

Where is China heading?

What is it in for Latin America?

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Key takeaways

1. **So far China slowing down... nicely**
2. **Hard landing can be averted for the time being**
3. **Short term risks manageable**
4. **The problems are years away... but are big**
 - Latin America to continue to profit from China's growth but
 - Diversification needed in the future!
 - Best opportunities still in Asia as well as in Latin America itself

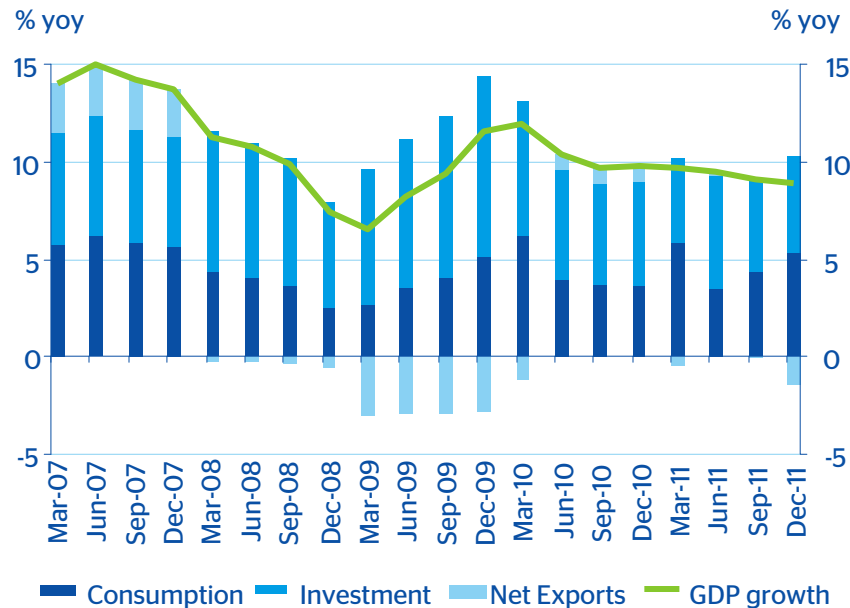
So far China slowing down...
nicely

Slowing, but resilient GDP growth

- Q4 growth slowed to 8.9% y/y (8.2% q/q saar), above expectations, from 9.1% y/y in Q3
- The contribution of net exports has been negative, offset by strong domestic demand (consumption)
- PMI has rebounded back to above the +50 expansion threshold on strong domestic demand
- Other activity indicators are pointing to moderating growth

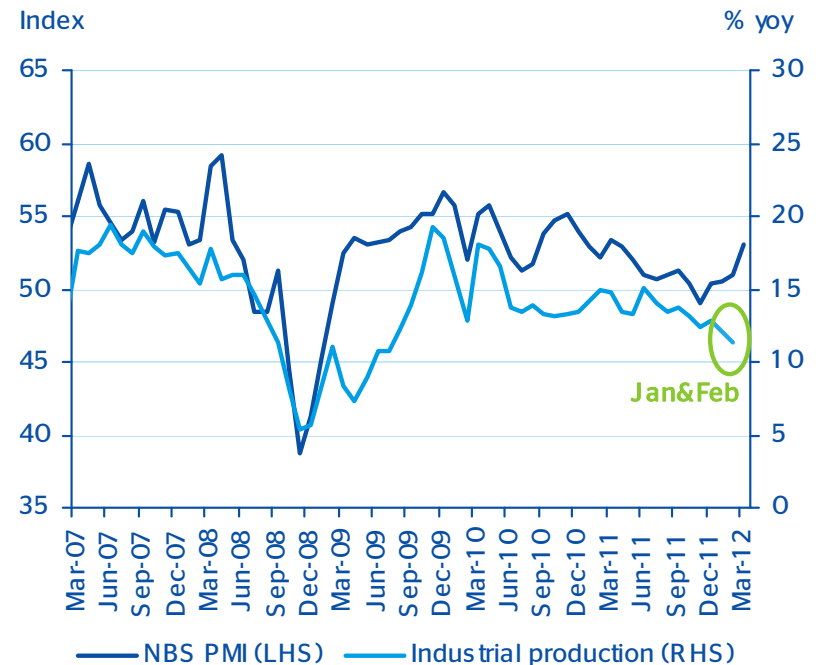
Q4 GDP growth remained resilient

Source: NBS, CEIC and BBVA Research estimates



PMI and industrial production have moderated

Source: CEIC and BBVA Research

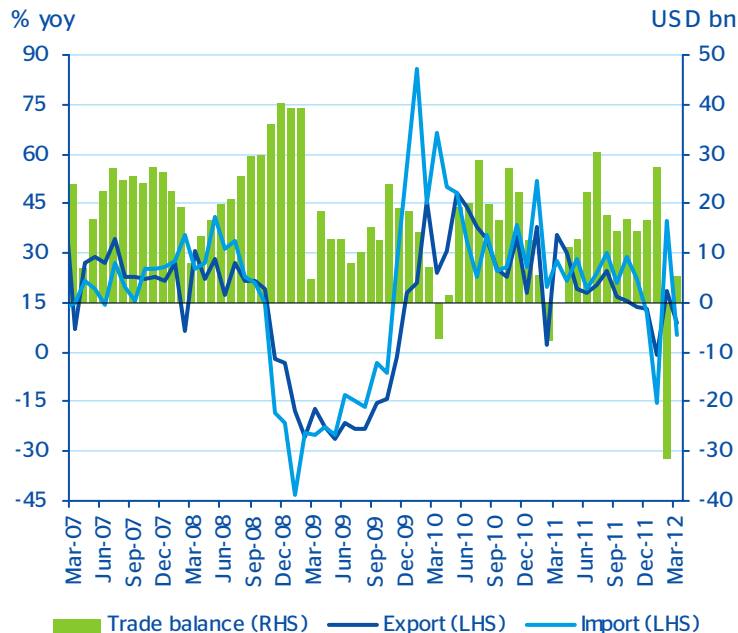


Slowing exports and also reserves

- Export growth has slowed down more than expected
- Buoyant imports led to a large, but probably temporary, trade deficit in February (we have seen this before!)
- Reserves accumulation has started to turn around, which does not augur well for currency developments...

