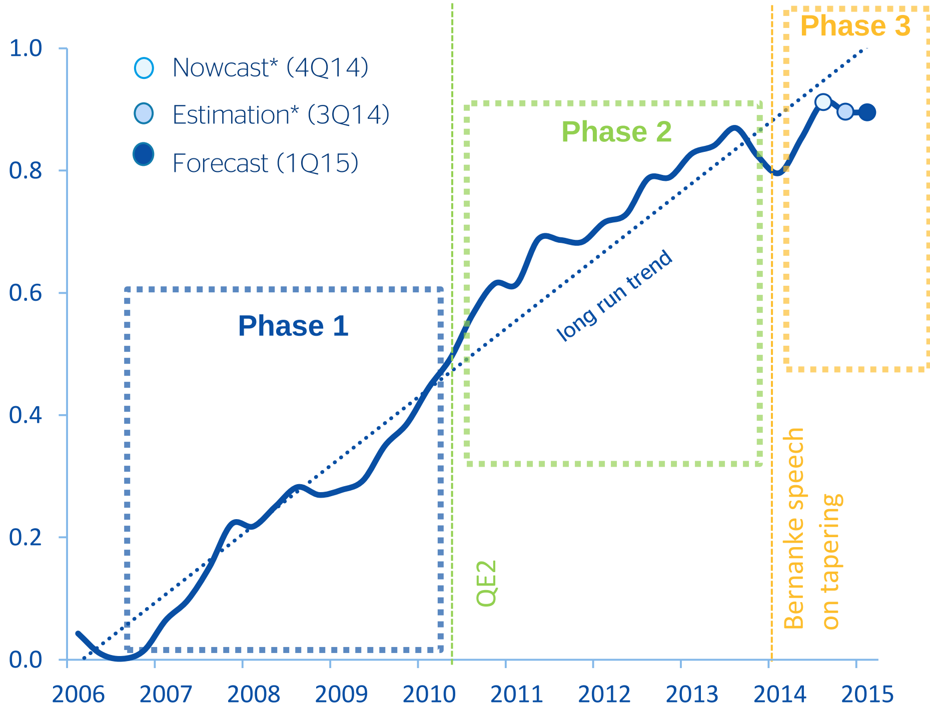
There was some revival of instability on the EU but less intensive than during the early 80´s and it's softening now…

EM Europe and CIS countries are facing increasing social unrest…

The Arab Spring spread protests across the Middle East region. Some countries remain under tensions…

Portfolio flows to EM adjust as policy normalisation in the West is becoming closer…

Update* of cumulated flows to Emerging Markets
(Official balance of payments data, in USD trn)



(*) Estimation s using BBVA's DFM/FAVAR Model
Source: BBVA Research. Update 27 Feb. 2015

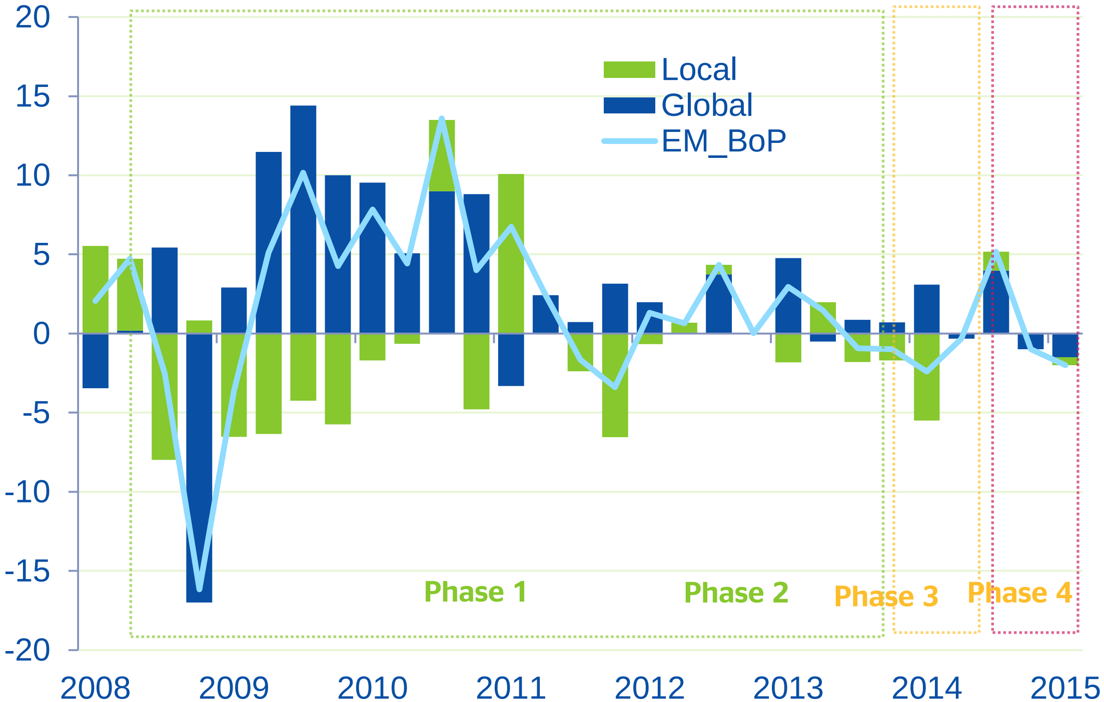
The monetary policy reactions in developed economies after the financial distress and favorable conditions in terms of economic growth and lower risk premia triggered **supporting global push and pull factors for flow dynamics across Ems**, leading to strong and sustained flows into them (**phase 2**).

