



BBVA

RESEARCH

Politics and the economic outlook

Global Economic Outlook – Third quarter 2011

Madrid, 3 August 2011

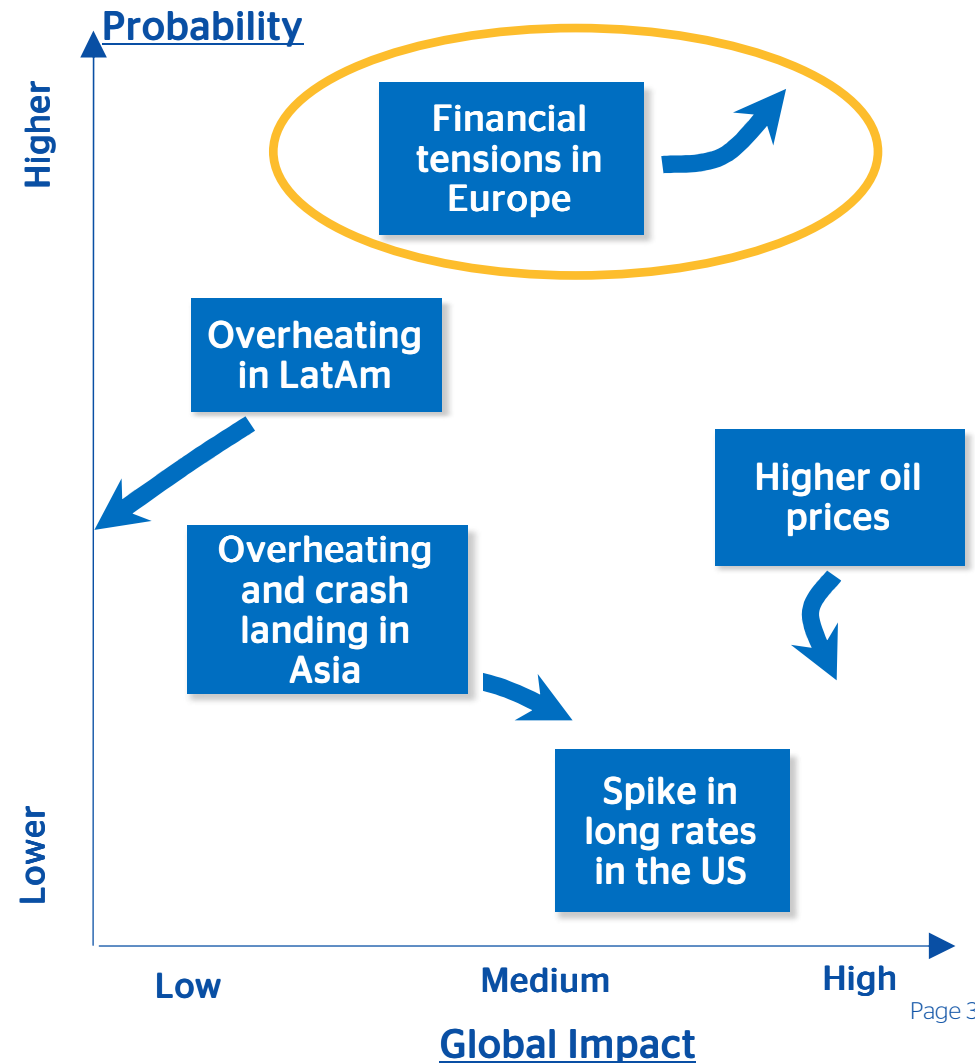
Main messages

- 1 Politics and economics:** the economic outlook is highly conditioned by the incentives to delay tough policy decisions to address fiscal concerns in Europe and the US. Political noise also adds to uncertainty in Latam and keeps pressure on oil prices.
- 2 European outlook:** July summit surprised positively on liquidity support, but does not address solvency concerns satisfactorily. Tensions will ease, but not by much until measures are implemented. Damage to growth has been done already in high spread economies.
- 3 US outlook:** soft patch in the first semester will prove temporary but risks to the downside have increased. Short-term fixes to avoid a technical default do not provide a long-term solution to fiscal deficits and increasing debt.
- 4 Emerging Economies:** overheating concerns remain, but have eased after continued policy tightening and some headwinds to growth, especially in Asia.

The European debt crisis represents the main risk to the global outlook

Change in growth forecasts from April 2011

	2011	2012
US	↓	≈
Europe	↑	≈
Spain	≈	↓
Mexico	↓	≈
Latam-5	↑	↑
Emerging Asia	≈	≈
World	↓	≈





Outline

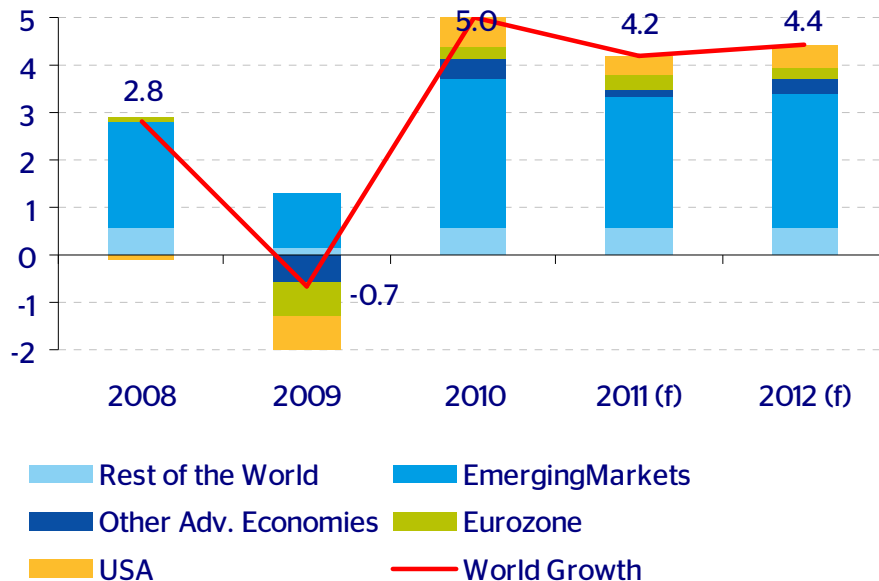
- 1 Global growth and emerging economies**
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Global growth will continue to be supported by emerging economies.

