

Europe and China

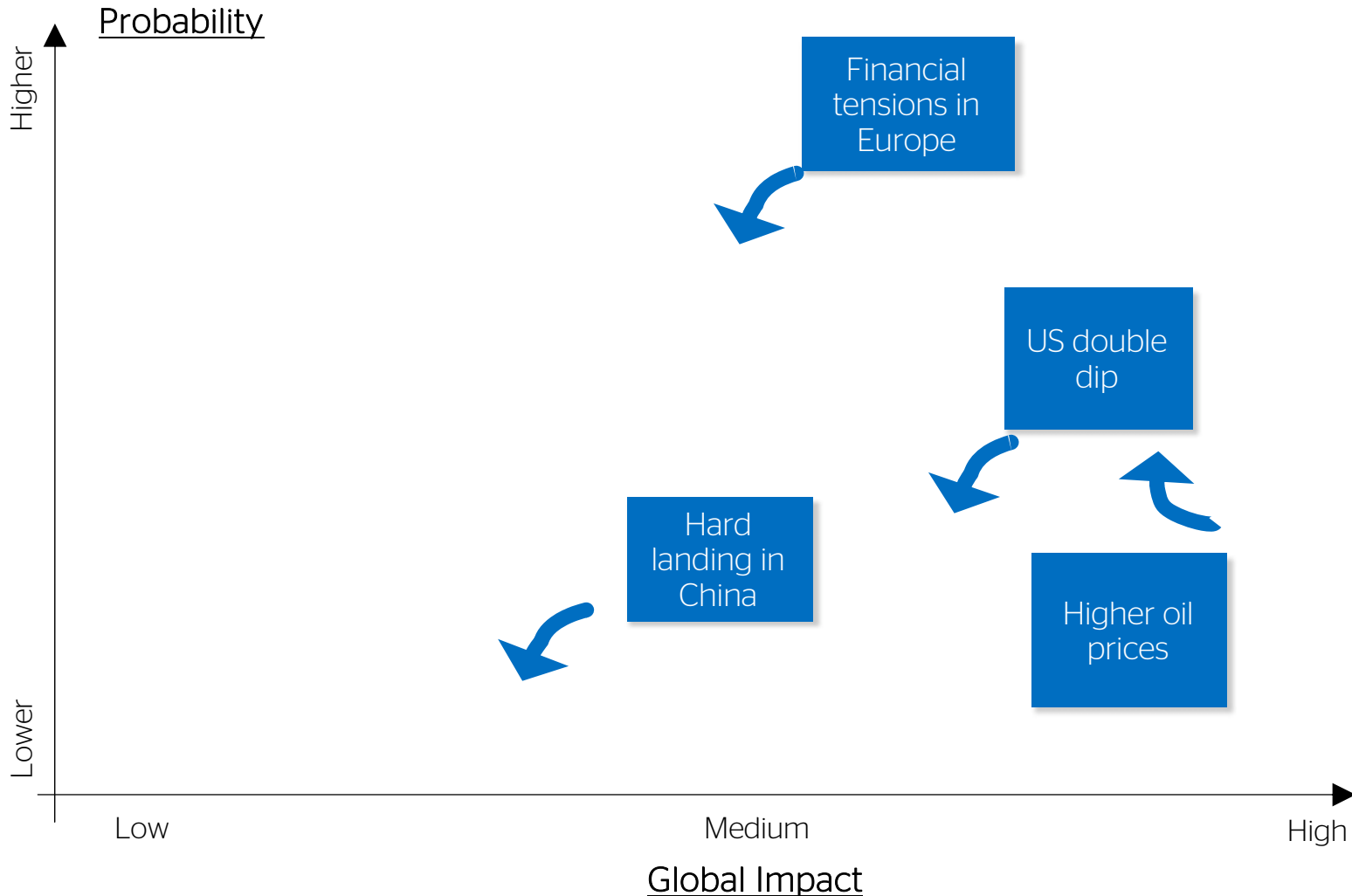
How does it look from Latin America?

