

The global crisis and emerging markets:

An evaluation

Alicia Garcia-Herrero

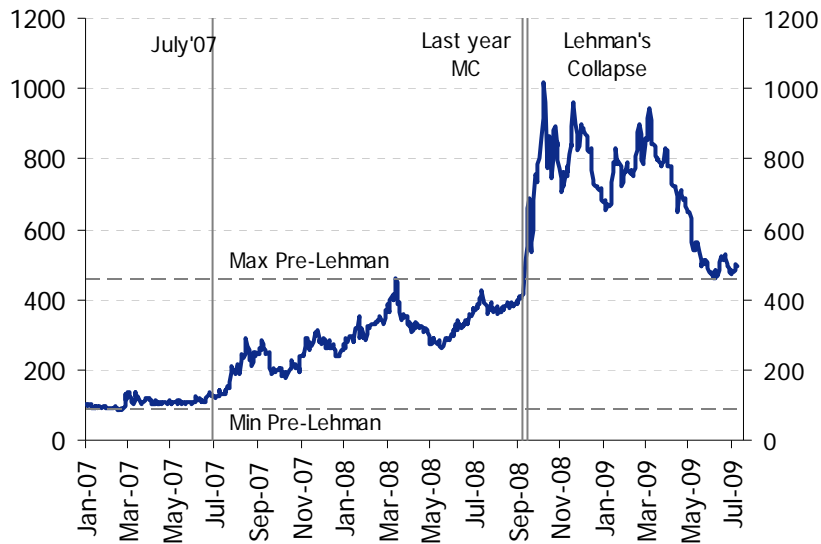
Chief Economist for Emerging Markets

BBVA

- 1. What has characterized the global crisis?**
- 2. The developed versus the emerging world**
- 3. Heterogeneity among emerging countries:**
 - a. Emerging Europe's drama**
 - b. Latin America's hopes**
 - c. Asia's emergence**
- 4. Growing links between Latin America and Asia**
 - a. Trade**
 - b. FDI**

1. High risk aversion

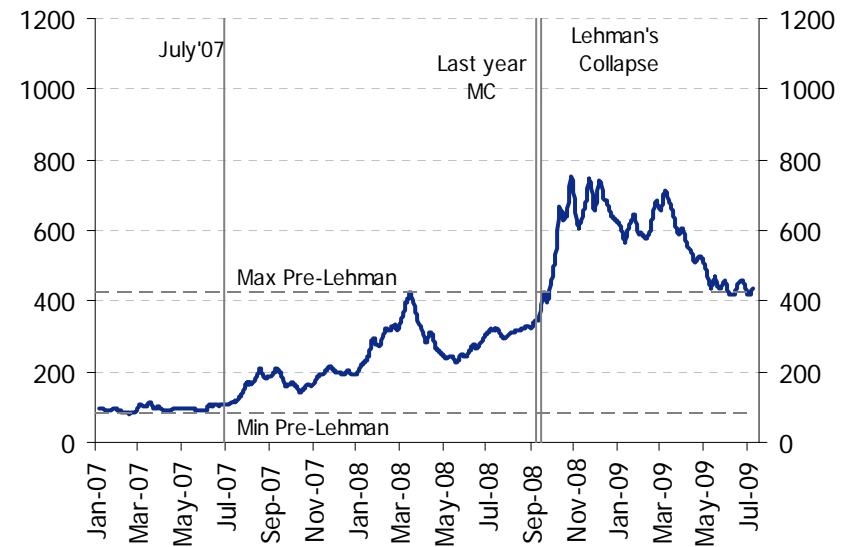
USA: Financial Tensions Indicator
100 = January-07



Source: BBVA-ERD

First normalized principal component of the following series: OIS spread, implicit volatility, and banking and corporate CDS spread

EMU: Financial Tensions Indicator
100 = January-07



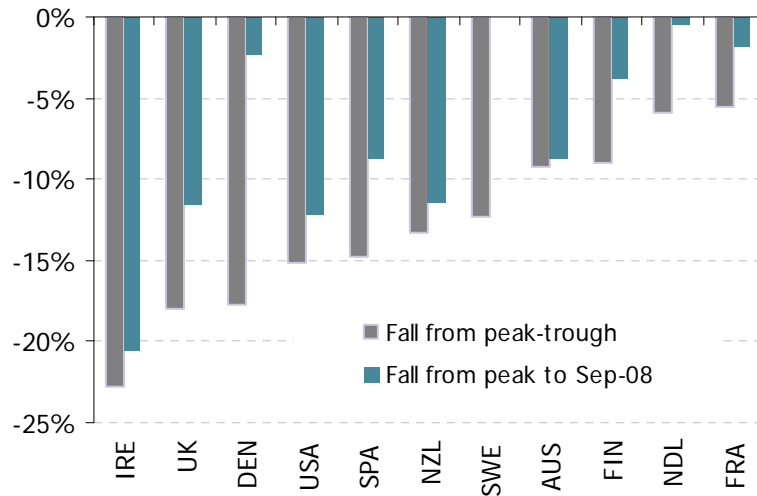
Source: BBVA-ERD

First normalized principal component of the following series: OIS spread, German implicit volatility, and banking, corporate sector and sovereign CDS spread

- The collapse of Lehman Brothers just after last year Management Committee provoked a jump in risk aversion levels.

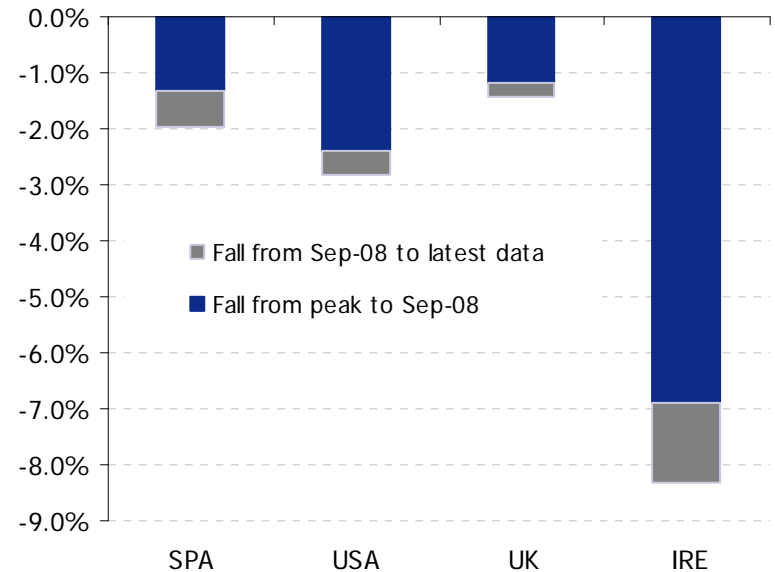
2. Housing adjustments

Real house price adjustments



Source: BBVA ERD.

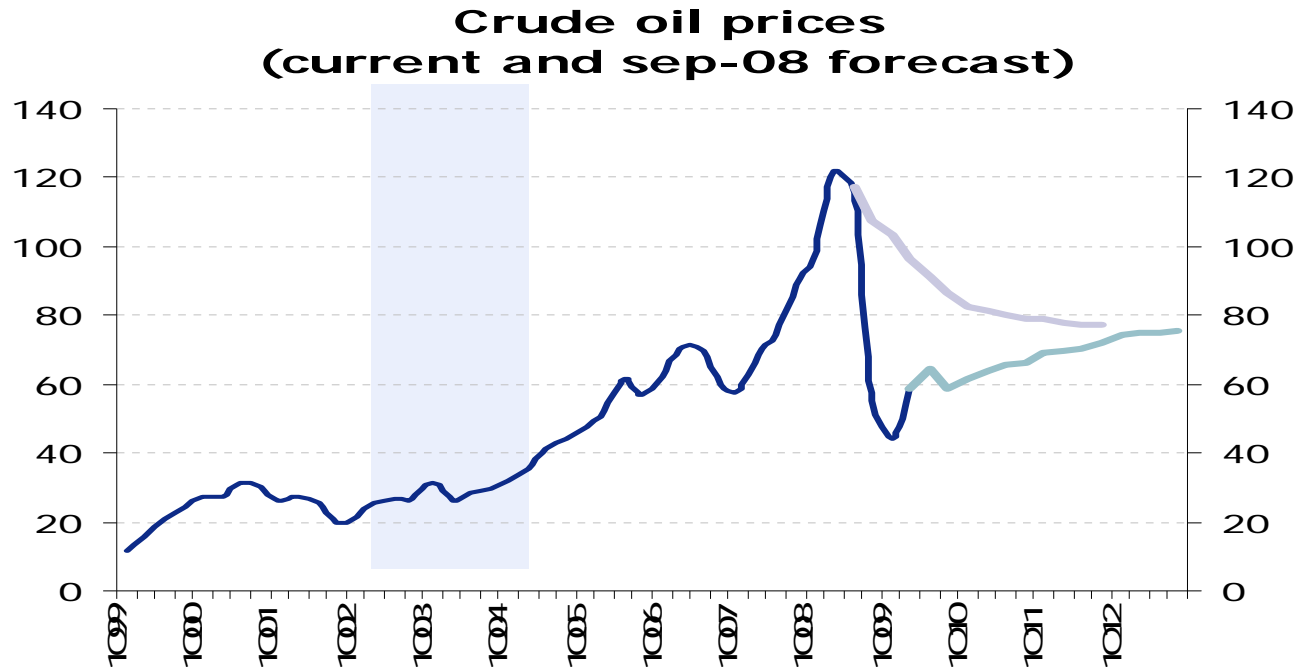
Residential investment adjustments



Source: BBVA ERD.

- Housing real prices have fallen in most countries in the last year

3. High volatility in commodity prices



Source: Datastream and BBVA ERD

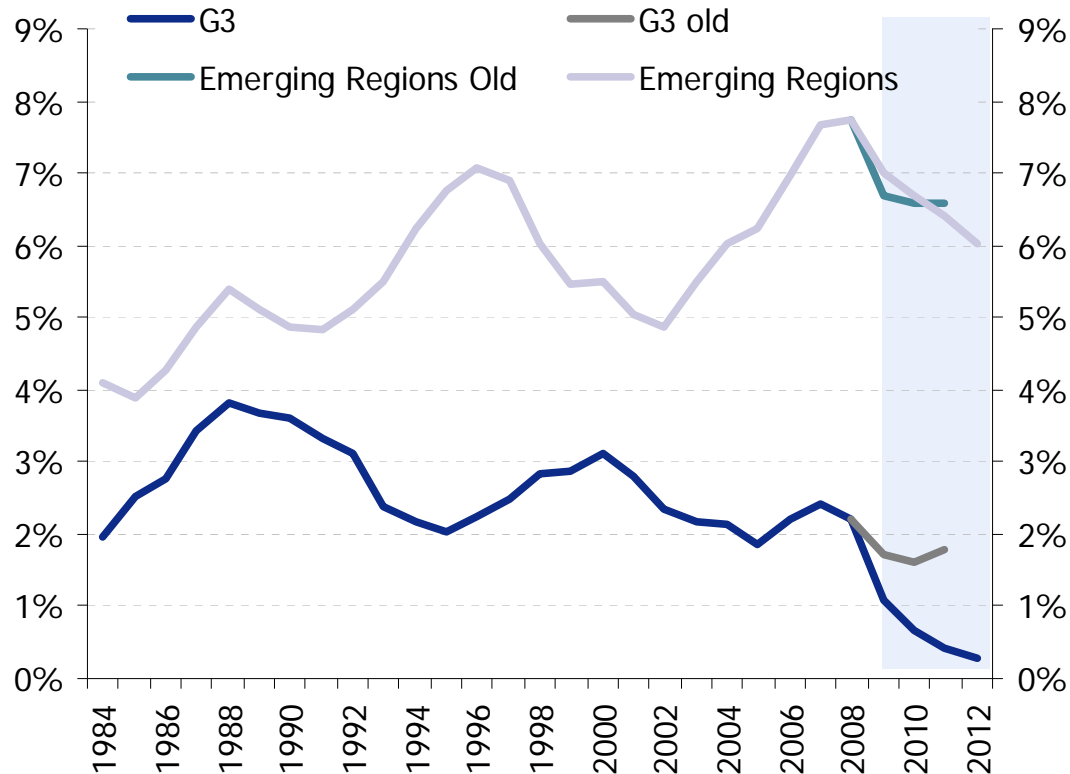
- Oil prices slumped following the sharp contraction in activity and the financial crisis, but prices are substantially higher than in previous years.

1. What has characterized the global crisis?

A Developed countries: negative surprise

B Emerging countries: resilience

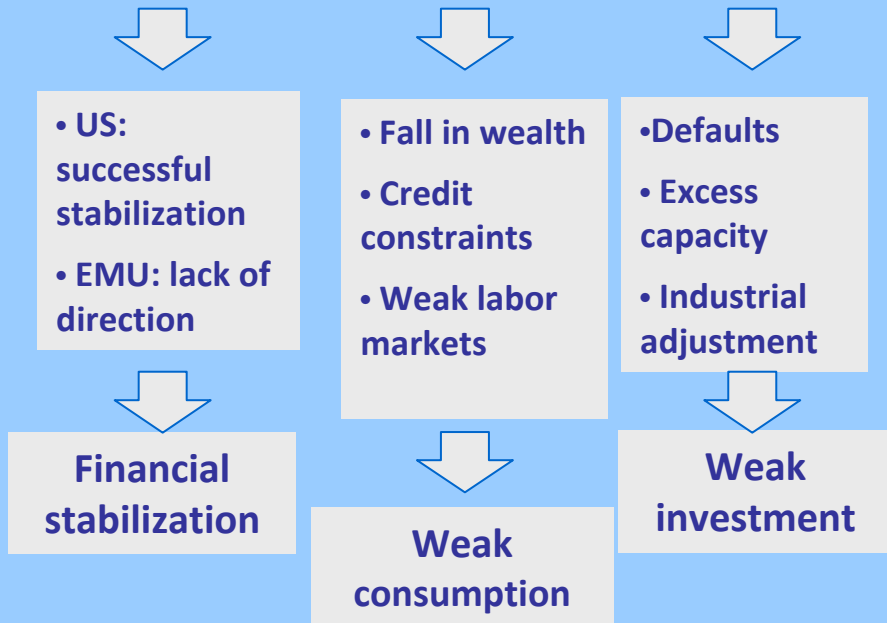
Growth forecast: 5 year moving average



Source: BBVA ERD

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A Developed countries: **negative surprise**