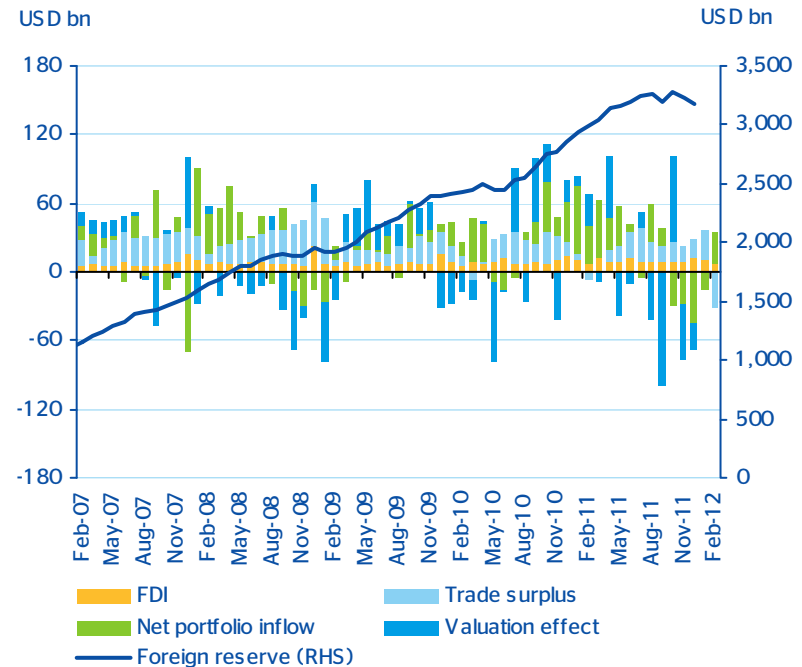
The trade surplus has turned negative

Source: CEIC and BBVA Research



Reserves declined on capital outflows

Source: CEIC and BBVA Research

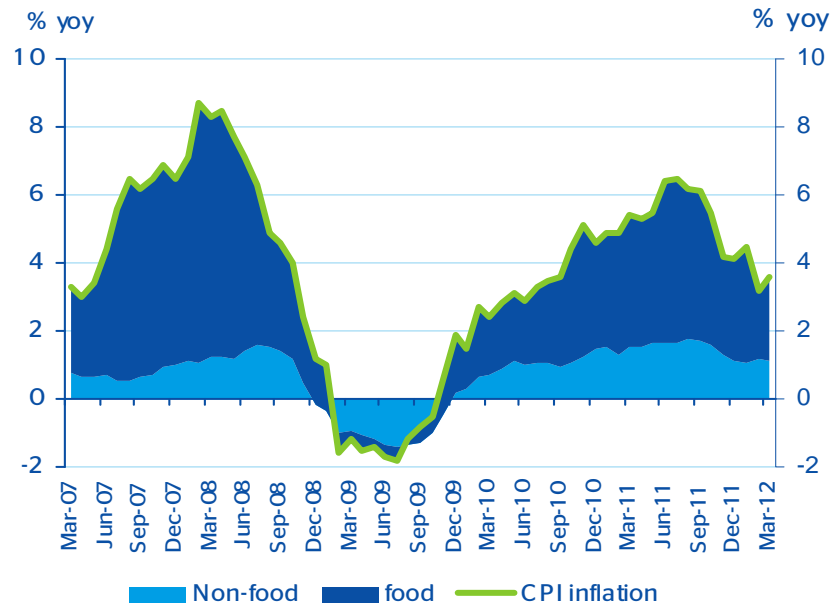


Easing inflation

- Inflation has been easing on favorable base effects and moderating food prices
- Offering a much clearer sky for the PBoC to react to the slowdown of the economy

Inflation has eased...