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Rio de Janeiro, IIF Meeting, 7-8 March 2012

Global risks are coming down except for a oil-related geopolitical risk



Roadmap to presentation

We pick up 2 of those risks:

Risk 1. Most likely: “Accident” in Europe

Risk 2. Most feared in South America: Hard landing in China

Key take aways:

Risk 1 Increasingly less relevant (except in a mass destruction scenario)

Risk 2: Less likely than we think

On that basis key issues for Latin America

1. What about exchange rate appreciation?
2. What about macroeconomic imbalances?

Risk 1

Europe's looming risk

**So persistent but still changing
dynamically**

An “event” in Europe less likely (specially mass destruction)

Good news coming from:

1. ECB larger and more predictable provision of liquidity
2. More -even if not full -clarity on Greece
3. Stricter fiscal surveillance at European level with the end goal of a fiscal union!
4. Progress on structural reforms

But important milestones still pending which will make Europe's recovery long and painful

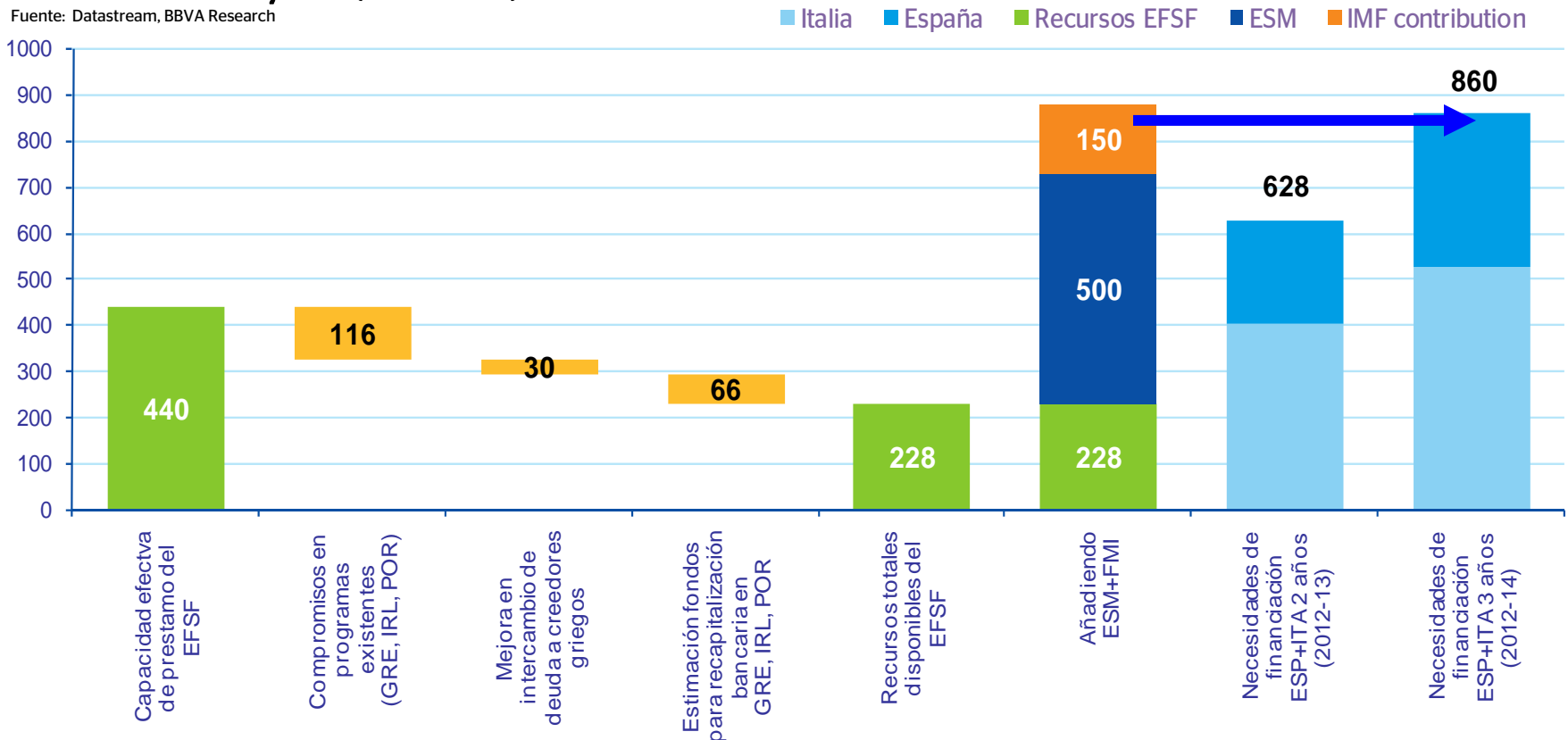
- Reforms have been legislated but need to be implemented!
- In the medium term some kind of Eurobonds needed while heading towards fiscal union
- In the short term, enough ammunition for countries at risk
- Try EFSF with Ireland first so as to have a success case
- Then avoid Portugal going to the market in 2013

More countries at risk so funds available for insurance should increase

Germany seems ready to put EFSF and ESM together for a total of 730 billion EUR. Topping this up with IMF contribution should be enough to cover Spain and Italy as well. The key hurdle is parliamentary approval for ESM

