1. Reevaluation of the outlook for the global economy

The effects of the fiscal adjustment on growth in Europe will be less than what might be assumed. The positive repercussions on credibility will almost offset the negative effects of the reduction in public demand. On the contrary, the medium-term risks derived from unsustainable fiscal situations in other developed regions are possibly being underestimated.

One of the most important channels through which the fiscal crisis has affected the European economy has been the loss of confidence, and a sine qua non requirement to reestablish such trust is fiscal prudence. The European consolidation plans are being implemented in accordance with a calendar presented to the EC at the beginning of 2010. The European fiscal consolidation must be centered on the structural level, but a positive factor is that the adjustment is rapid and is oriented toward a reduction in spending, which will improve confidence and practically counteract the negative effects on growth derived from lower public demand. Therefore, as long as the fiscal consolidation persists, the repercussions on European economic activity will be limited and transitory. Moreover, other advanced economies in which fiscal stimuli have been substantial and whose debt levels grew at the same rate as in Europe, have been shown to be relatively slow in facing their obligation to reduce their deficits, and at least stabilize their debt levels. There is a medium-term risk that is being underestimated, since experience shows that the effects of a lax fiscal policy on interest rates are highly non-linear, with the risk of a sudden increase in long-term rates and a shift in private demand, exactly the opposite effect that the fiscal stimuli packages seek to achieve.

The main risk for the global outlook still comes from the financial markets. The stress tests have had positive, if asymmetric, repercussions, in Europe. Although the risks have decreased, the possibilities of a setback continue to be significant.

The financial risks, derived from sovereign debt problems, resulted in a vicious circle that ended up increasing market risk and absorbing liquidity, particularly in Europe. Nevertheless, the strong increase in financial stress in Europe during the second quarter is beginning to recede (see Graph 1). Publication of the results of the stress tests in Europe has had the positive effect of reducing tensions, although a clear differentiation has been observed among the countries. Specifically, they can serve as a strong motive to dissipate uncertainty with regard to the Spanish financial system, since the implementation of the stress tests has been rigorous and their results, which are very informative, appear credible. Undoubtedly, the risks for Europe and for the world economy coming from the financial markets continue to be the main cause for concern.

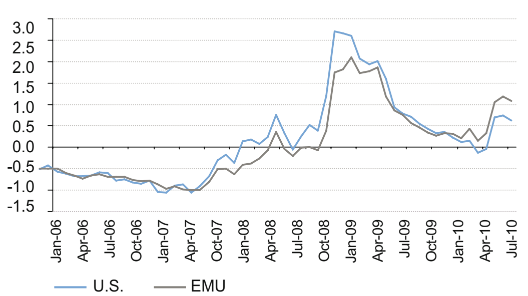
Growing divergence in the strategies of monetary policy. The increased uncertainty will lead the Fed and the CBE to delay the withdrawal of the monetary stimuli. On the opposite end, in a large part of Asia and Latin America, the rise in interest rates has already begun.

The financial tensions in Europe and the uncertainty with regard to the rhythm of the U.S. economic recovery will force the central banks of both regions to delay their initial interest rate hikes, as well as to maintain very low benchmark rates over a prolonged period. The inflationary pressures in both areas will continue to be under control, which will allow the authorities to maintain flexible monetary policies. Nevertheless, a more rapid economic recovery in the United States will lead to a change in monetary policy in that country before it occurs Europe, and both factors will weigh on the euro. Although the two central banks will postpone the monetary adjustments, the manner in which such decisions are communicated and how risks are evaluated continue to be different for the two institutions, which limits the CBE's relative ability to react, especially to deflationary risks. At the same time, in the emerging economies the increases in benchmark rates has already begun, following the pause (especially in Asia) that caused the European debt crisis. This will contribute to reducing inflationary pressures in Asia —where they had begun to mushroom— and will prevent possible pressures from emerging in South America later on this year. An important exception is the Banco de México, (Mexico's central bank) which could possibly maintain its interest rates until the second quarter of 2011. Inflation will increase over the course of the second half of 2010, but in the 4Q10 it is expected to reach 5%, in the center of the range anticipated by the central bank, and with a long-term outlook very much anchored at the 3.5% level. With inflation being anchored at above 3%, the gradual reduction of the negative output gap, and the existing rigidities in price formation in some markets will allow ruling out additional rate reductions in the projected scenario.

The world economy is moving toward a soft and differentiated downturn. This situation will be advantageous for China and the rest of the emerging Asian economies, since a convergence in growth will take place with a trend toward more sustainable rates. Nevertheless, private U.S. demand will continue to be fragile without official support, while in Europe confidence will be negatively affected by the consequences of the financial crisis.