The global economy slowed down in the first half of 2011. As long as this is due to temporary factors (oil prices, supply chains disrupted by the Japan earthquake) global growth will continue to be strong, supported by emerging economies.

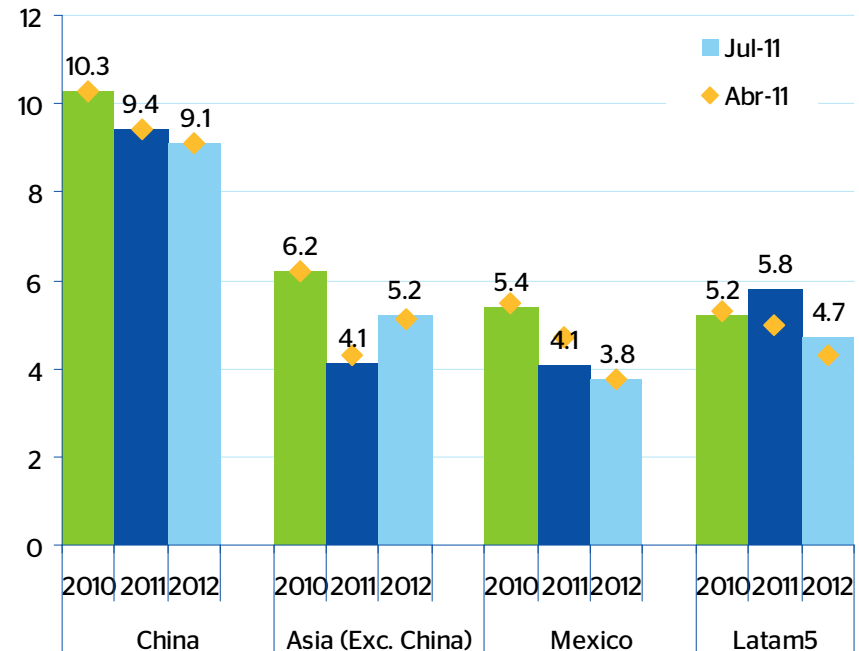
Contributions to global growth (%)

Source: BBVA Research



Growth in Asia and Latam (%/a)

Source: BBVA Research



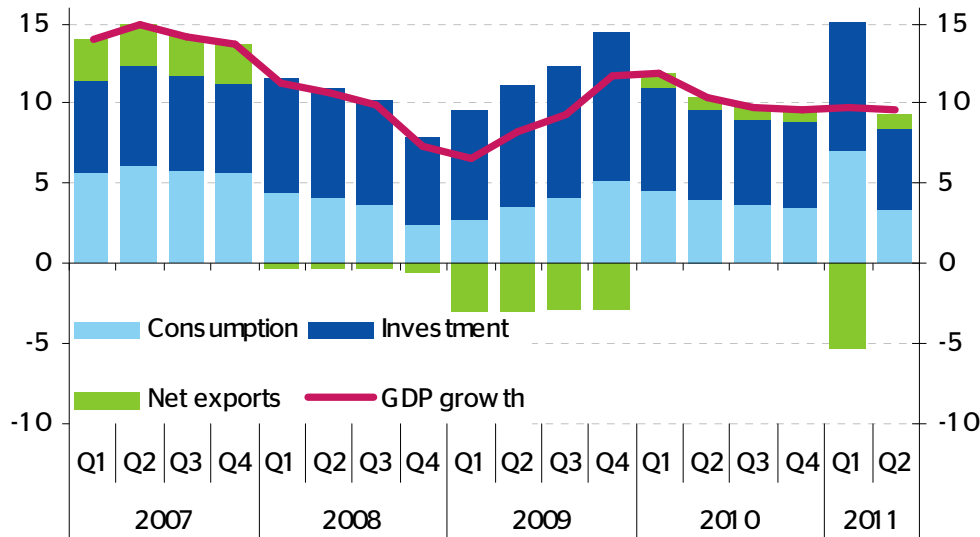
China: tightening policies lead to a soft landing

In China, growth is slowing gradually due to tightening policies. Second quarter growth confirms China is still going for a soft landing, despite headwinds from oil prices and disrupted supply chains.

The increase in house prices moderated in the last two years. According to our estimates, house prices are only slightly overvalued (7%).