Resources of EFSF y ESM (billion EUR)

Fuente: Datastream, BBVA Research



Risk 2

**China's risk of a hard landing
obviously systemic but less likely than
people think**

No signs of sharp slowdown

- **Real economy data still points to a soft landing.**
 - Government GDP revision could well be another negotiating tool given mounting pressure to be a responsible stakeholder in the global arena
- **Exports have softened, not plummeted**
 - As one could have expected being Europe its major trading partner
- **Exchange rate helping as it is now depreciating in real terms**
 - Thanks to Euro strength and sudden stop in RMB/USD appreciation trend
- **Investment will not suffer much either**
 - Infrastructure and high end housing construction to be substituted by a frontloaded social housing program
- **Even if there were a European “event”, room for monetary and fiscal policies.**
 - Not as much as in 2008-09, specially on the fiscal side but still relevant

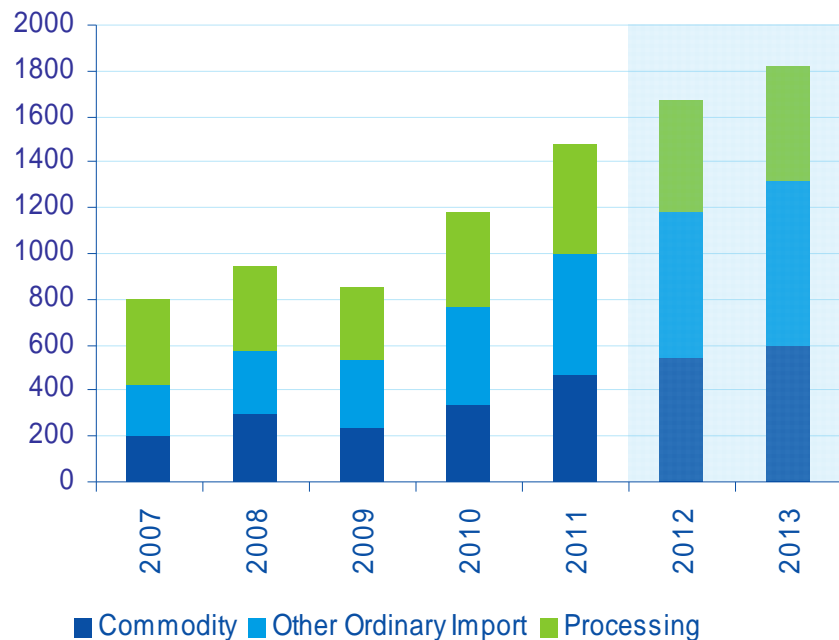
China has the size and openness to be a growth engine

- Quota in global imports growing: 10% in 2010 right after EU=12.9%, US=12.8% .
- According to IMF's network analysis, China actually stands first in terms of centrality in trade
- In the current juncture – as in 2009 - processing imports (mainly from Asia) growing more slowly than commodities and rest

Breakdown in Chinese imports

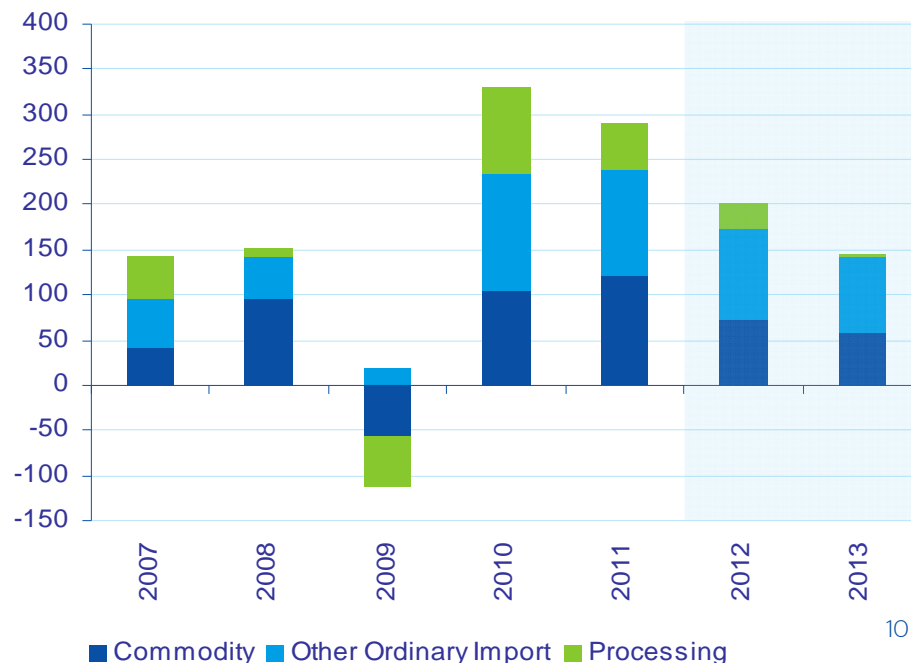
Source: CEIC and BBVA Research estimates

