# Global Economic Environment

## The world economic outlook improves....

Since the publication of the last Mexico Watch last June, the global economic scenario has undergone a recovery. The feeling of a free fall of most economies that had taken hold since the end of 2008 has given way to a situation of relative stability and, in some cases, of moderate growth.

The change in trend operating since then has been boosted by the exceptional public stimulus measures taken by most of the economies. These measures are framed both in the monetary front—with substantial reductions of the types of intervention, massive injections of liquidity and unconventional operations with assets, the launching of which has allowed the partial reestablishment of liquidity conditions—, such as in the fiscal and budgetary front—-with ambitious fiscal stimulus public packages that have provided a boost to specific sectors, such as for example the automobile industry and the temporary maintenance of the rents and the expenses of private agents—.

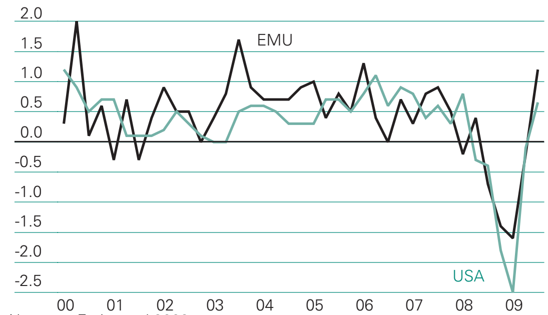
## ......although in the short term the downward risks are still latent, particularly in the more advanced economies.

The fundamentals of the world economic situation continue to be fragile, and, therefore, the downward risks are still fully in force. Thus, the main risk now being faced by the global recovery is a probable premature withdrawal of the stimulus plans, particularly in the more advanced economies and the uncertainty regarding whether private spending could substitute public spending as the main vector of the recovery. This affirmation is supported by the fact that, as opposed to what has occurred in the emerging economies, in the developed countries, the growth pattern during the expansive phase is characterized by a strong boost in domestic demand supported not only by the available income of participants but also by the need to later resort quite markedly to indebtedness by private agents, something that would not have the same importance in playing the lead role in this new phase of the cycle. In addition, the performance of employment does not seem to be contributing to a quick way out of the crisis, inasmuch as the employment destruction rate continues to be still very high in many economies.

Because of this, the greatest challenge that the economic policy is currently facing is the appropriate implementation in time and term of the withdrawal of the public, fiscal and monetary support programs. Thus, the premature withdrawal of the stimuli, very particularly of the latter programs, would run the risk of being able to reactivate the economic contraction process observed in the last four months of 2008. At the same time, progress must be made in the design and communication of feasible exit strategies.