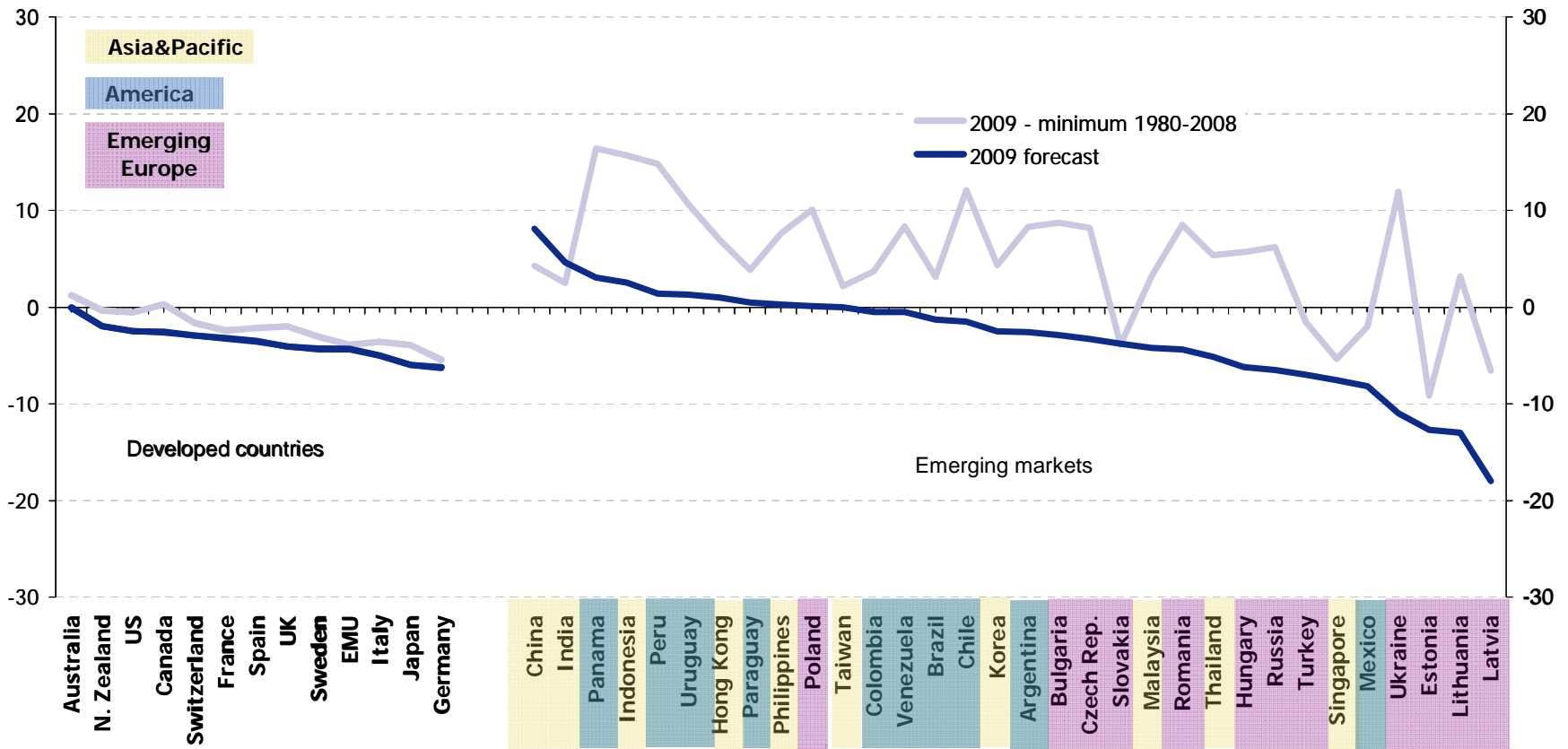


B Emerging countries: **resilience**



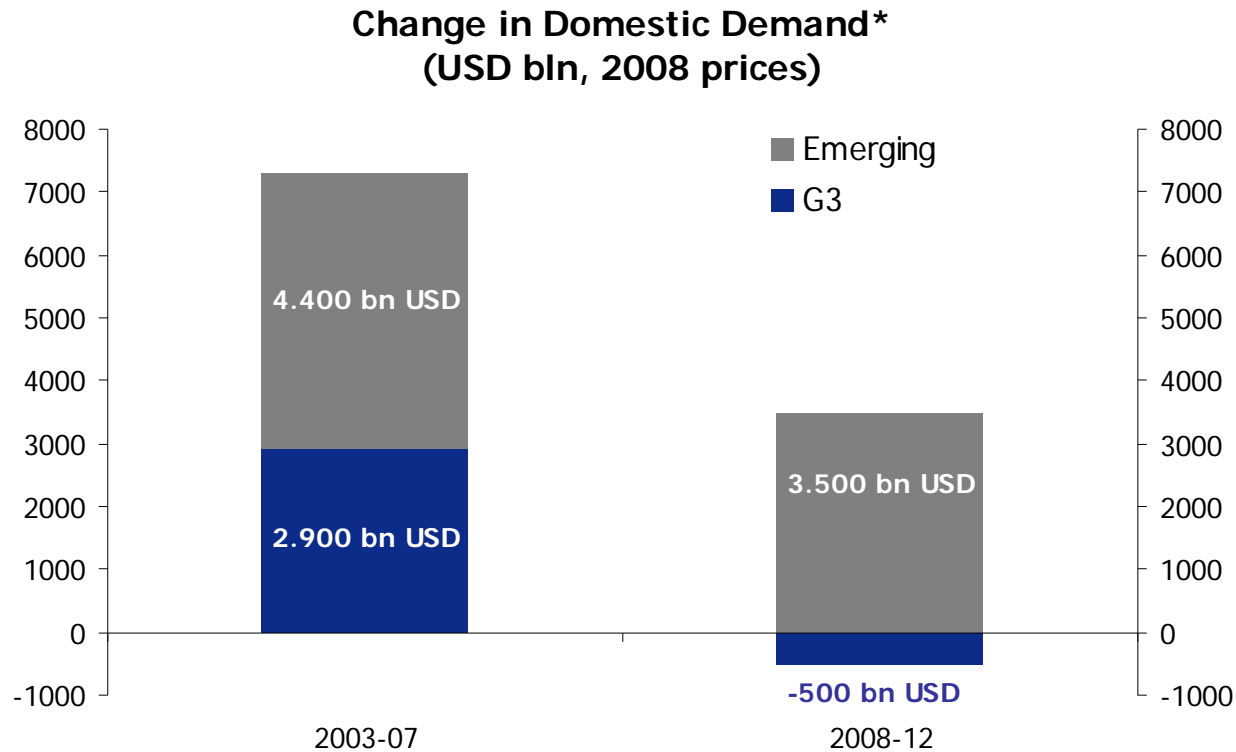
Emerging markets don't collapse

GDP (% y-o-y): Worldwide countries



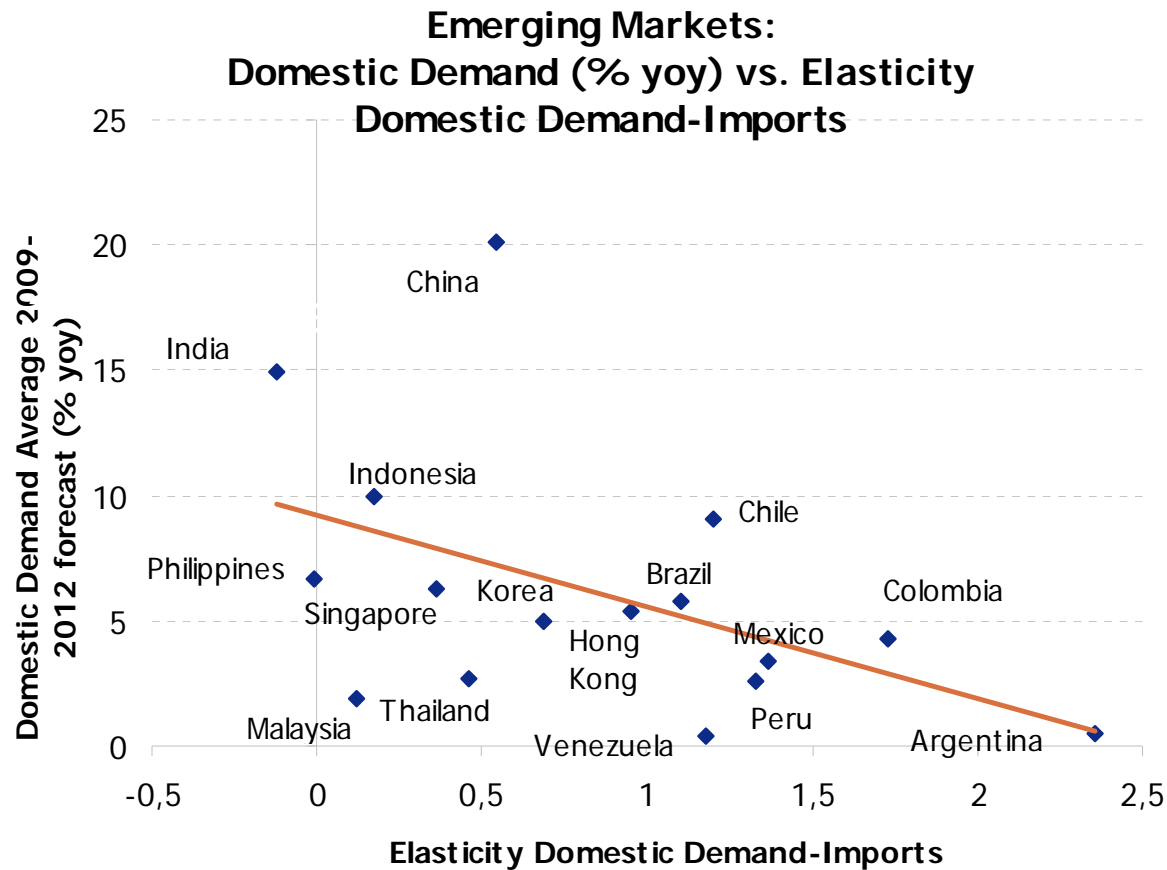
Source: BBVA

World domestic demand will be supported exclusively by emerging economies. Yet, they also face a moderation, so that they will not compensate the G3 fall.



(*): Private consumption + Gross fixed investment

Moreover, those countries are characterized by low import elasticities:
limited beneficial impact through trade channel



Several risks remain: too many drivers could move us to an scenario of even lower growth

Included in our risk scenario

Wealth, saving and deleveraging

Asset price correction and caution among economic agents may be even more intense

Effect of economic policies

Impact could be more muted than anticipated and may fade before private sector growth resumes

Financial conditions

Failure to restore to a sufficient level the health of banking institutions results in longer strain in credit

Emerging markets: contagion

Crisis in Eastern Europe leads to a new bout of negative impacts in other emerging economies

Sovereign defaults

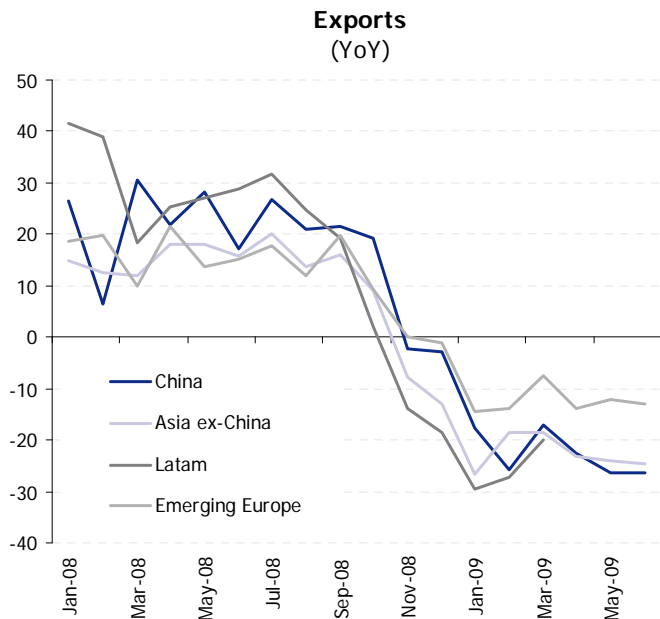
Fiscal policy may find a limit in smaller countries, creating significant contagion effects

More likely

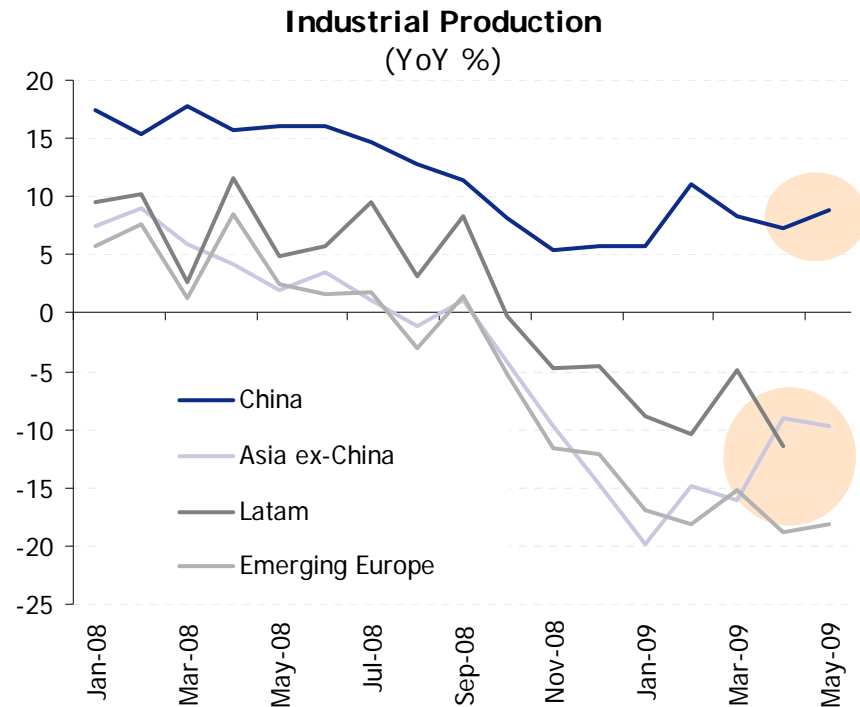
Less likely

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- Since the bottom of January 2009, Asian IPs have significantly moderated their rate of decay.
- Latam registers a more moderate rate of decline, but without clear rebound signs.
- EE combines of the two former: decline intensity and absence of clear recovery symptoms.



Source: Bloomberg

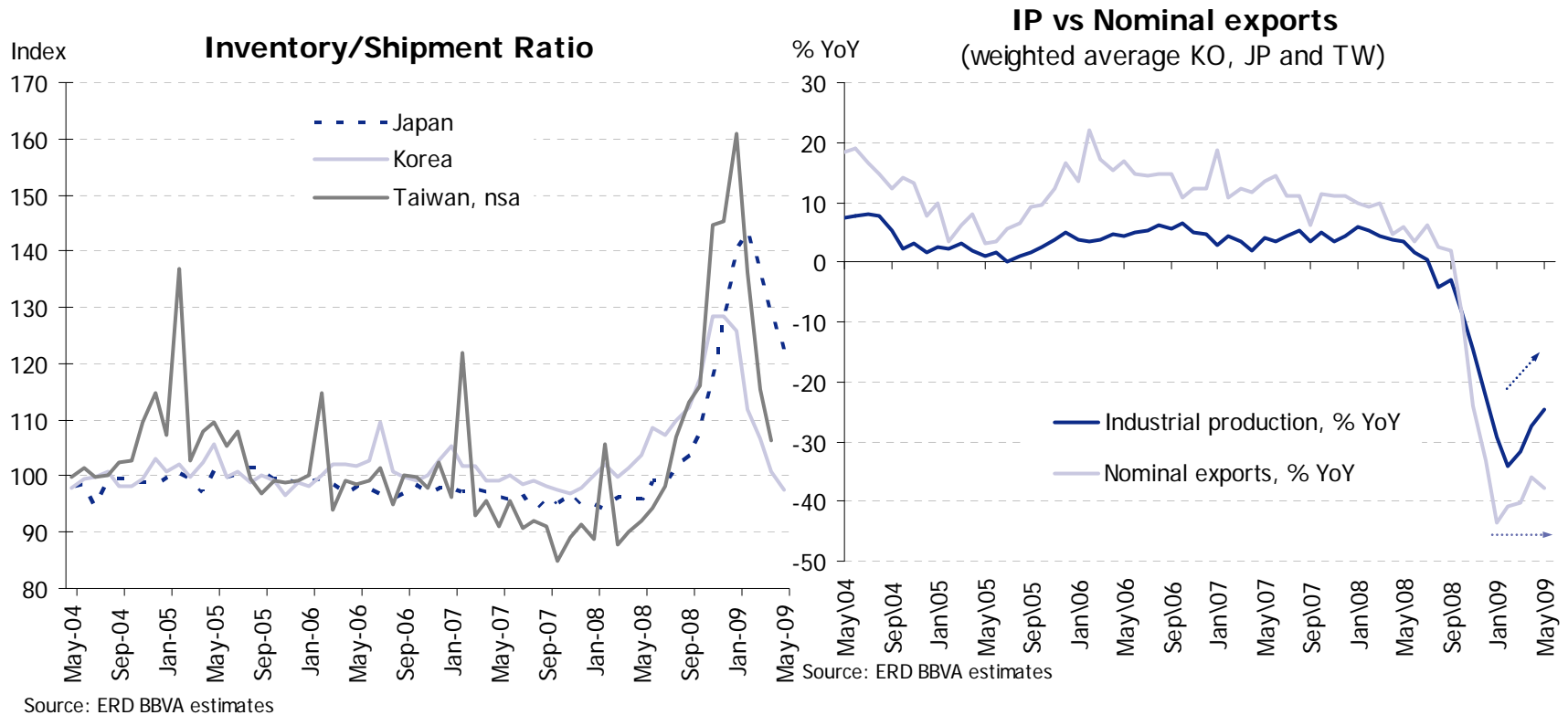


Source: Bloomberg



- External demand keeps dragging growth in EMs in a much more indiscriminating fashion.