However, the announcement of the normalisation of monetary stimuli, the recovery of Developed economies and lower appeal of Ems is triggering a **portfolio rebalancing in favor of DM**. (**phase 3**).

…but still global factors dominate the correction of flows so far. However, some local strains have emerged

Emerging Markets flows

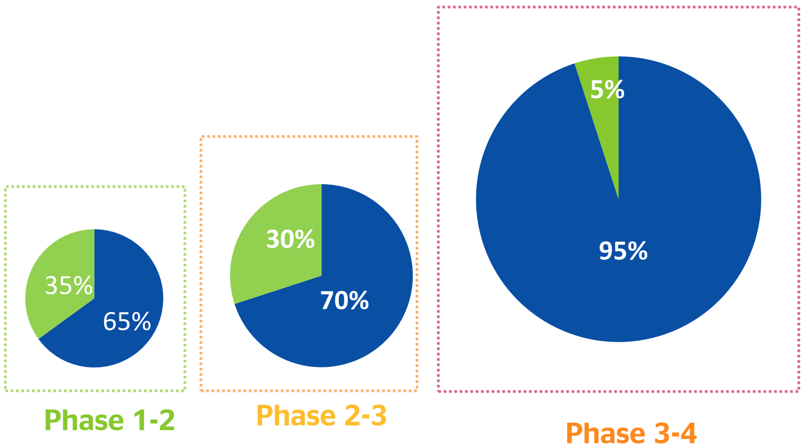
(Median Emerging Market portfolio flow breakdown as per BoP, monthly change in %)



Source: IMF, IFS Data , BBVA Research

Emerging Markets flows' drivers

(Median Emerging Market portfolio flow decomposition, in % change MoM)