### GDP Growth

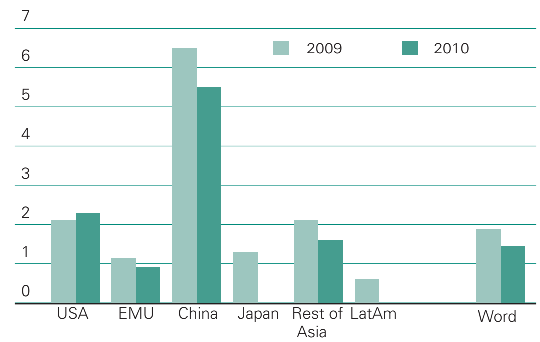
**Quarterly % change**




Note: Estimated 2009 quarter
Source: BBVA

### Fiscal Stimulus Programs: Size

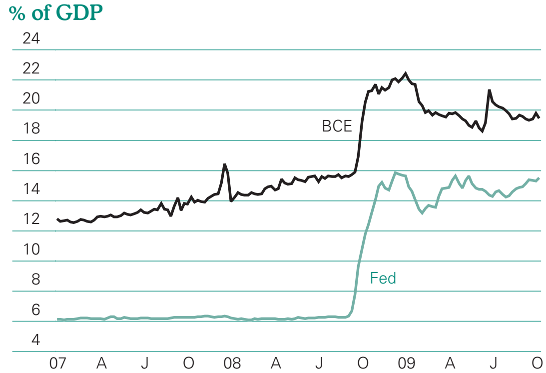
**% of GDP**




Source: BBVA

### Central Banks: Total Assets

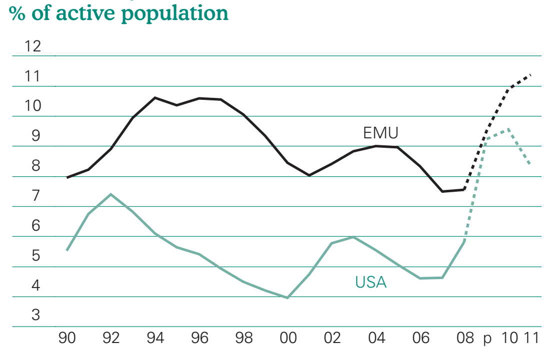
**% of GDP**




Source: BBVA with Datastream data

### Unemployment Rate

**% of active population**




p forecast as of 2009
Source: BBVA

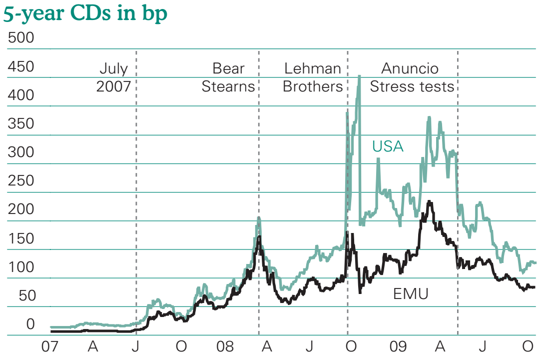
## Financial Tensions Indicator
**Index January 2007 = 100**


Note: First principal normalized components of the OIS spread series, implicit volatility of the U.S. Stock Exchange. Bank CDs and Corporate CDs
Source: BBVA

## Inter-Bank Markets: 3-month OIS Spread
**3M Libor - 3M OIS**

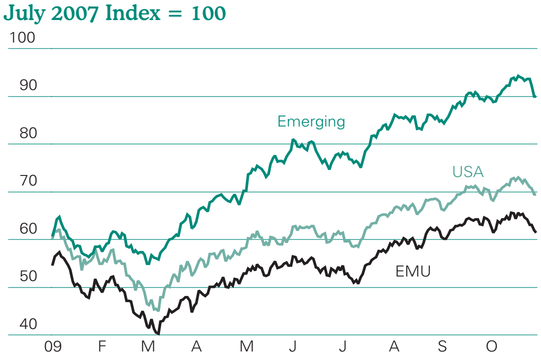

Source: BBVA with Bloomberg data

## Banks: Risk Premium
**5-year CDs in bp**




Source: BBVA with Bloomberg data

## Stock Markets
**July 2007 Index = 100**




Source: BBVA with Bloomberg and MSCI data

In this situation, the most probable scenario would point towards maintaining the official rates low for a prolonged period of time, since it does not seem that there will be a relevant upturn in inflation within a context of high available productive capacity. However, maintaining the stimuli over time could have, in turn, harmful consequences when it distorts, first, the incentives of participants to make adjustment decisions of their balances that cannot be postponed indefinitely and, second, when questioning the sustainability of the public accounts of many economies.

Due to all of this, the monetary and fiscal authorities should be mindful of the current balance of risks, being that one premature or badly designed step relative to the support of the public policies could seriously place in doubt the continuity of the recovery. In this sense, it seems probable that the central banks will gradually try possible alternatives so as to normalize, when the time comes, their liquidity policies. Thus, it will be especially important that the communication made by the monetary authorities clearly separate the design of the exit strategies at the moment of their application, which should be postponed until the economy has resumed more stable growth under sounder bases.

Nevertheless, progress in the financial markets has been substantial in recent months. Tension has been declining progressively since the maximums were reached following the fall of Lehman. However, the current situation is far from being fully satisfactory, since the tension levels in the market are still far from the pre-crisis levels. The greatest progress to date has been produced, however, on the Inter-bank markets. Thus, the three-month OIS spread in the U.S. and in the European Monetary Unit (EMU) is currently at its lowest since over a year and a half ago. Nevertheless, the evolution in said markets continues to be very dependent on the massive injections of liquidity by the central banks, which is why a premature withdrawal of the monetary stimuli could antedate part of the prior improvement.