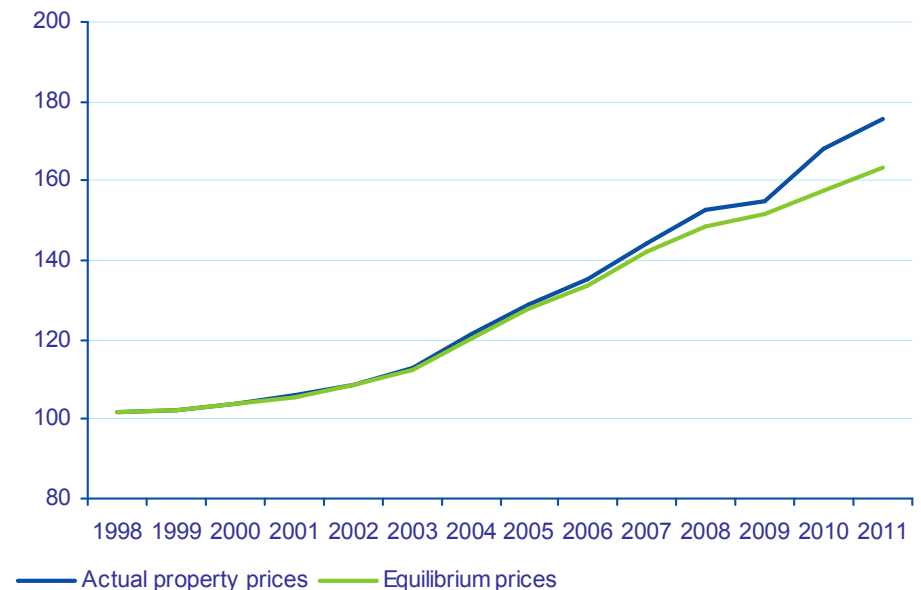
China: contributions to GDP growth (%yoy)

Source: BBVA Research,



China: actual and equilibrium house prices (index)

Source: BBVA Research,

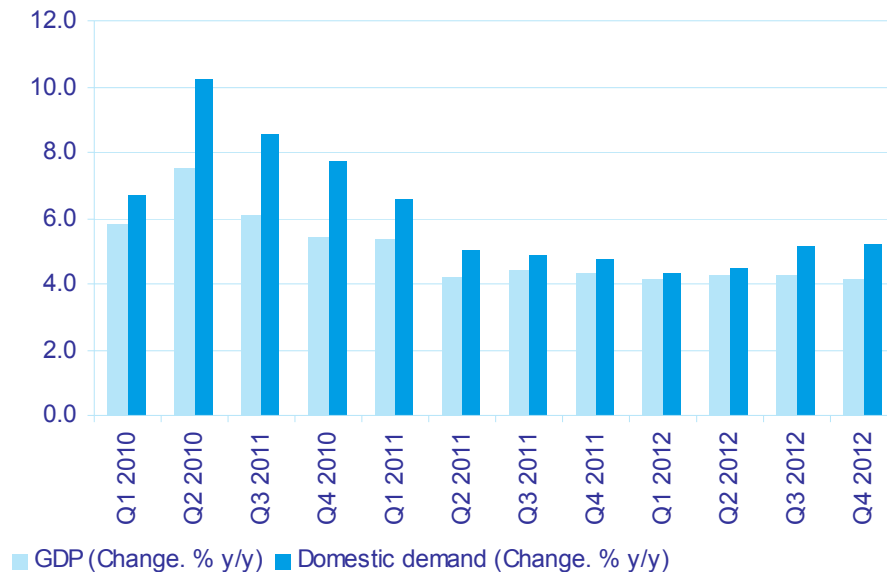


In Latin America, overheating concerns also diminish somewhat

In Latam, data in Q1 and Q2 have also reduced overheating concerns, as domestic demand started to decelerate and forecasts point to growth similar to that of GDP by end-2011. However, inflation is still high in the region (and in Asia) although it should peak soon.

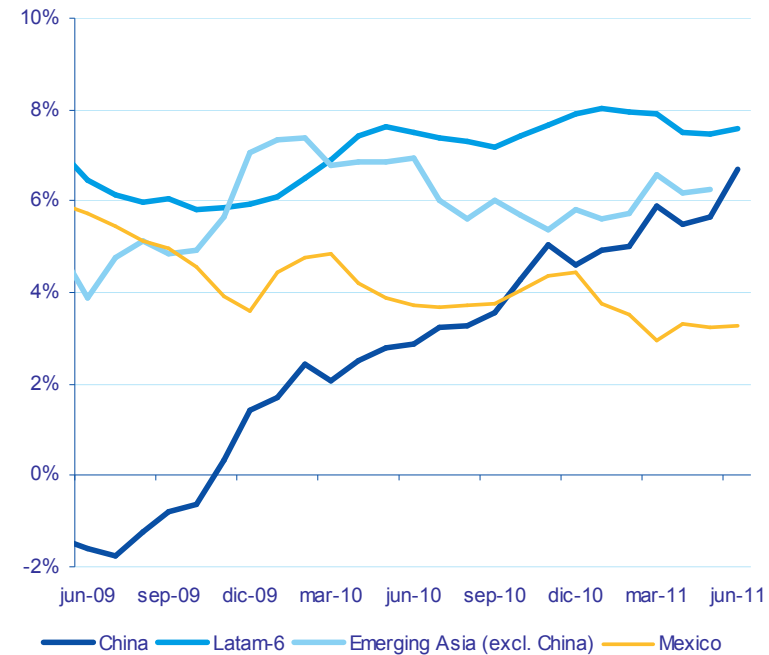
Latam: GDP and domestic demand growth (%yoy)

Source: BBVA Research,



Inflation in emerging economies (%yoy)