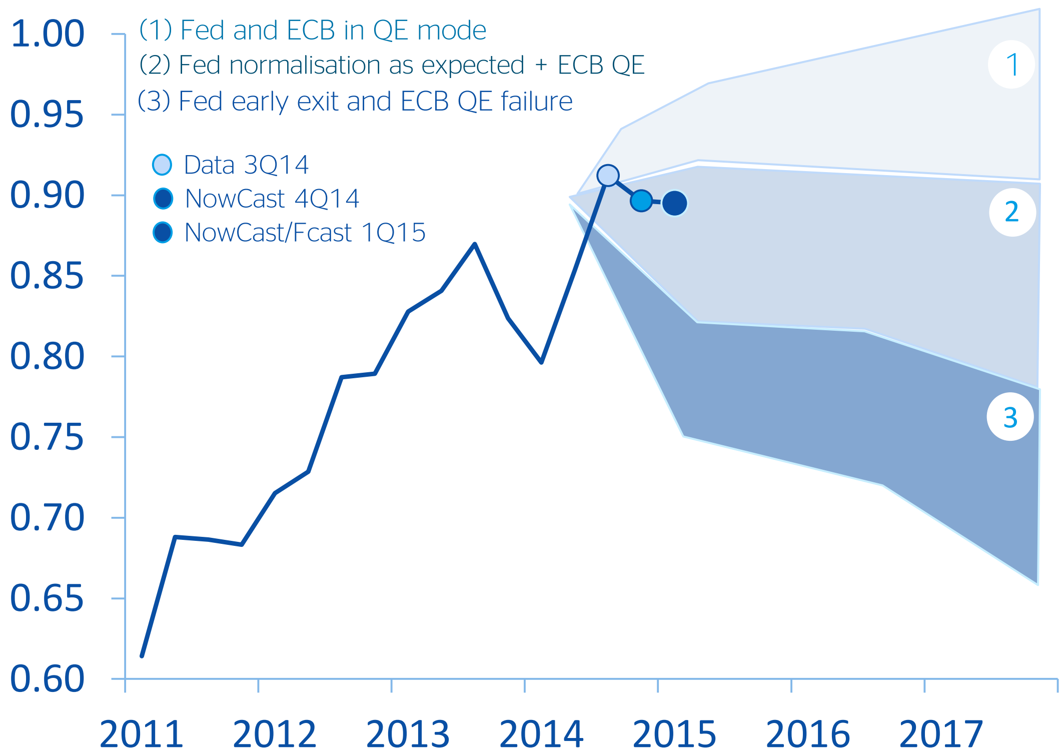


Source: IMF, IFS Data , BBVA Research

Global Factors dominated the reallocation at the end of 2014 and the beginning of the first quarter of 2015. However, high frequency data reveal that idiosyncratic elements are also emerging.

The Fed will dominate and the ECB's push will only partially compensate

Monetary policy in the north and flows in the south (alternative QE, Fed and ECB scenarios)
Cumulative response of portfolio flows in USD bn, forecast made at end 2Q14)