USD bn



Change compared to last year

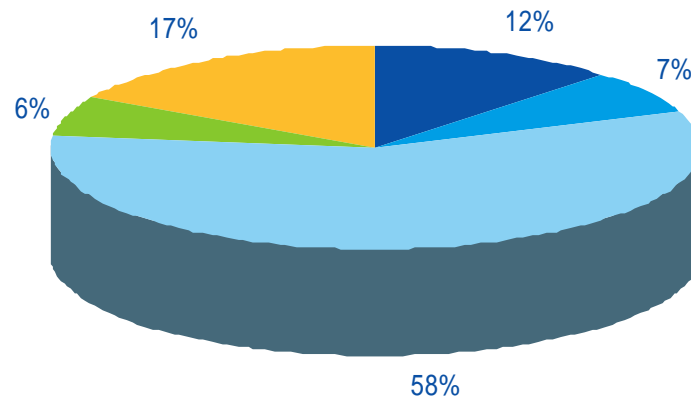
USD bn



Even if Latam has a smaller share of Chinas' imports, it will benefit more than East Asia in current juncture

Imports by region (2011)

Source: CEIC and BBVA Research

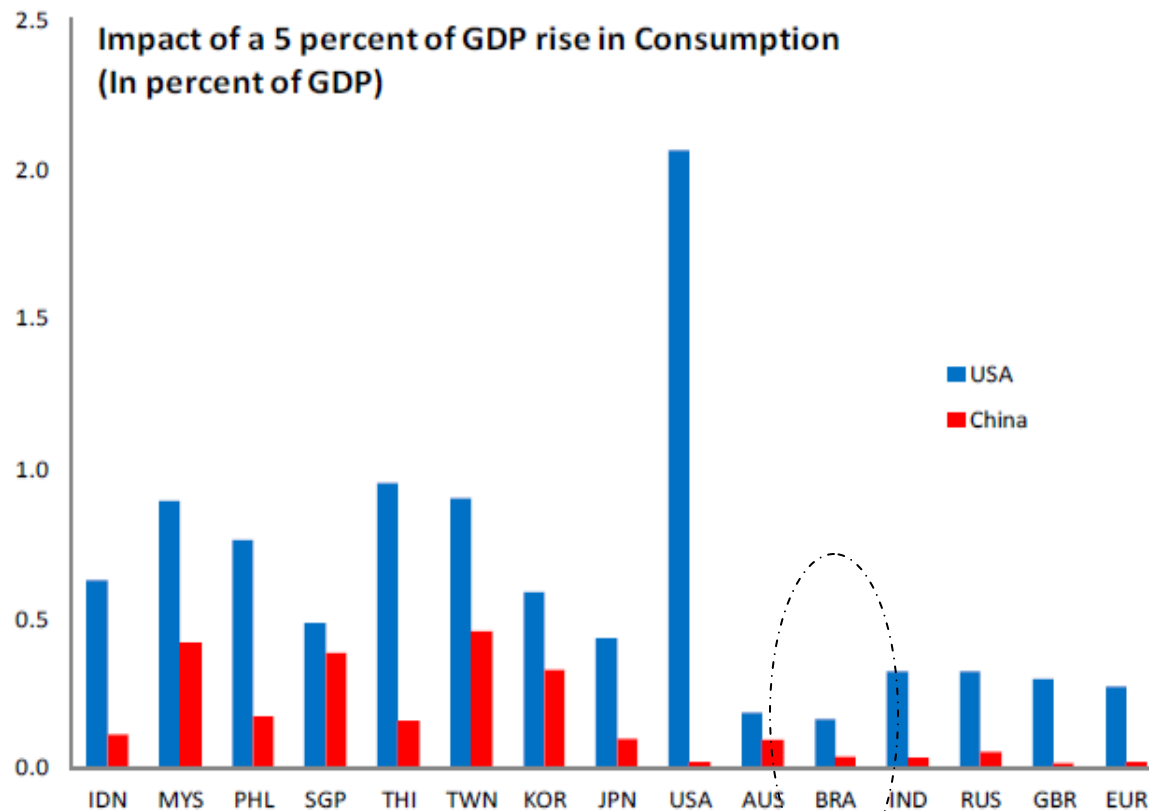


■ European Union ■ United States ■ Other Asia
■ LATAM7 ■ Other

In the medium term, with China's rebalancing towards consumption, Asia will clearly benefit more