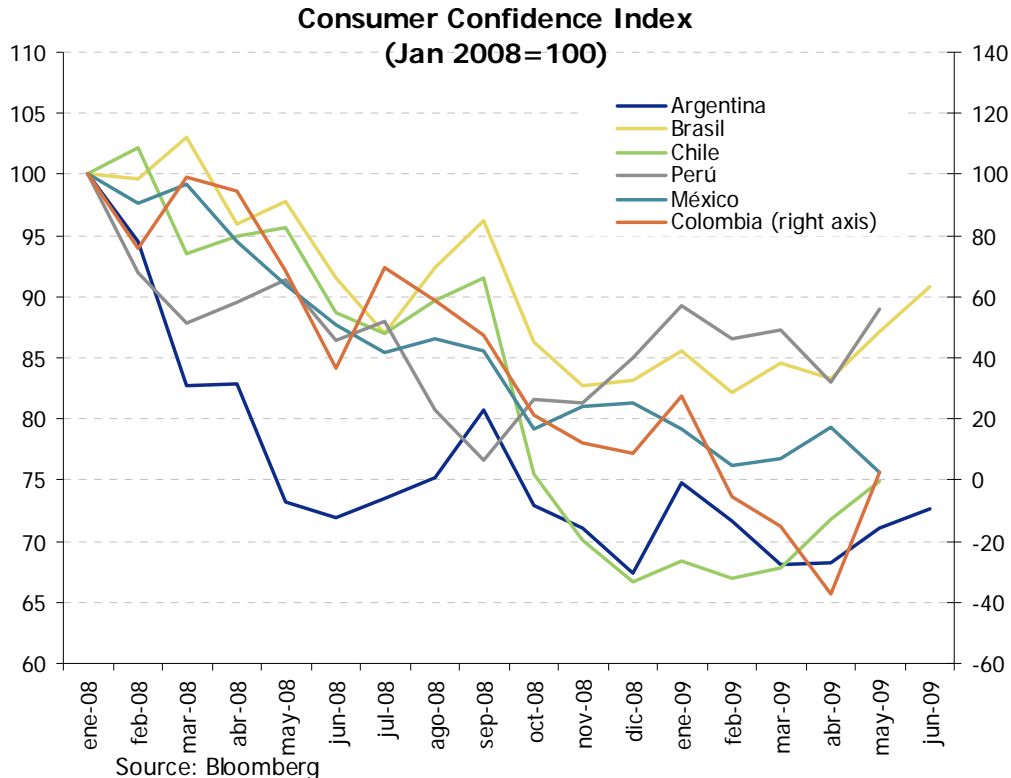
Asia outperforms their EM peers. With Business and Consumer confidence on the rise, IP deterioration seems to have corrected



Rebound in industrial output may reflect slowdown in inventory adjustment

Export data is not improving to the same extent.

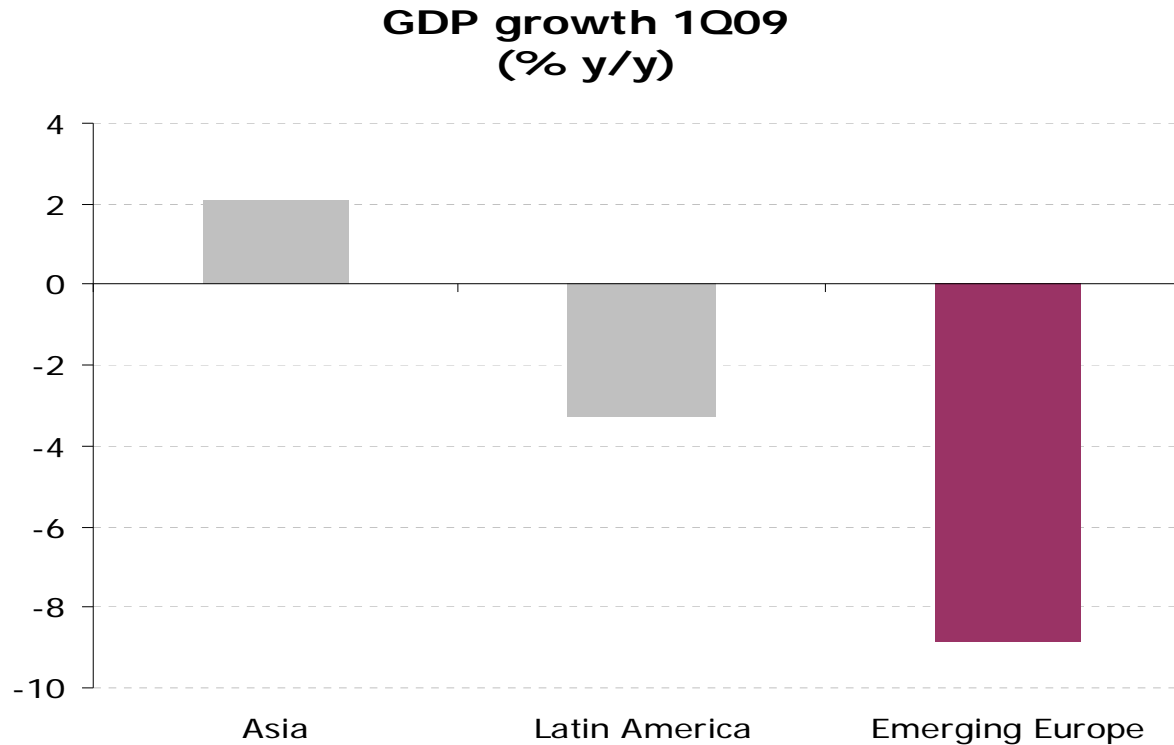
Latin America: Some signs of stabilization, but mixed data remains. Our baseline scenario gains relevance.



- 1- Regional confidence indicators start to improve, but they remain below 3Q08 levels. Other demand indicators show a similar pattern.
- 2- No firm evidence of bottoming out, but the pace of deterioration is slowing, particularly in Brazil.
- 3- GDP forecast for Peru have been revised downward (2.4 to 1.4% in 2009; 3.6 to 3.3% in 2010).
- 4- Latest IMACEC for Chile records a fall of -4.4%, significantly below our expected -3%. The economy would not have reached bottom in 1Q09.

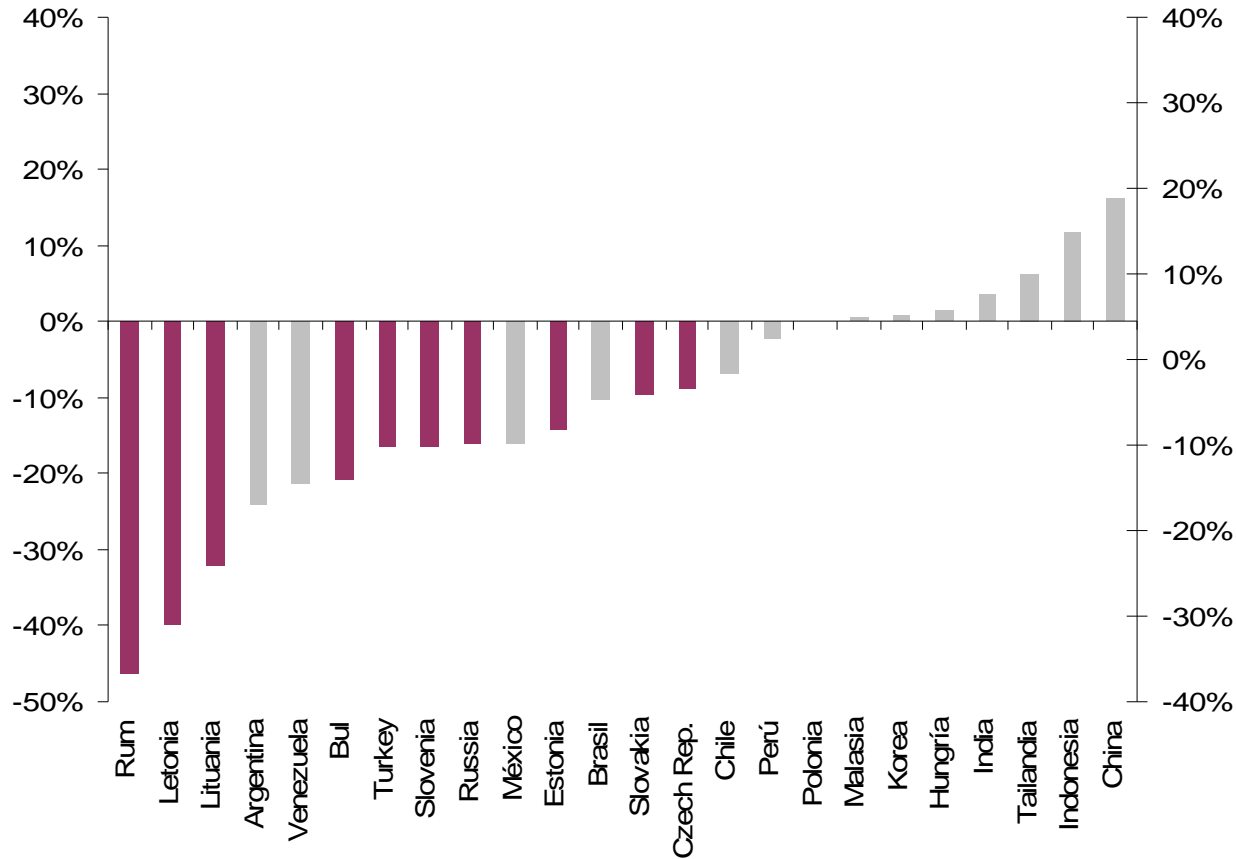
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Emerging Europe's growth has collapsed



Real credit growth is decelerating very rapidly, after growing at high rates

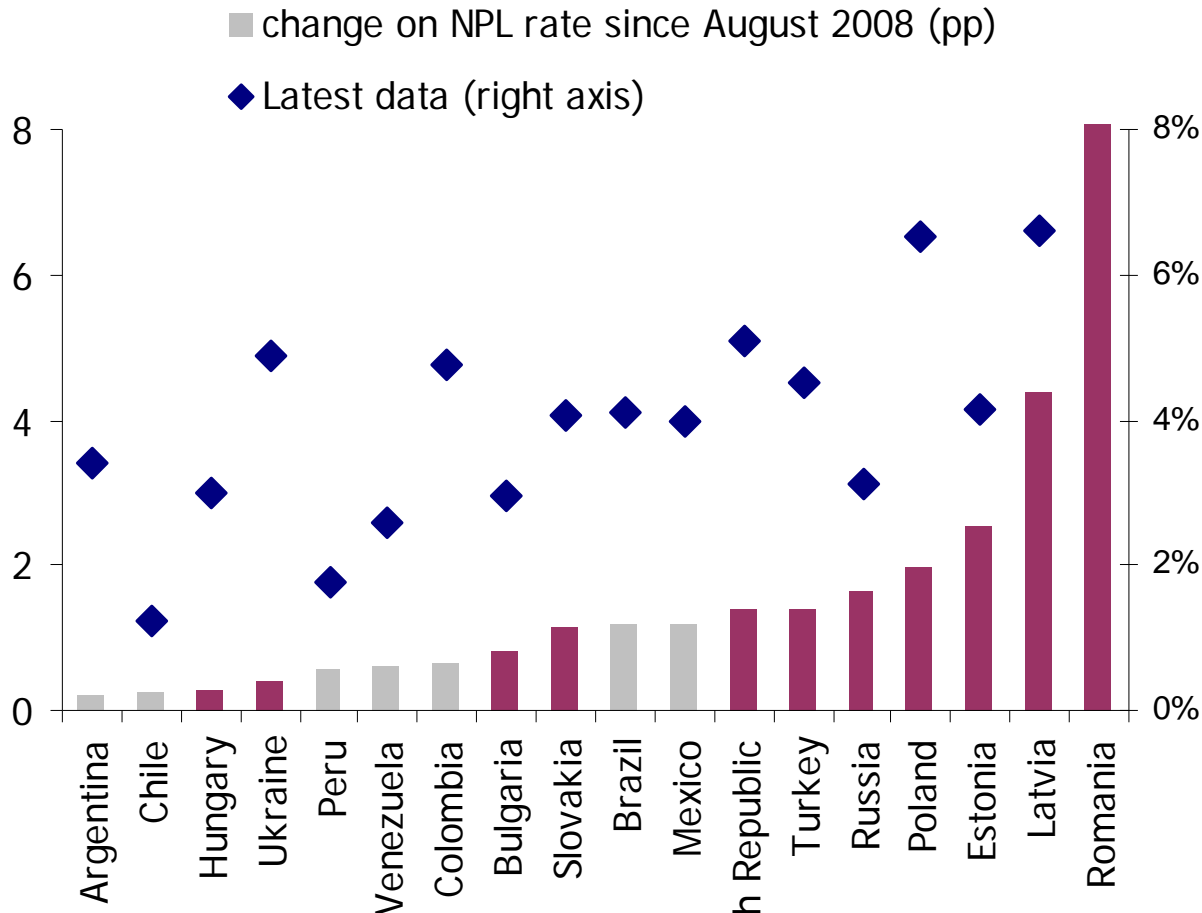
Change on real credit growth over the past 12 months (yoy rate)



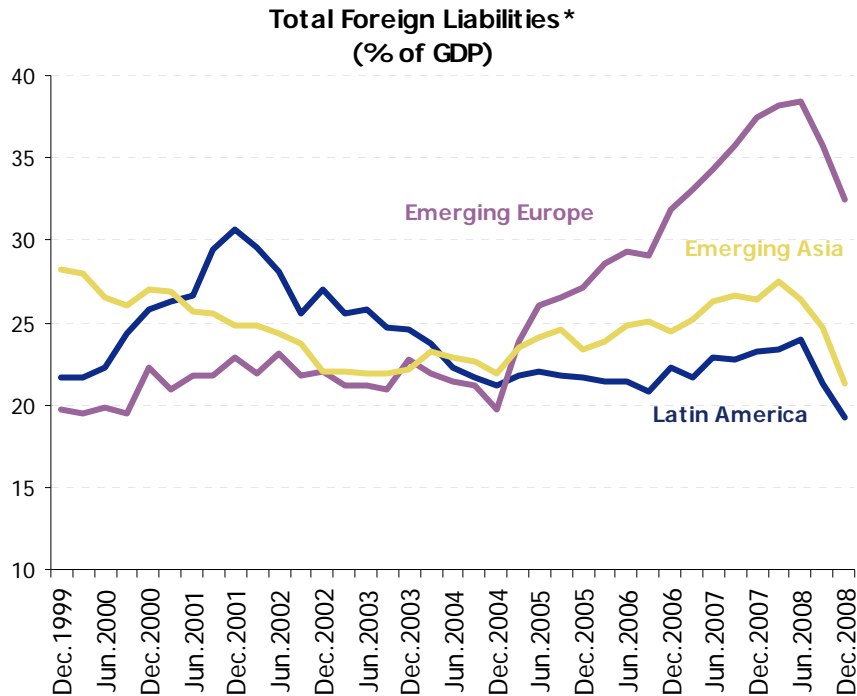
Latest data Apr-09, for most countries

Non performing loans are increasing over the last year, and are expected to worsen very quickly as macroeconomic conditions deteriorate.