Source: BBVA Research,





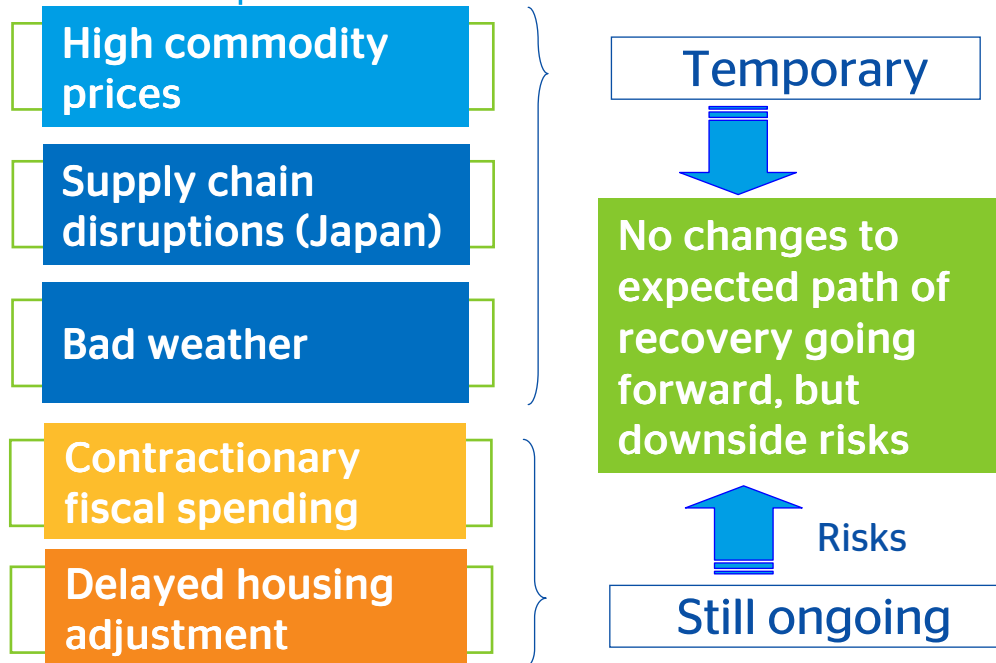
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US: a soft patch

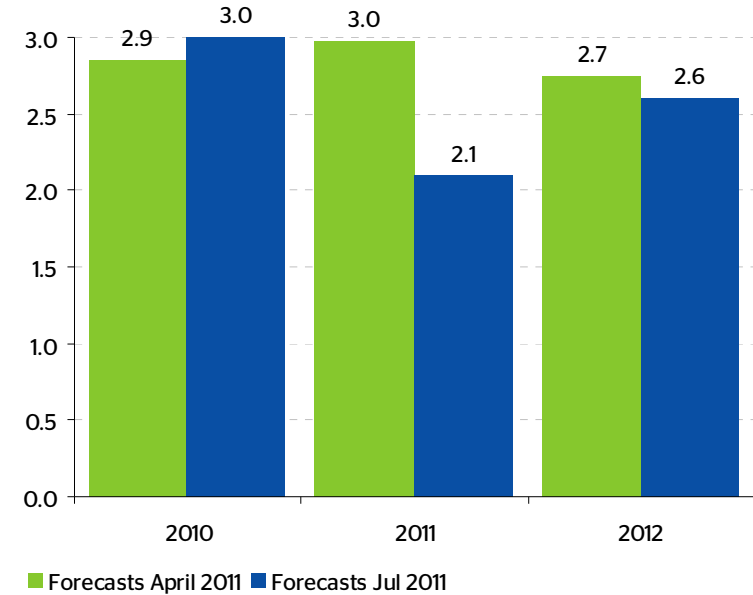
The recovery stalled in 2011, mostly due to temporary factors, although structural weakness remains: house market weakness, deleveraging, tight credit conditions. Inflationary pressures are subdued. Fed needs clearer signals before changing its lax monetary policy. No changes at least in 2011.

Growth in 2011H1 below expectations



US GDP growth in baseline scenario

Source: BBVA Research,

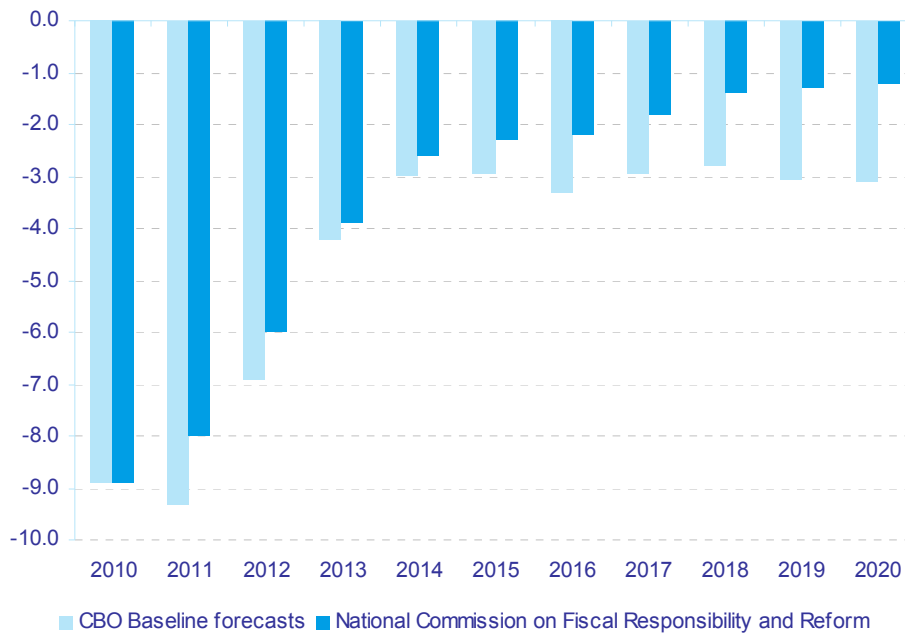


In the US, a long-term fiscal consolidation plan is needed

The deal to raise the debt ceiling avoided a technical default in the US. However, the plan does not fully address concerns about long-term deficit reductions and the stability of public debt.