Source: CEIC and BBVA Research

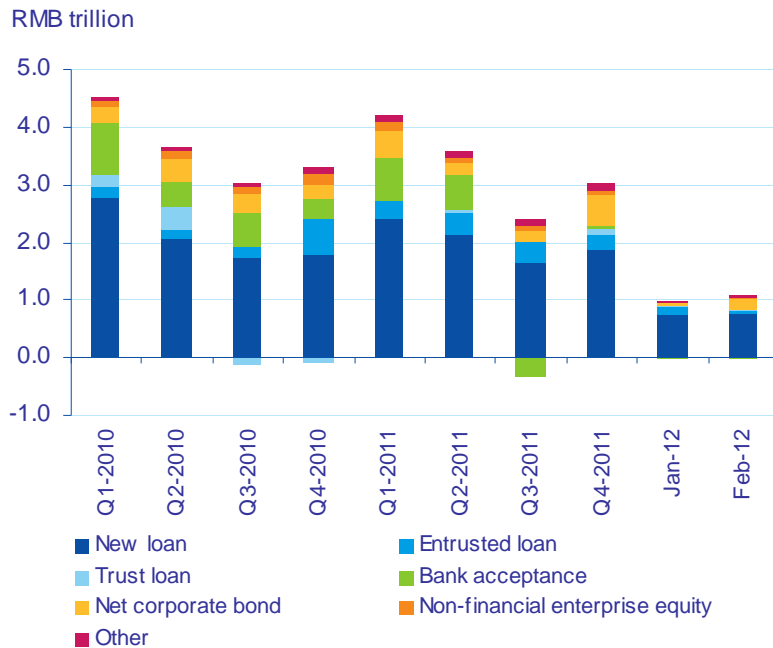


Slowing credit growth

- Credit aggregates has been slowing down for some time
- The slowdown down in the formal banking sector had been feeding the shadow banking but even that is slowing down now
- Liquidity is an issue for some sectors, specially real state developers

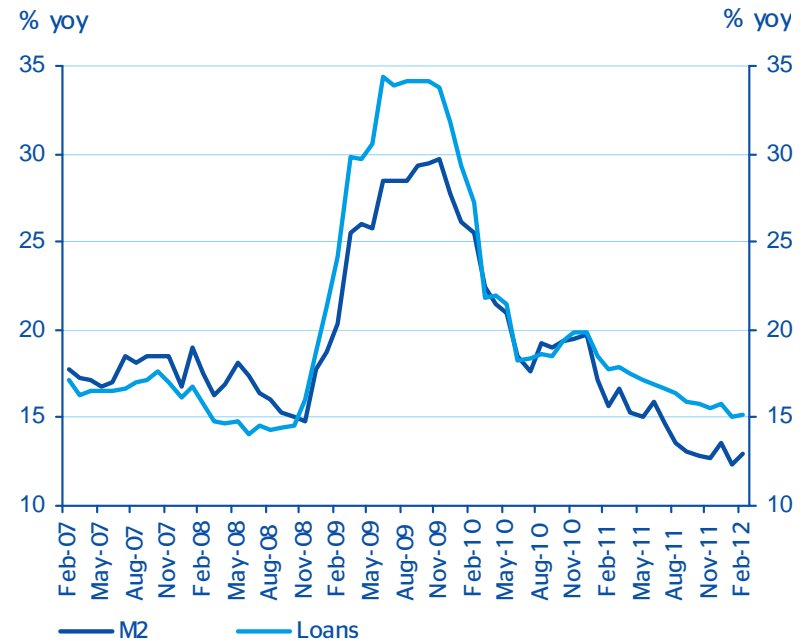
Total social financing has slowed...

Source: CEIC and BBVA Research



...and loans and M2 are on a declining trend

Source: CEIC and BBVA Research



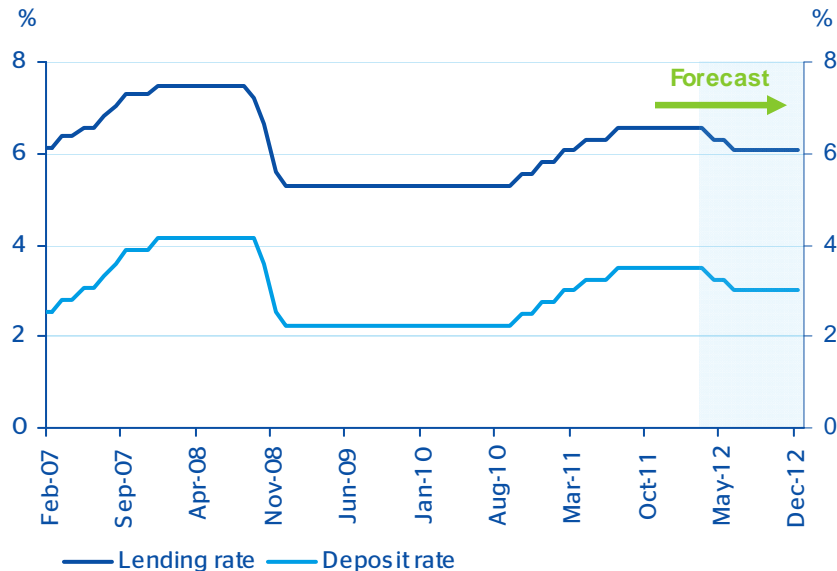
Hard landing can be averted...
for the time being

Policies becoming more growth-supportive

- Official stance as emphasized in the NPC: “pro-active fiscal and prudent monetary”
- RRR cuts at end-November and February signal a loosening cycle but, more importantly, liquidity support given the disappointing loan growth (in fact no IR movement yet)