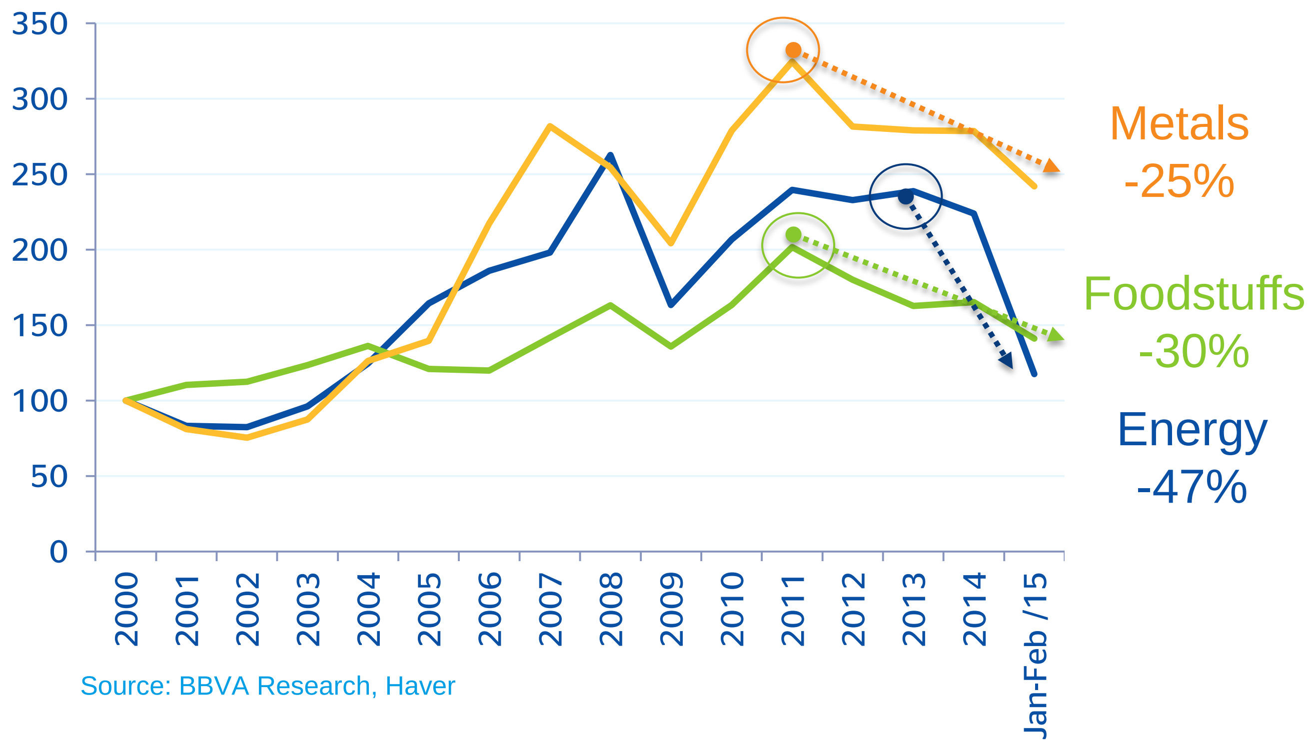
Source: IMF, BBVA Research

EM Flows will continue to be challenged by Monetary Policy normalisation by key Central Banks…

… **but part of the adjustment have already been materialised**

Beyond flows adjustments, commodity exporters will have to adapt to lower prices…

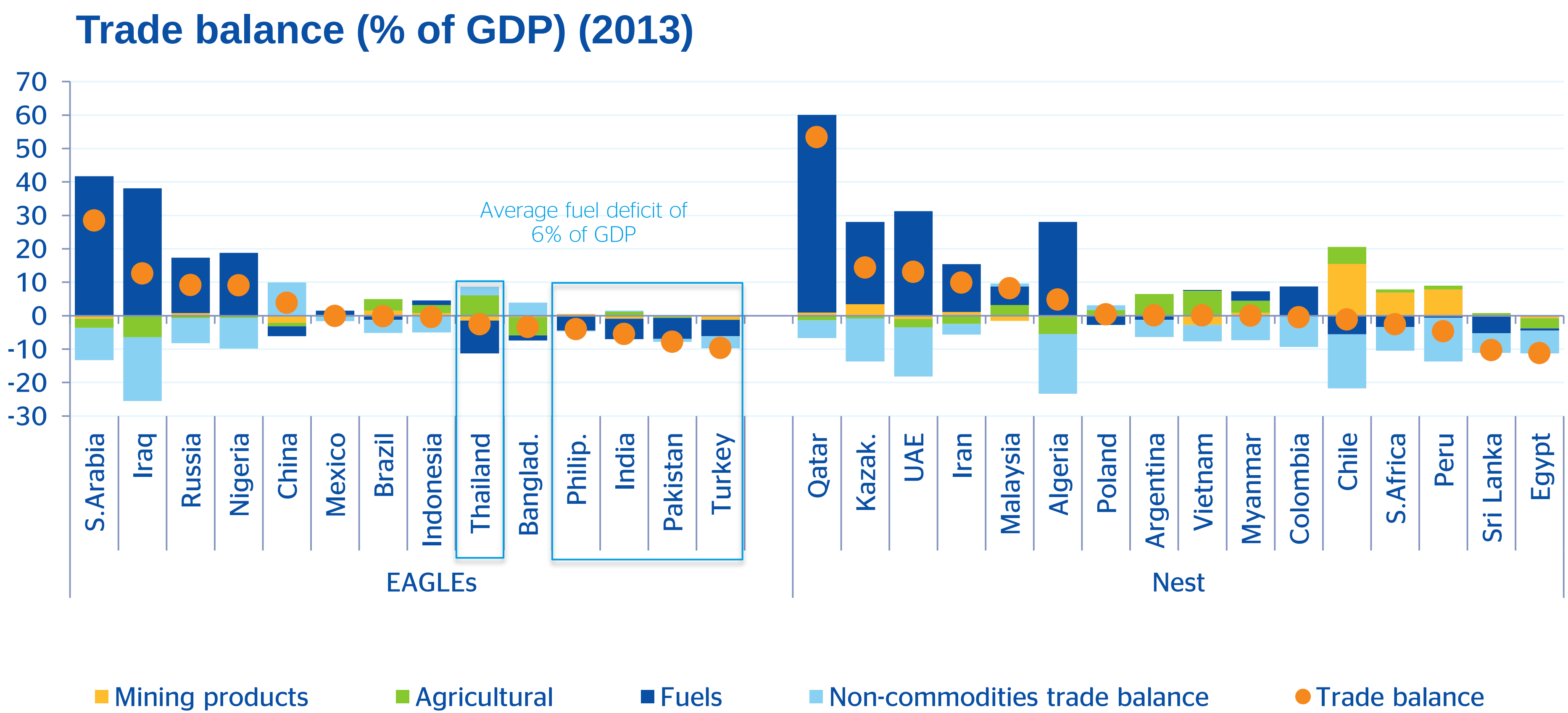
Commodity prices in 2000 USD
(index 100 = 2000)



Source: BBVA Research, Haver

Commodity prices, especially the oil price, have experienced a declining trend since 2011, introducing important challenges and potential risks for exporting countries.