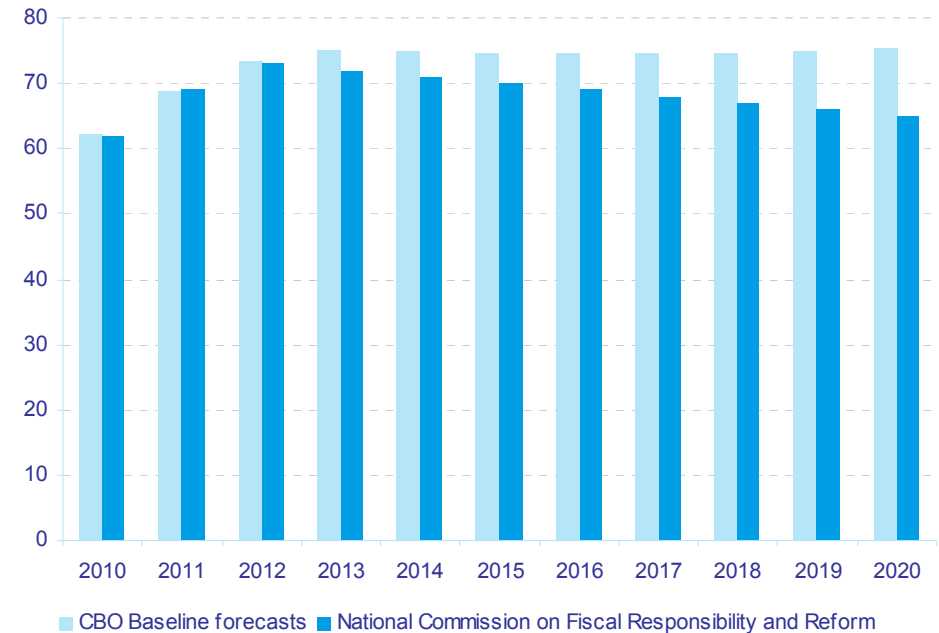
US: fiscal deficit (% GDP)

Source: BBVA Research, CBO y Commission on fiscal Responsibility and Reform



US: public debt (% of GDP)

Source: BBVA Research, CBO y Commission on fiscal Responsibility and Reform





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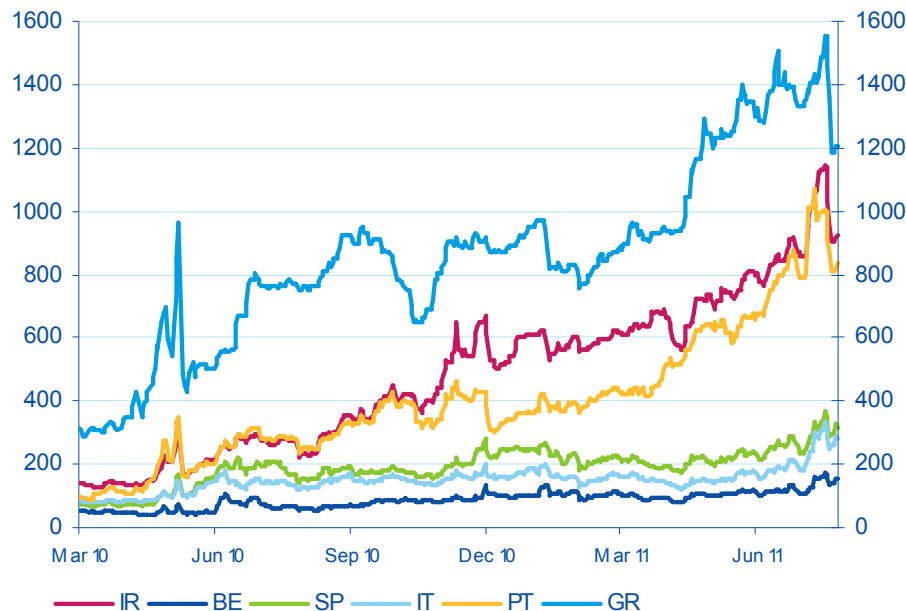
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Financial tensions will hurt peripheral more than core Europe

In Europe, stronger-than-anticipated Q1 and Q2 growth leads to slight revision up in 2011. Decoupling between core and periphery growth will continue in 2011 and 2012. Higher spreads will be a drag on growth in countries with elevated risk premia.

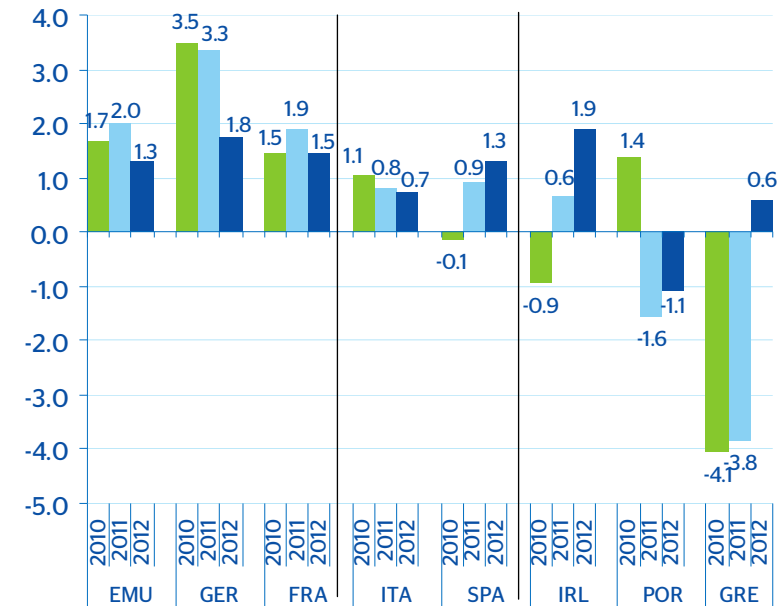
European sovereign spreads (10Y bonds vs Germany)

