

The Global Economy and China: Some key challenges Ahead

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Key risks ahead

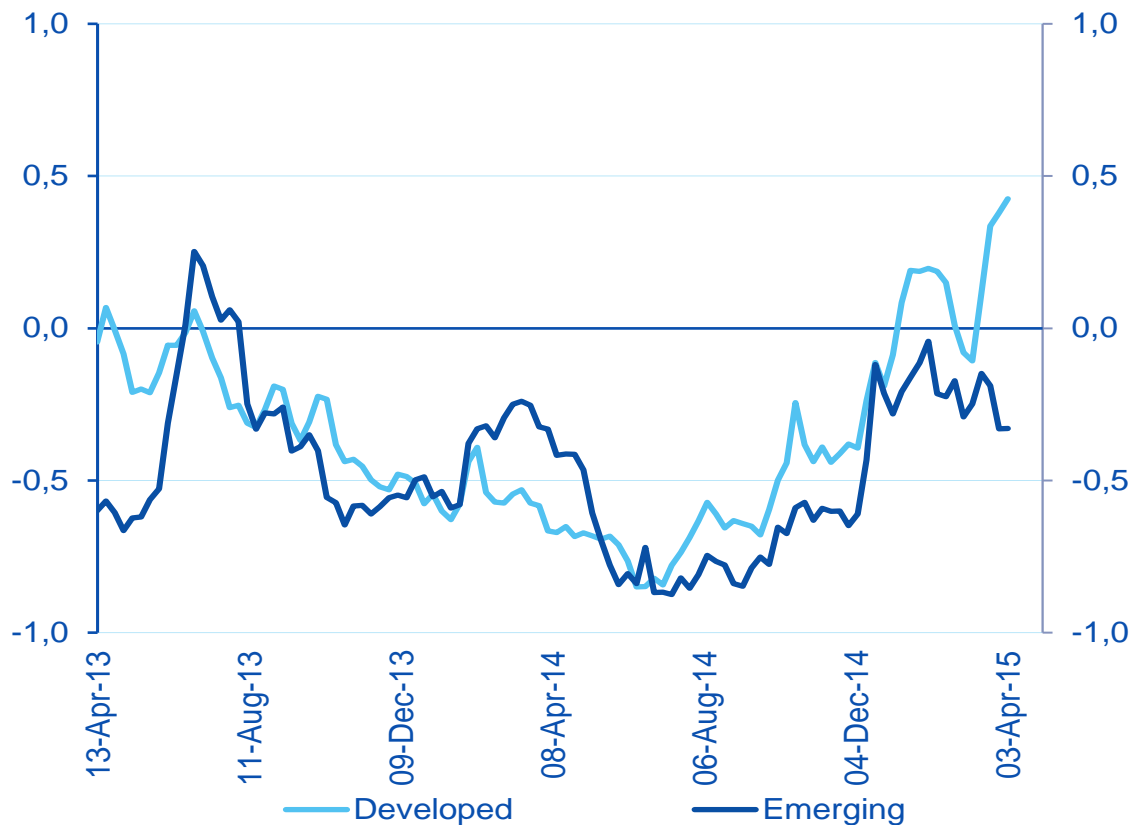
- 1. Geographically, Europe again at the forefront with Greece.**
 - However more to come from commodity exporters
- 2. Investors very complacent with EMEs. Will it last?**
- 3. Inflation dangerously low**
- 4. Activist central banks and increasingly dovish.**
 - FED normalization to change the picture
- 5. If the world is still leveraging, what will happen when we deleverage?**
- 6. Geopolitical risk always more relevant and more systemic**
- 7. China: swamped with debt too early in the development path**