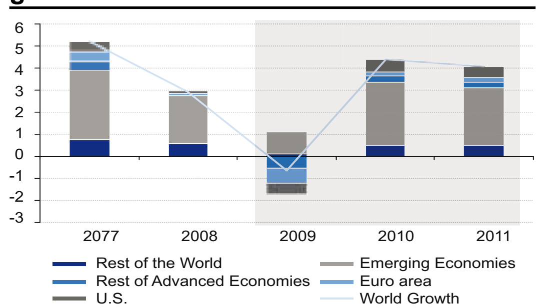
The fallout from the European financial crisis in other geographical regions has been relatively limited. Nevertheless, in the near future the global economy can be expected to slow down (see graph 6). The seriousness of the European financial tensions will affect confidence and will reduce growth in the second half of 2010 and the beginning of 2011. Furthermore, external demand will not be as solid as during the first half of the year, although it will contribute a certain degree of support to economic activity. In the United States it is likely that the recovery will lose some steam as a result of the situation in the labor and housing markets. This shows the limits of private demand as an autonomous driving force for growth. In China, the downturn in the growth of GDP in the second quarter and some indicators of an easing of economic activity demonstrate that the authorities' adjustment measures are being effective in directing the economy toward more sustainable growth rates. The economy is also expected to slow down in Latin America during 2011, although maintaining high growth indexes. As a result, the disparities will continue growing between the advanced and emerging economies, and also within each of these categories..

Graph 1
Financial stress index *



* Index comprised of financial stress in three credit markets (sovereign, corporate, and financial), liquidity restrictions, and volatility in interest rates, exchange rates and equity markets.
Source: BBVA Research

Graph 2
Contributions to growth in world GDPI



Source: BBVA Research, based on national accounts

Although some measures have been taken in the right direction, with a view toward the future, the necessary global rebalancing of demand and the reduction in global imbalances is still pending.

The re-equilibrium of the Chinese economy toward an increase in internal demand (especially consumption) has begun and the reinitiation of a more flexible exchange rate should contribute to this process. Nevertheless more reforms are necessary to better adjust the weight of consumption toward levels similar to those of the region. Furthermore, other advanced economies with surpluses should implement reforms to increase internal demand, notably in the services sector. At the same time, the United States and other countries with important external financing needs should move from a model based on consumption to another based on investment, especially in the tradable goods sectors. The recent financial crisis has shown the limits of external financing of growth. The economies with high external financing needs are very vulnerable to the worsening of international financial tensions, and the resulting sudden fluctuations of the exchange rates can undermine global financial stability.

2. Appendix

Table 3

United States Indicators and Forecasts

	2008	2009	2010	2011	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11
Macroeconomic Indicators												
Real growth (%)	0.4	-2.4	**3.0**	**2.5**	2.4	0.1	**2.4**	**3.3**	**3.4**	**2.6**	**2.5**	**2.5**
Personal consumption (real % change)	-0.2	-0.6	**2.3**	**1.9**	1.6	1.0	**1.6**	**2.6**	**2.5**	**2.6**	**2.3**	**2.0**
Government consumption (real % change)	3.1	1.8	**0.6**	**1.9**	1.8	1.3	**1.5**	**0.3**	**0.0**	**0.7**	**1.7**	**1.8**
Gross fixed investment (real % change)	-5.1	-18.3	**1.6**	**6.7**	8.5	-13.8	**-2.6**	**2.2**	**3.6**	**3.4**	**5.4**	**6.0**
Construction[1]	-22.9	-20.5	**1.2**	**8.4**	10.3	-12.6	**-4.0**	**4.6**	**1.8**	**2.7**	**7.8**	**7.9**
Industrial production (real annual % change)	-3.3	-9.2	**4.7**	**3.5**	2.5	-3.8	**2.7**	**7.2**	**4.5**	**4.5**	**3.5**	**3.5**
Current account balance (% of GDP)	-4.9	-3.0	**-3.7**	**-3.9**	-4.2	-3.3	**-3.6**	**-3.4**	**-3.6**	**-4.0**	**-4.2**	**-3.7**
Final annual inflation	0.1	2.7	**1.0**	**2.2**	2.0	2.7	**2.3**	**1.1**	**1.1**	**1.0**	**1.2**	**2.0**
Average annual inflation	3.8	-0.4	**1.6**	**1.8**	2.2	1.4	**2.4**	**1.8**	**1.1**	**1.0**	**1.0**	**1.7**
Primary fiscal balance[2] (% of GDP)	-3.2	-9.9	**-10.7**	**-8.5**	-5.3	-9.9	**-**	**-**	**-**	**-10.7**	**-**	**-**

1: Residential Investment
2: Fiscal Balance (% GDP)
Note: Bold figures are forecast
Source: BBVA Research with Federal Reserve, Bureau of Labor Statistics

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document is based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates´ salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

This document is provided in the United Kingdom solely to those persons to whom it may be addressed according to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 and it is not to be directly or indirectly delivered to or distributed among any other type of persons or entities. In particular, this document is only aimed at and can be delivered to the following persons or entities (i) those outside the United Kingdom (ii) those with expertise regarding investments as mentioned under Section 19(5) of Order 2001, (iii) high net worth entities and any other person or entity under Section 49(1) of Order 2001 to whom the contents hereof can be legally revealed.

The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA and the rest of entities in the BBVA Group which are not members of the New York Stock Exchange or the National Association of Securities Dealers, Inc., are not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".