Source: BBVA Research,



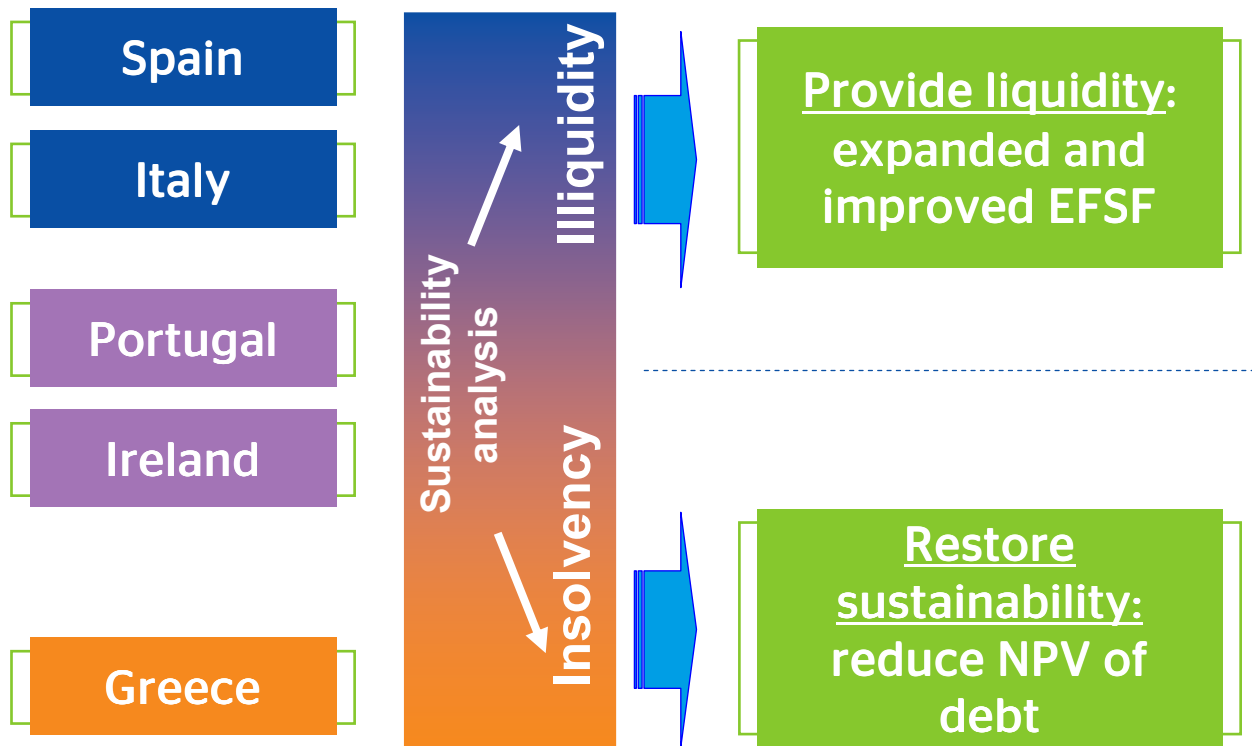
EMU GDP growth in baseline scenario

Source: BBVA Research,



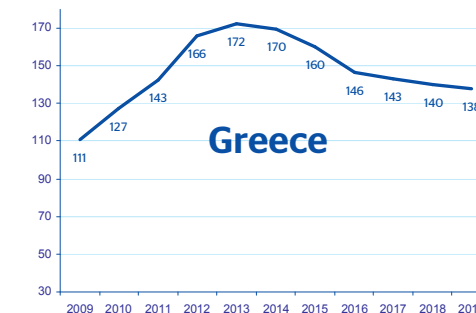
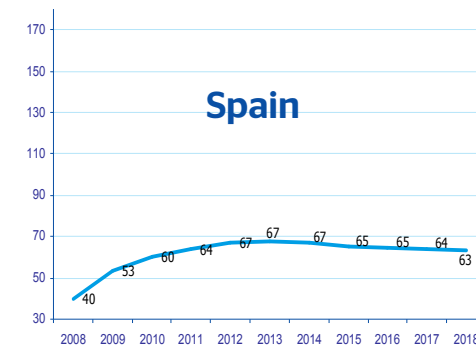
Need to separate clearly insolvent from illiquid countries to avoid contagion

Solution to financial tensions in Europe requires clearly differentiating insolvent and illiquid countries. The former need to repair their solvency by a substantial debt reduction. The latter need to have a strong mechanism to provide liquidity in Europe.