At the same time, the reduction of the risk premiums has been extraordinarily quick in recent months. Thus, U.S. bank CDs[1] in October reached their lowest level since the explosion of the crisis, while European CDs stood at their lowest level since a year ago. Nevertheless, since the beginning of the summer, the downward correction has stabilized. Caution seems to have prevailed in most of the markets (also in those of equity funds, with relatively modest revaluations since July) within a context where the strength and sustainability of the economic recovery at a global level is still difficult to gage and a historically high aversion to risk prevails.

1 *Credit Default Swap* or agreement of risk coverage of a financial certificate.

## The emerging economies, a new driving force for global growth,...

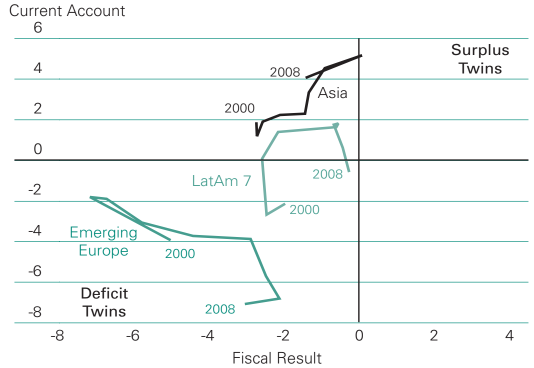
Economic recovery emerges, although in a very heterogeneous way. In general terms, the emerging economies are on a more solid road to recovery than the developed countries This is due to a series of differentiating factors that have allowed the greater part of these economies (with the exception of the countries of Emerging Europe) to more easily avoid the loan markets that are becoming more expensive and deal with the contraction in activity and employment. In particular, their lower exposure to the financial crisis, particularly in its initial compasses; the success of the fiscal and monetary stimulus programs launched after the outburst of the crisis; the rise in raw material prices in these recent months; the recovery in world trade following the collapse suffered at the end of 2008; and,. perhaps, what is perhaps most important for the sustainability of their long-term growth, the prior efforts, in many of these countries, to foster and practice a policy of macroeconomic stability. Due to all of this, it is expected that, going forward, the gap will be wider in terms of growth among the emerging economies and the more developed ones in favor of the former.

As regards the developed economies, that of the U.S. seems to be better positioned than those of Europe, for a faster resolution of the crisis, given the more decisive measures that have been taken, particularly in the financial and banking environment. Also, the fiscal boost in the U.S. will have a more significant impact on growth in the coming years. Thus, in 2010, it is estimated that it will reach three percentage points (3 pp) in contrast to the 1.5 pp in Europe. However, the most probable scenario for the U.S. economy is one of moderate growth going forward, since there is no certainty that, once the public stimulus ends, the private sector will once again resume a course of sustained growth, and the risks of a renewed drop have diminished sufficiently for issues such as unemployment or the public accounts to stop being an evident concern.

As regards Europe, the fiscal boost will be comparatively lower in 2010, as well as heterogeneous among countries, and maintains a less decisive attitude in face of the resolution of the financial crisis. The recovery of activity will also be postponed due to the greater rigidity of the European labor market (which supposes more prolonged impacts on employment), as well as due to potentially lower growth than that of the U.S.

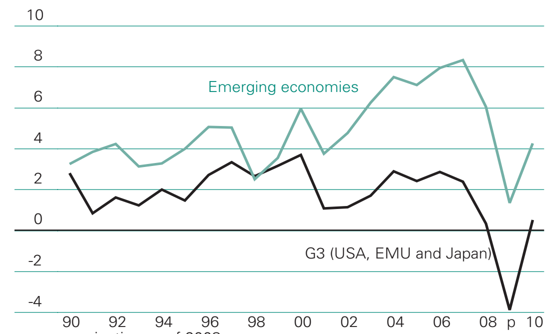
Among the emerging countries, signs of a recovery of activity are already clear, although the pattern presents some outstanding differences. China resumed very high growth rates in the last quarter (7.9% y/y), in part justified by a very quick rise in loans and other stimulus measures. In Latin America, most of the countries are showing signs of positive growth as of the third quarter, although these positive trends should still delve deeper in 2010. However, the situation In the European emerging economies presents more risks, where there are cases, where countries,