Impact of a 5 percent of GDP Rise in China's and US's Consumption

Source: IMF



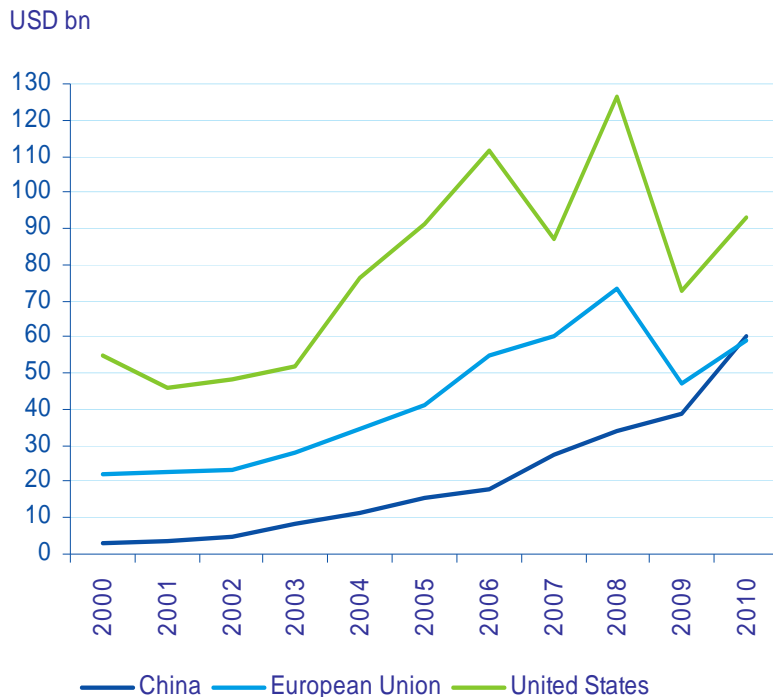
Still, China relevant for commodities but US relevant for commodities and the rest!

A double dip in the US would still be more of a problem than China

Commodity exports from LATAM 7

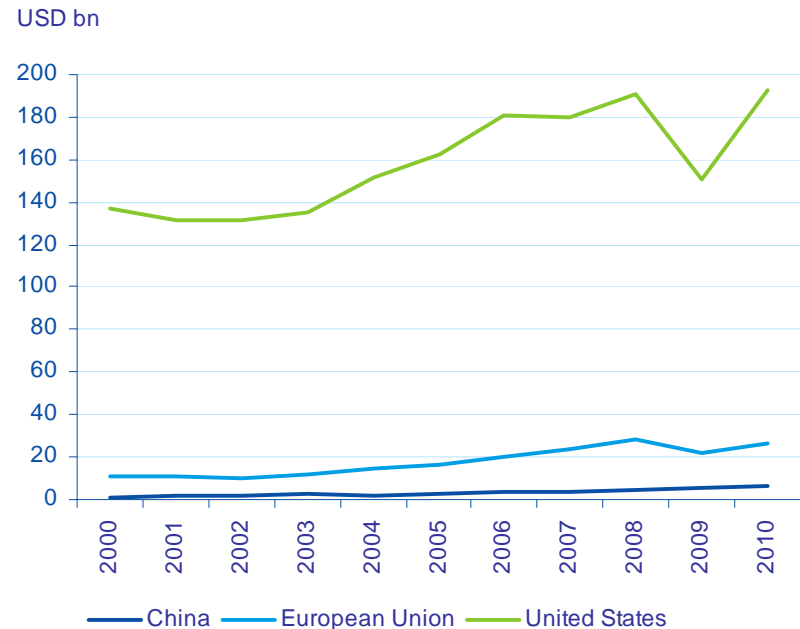
Source: Comtrade and BBVA Research

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Non-Commodity exports from LATAM 7