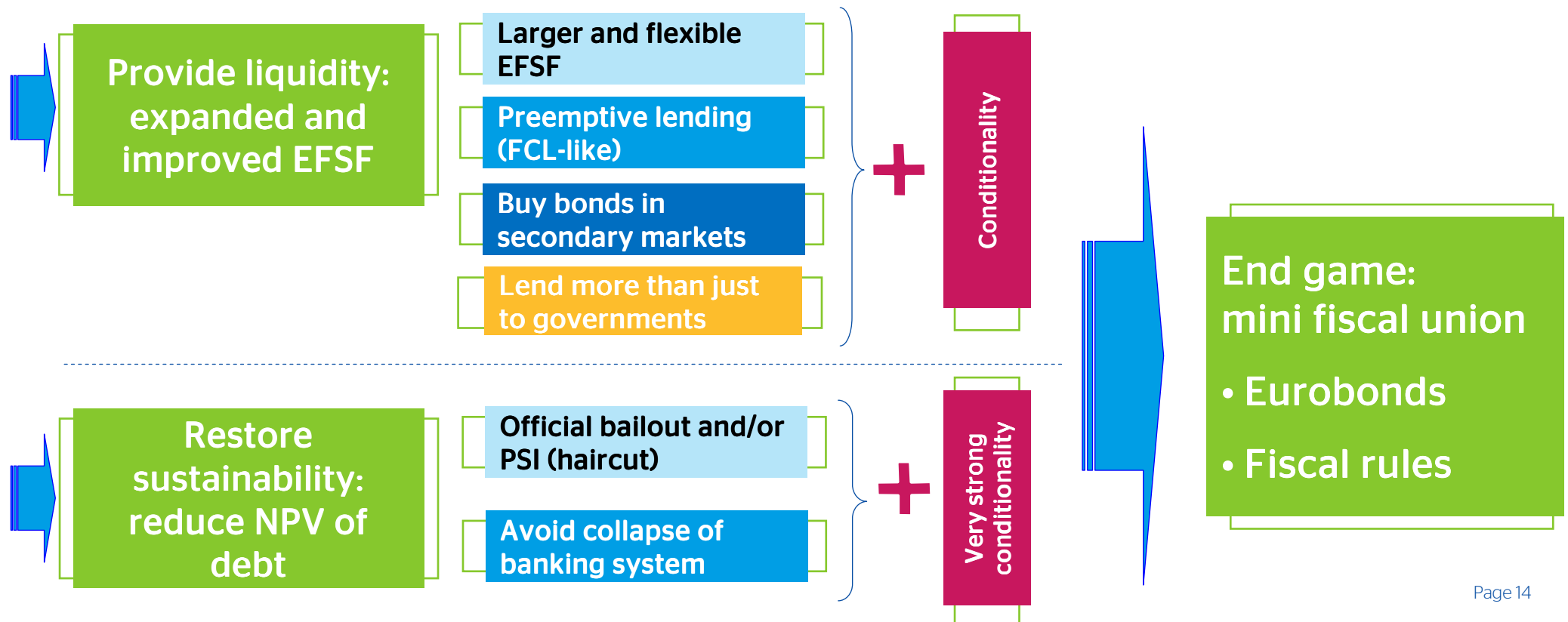
Public debt (% of GDP)

Source: BBVA Research



What are the main elements in each of the two pillars?

The path to debt reduction has to be coupled with very strict conditionality. Liquidity provision needed and enlarged and improved EFSF and less strict conditionality. Both pillars should gradually push Europe to some degree of fiscal union.



July summit: European authorities surprise on liquidity support, not on debt reduction

July 21 summit did not fully address solvency concerns, but tried to ring-fence peripheral countries from Greece.

What's needed in the summit?

Done?

Agreed at July 21 summit

Expanded EFSF, allowed to lend preemptively (FCL-like) and to buy bonds in secondary markets



All these elements, but ...
... size of EFSF unchanged

Decide a public bailout, or reach consensus with private sector for substantial reduction in NPV of Greek debt



Extension of maturities and debt buybacks, but scant debt reduction

Creation of eurobonds to cover debt up to 60% of GDP and impose conditionality



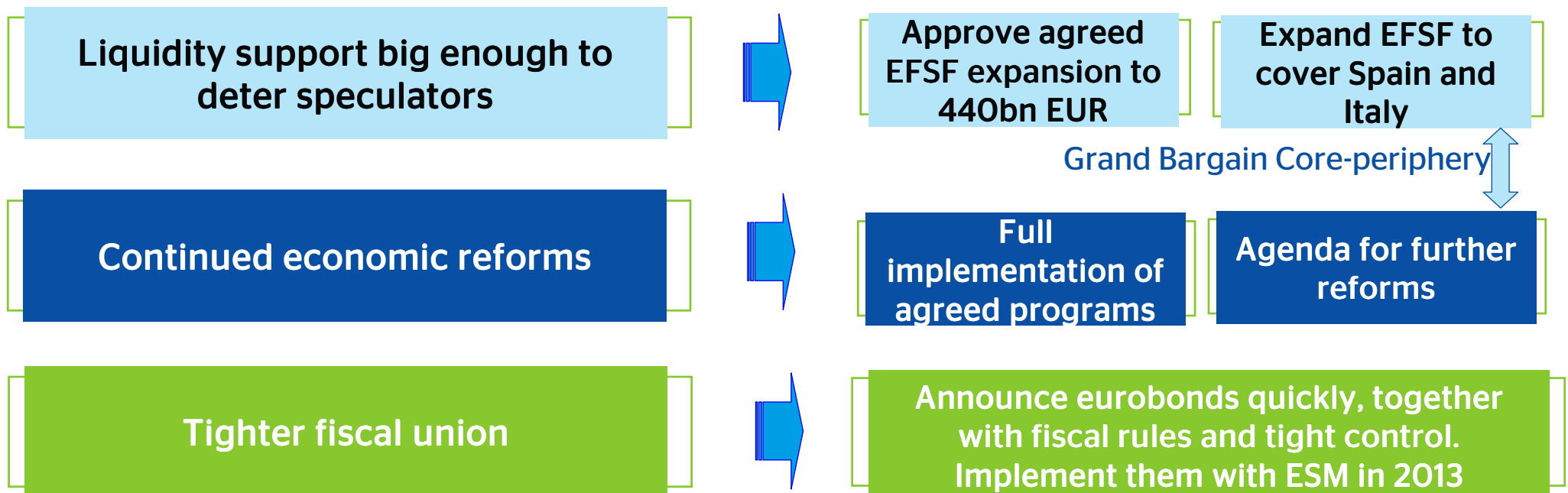
No agreement on eurobonds

What is left to do after the summit?