NPL (%)



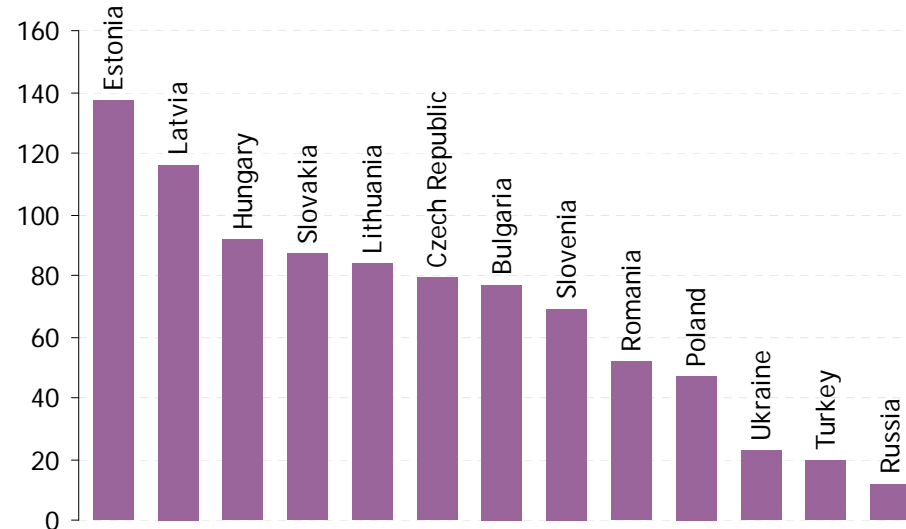
Liabilities to foreign banks (mainly European banks) are very has increased notably over the past 3 years



*: BIS reporting banks

Source: BIS, WEO and BBVA

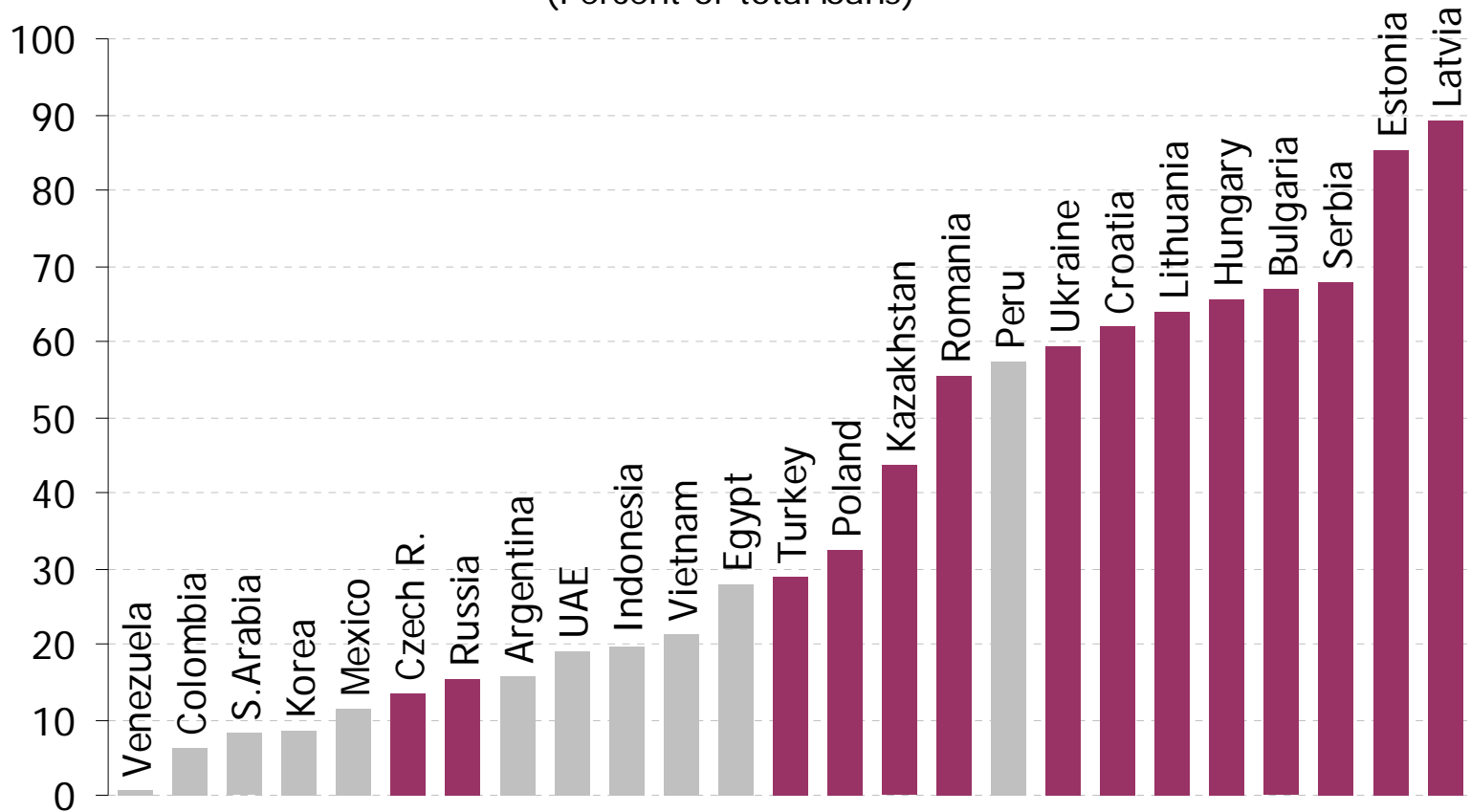
Emerging Europe: Total Foreign Liabilities as % of GDP (Dec. 2008)



Source: BIS and BBVA

The share of forex loans has also increase (€ and Swiss Franc), reaching a high portion of total loans. Vulnerability increases as depreciation pressures persist.

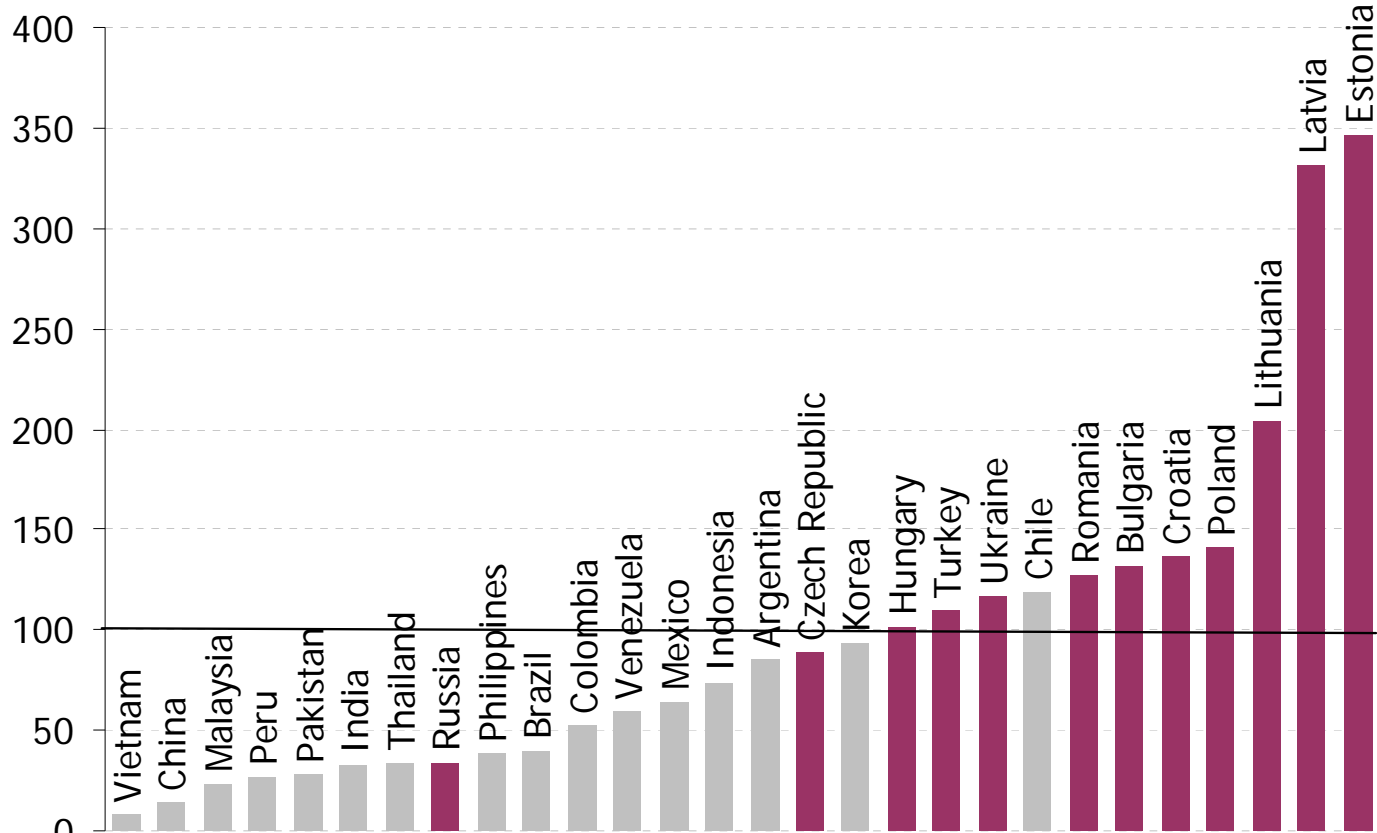
Forex Share of Total Loans
(Percent of total loans)



Most countries in the region could confront difficulties in refinancing their external debt

External Debt Refinancing Needs in 2009

Percent of reserves



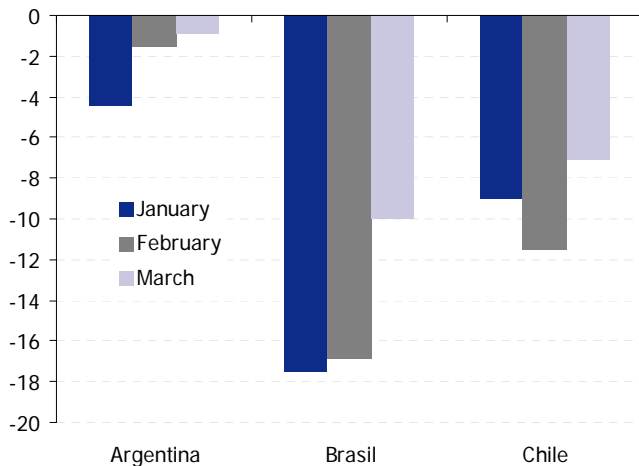
Source: GFSR, IMF

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LATIN AMERICA: Brazil offers more room for optimism due to the recent increase in industrial production. This, added to the moderation in the rate of decay in Argentina and Chile, has favored a mild rebound in the aggregate index.

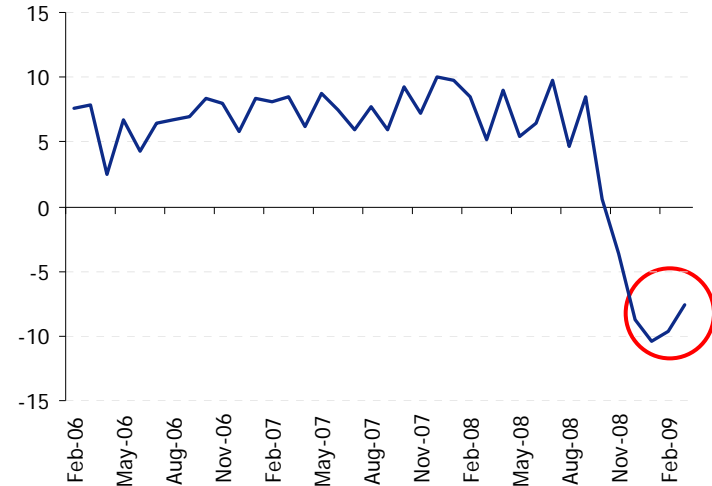


South America: Industrial Production
(% YoY; Selected countries)



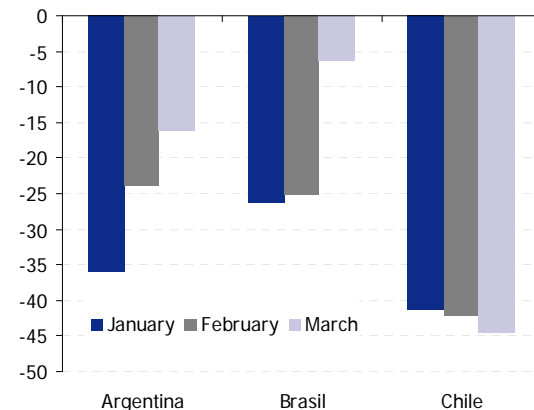
Source: Bloomberg and BBVA

Latam ex-Mexico: Industrial Production
(YoY %)



Source: Bloomberg y BBVA

South America: Exports
(% YoY; Selected countries)



Source: Bloomberg and BBVA

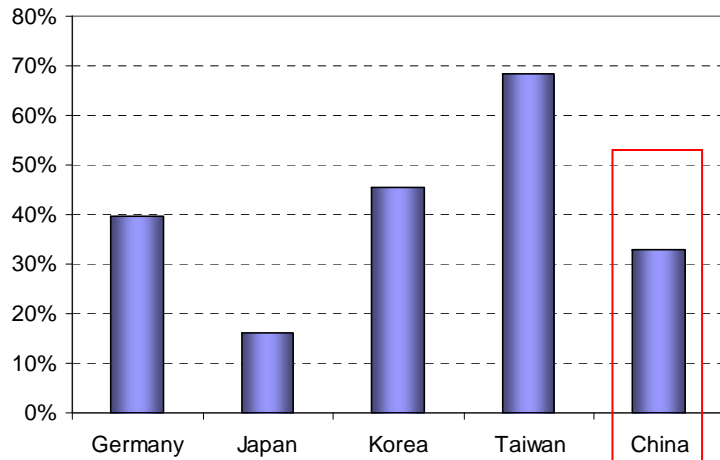
Export declines recede in Argentina and Brazil but it has remained intense in Chile

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- We maintain our baseline forecast that China's growth in 2009 at 8.1% close to its economic potentials.
- The driver for growth is mainly due to domestic demand led particularly by strong investment growth, facilitated by its massive fiscal stimulus package, favorable monetary conditions and fast implementation.
- Surging investment and resilient domestic consumption provide good cushion for short-term growth. But growth in exports is expected to remain sluggish on weak recovery externally.
- However, structural reforms in areas of pension, under-funded education system, and medical reform are urgently needed in order to reduce savings and stimulate consumption. In addition, increased competition in sectors with state monopoly is also required in order to stimulate investment efficiency and productivity growth. Given some of the policy initiatives are underway, we are therefore optimistic on China's medium-term prospects.

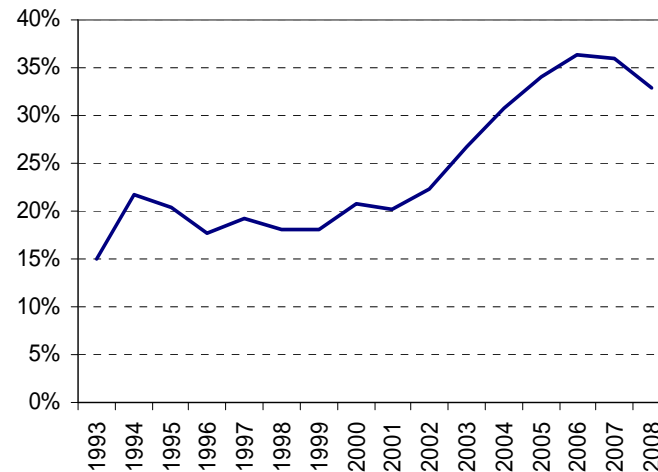
- Although very high, China's reliance on exports is higher than Japan but lower than Germany, Korea, and Taiwan.
- China's reliance on exports has declined since 2006 onwards.
- The global recession and a weak recovery in 2010 will continue to weigh on Chinese economy.