Source: Comtrade and BBVA Research



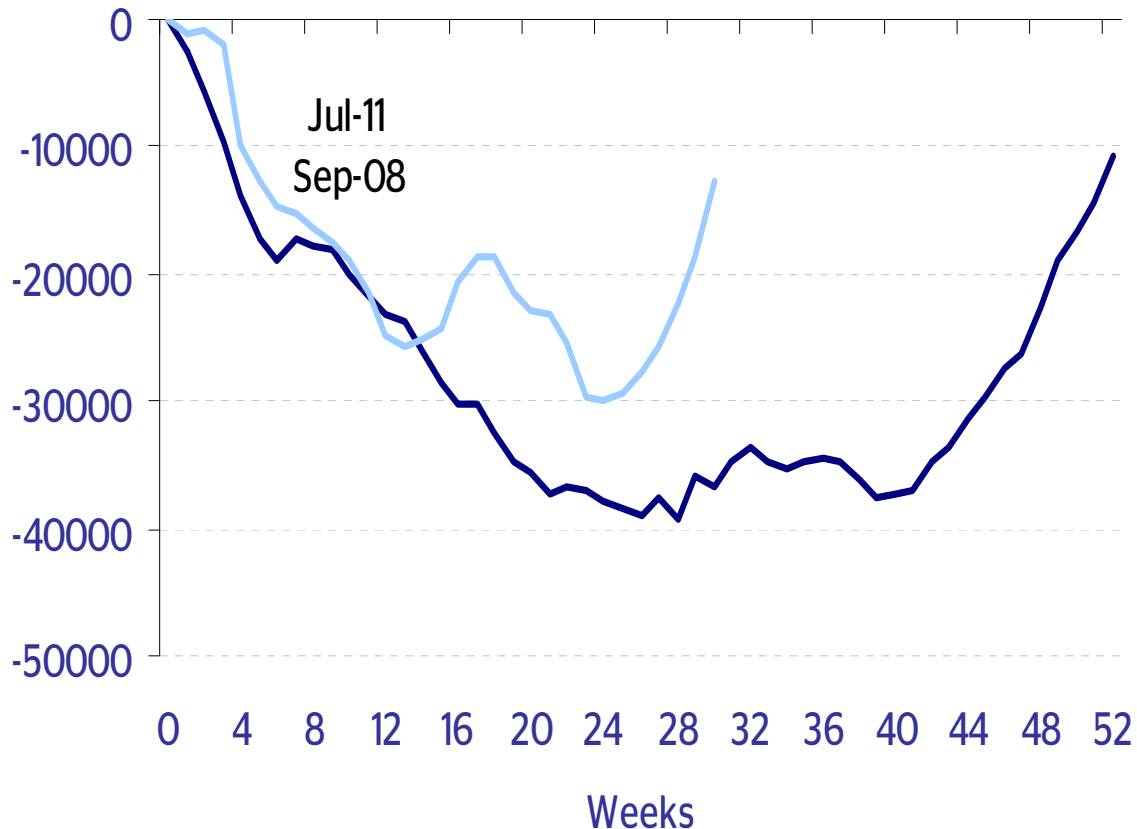
The world from Latam perspective

1. What about exchange rate appreciation?

Capital inflows to return to the forefront

Further accommodative global monetary policy measures in the developed world (LTRO, etc) will bring new capital inflows in the emerging world

Emerging markets: Net Portfolio outflows during the Lehman's episode and recent European debt crisis, Cumulative bn USD
Source: EPFR and BBVA Research



China's exchange rate diversification to include emerging (and Latam) currencies

Easing Off on Dollars

U.S. dollar holdings have become a smaller share of China's total foreign-exchange reserves.



Note: Figures as of June each year

Sources: People's Bank of China; U.S. Treasury; WSJ calculations

The Wall Street Journal

Appreciation already happening in Latam much faster than in Asia: Where is the limit?

LATAM, Asian currencies* & EUR vs. USD1
1 JP Morgan LACI and ADXY trade-weighted indexes



Even more relevant reasons in the medium term

- Based on the convergence with the rest of the world
- The more so the more undervalued the currencies now
 - More for Asian currencies but still