### Evolution of the Current Account and Fiscal Result 2000-2008
% of GDP



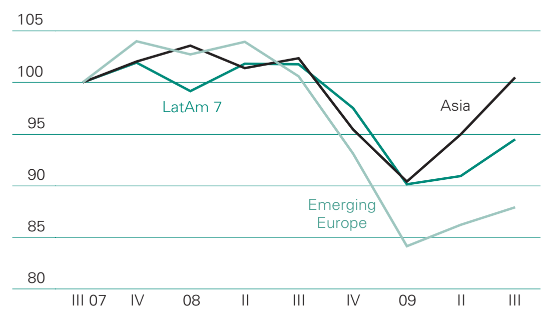

LatAm 7: Brazil, Chile, Colombia, Peru, Mexico and Venezuela
Europe: Poland, Hungary, Czech Republic, Slovakia, Estonia, Letonia
Emer: Lithuania, Bulgaria, Romania, Turkey, Ukraine
Asia: China, Hong Kong, India Indonesia, Korea, Philippines, Singapore, Taiwan, Thailand
Source: BBVA with WEO and IIF data

### GDP Growth
Annual % change



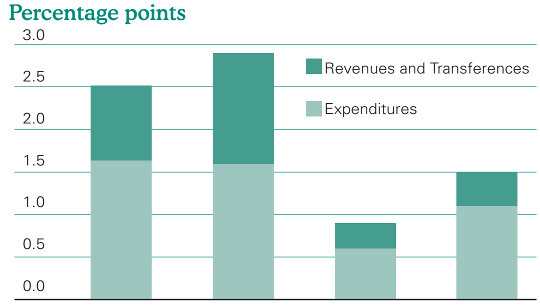

p projection as of 2008
Source: BBVA

### Industrial Production; Index 3Q 07
Latin America, Emerging Europe



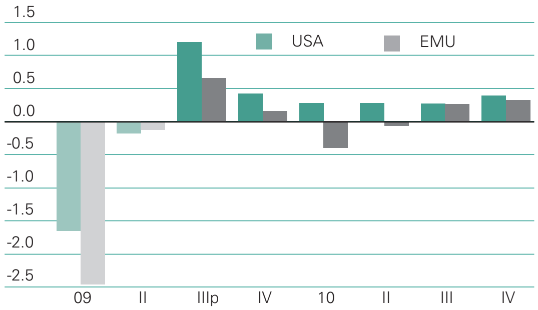

Source: BBVA with Bloomberg data

### Contribution to GDP Growth of the Fiscal Stimulus Packages
Percentage points



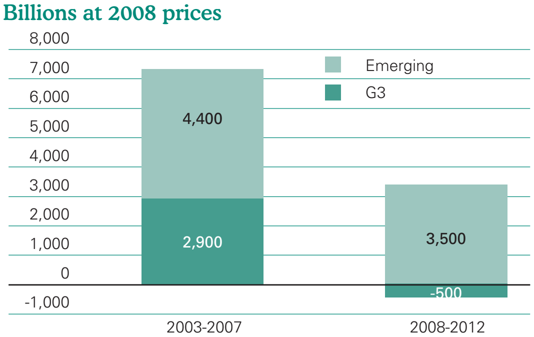

Source: BBVA

## GDP Growth
### Quarterly % Change




p projection as of 3Q09
Source: BBVA

## Change in Demand*
### Billions at 2008 prices




* Private Consumption + gross investment
Source: BBVA

highly affected by the crisis and its impact on the mortgage segment, have adopted heterodox financial policies.

## ...although the challenge of correcting the global disequilibrium continues to be present

In general terms, maintaining a long-term sustainable growth pattern will depend to a large extent on a re-equilibrium of strength on a global scale that will allow the alteration of savings and investment patterns observed up to now among the advanced and emerging economies, the result of which was the appearance of marked macroeconomic imbalances at a world level. This would lead to a greater expenditure in those economies with current account surpluses (fundamentally, the Asian), of which the growth in recent years has been based on a model guided by a depreciated exchange rate, which stimulates exports and the accumulation of foreign currencies due to precautionary motives. In turn, these economies maintain a high savings rate which reduces domestic demand.