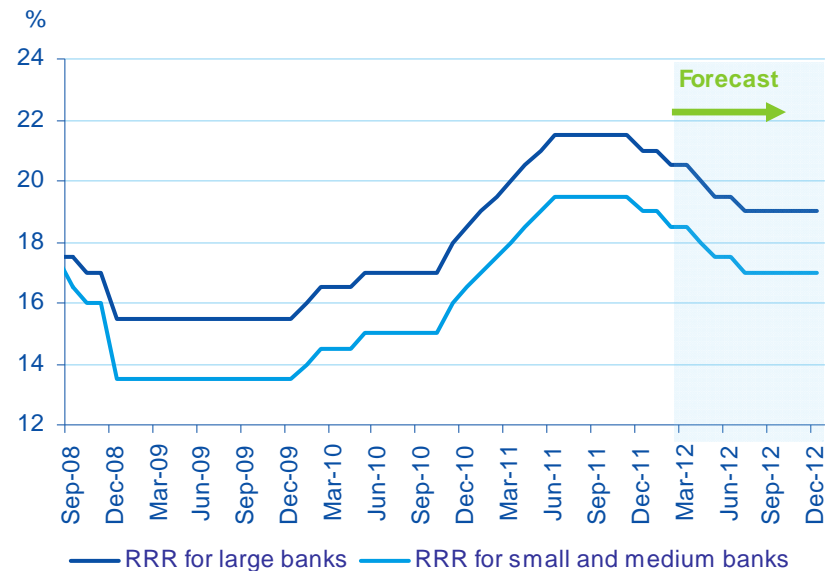
Interest rates on hold, next move down

Source: CEIC and BBVA Research



An RRR cut signals more easing ahead

Source: CEIC and BBVA Research



Not much from the fiscal side

- Deficit target 1.5% of GDP in 2012 from a 1.3% outturn in 2011
- *This is actually contractionary (structural deficit is coming down!*
- However, several items left out: probably 2% of GDP if properly measured

- Key initiatives:

- Social housing →
36 million housing units to be built by 2015
10 million started in 2011!
- New consumption incentives after having being dismantled only recently?
Consumption to GDP stubbornly low
And income elasticity of imports even lower!

Good news for commodity demand!

Bad news for those trying to export consumer goods to China

Currency appreciation has slowed

- RMB appreciation has virtually stopped against the USD so far in 2012
- Market expectations of currency appreciation have evaporated

Appreciation has slowed

Source: Bloomberg and BBVA Research



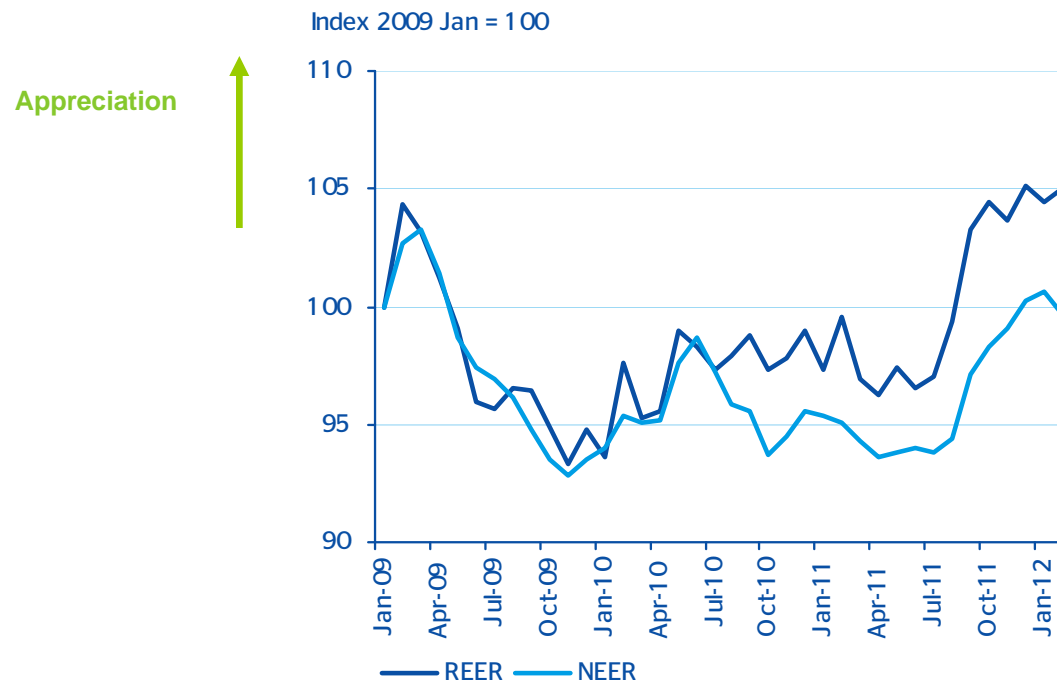
Widening of the exchange rate band to create higher two-way volatility

- Chinese authorities starting to believe that the RMB has reached the equilibrium level !
- Real effective exchange rate has appreciated significantly recently (wages are booming)
- Weak exports and negative reserve accumulation make the rest
- Expecting a much weaker RMB appreciation against the USD this year compared to last year (5%) and much more volatility within a wider band!

NEER and REER appreciation

Source: BIS and BBVA Research

Latam will not be thrilled...specially Brazil



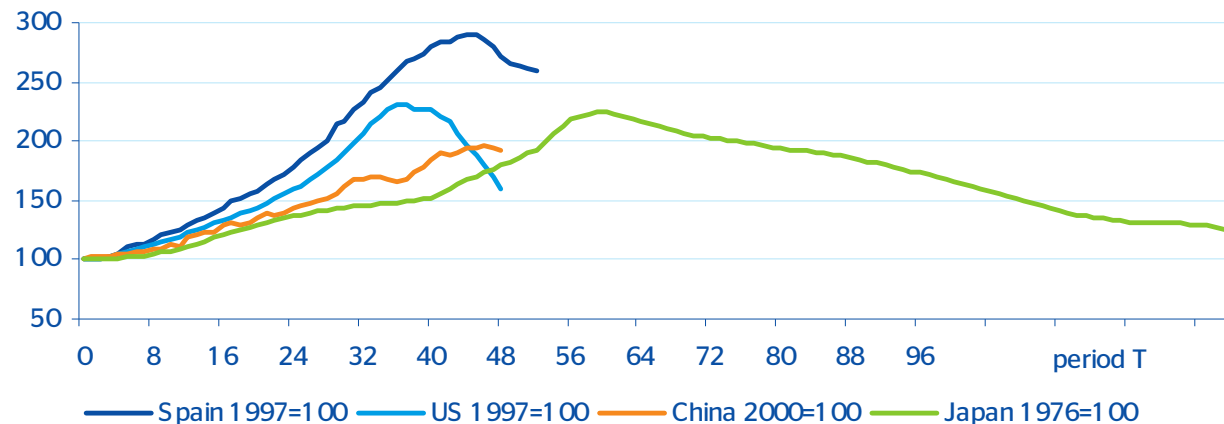
How important are
short term risks ?