The world from Latam perspective

**2. Should we be worried about
exchange rate appreciation?**

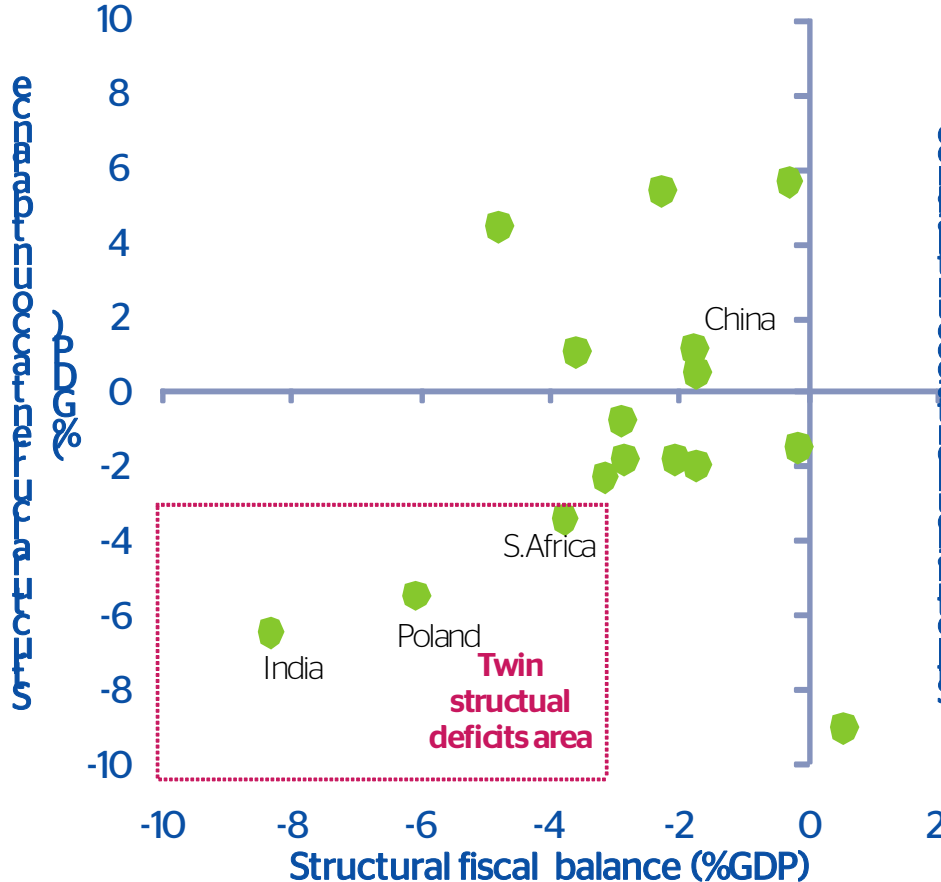
**What about macroeconomic
imbalances?**

Structural imbalances not so relevant for emerging economies than developed ones and exceptions not in Latam

Structural Balances 2011 : Dev Economies

(% GDP)