Exports / GDP



Source: CEIC

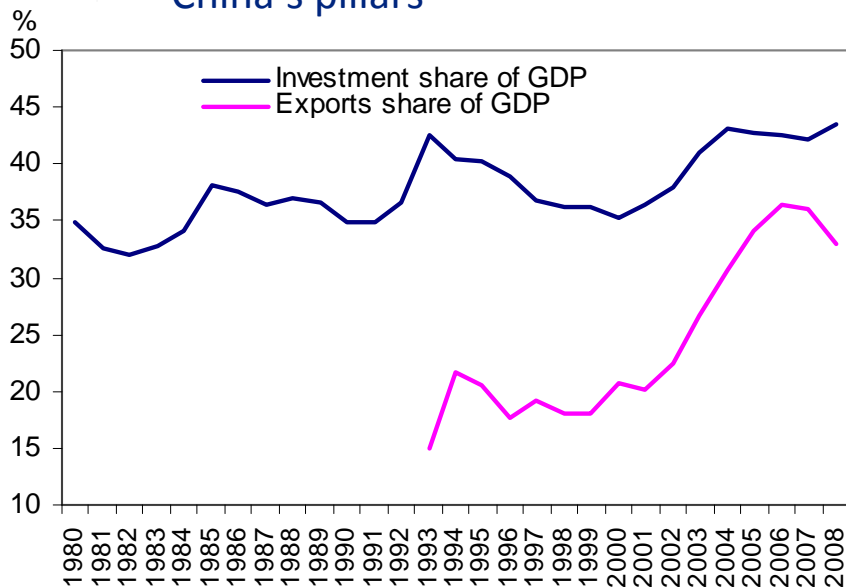
China's exports/GDP



Source: CEIC

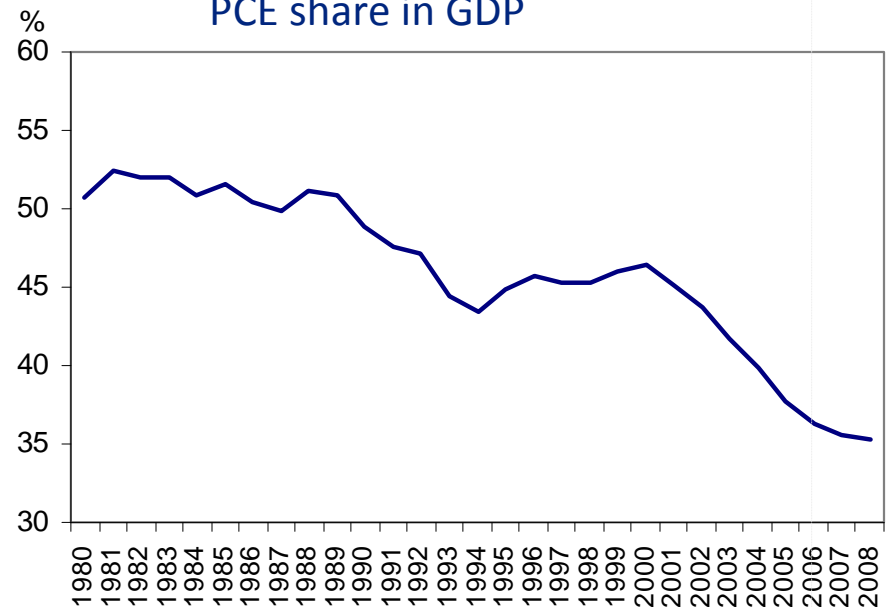
- Investment-GDP ratio remains at high level has a high correlation with export share between 2001 to 2007, led by rapid expansion in exports.
- Private consumption share in GDP fell sharply from 2000 onwards, but the pace of the decline has slowed recently.

China's pillars



Source: CEIC

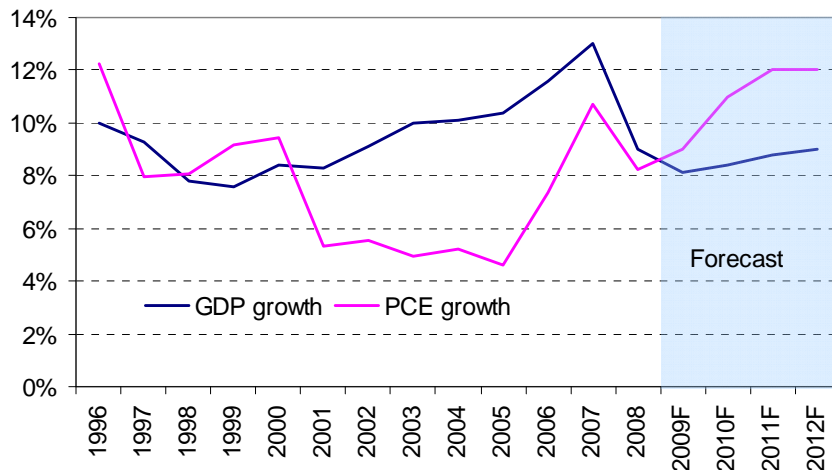
PCE share in GDP



Source: CEIC

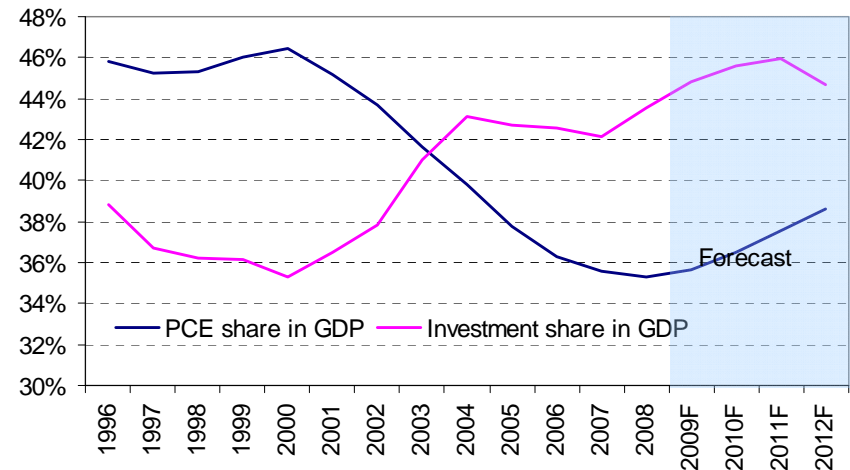
- For our medium run scenario, our simulation indicates that private consumption growth will need to pick up further to up to 12% yoy.
- This will gradually raise the consumption share to GDP from 35% to close to 40%.
- Under the current environment, this appears to be achievable because of both policy awareness and resources available to tackle the structural imbalance.

Real Private Consumption and GDP growth



Source: CEIC

PCE and Investment share in GDP

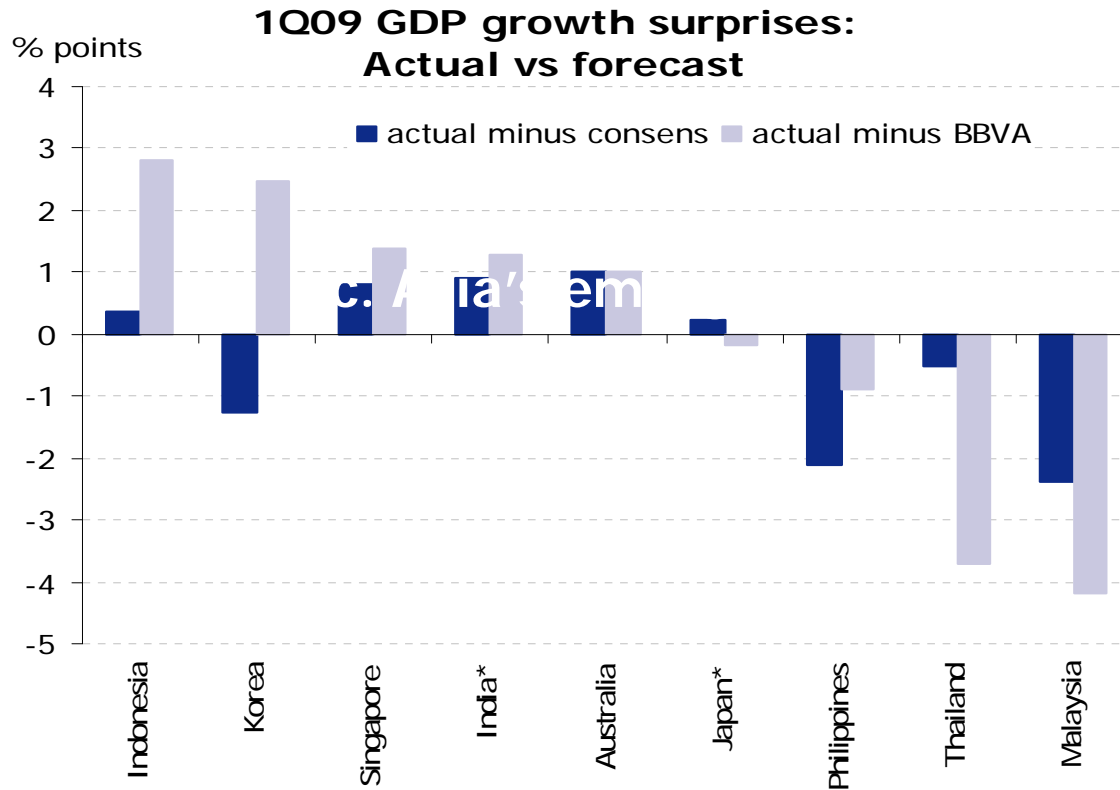


Note: Private consumption expenditure (PCE) share in GDP is calculated as PCE/GDP. Same to investment. Investment is gross capital formation.

Source: CEIC

- Asia began to show some signs of rebound in activity in Q2, after the sharp decline in the previous quarter
- Asia's larger, more closed economies outperformed in Q1. The next two quarters may favor the recovery of small, open economies of Asia that have experienced the deepest contractions
- As confidence returns, financing conditions ease and inventory adjustments bottom up, increased demand for re-stocking and expenditure can boost industrial production and lead exports
- All in all, quarter-on-quarter growth is expected to strengthen from Q2 and year-on-year growth to turn positive by 2009Q4.
- We expect large countries, with a broad domestic demand base and supportive macro policies (CH, IN, ID) to fare better a global recessionary scenario; these larger countries will post a rebound less steep than the small, open ones as global growth turns up

- 1Q09: Positive surprises vs BBVA forecast (April estimates) in Indonesia, Korea, Singapore, India and Australia. Largest negative surprises in Malaysia and Thailand

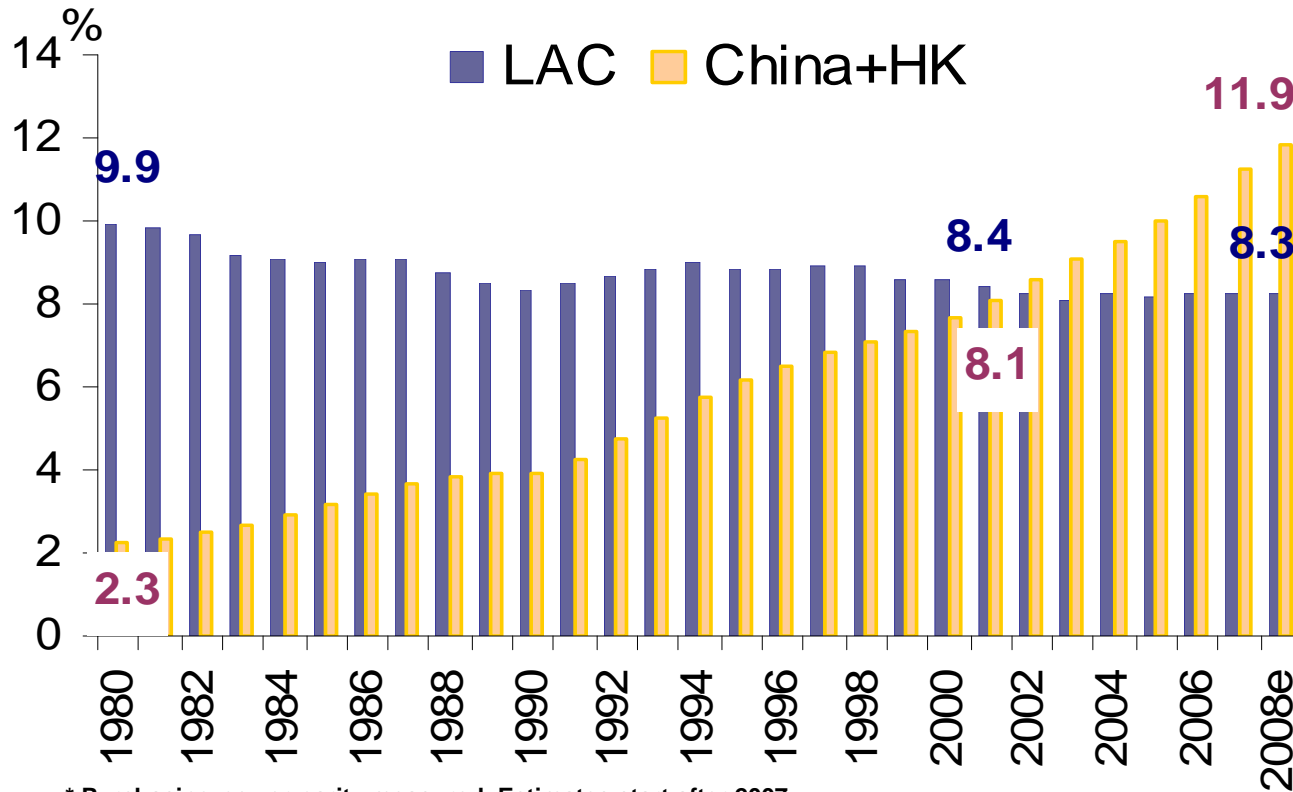


GDP Growth Forecasts for Asia 2009-2010 (Jun-09)

Country/ Aggregate	2009			2010		
	Apr\09	Jun\09		Apr\09	Jun\09	
	Previous	Revised	Consensus Forecast	Previous	Revised	Consensus Forecast
Australia	-0.3	0.0	-0.2	1.5	1.1	1.5
India	4.1	5.0	5.8	4.0	5.7	7.0
Indonesia	1.7	2.6	3.7	4.7	4.1	4.7
Japan	-6.0	-6.0	-6.6	-0.4	0.5	1.3
Malaysia	-1.0	-4.2	-3.2	3.9	2.7	3.6
Philippines	1.2	0.3	0.6	3.5	2.5	3.2
Singapore	-7.5	-7.5	-7.0	3.0	3.0	3.5
Korea	-4.9	-2.5	-2.7	3.1	2.4	3.1
Thailand	-2.8	-5.1	-3.8	2.5	2.0	2.8
Asia-Pacific		-0.7			3.4	
Emerging Asia (EA)		3.7			5.9	
EA exCh,HK,Tw		0.2			3.8	