1. Collapse of the housing bubble?: Much more of a soft landing

- Not yet a bubble -- BBVA 2011 Real Estate Outlook published last July estimates only minor overvaluation at a national level and prices have declined since (-1.2% nation-wide)
- The rise in prices still does not look so large in comparison with international case studies of classic real estate bubbles
- Market cooling measures remain in place.

International comparison of price bubbles

Source: BBVA Research



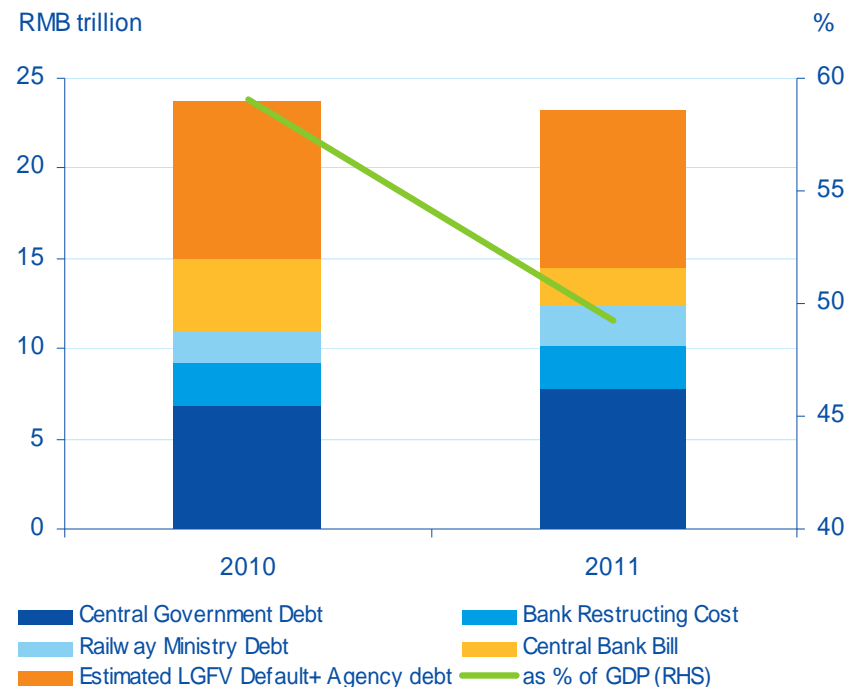
2. NPLs from massive stimulus package?

Also manageable as long as China grows

- Build-up of local government debt under massive 2008-09 fiscal package could add as much as 30% of GDP to China's public debt if the central government accepts the debt
- At other extreme - if banks take all the hit - they would need to raise 600 billion RMB new capital
- So far regulatory forbearance. Furthermore, China's small public debt shrinking thanks to growth

Public debt has been flat in nominal terms, and has declined as % of GDP

Source: BBVA Research



3. Shadow banking? Being tamed

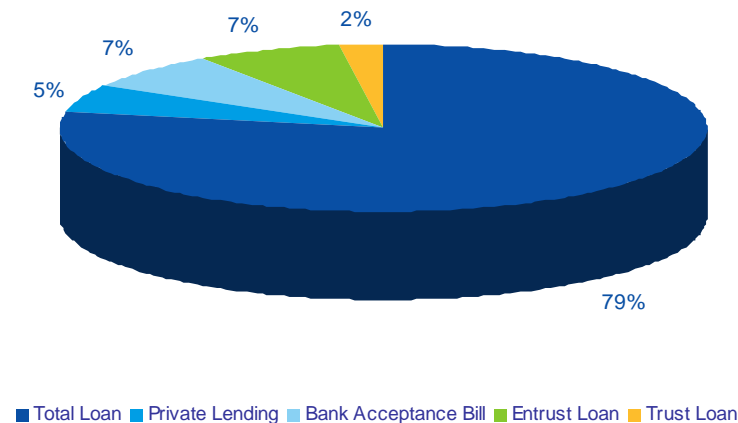
- High concentration of loans to the real estate sector combined with weak risk management practices
- Possible maturity mismatches
- Liquidity risks to the formal sector as deposits are siphoned

Strong measures have been taken to contain the growth of shadow banking

Shadow banking accounts for a fifth of the financial system...