**1. Europe again at the forefront with Greece.
However more to come from commodity exporters**

Increasing financial tensions in developed economies, driven by Greece

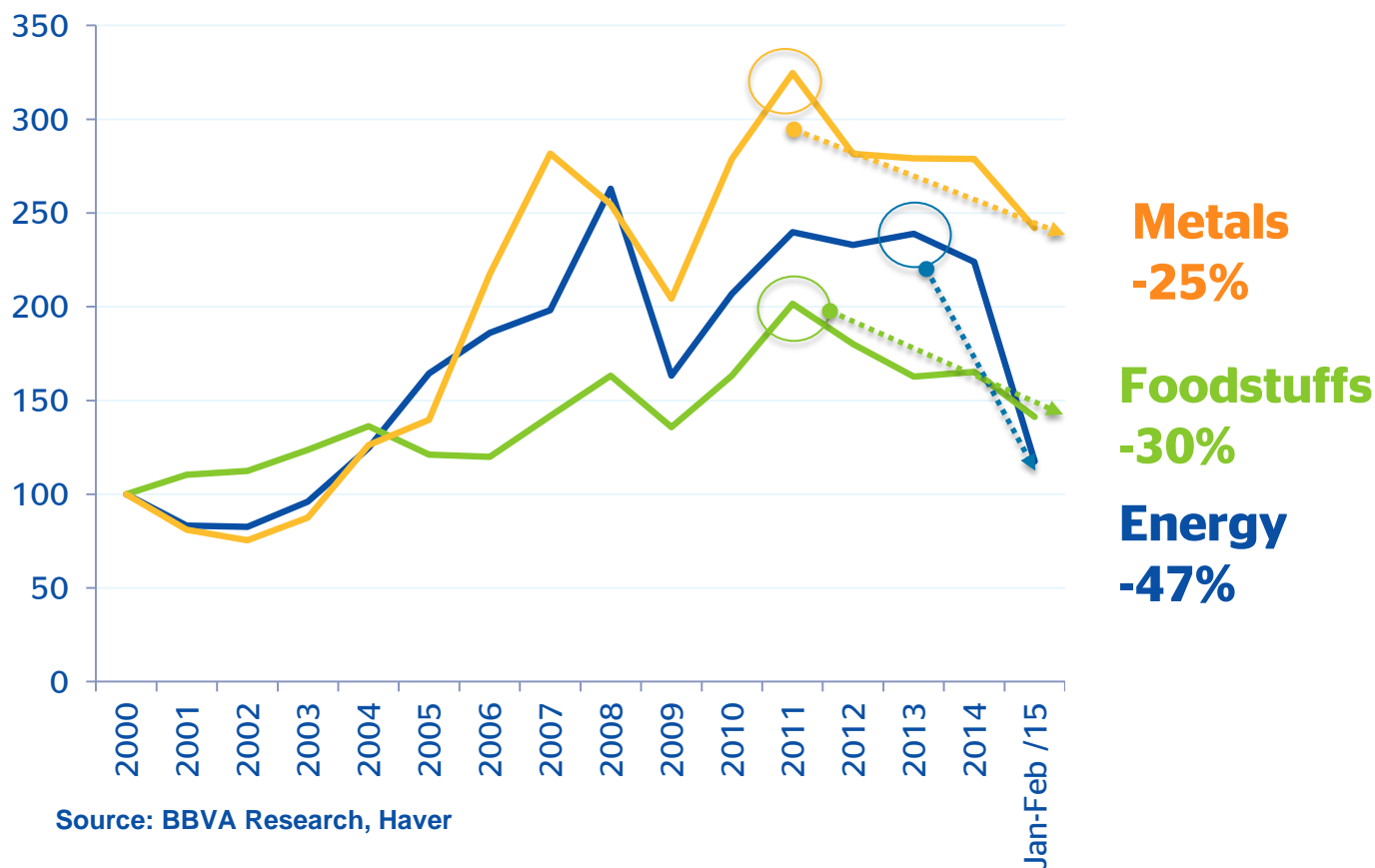
Financial Tensions, BBVA Research Index

Source: BBVA Research



Commodity exporters to adapt to lower prices and some do not have room (high current account deficits)

Commodity prices in 2000 USD (index 100 = 2000)

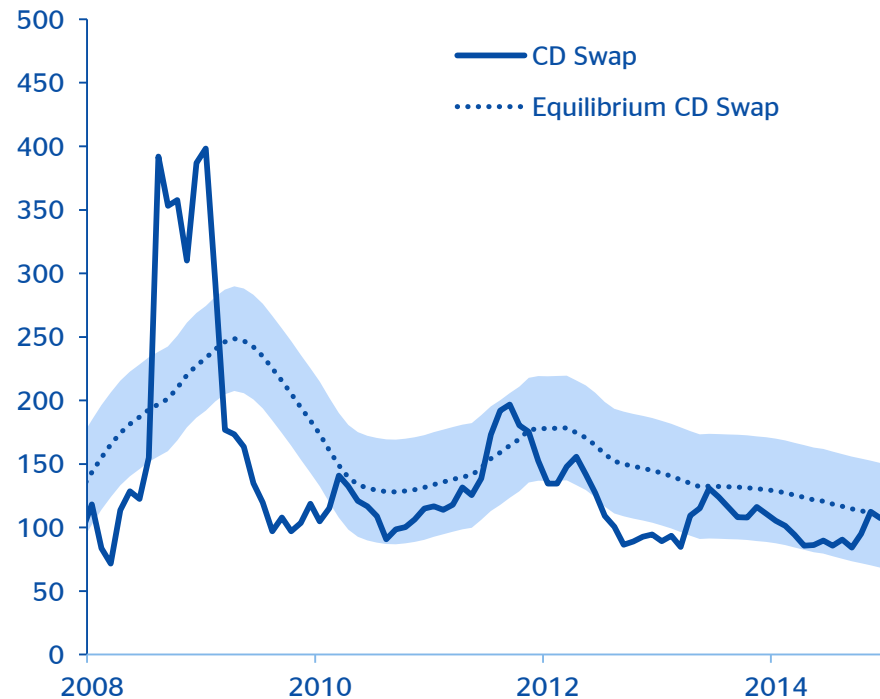


2. Investors very complacent with EMEs. Will it last?

Asia is not the biggest problem: Risk premia close to fair values

Emerging Asia: CDS and equilibrium risk premium

(Source: BBVA Research, Equilibrium: average of four alternative models
+ 0.5 standard deviation)

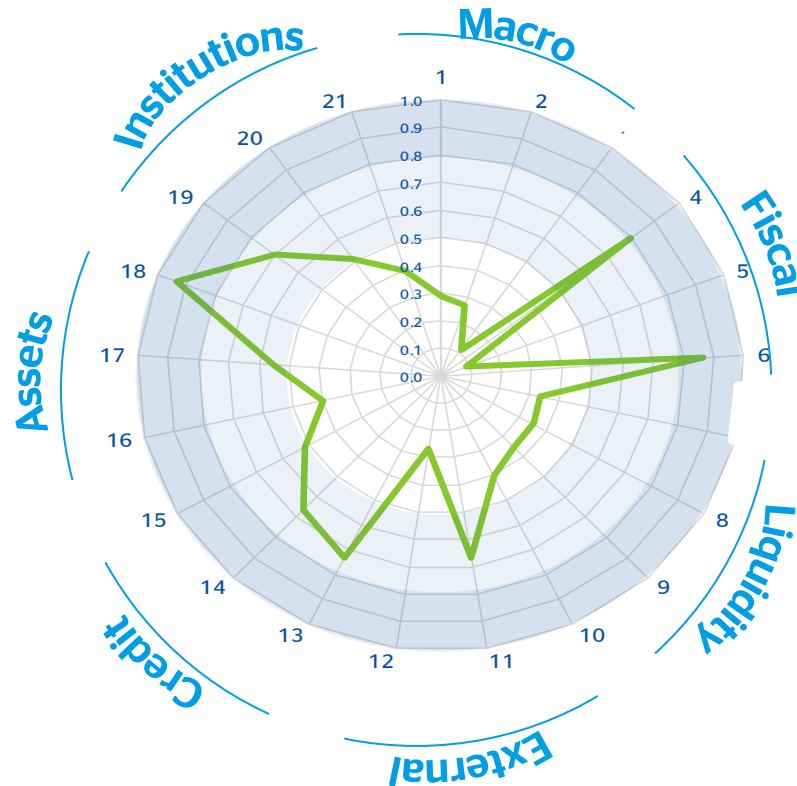


Still, asset price boom and fiscal two key vulnerabilities for Asia

Emerging Asia: vulnerability radar 2015

(Relative position for the emerging developed countries. Max risk=1, Min risk=0)