Emerging Markets asymmetry in oil dependence…



Source: BBVA Research, WTO, IMF

Oil-producing countries suffer the sharp drop of oil prices, but some other **emerging countries from Asia, such as India and Phillippines, and also Turkey benefit from cheaper energy.**

…explains the different sentiment to the sharp fall in oil prices across countries

The world sentiment to the drop in oil prices

Source: BBVA Research and www.gdelt.org

See "Very low energy prices and geopolitical risks", BBVA Research.

Main takeaways

- The contribution of the Emerging World to global growth is bound to be even bigger than we had initially projected, due to recent updates in purchasing power parity estimates across the globe. In fact, in 2024 they will have an almost two-thirds share of the global economy.
- There are now more countries included in our EAGLEs list. The new additions come mainly from Asia and the Middle East.
- The creation of a new middle class is well underway and this will continue to push consumption.
- A flourishing middle class in emerging markets, fiscal redistribution, equality of opportunities and financial inclusion will all be instrumental in reducing income inequality.
- Geopolitical risk in Emerging Markets has become one of the main risks of 2015. The single-polar word is changing towards more multipolar geopolitics. Instability’s spots appear in several geographies at the same time.


Annex

Methodological issues: BBVA EAGLEs and Nest membership definition

The **reference variable** in our calculations is the **incremental GDP**, i.e. the increase of real GDP in PPP-adjusted terms during the following ten years. To compute it, we add growth forecasts to the estimate of PPP-adjusted for the starting year provided by the IMF. Our approach is therefore a mixture of size and growth.

We update growth forecasts for the following ten years on an annual basis. We use BBVA Research projections for those countries that we cover in depth, and IMF projections in the latest World Economic Outlook (and updates) for the remainder. In the latter case, we extend the available forecast horizon by assuming as constant the growth rate available for the last year.

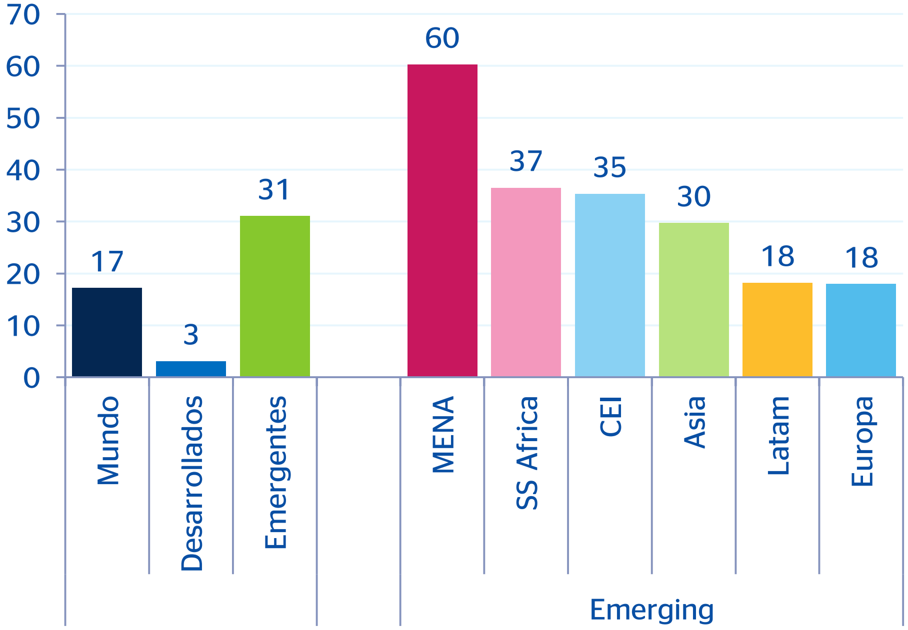
After updating the growth forecasts we compute the incremental GDP for all countries in the world and then rank them from largest GDP to smallest, defining membership of BBVA EAGLEs and Nest as follows:

- The **BBVA EAGLEs** are defined as those emerging economies contributing to world growth more than the average of the G6 countries in the next ten years.