Apart from implementing the agreement and providing important details (EFSF, private sector involvement), European authorities need to continue building on a robust mechanism for liquidity provision, bring credibility to continued economic reforms and advance in the road to a tighter fiscal union.

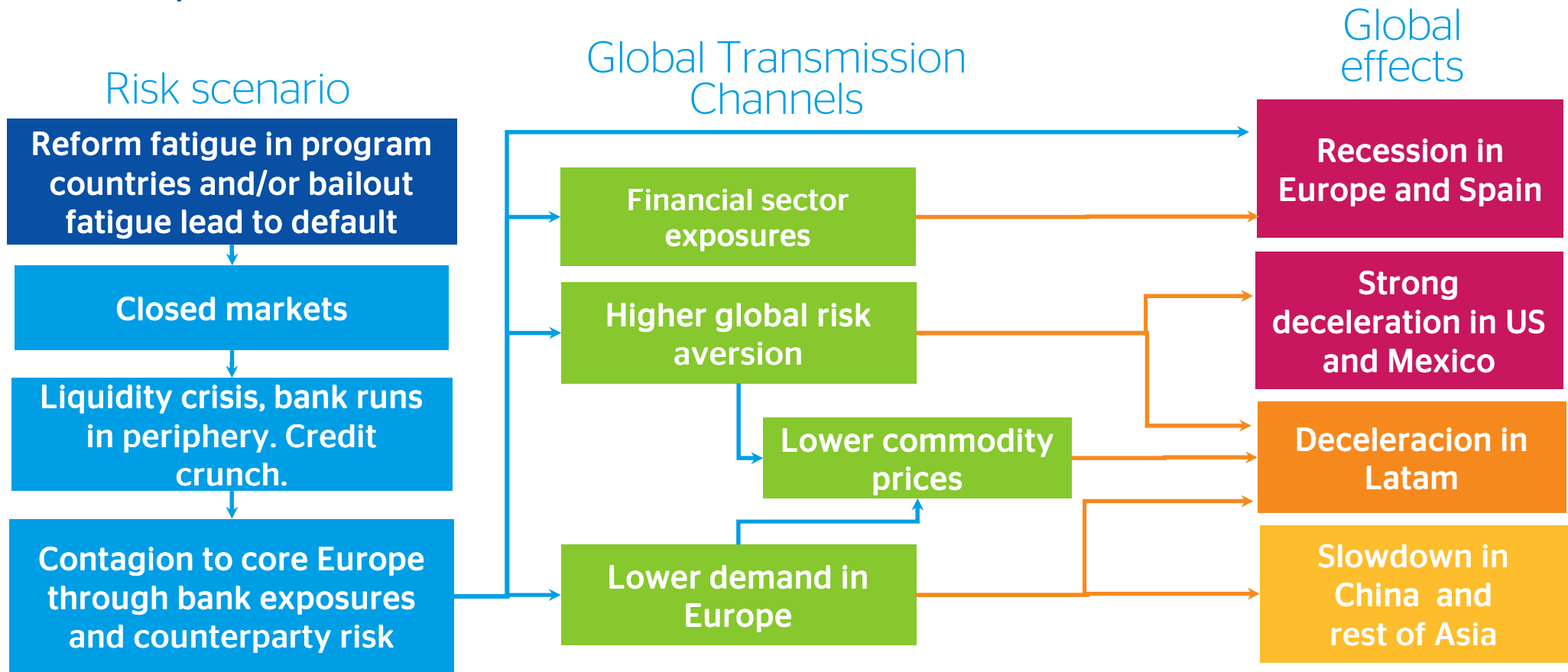
3 pillars for continued action

To-do list



Delay to address solvency concerns generates global risks

Europe continues to risk an “accident” due to reform fatigue in the periphery or bailout fatigue in core countries. This would have strong global spillovers, especially in other developed countries.





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GDP growth forecasts

Europe: GDP growth decoupling between core and periphery.

US: recovery with downside risks after soft patch in first half of 2011.

Emerging economies on track for a soft landing.

	GDP growth forecasts			
	2009	2010 (e)	2011 (f)	2012 (f)
US	-3.5	3.0	2.1	2.6
EMU	-4.1	1.7	2.0	1.3
Spain	-3.7	-0.1	0.9	1.3
LatAm 7	-2.3	6.2	4.6	4.2
Argentina	-2.1	8.7	7.5	5.7
Brazil	-0.2	7.6	4.0	4.1
Chile	-1.5	5.2	6.5	4.7
Colombia	0.8	4.3	5.0	5.4
Mexico	-6.2	5.4	4.1	3.8
Peru	0.9	8.8	6.3	5.5
Venezuela	-3.0	-1.6	2.8	2.0
EAGLES	4.0	8.3	7.0	6.9
Turkey	-4.7	8.2	6.3	4.2
China	9.2	10.3	9.4	9.1
Emerging Asia	6.7	9.2	7.9	7.8



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