Source: BBVA Research



Fast growth in equity markets should be monitored. Public balances and public debt levels have increased fiscal vulnerability

- High risk
- Risk to monitor
- Safe

Macro: (1) GDP (%YoY) (2) Prices (% YoY) (3) Unemployment (% LF)

Fiscal: (4) Structural balance (%) (5) Interest rate - GDP % YoY (6) Public debt (% GDP)

Liquidity: (7) Debt by non-residents (% total) (8) Financial needs (% GDP) (9) Financial pressure (% GDP)

External: (10) External debt (%GDP) (11) RER appreciation (%YoY) (12) CAC balance (% GDP)

Credit: (13) Household (% YoY) (14) Corporate (% YoY) (15) Credit-to-deposit (%)

Assets: (16) Private credit to GDP (% YoY) (17) Housing prices (% YoY) (18) Equity (%)

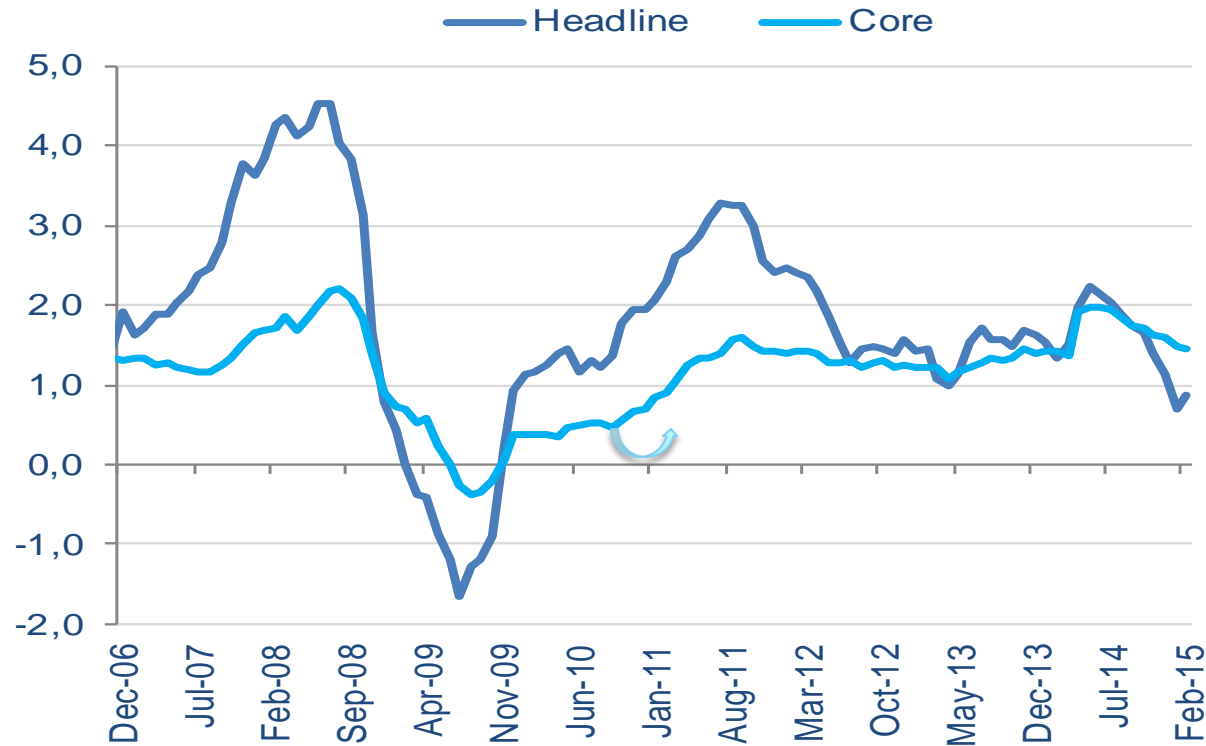
Institutional: (19) Political stability (20) Corruption (21) Rule of law