In view of the difficulty that consumption in the advanced economies will once again be the main contributor to global growth, given the need that in the U.S. its growth be re-directed toward a higher share of savings in the GDP and with greater support of exports, the composition in global demand should operate to obtain a more balanced long-term world economy. This imposes a series of challenges for the different economies, where countries like China with a prominent external surplus should increase their consumption. Also, a brusque misalignment of currencies should be avoided within a context marked by high volatility in currency exchange.

Also, in the medium term, it will be necessary to launch credible plans for fiscal consolidation in order to avoid that public spending drive out private demand in countries that have been seen to be disposed to increasing their deficits. Once again, the design of these plans does not necessarily have to coincide with the moment of their application.

# United States Indicators and Forecasts

| | 2008 | 2009 | 2010 | I'09 | II'09 | III'09 | IV'09 | I'10 | II'10 | III'10 | IV'10 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Economic Activity** | | | | | | | | | | | |
| GDP (US$ billions) | 14,441 | **14,293** | **14,743** | 14,178 | 14,151 | 14,302 | **14,540** | **14,641** | **14,680** | **14,706** | **14,944** |
| Nominal growth (%) | 2.6 | **-1.0** | **3.1** | -1.4 | -2.4 | -1.7 | **1.3** | **3.3** | **3.7** | **2.8** | **2.8** |
| Real growth (%) | 0.4 | **-2.5** | **1.5** | -3.3 | -3.8 | -2.3 | **-0.4** | **1.6** | **2.0** | **1.4** | **1.2** |
| GDP deflactor | 2.1 | **1.5** | **1.6** | 1.9 | 1.5 | 0.7 | **1.8** | **1.7** | **1.7** | **1.3** | **1.6** |
| Personal consumption (real % change) | -0.2 | **-0.8** | **0.3** | -1.5 | -1.7 | 0.0 | **0.3** | **0.2** | **0.5** | **-0.1** | **0.6** |
| Government consumption (real % change) | 3.1 | **2.0** | **4.4** | 1.7 | 2.5 | 1.8 | **2.0** | **4.2** | **4.0** | **4.5** | **5.1** |
| Gross fixed investment (real % change) | -5.1 | **-18.3** | **-0.9** | -18.8 | -21.0 | -18.8 | **-14.5** | **-4.1** | **-0.6** | **-0.3** | **1.6** |
| Construction[1] | -22.9 | **-20.3** | **1.7** | -23.9 | -25.6 | -18.1 | **-12.6** | **-1.9** | **5.4** | **1.0** | **2.5** |
| Industrial production (real annual % change) | -2.2 | **-10.1** | **-8.1** | -11.6 | -12.9 | -9.7 | **-6.3** | **-8.1** | **-8.1** | **-8.1** | **-8.1** |
| **External Sector (constant US$ billions)** | | | | | | | | | | | |
| External balance | -494 | **-351** | **-382** | -387 | -330 | -348 | **-338** | **-350** | **-369** | **-396** | **-413** |
| Total exports | 1,629 | **1,435** | **1,385** | 1,435 | 1,420 | 1,469 | **1,416** | **1,391** | **1,377** | **1,379** | **1,393** |
| Total imports | 2,124 | **1,786** | **1,767** | 1,821 | 1,750 | 1,817 | **1,754** | **1,740** | **1,746** | **1,775** | **1,806** |
| Current account balance (% of GDP) | -4.9 | **-2.6** | **-2.0** | -2.9 | -2.8 | -2.8 | **-2.1** | **-1.6** | **-2.0** | **-2.4** | **-2.0** |
| **Prices (annual % change)** | | | | | | | | | | | |
| Final annual inflation | 0.1 | **0.9** | **1.7** | -0.4 | -1.4 | -1.3 | **0.9** | **1.1** | **0.8** | **0.7** | **1.7** |
| Average annual inflation | 3.8 | **-0.7** | **1.1** | 0.0 | -1.2 | -1.6 | **0.2** | **1.0** | **1.1** | **1.0** | **1.4** |
| **Other Indicators** | | | | | | | | | | | |
| Primary fiscal balance[2] (% of GDP) | -3.2 | **-9.9** | **-9.5** | — | — | — | **-9.9** | **—** | **—** | **—** | **-9.5** |

1 Residential investment
2 Fiscal Balance (% of GDP)
Note: forecasts in **bold**