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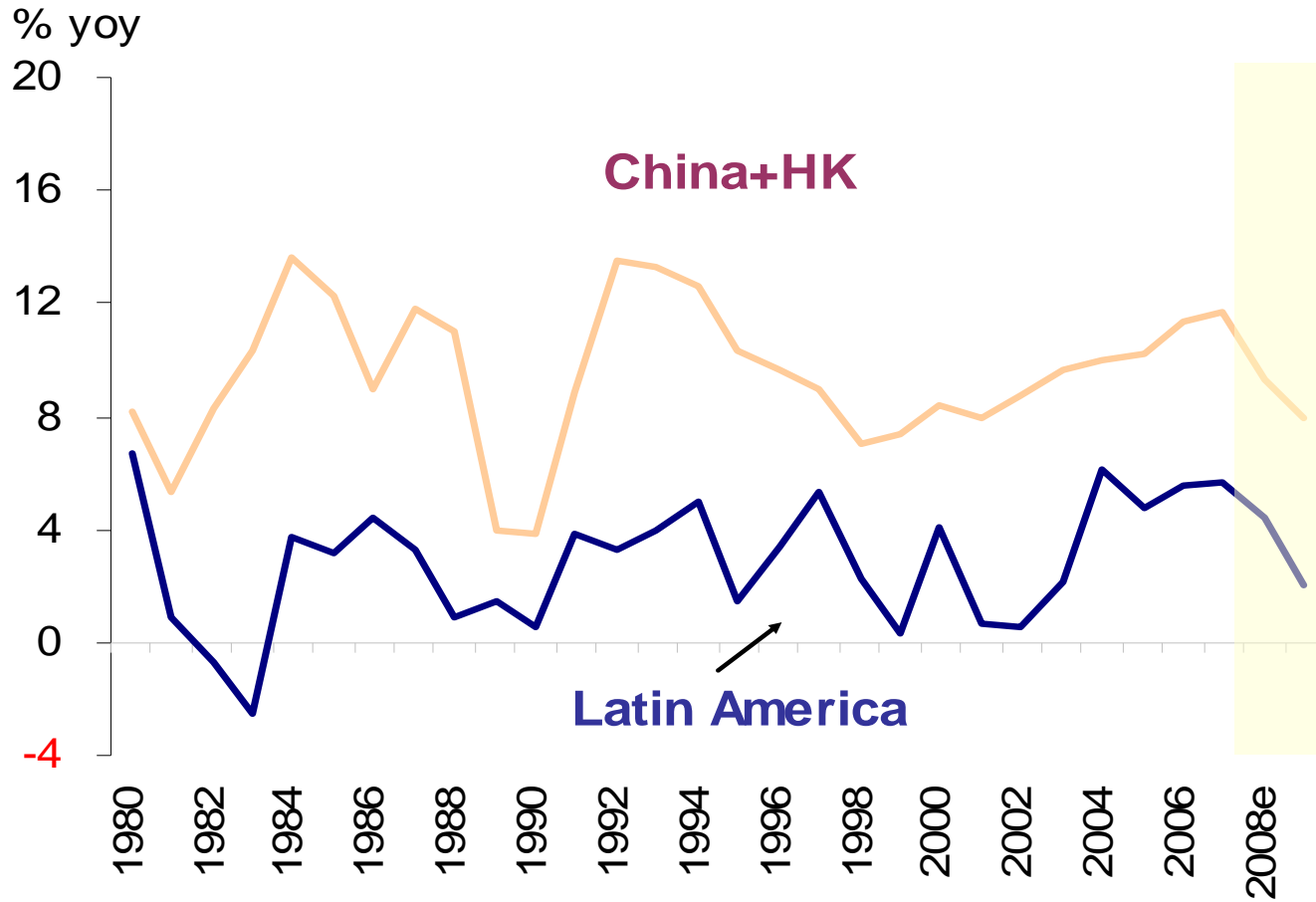
China/HK and Latin America's share of world GDP (PPP*)



* Purchasing-power-parity measured. Estimates start after 2007.

Source: ERD BBVA, IMF (October 2008)

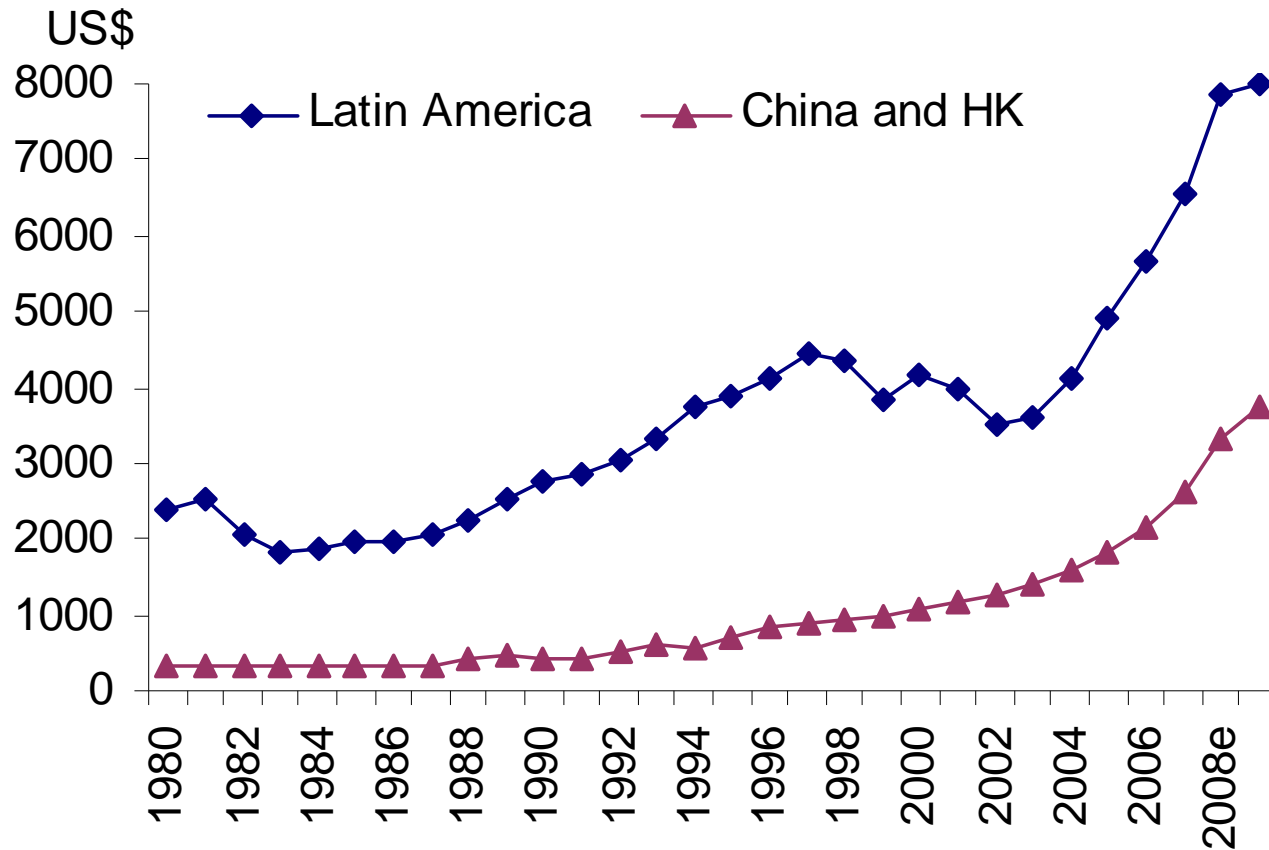
Real GDP growth in annual % change (2008-9 estimates)



* BBVA forecasts for 2008-2009 (baseline scenario). China and HK growth: PPP weighted.

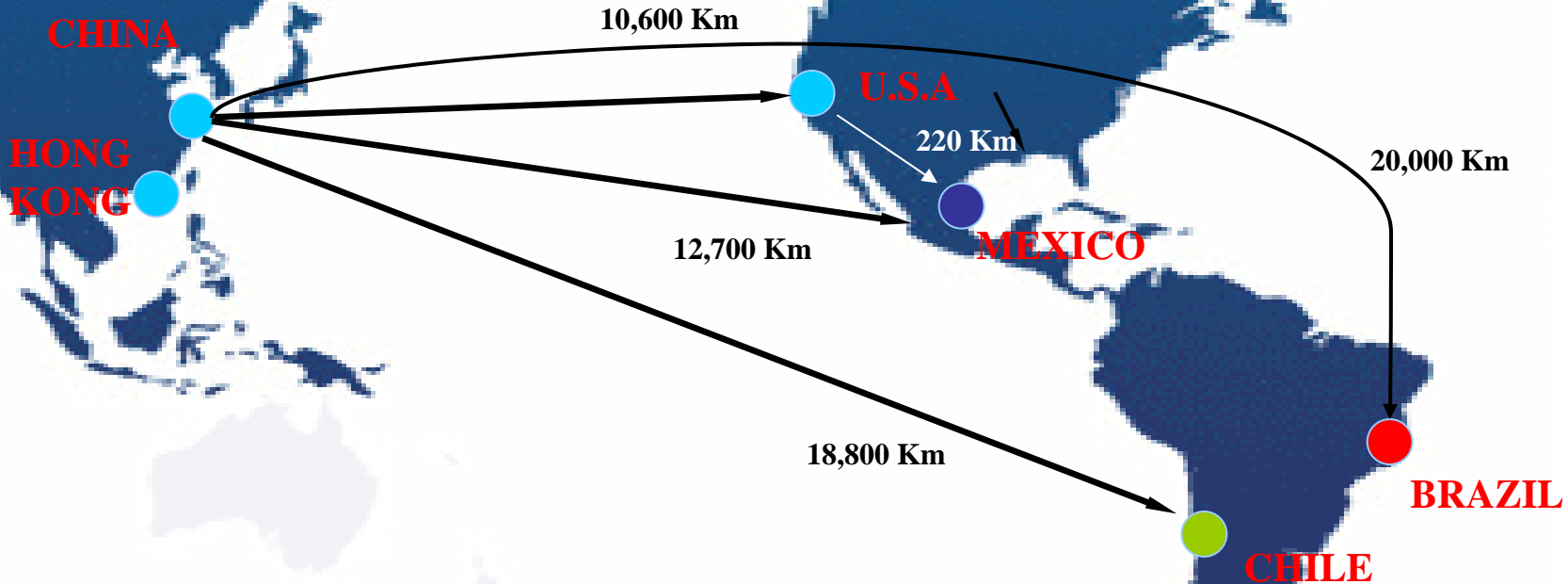
Source: ERD BBVA, IMF (October 2008)

China and HK vs Latin America: GDP current per capita
(in US dollars)



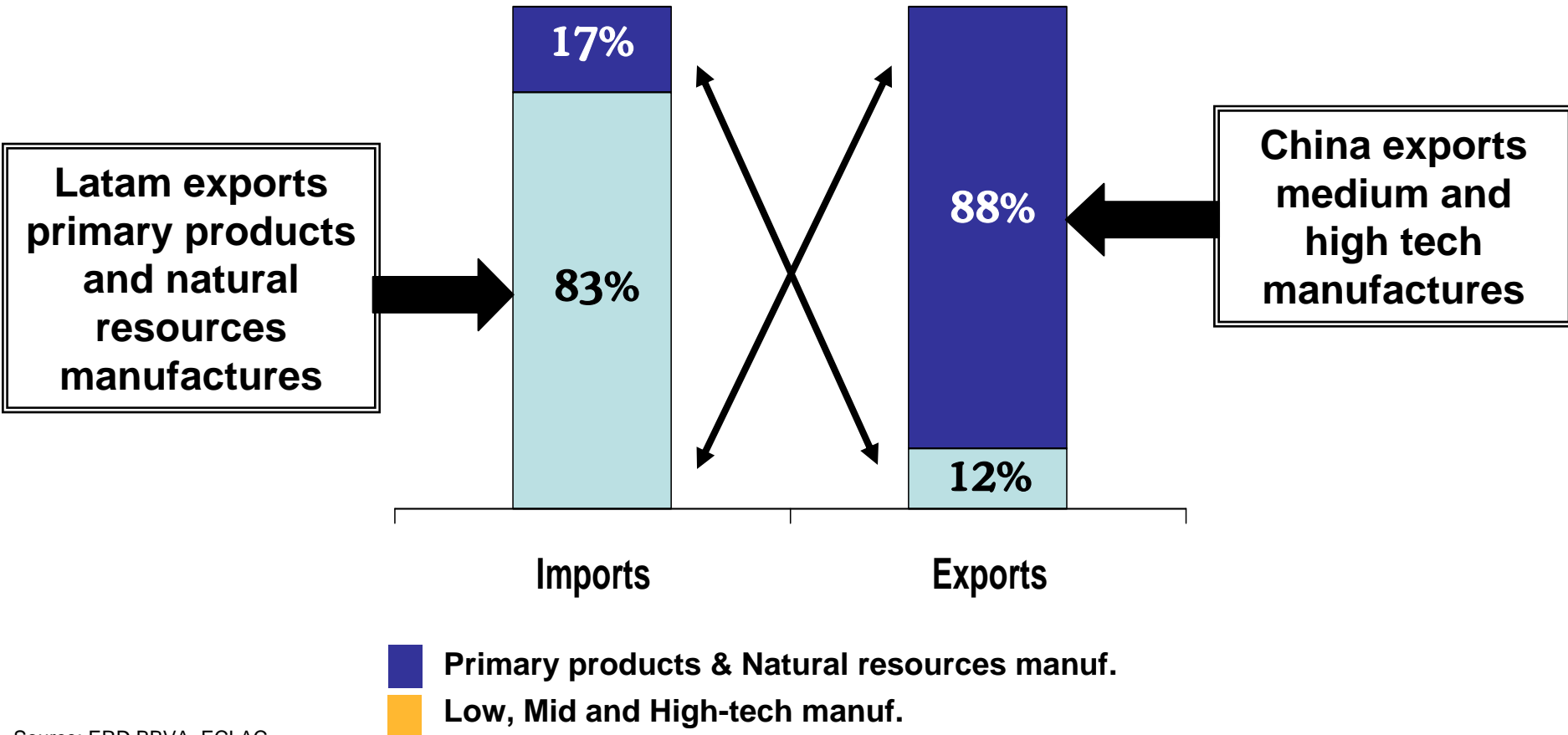
Source: ERD BBVA, IMF (October 2008)

- High transport and communication costs
- Long delivery time
- Very different time zones
- Few direct air links
- Few free trade agreements so far...