3. Inflation dangerously low, even in China

Inflation in the developed world too close to zero... Also very low in EMEs

World Inflation (%) *

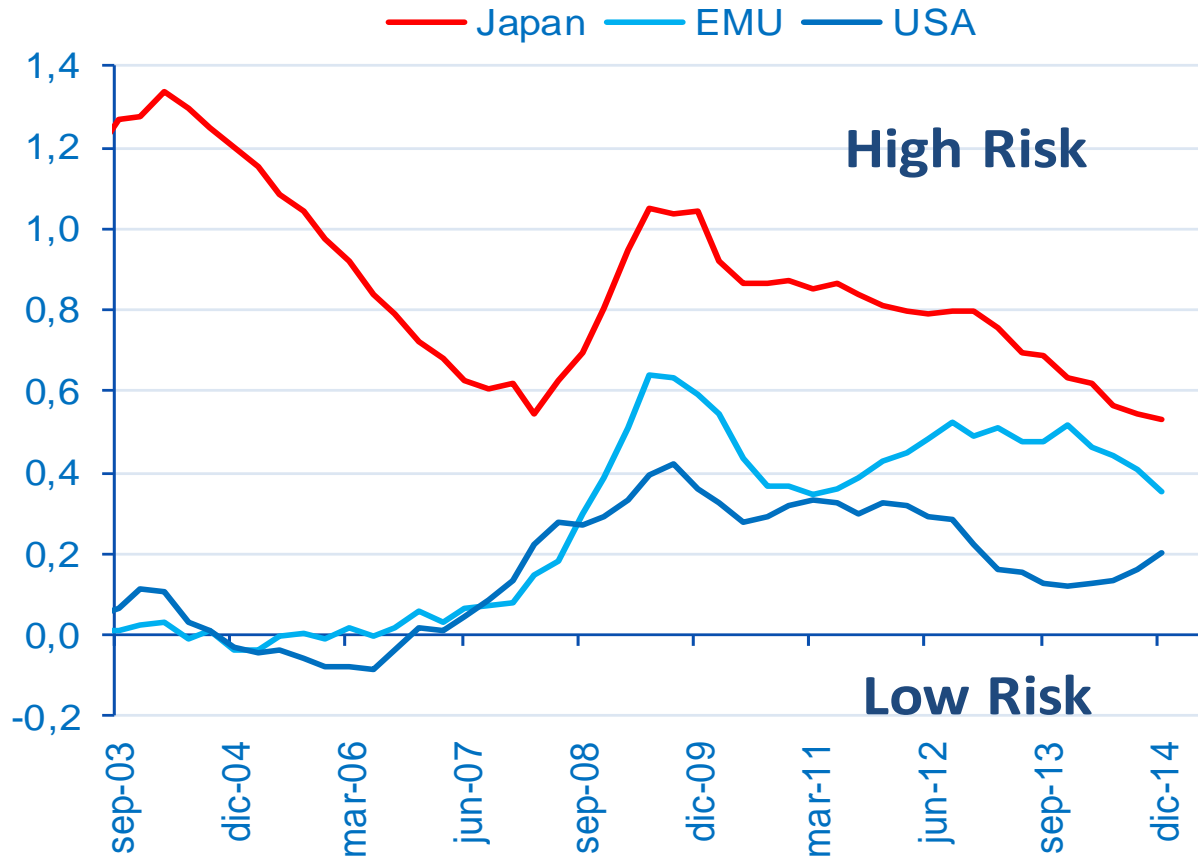
Source: BBVA Research based on Haver



* It is calculated as simple average of inflation in US, Eurozone, Japan and China

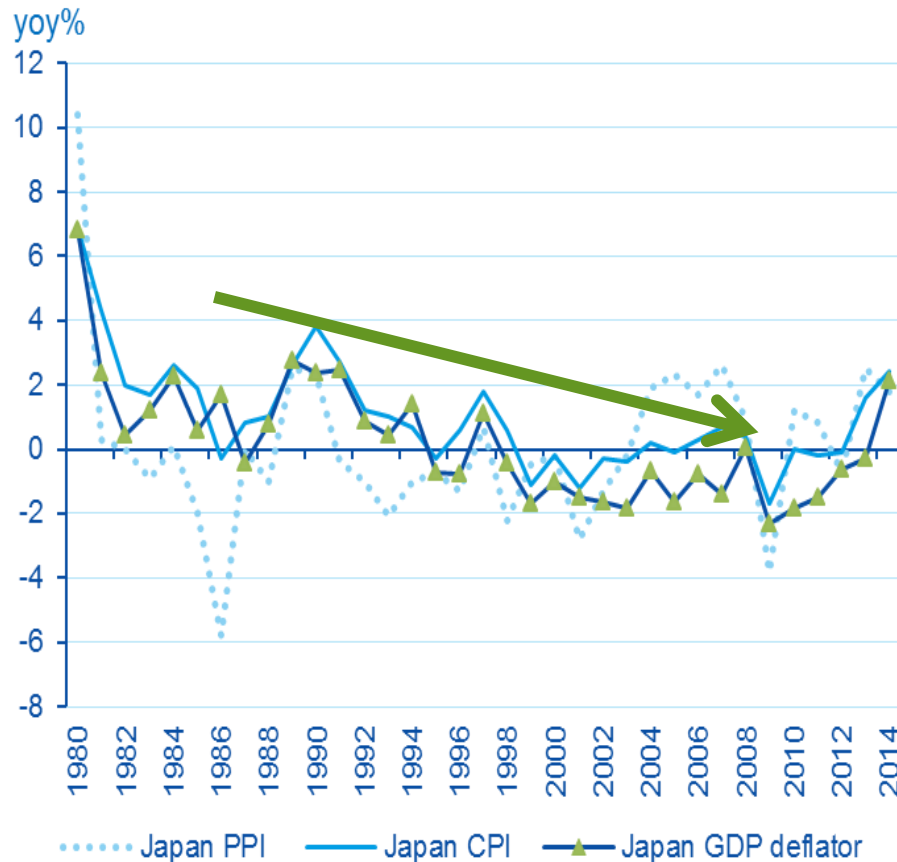
US and EU vulnerability to deflation too close to Japan

Vulnerability to deflation *
BBVA Research Debt-Deflation Tension Indicator
 Source: BBVA Research