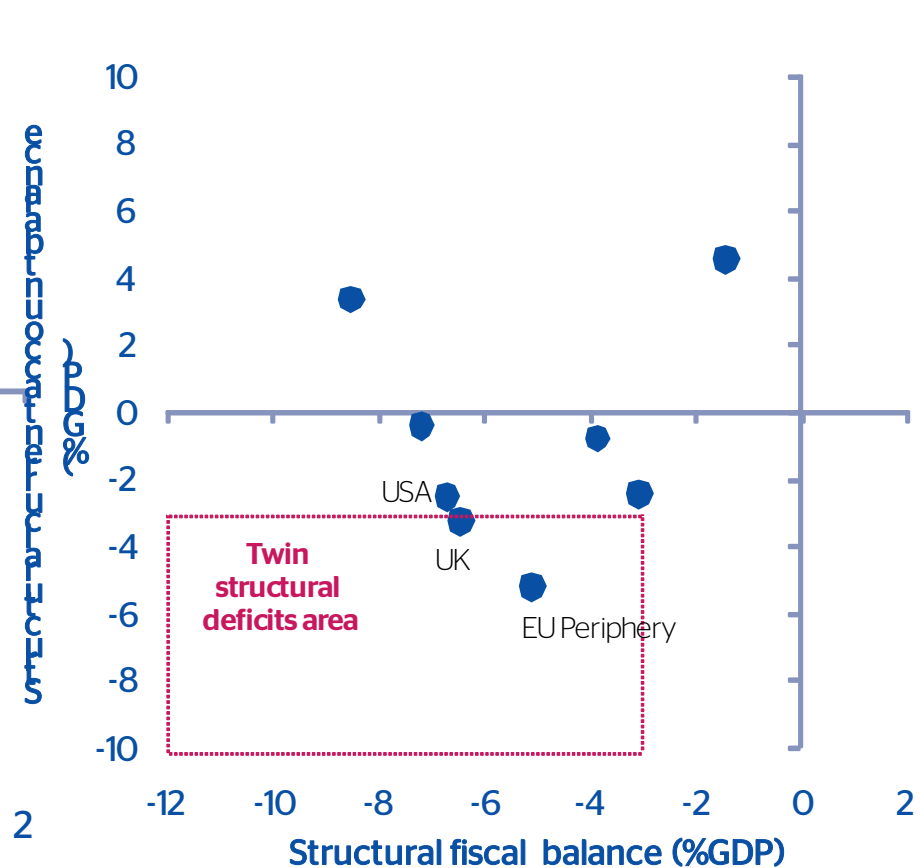
Source BBVA Research



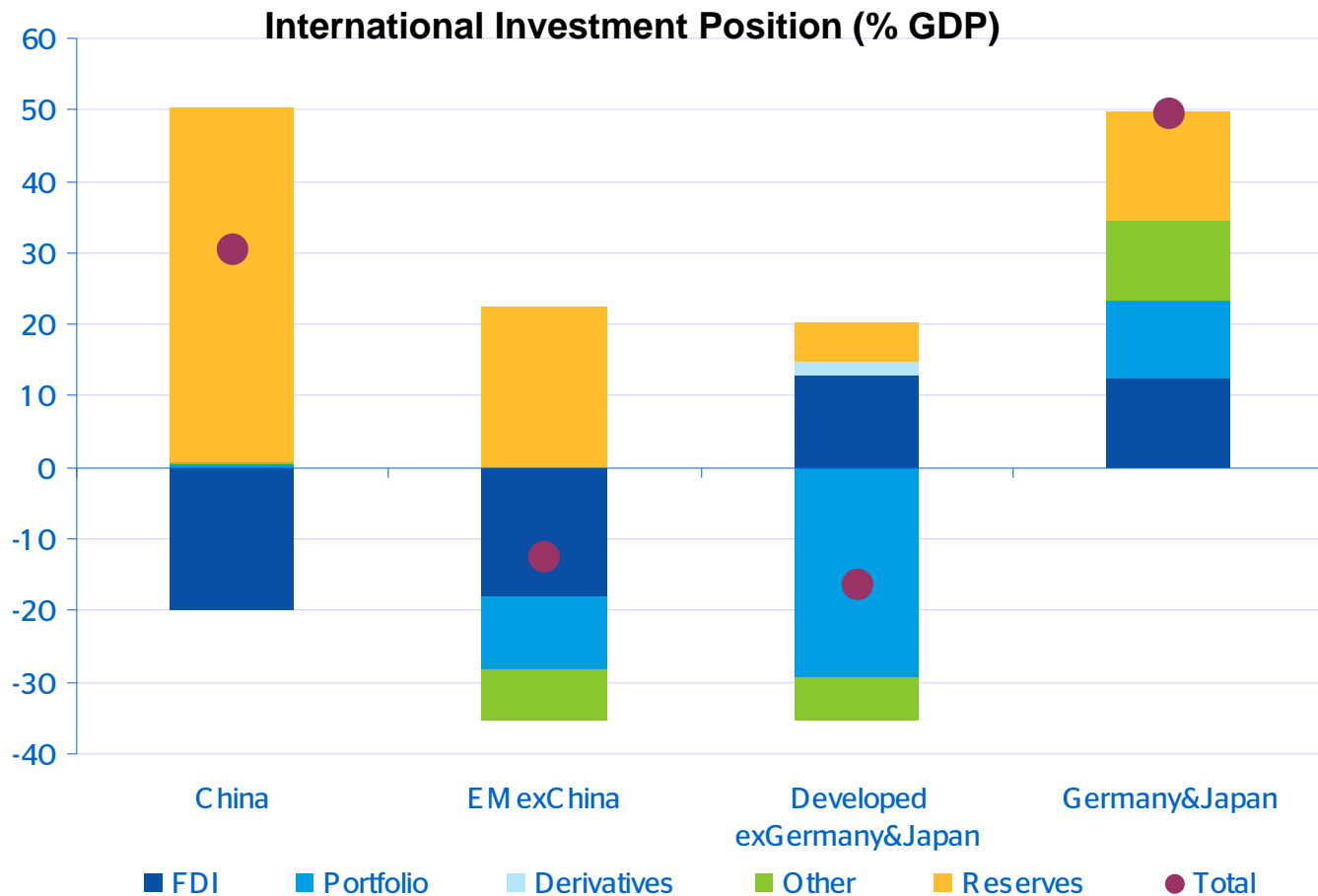
Structural Balances 2011 : EM Economies

(% GDP)

Source BBVA Research



While China is the only large creditor among the emerging world, other emerging countries (also Latam) in less negative position than the developed world



All in all

- Exchange rate appreciation is bound to happen
- But it should not be such a big problem in the medium term based on the relatively moderate structural imbalances in the region and the moderately negative external wealth
- However, when thinking about FUTURE structural imbalances productivity/competitiveness are key issue
- As for the external environment China clearly more relevant than Europe but US probably even more relevant than China for the region as a whole

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