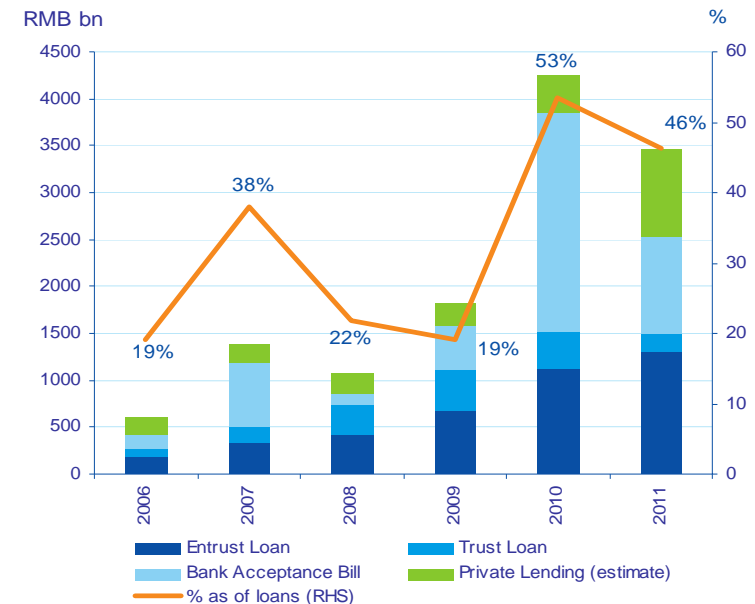
Source: PBoC and BBVA Research estimates

as % of total credit (2011)



...but a much larger share of new credits over the past year

Source: PBoC and BBVA Research estimates



The problems are years away...
but are REAL!

Aging is probably the most important

- Shrinking labor force
 - Already today, tight labor market conditions putting huge upward pressure on wages in the costal areas
- Ballooming fiscal expenditure (pension and health care)
 - Even more so since the government is rapidly increasing coverage of pensions and healthcare to quesh social unrest

Clock will start ticking from 2015 onwards

Key takeaways

China still a key engine for Latin America

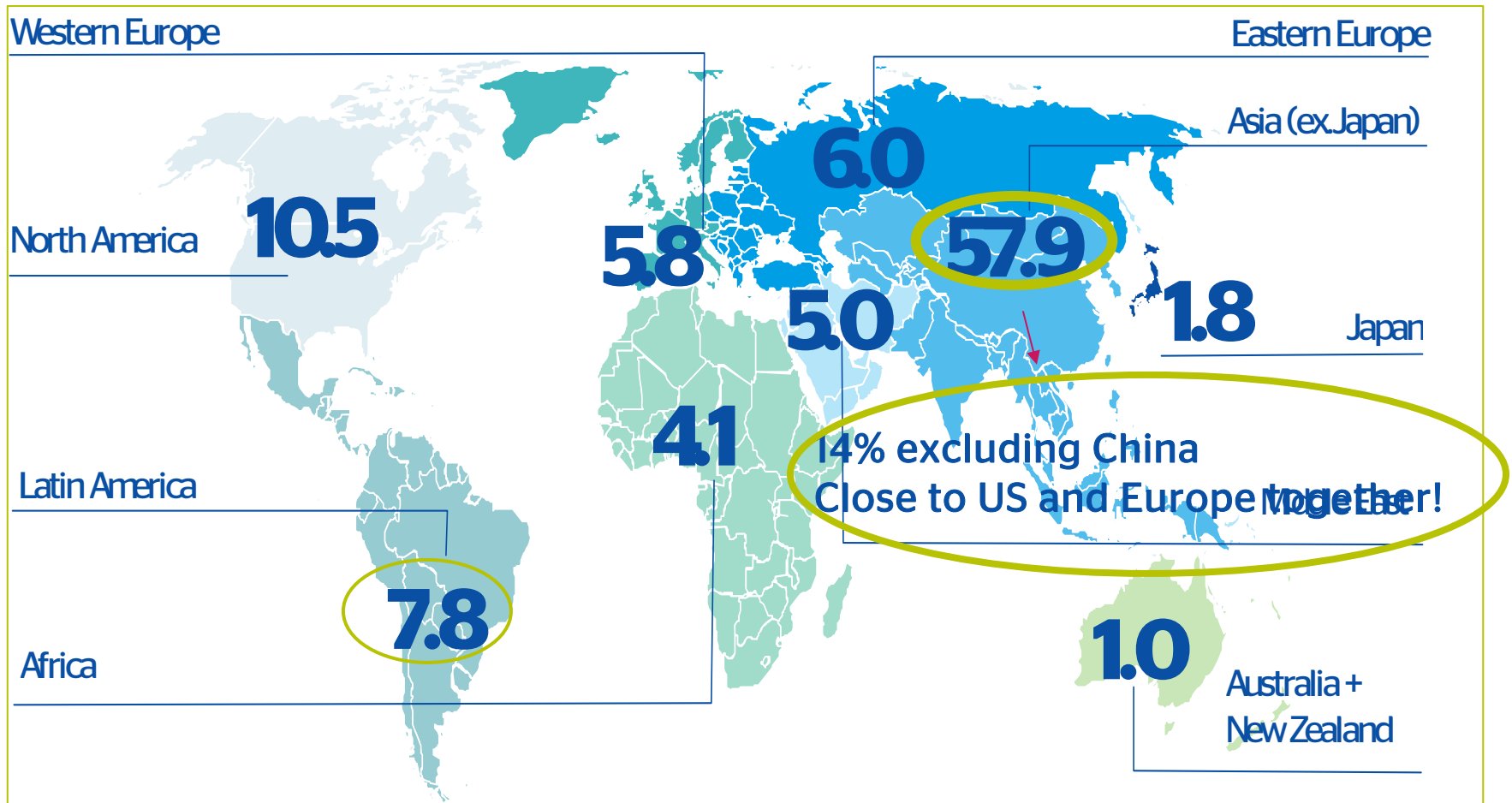
- But it will continue to be commodity oriented

But other growth engines need to be found!