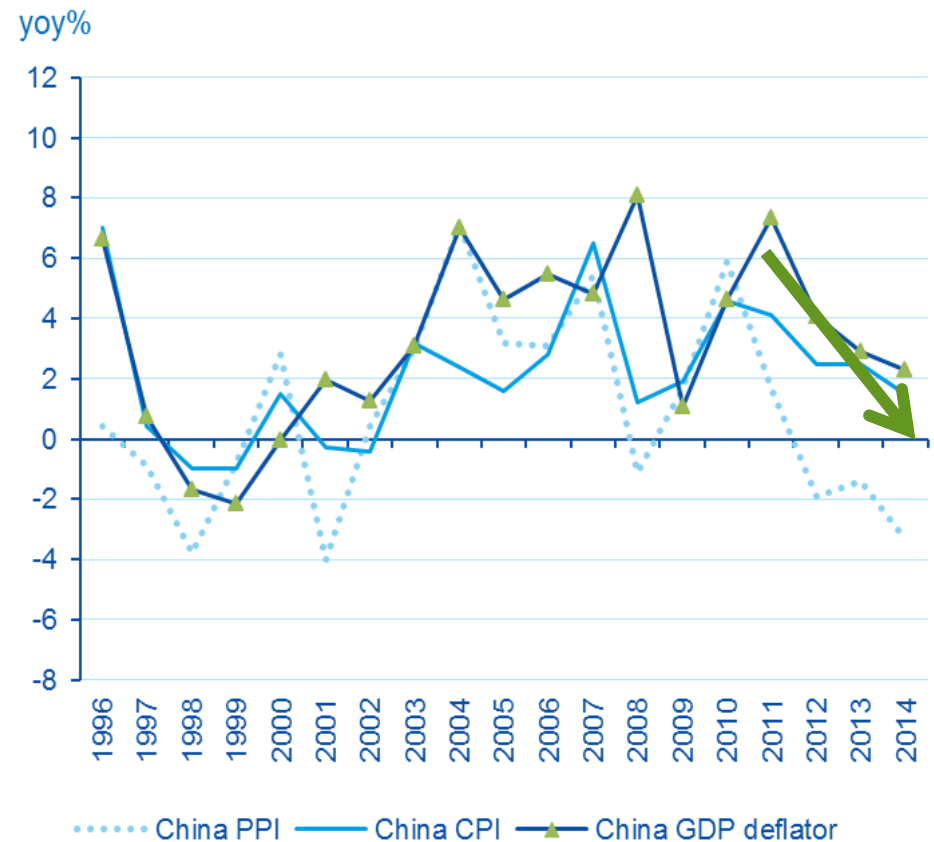


* The highest level of the indicator in Japan during the deflation period was 1.4%