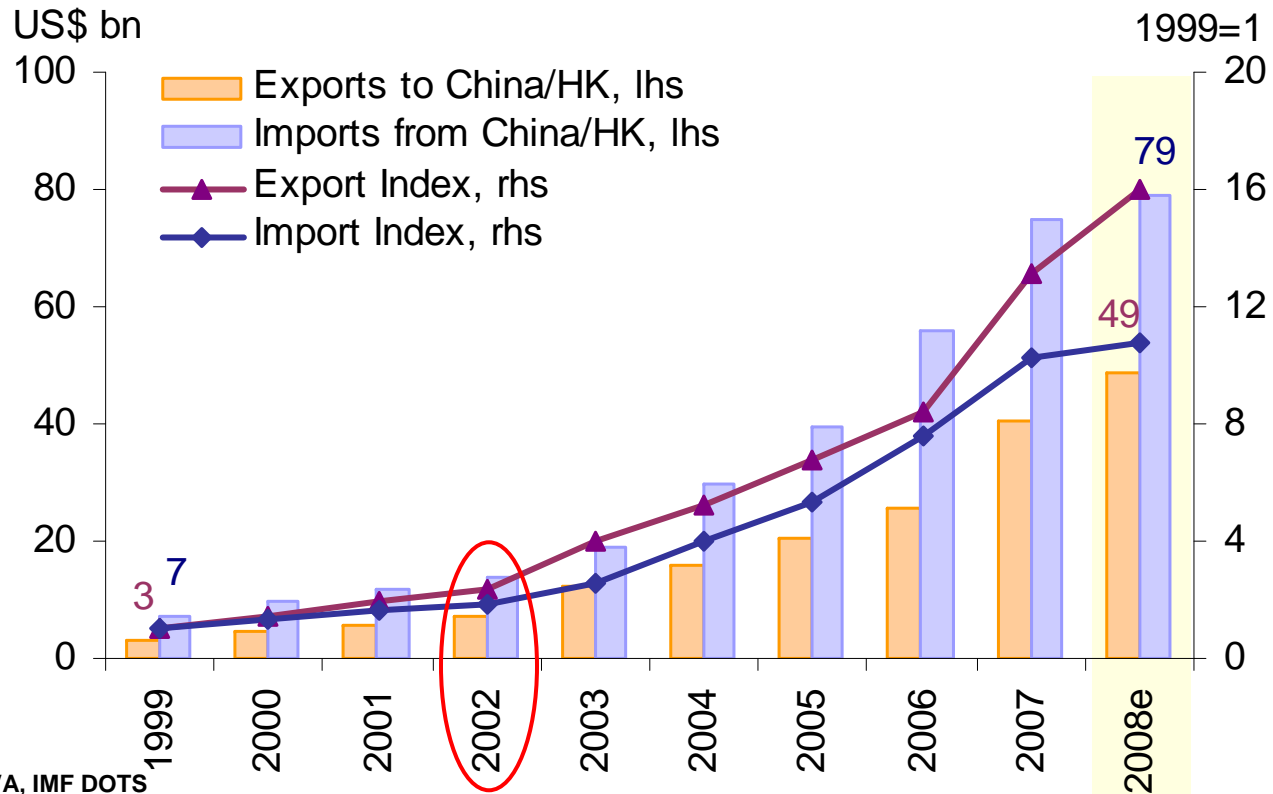
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China: import/export structure with Latam, 2006
(% of imports/exports flows)



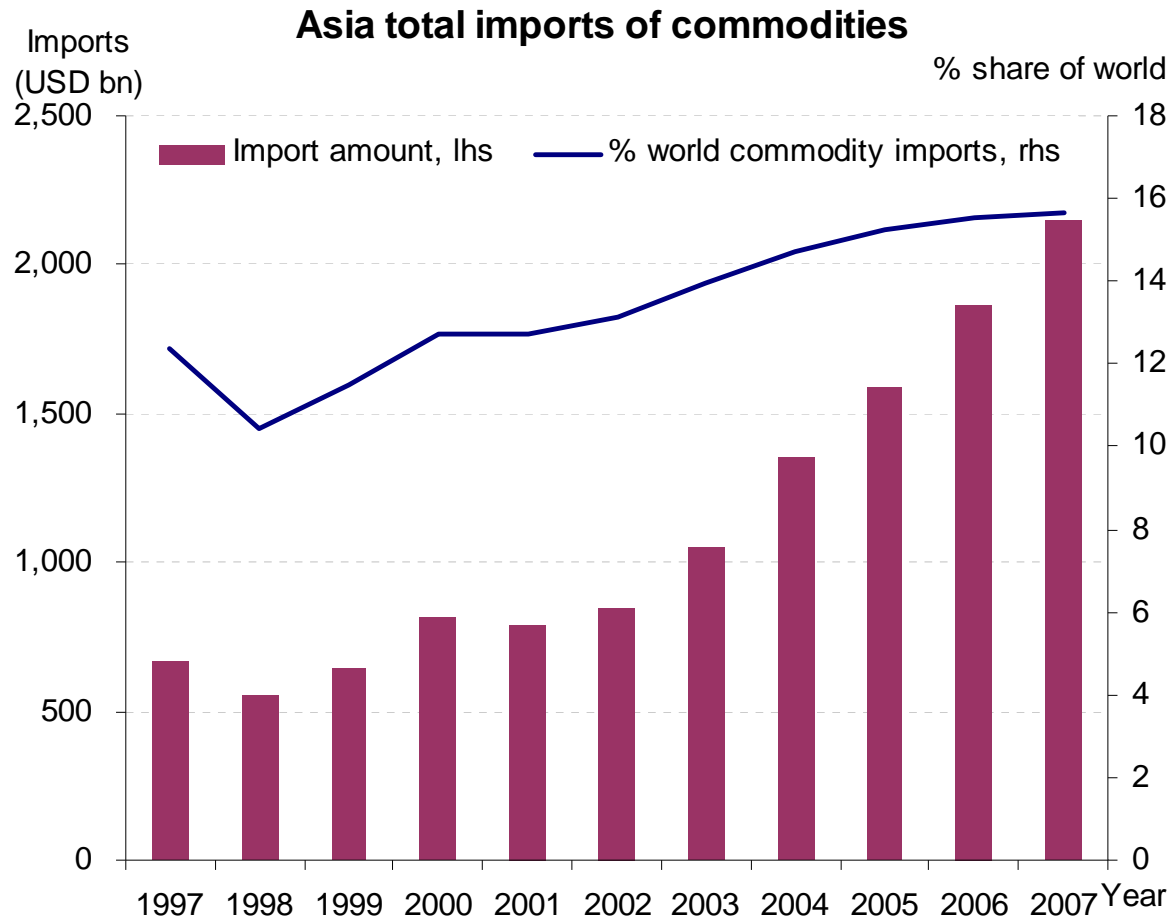
Source: ERD BBVA, ECLAC

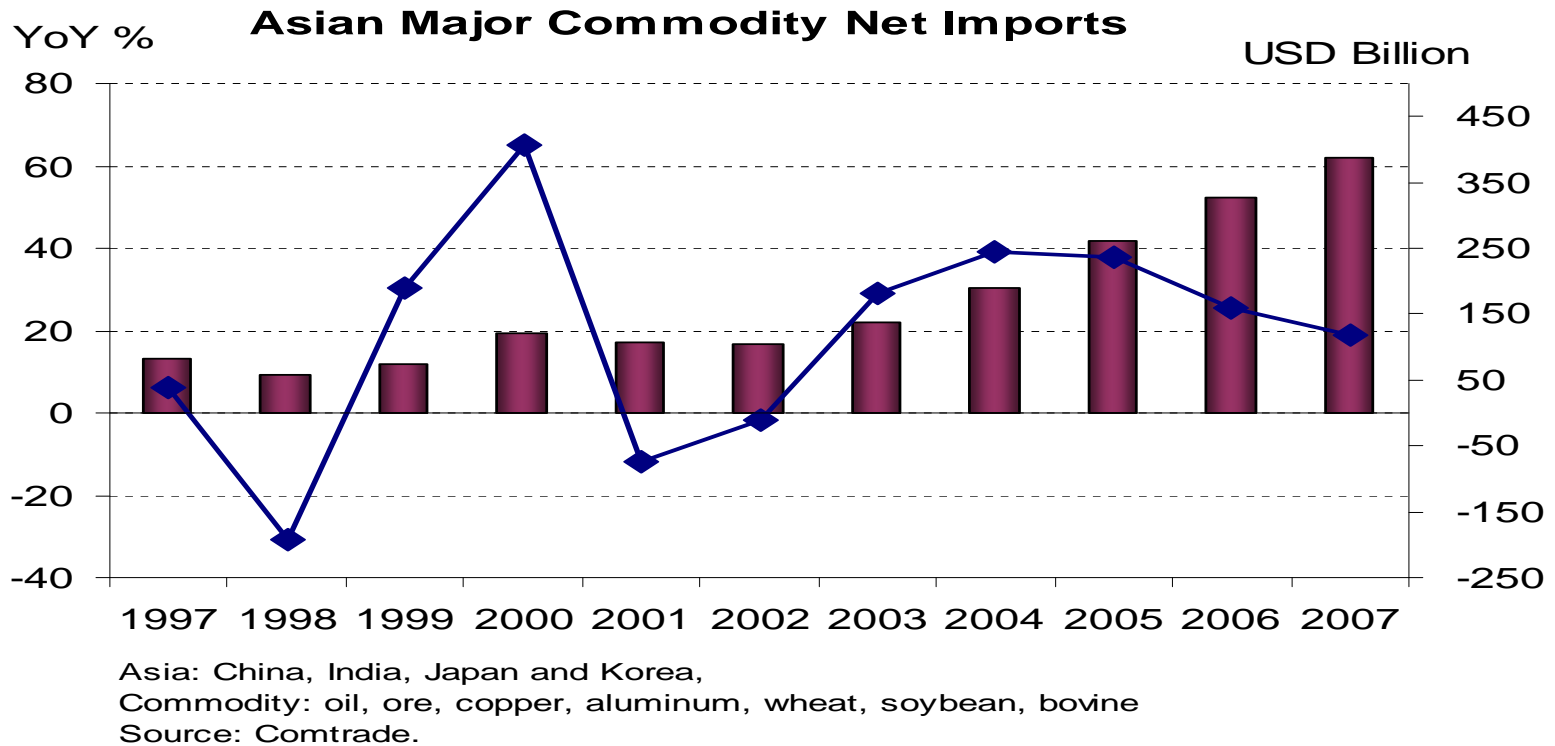
LAC: trade with China and HK, 1999-2008e
(USD billion current, index 1999=base)



Source: ERD BBVA, IMF DOTS

Latin America's exports to China has grown 163% since 2000; imports from China 136%.

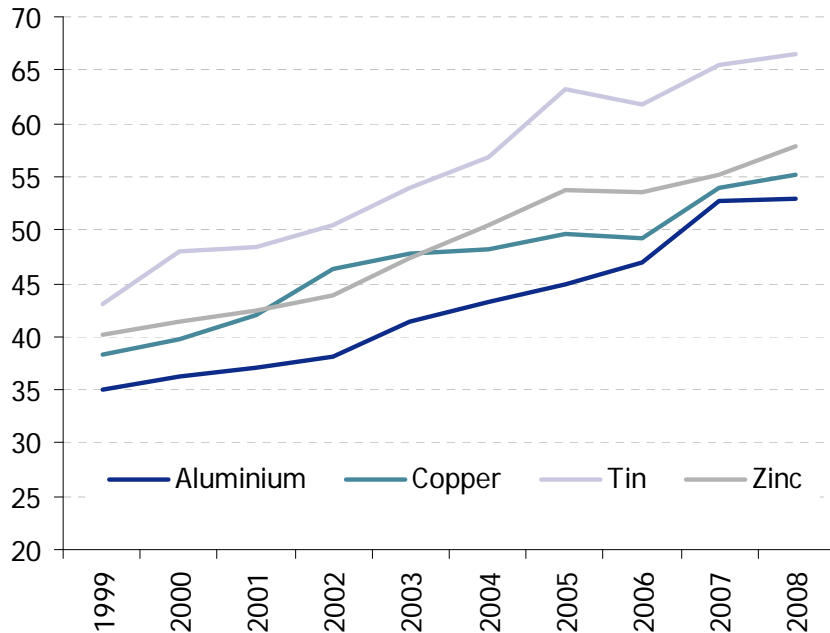




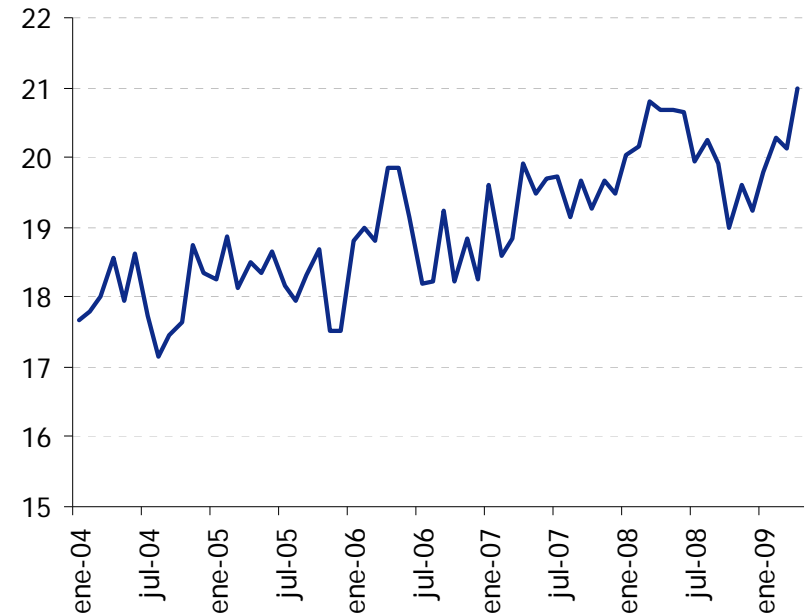
- ❑ Asia is a net importer of commodities: Asian commodity imports are 9 times higher than exports.
- ❑ Net imports have been growing rapidly (at an average of 18% per year since 2000) . As a result they stood at 400 billion USD in 2007 for the five largest countries of the region.

Asian increasing appetite for commodities transformed the region in the main world consumer of metals and a more significant player in oil markets.

Asian Metals Consumption as a Share of World Metals Consumption (%)



Asian Oil Consumption as a Share of World Oil Consumption (%)

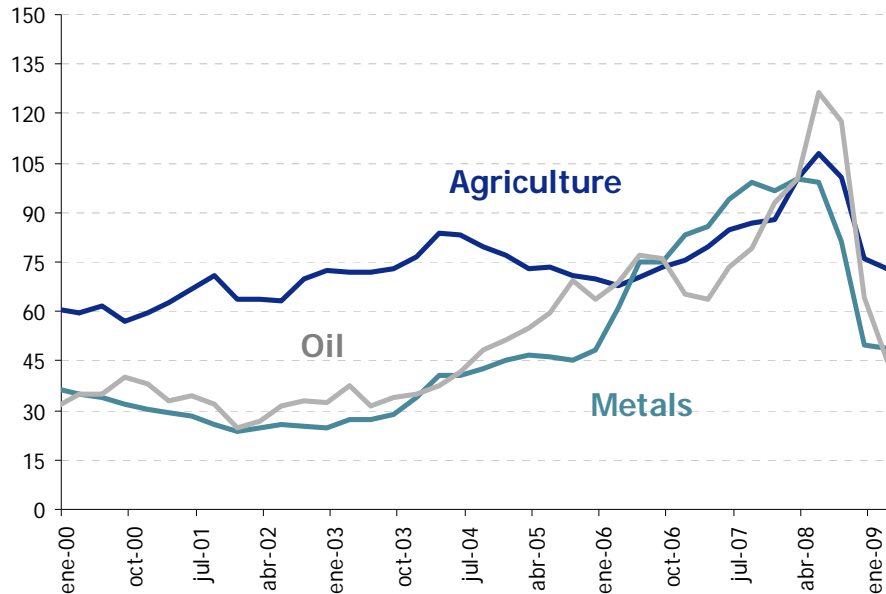


Source: WMS

Source: EIA

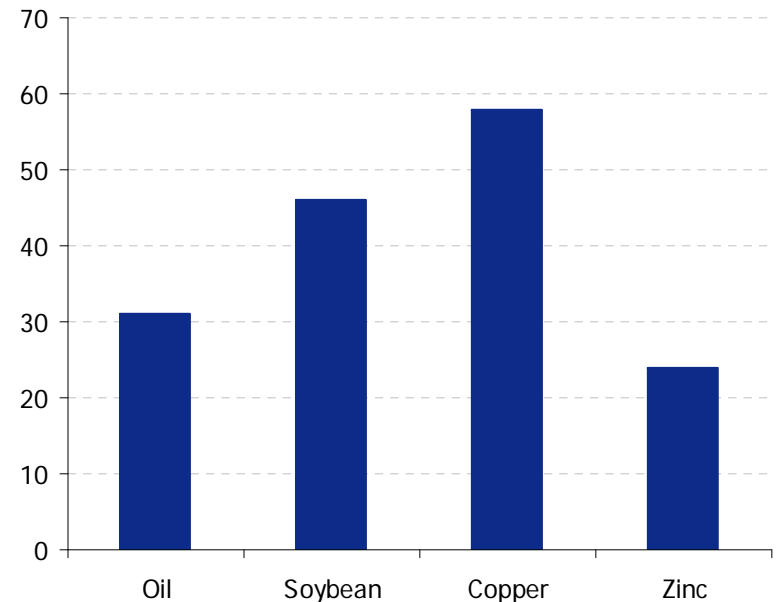
Beyond speculative reasons, Asian higher demand for commodities is behind the surge of prices observed in the last couple of years and also behind 2009's rebound (given slow supply response to such demand)