Asia - not only China - dominant in the next 10 years

Contribution to global economic growth by region, 2011-2021 (%)

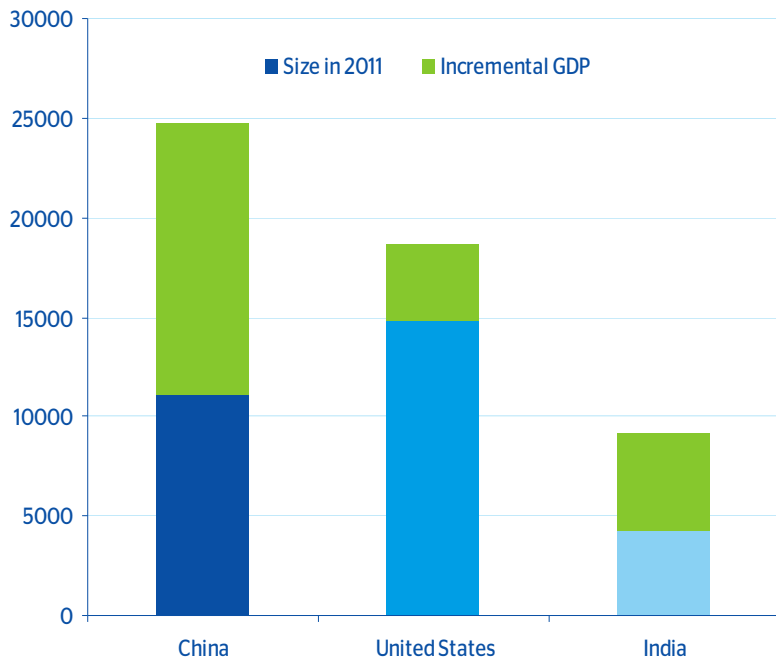
Source: BBVA Research and IMF WEO



India to contribute to global growth more than the US

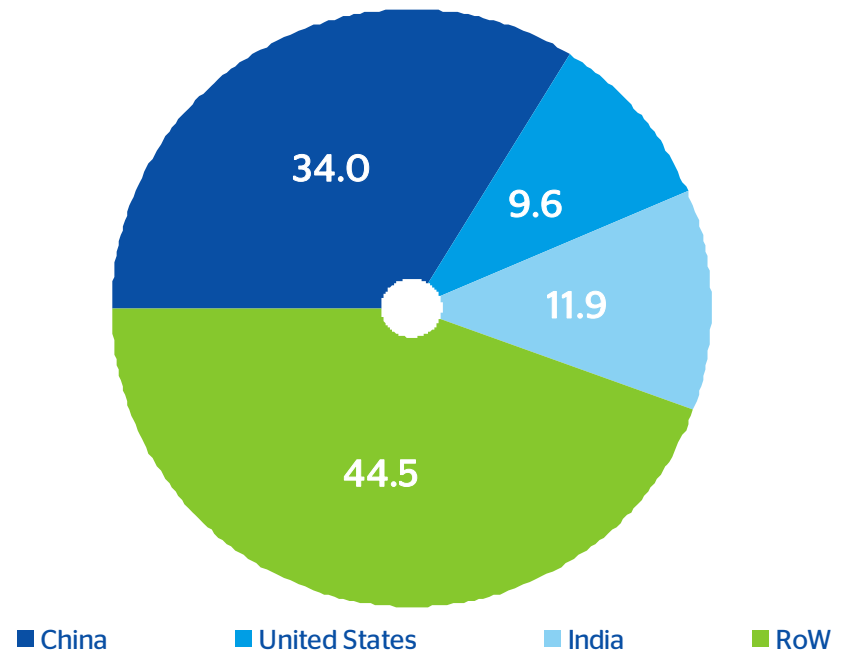
Global leaders in the next 10 years: GDP adjusted by PPP (billion USD)

Source: BBVA Research and IMF WEO



Global leaders in the next 10 years: contribution to World economic growth (percentage)