China's desinflating too rapidly Japan's woes come to mind



Source: Bloomberg and BBVA Research



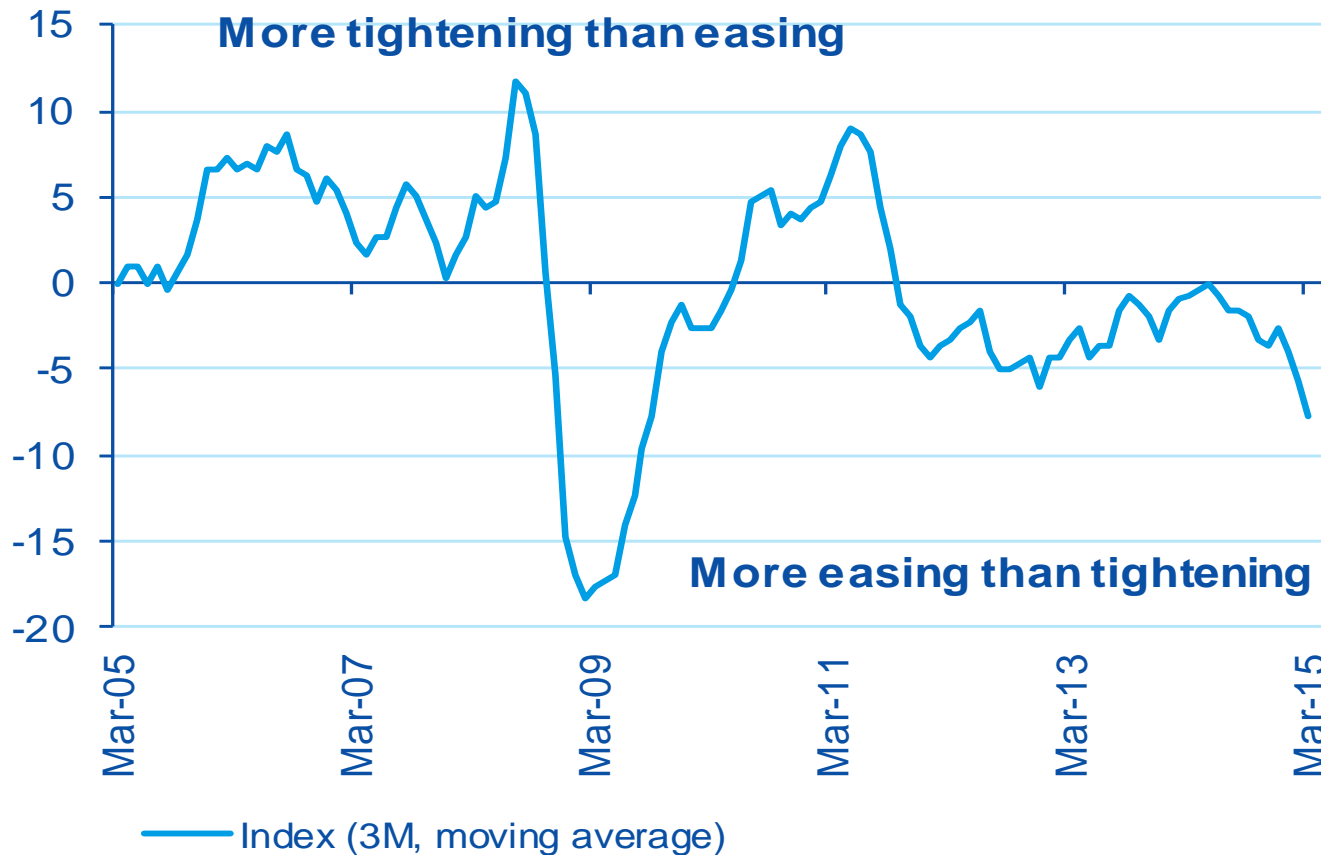
Source: Bloomberg and BBVA Research

4. Activist central banks and increasingly dovish. FED normalization to change the picture

Heightened (dovish) activism across the board but Fed's tightening looming

Index of monetary policy decisions *

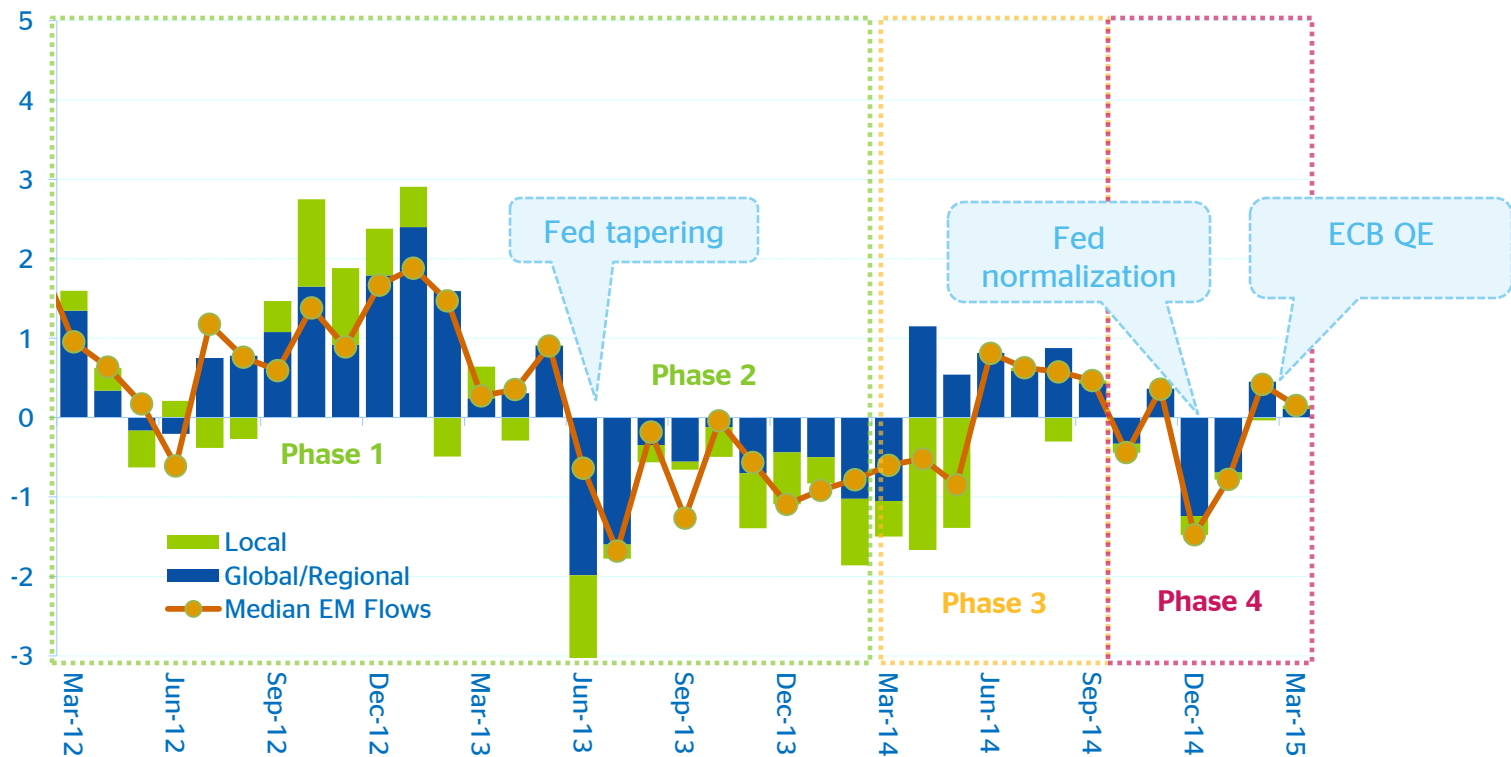
Source: BBVA Research based on Haver



*Number of rate hikes minus number of rate cuts by 35 central banks covered

So far, EM capital flows have survived the FED with some help from ECB

Emerging Markets Capital Flows (median Emerging Market Portfolio Flow Decomposition, monthly change in %)
 Source: BBVA Research & EPFR



**5. If the world is still leveraging,
what will happen when we deleverage?**

Global Debt: From Private to to Public

Global Debt: Public vs Private

(year 200= 100)

Source: McKinsey



¹ Includes household and non-financial corporate sector debt.

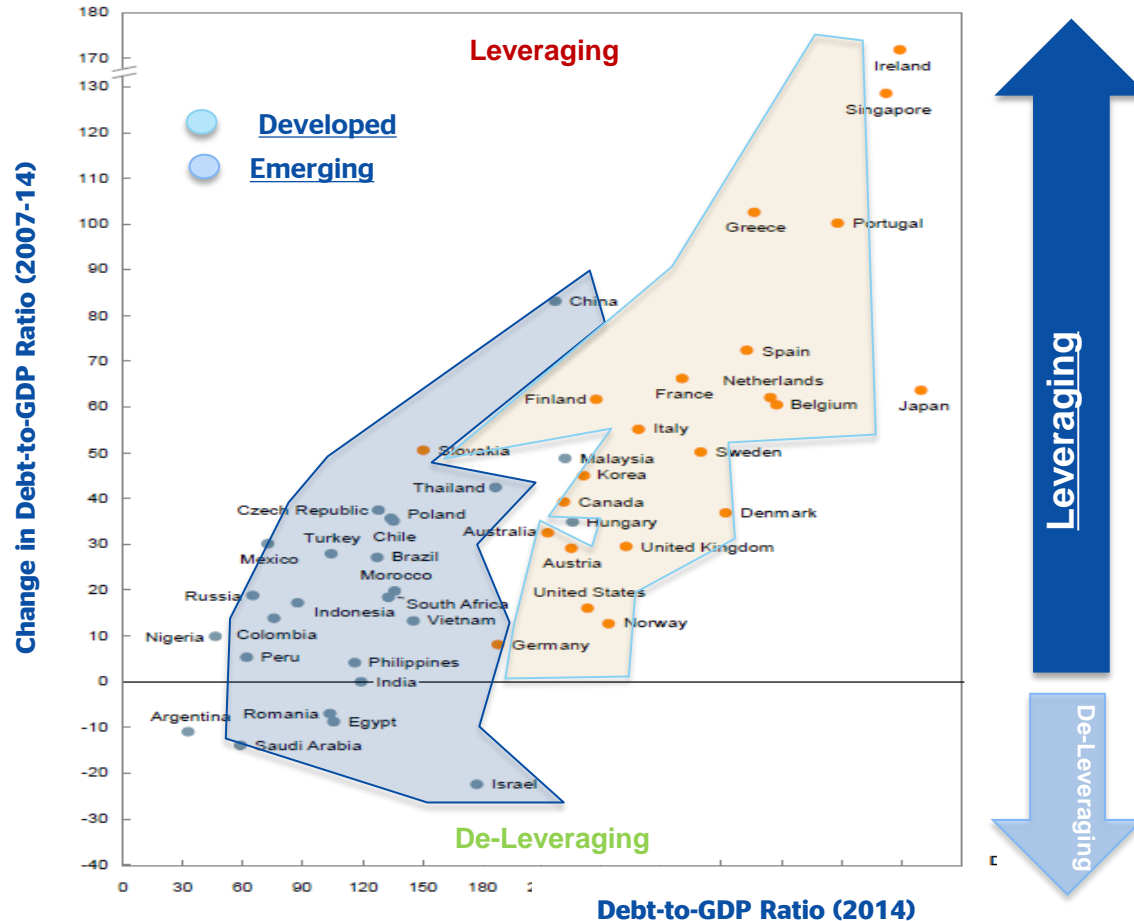
NOTE: Debt as percent of GDP is indexed to 100 in 2000; numbers here are not actual figures.