- The **BBVA Nest** is formed of those emerging economies contributing to world growth more than the average of the non-G7 developed economies, which have a PPP-adjusted GDP of over USD100bn but below the EAGLEs threshold.

Methodological issues: new PPP valuations

Valuation of 2013 GDP in PPP-adjusted terms (% change between previous and new estimates)



Source: BBVA Research, IMF

The IMF updated its WEO database at the end of 2014, including a new set of Purchasing Power Parities (PPPs) computed in the 2011 round by the International Comparison Program (ICP), which imply significant revisions to those computed in 2005*.

In particular, among emerging economies the **PPP-adjusted GDP levels have increased substantially for African and Asian countries** and to a lesser extent in Latin America and Europe, while the figures have remained almost unchanged in developed economies.

* A thorough analysis on methodology changes between the 2005 and 2011 rounds is available at Deaton, A., and Aten, B., 2014, "Trying to understand the PPPs in ICP 2011: why are the results so different?"

Methodological issues: population projections

We use PPP-adjusted real GDP per capita measured in 2010 dollars. GDP values and projections correspond to the October 2014 edition of the IMF/WEO database, while population estimates and forecasts are from the 2012 revision of the UN World Population Prospects. Regarding income distributions, our starting point is the information available in the WDI/World Bank, which includes the two top and bottom deciles and all quintiles. As data are not continuous we interpolate missing data. Projections until 2025 keep distributions constant from the latest observation.

We group population according to the following five income ranges: 1/ poor and low-income (up to USD5,000), 2/ low middle class (USD5,000-15,000), 3/ medium middle class (USD15,000-25,000), 4/ high middle class (USD25,000-40,000), and 5/ affluent (over USD40,000).

The number of countries included has been extended to 90 and the current coverage accounts for over 90% of the world population:

- **Developed economies**: United States, Japan, Germany, France, United, Kingdom, Italy, Korea, Spain, Canada, Australia, Netherlands, Belgium, Greece, Czech Republic, Portugal, Sweden, Austria, Denmark, Finland, Slovak Republic, Ireland, Slovenia, Estonia and Luxembourg.
- **Emerging economies**: China, India, Indonesia, Brazil, Pakistan, Nigeria, Bangladesh, Russia, Mexico, Philippines, Ethiopia, Vietnam, Egypt, Iran, Turkey, DR Congo, Thailand, South Africa, Tanzania, Colombia, Kenya, Ukraine, Argentina, Algeria, Uganda, Poland, Iraq, Sudan, Morocco, Afghanistan, Venezuela, Peru, Malaysia, Uzbekistan, Nepal, Mozambique, Ghana, Yemen, Angola, Madagascar, Cameroon, Syria, Sri Lanka, Romania, Côte d'Ivoire, Niger, Chile, Burkina Faso, Malawi, Paraguay, Mali, Kazakhstan, Guatemala, Ecuador, Cambodia, Zambia, Zimbabwe, Senegal, Hungary, Bulgaria, Croatia, Panama, Qatar, Uruguay, Lithuania and Latvia.

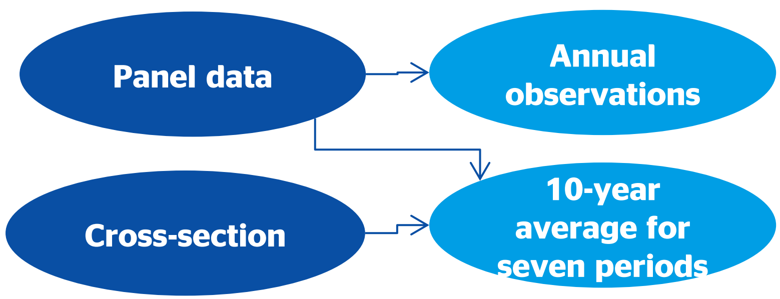
Methodological issues: determinants of inequality

To measure inequality, we use the UNU WIDER World Income Inequality Database that provides more than 7,000 observations. Why we focus on it?

UNU-WIDER World Income Inequality Database (WIID)

- **Data availability with a fair geographical and time balance**
- **High ratio of observations adjusted by household composition**
- **Much better data quality**
- **Better approach to inequality among income measures**

Period of analysis:



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