Source: BBVA Research and IMF WEO



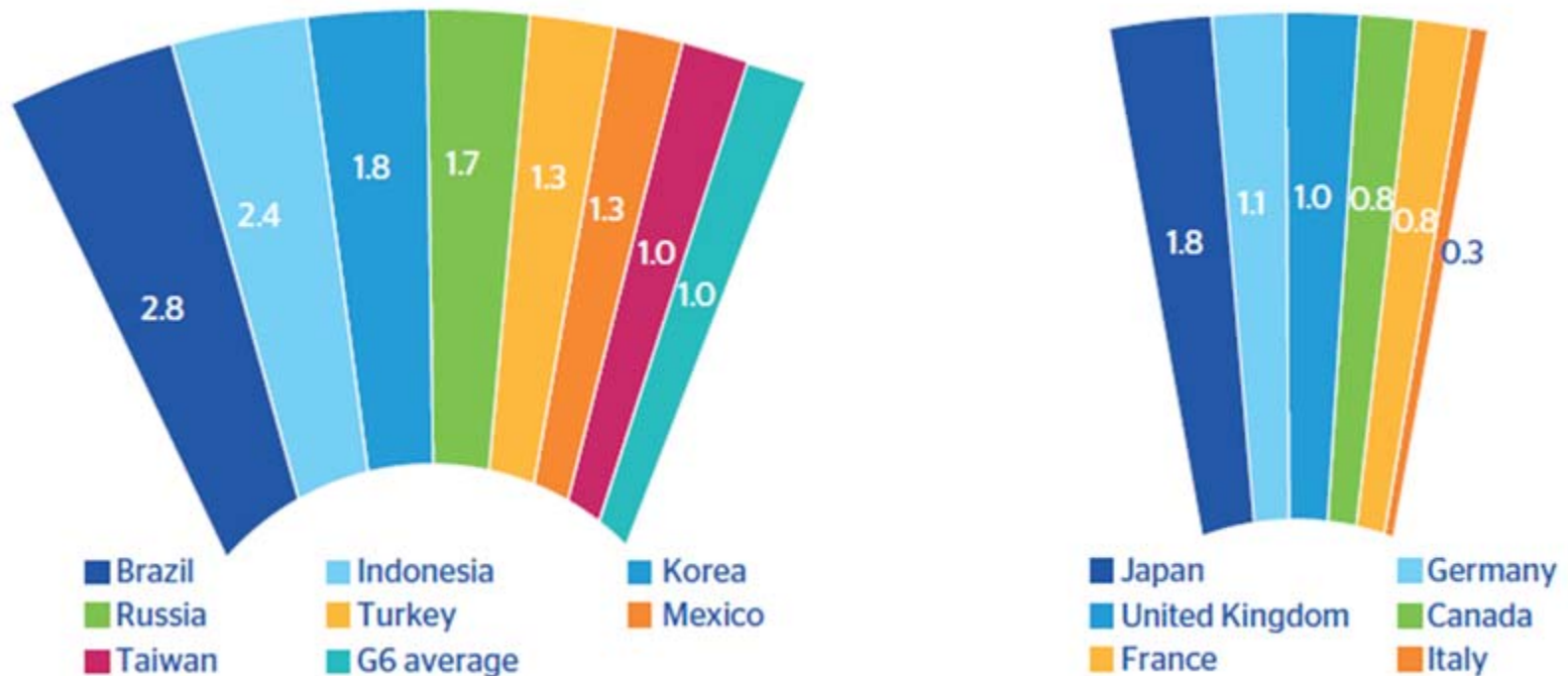
Indonesia, Korea & Taiwan also major contributors but also Brazil and Mexico

Brazil to contribute much more to global growth than Japan; Mexico more than Germany

EAGLEs ex China and India

Contribution to World economic growth 2011-2021 (%)

Source: BBVA Research and IMF WEO



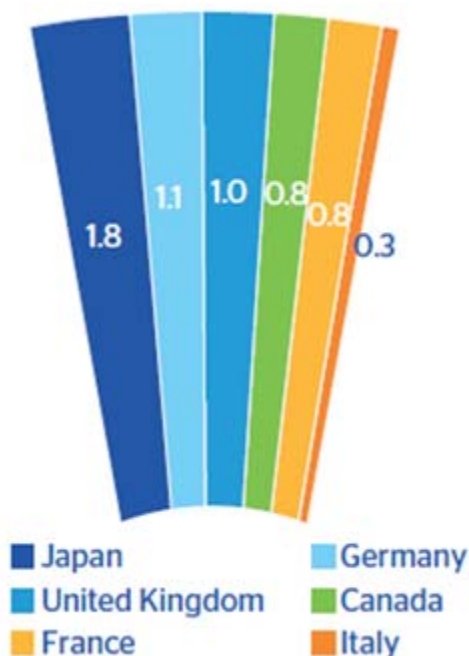
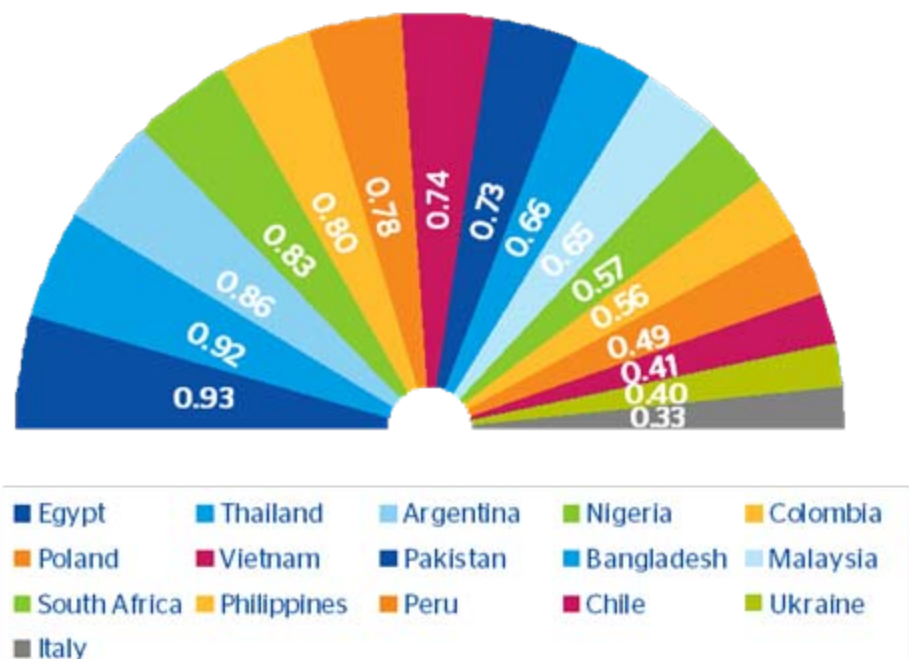
Other Asian economies also systemic As well as Colombia, Peru, Argentina and Chile

- Colombia, Peru and Argentina also relevant (more than Italy!) and recently even Chile

The Nest

Contribution to World economic growth 2011-2021 (%)

Source: BBVA Research and IMF WEO



In summary

- Latin America should not worry excessively about China for the next few years
- But should start preparing for the future by:
 1. Diversifying into other Asian countries
 2. Pursuing further economic integration

Comments welcome

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