SOURCE: Haver Analytics; national central banks; McKinsey Global Institute analysis

China leveraging as much as Southern European countries after crisis!

Debt and (low) De-Leveraging

Source: McKinsey

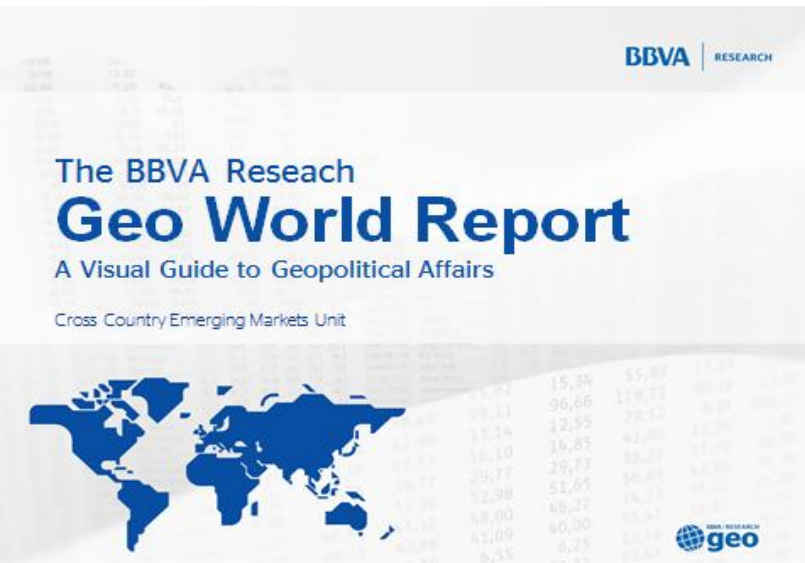


1 Debt owed by households, non-financial corporates, and governments.
2 2Q14 data for advanced economies and China; 4Q13 data for other developing economies.

SOURCE: Haver Analytics; national sources; McKinsey Global Institute analysis

6. Geopolitical risk more relevant and more systemic

At BBVA continuous track of geopolitical risk



<https://www.bbvarresearch.com/en/publicaciones/geo-world-report/>

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

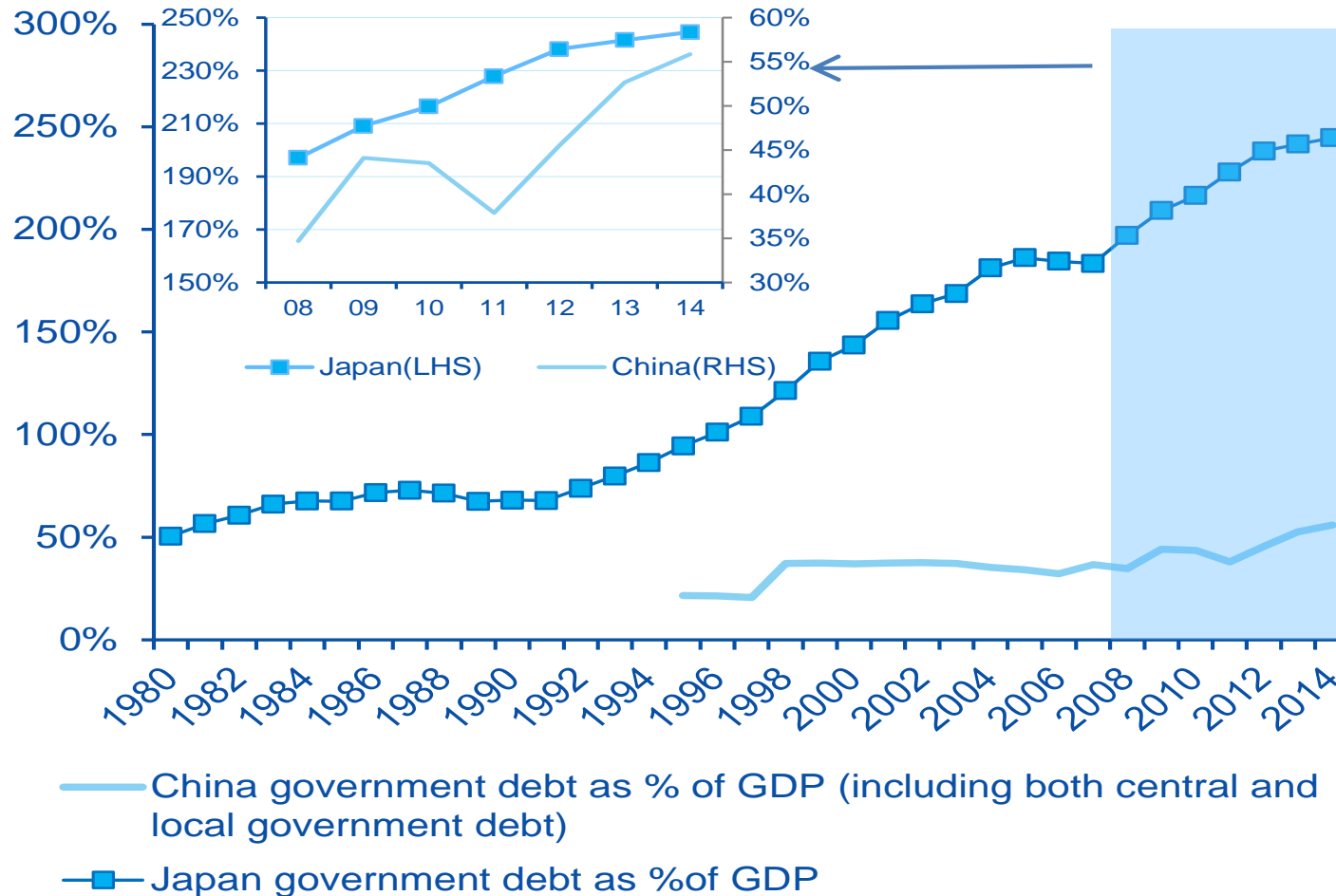


Source: www.gdelt.org & BBVA Research

<https://www.bbvarresearch.com/en/publicaciones/geo-world-conflict-social-unrest-march-update/>

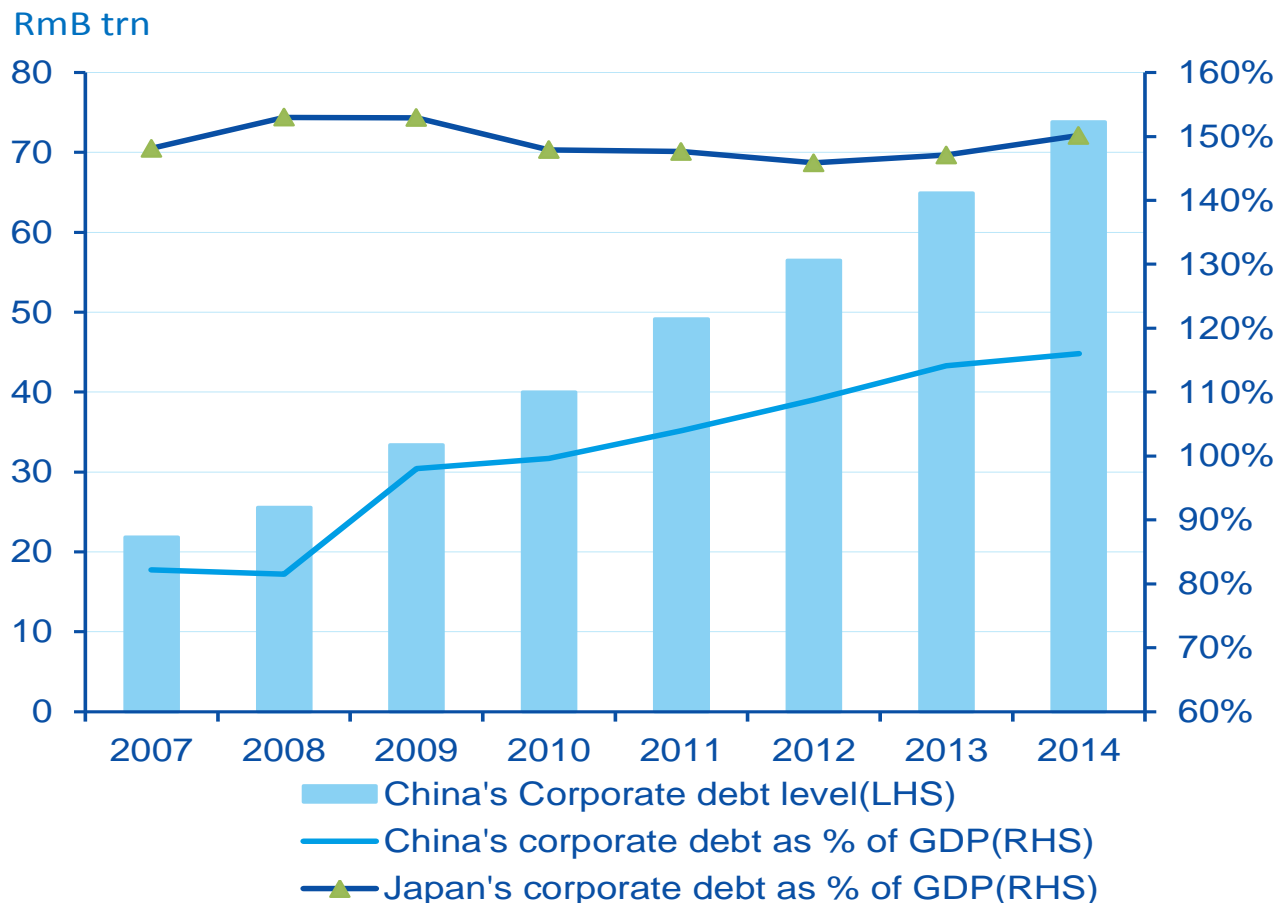
7. China: swamped with debt too early in the development path

Although still at much more moderate levels, public debt accumulating faster than in Japan



Source: CEIC, Haver and BBVA Research

Same is true for Chinese corporate debt which is now six times bigger than in 2007



My takeaways from a complicated risk landscape

- 1. Debt accumulation is still pervasive with a clear focus on China**
- 2. Very low inflation makes the debt burden even heavier**
- 3. Important to focus on the debt/desinflation dynamics including in Asia: China can be a key trigger point**