**Commodity Real Prices
(Index 2008 Q1 = 100)**



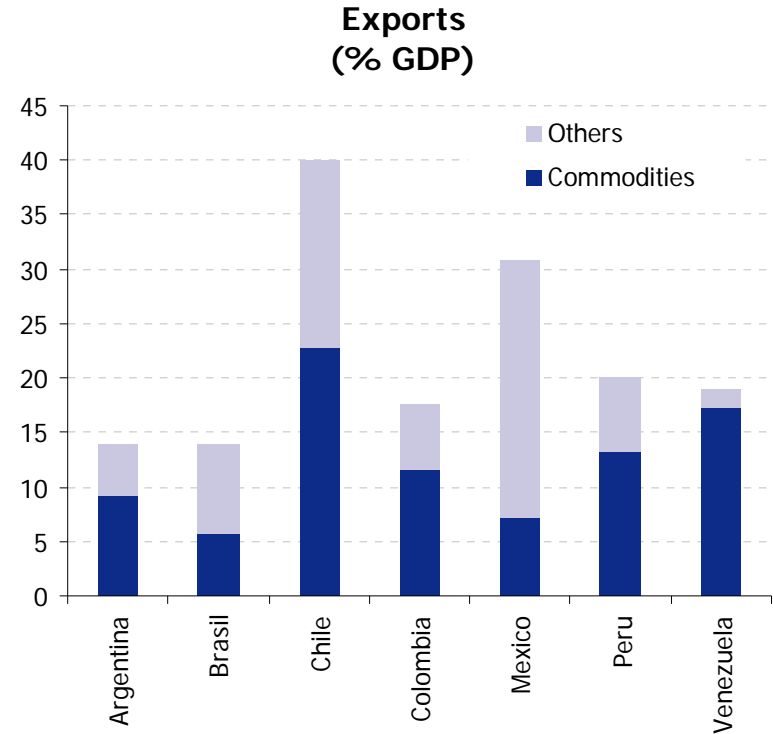
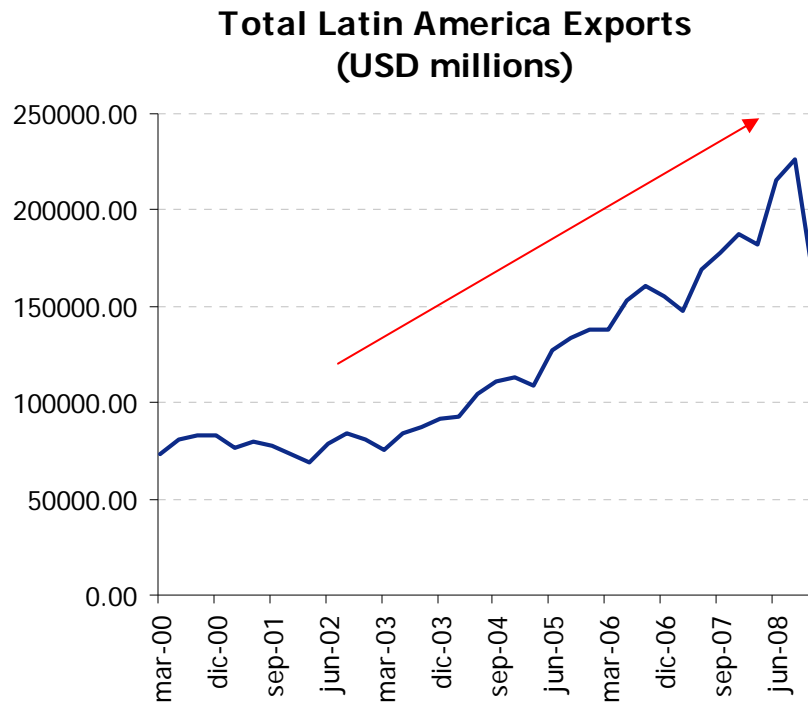
Source: CRB, Bloomberg, BBVA

Commodity Prices Variation Year-to-Date (%)



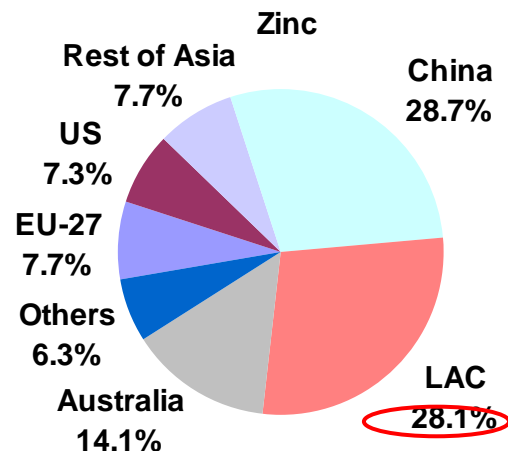
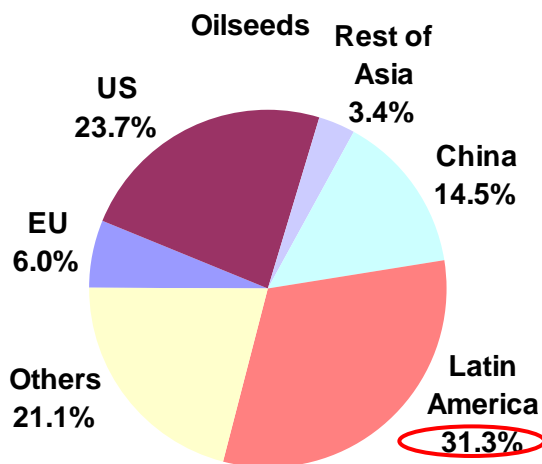
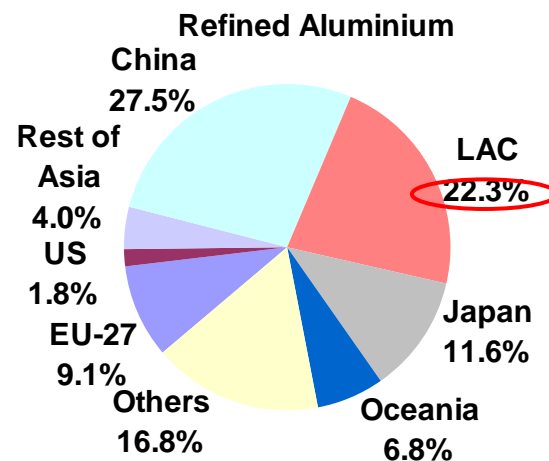
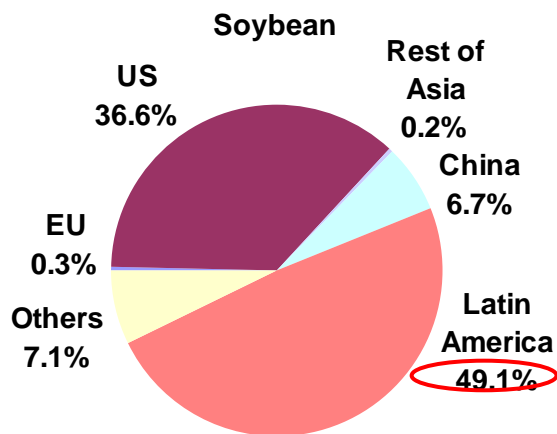
Source: Bloomberg

Higher demand and higher prices as well a more stable and sound macroeconomic environment strengthened both Latin American exports and the region's natural role of commodity supplier



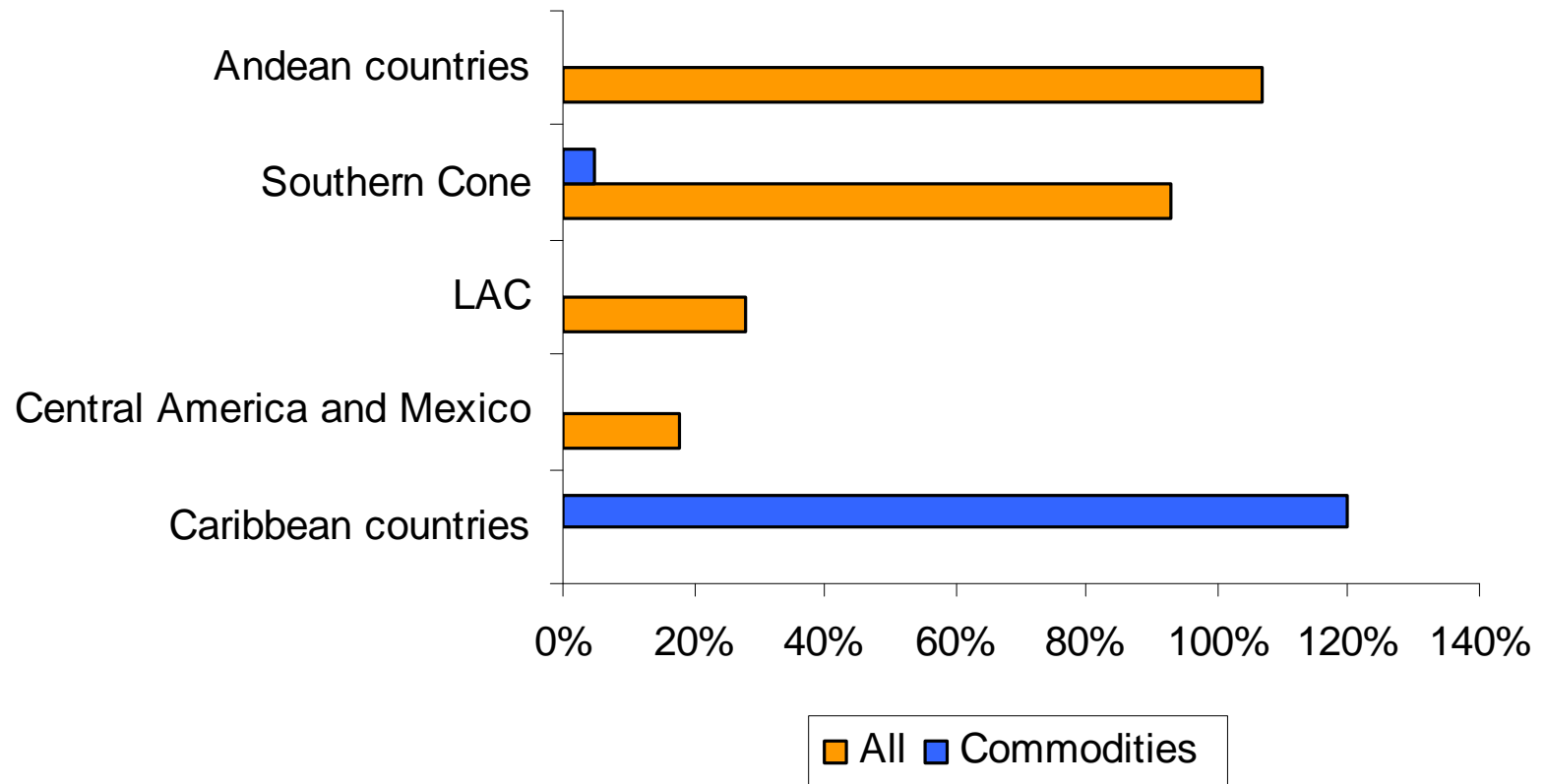
Source: National Statistics Agencies

It consolidated its position as main world provider of important commodities



Source: ECLAC (2008)

Unsatisfied Chinese demand for LAC products, as share of bilateral LAC exports



Asia–Latam regions can still benefit from easier access in terms of new trade agreements

Signed agreements:

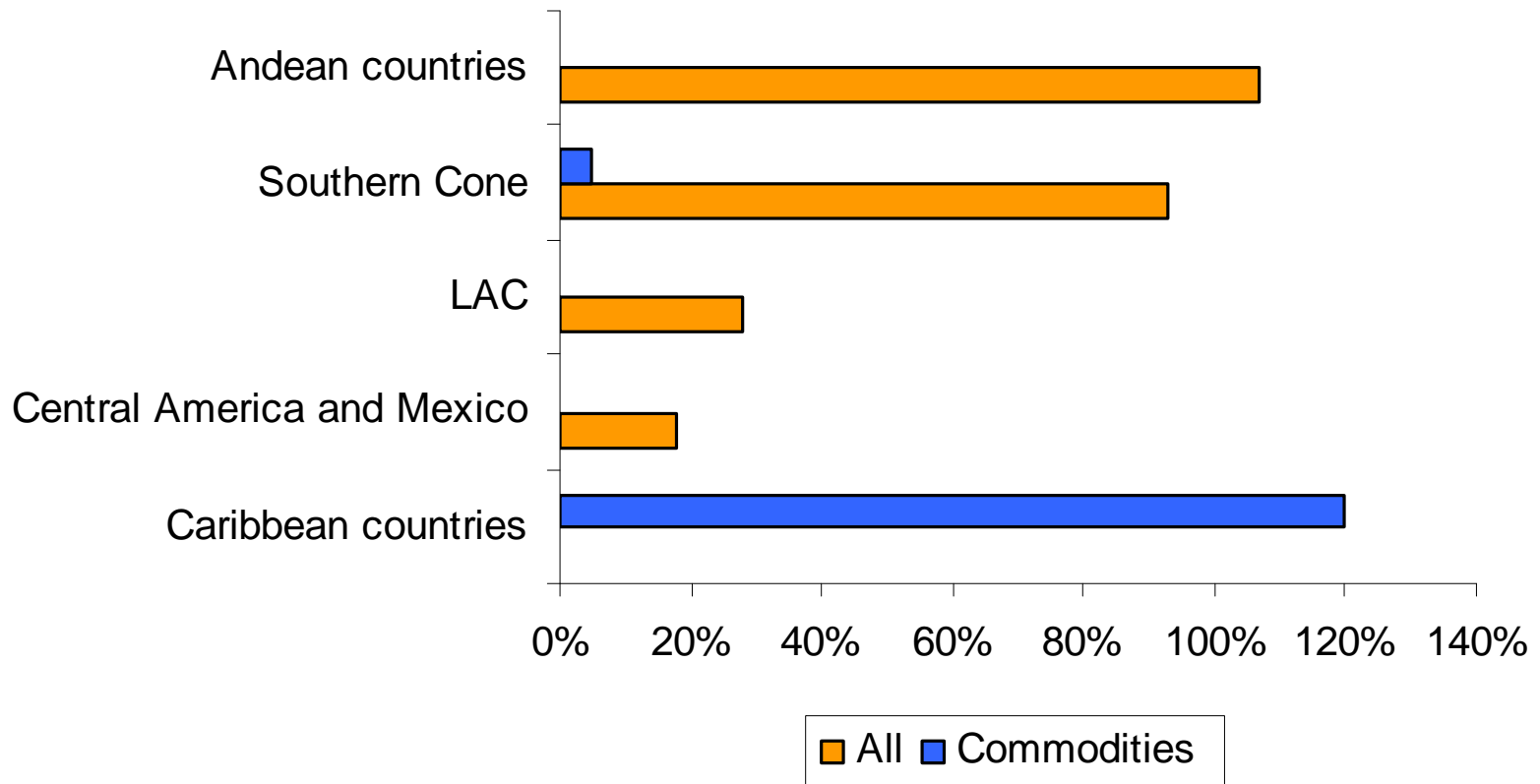
- Chile and China
- Peru and China
- Colombia and China
- Singapore and Chile
- Singapore and Panama

Under negotiation:

- Malaysia and Chile
- Singapore and Mexico
- Singapore and Peru
- Thailand and Peru
- Vietnam and Chile
- Costa Rica and China

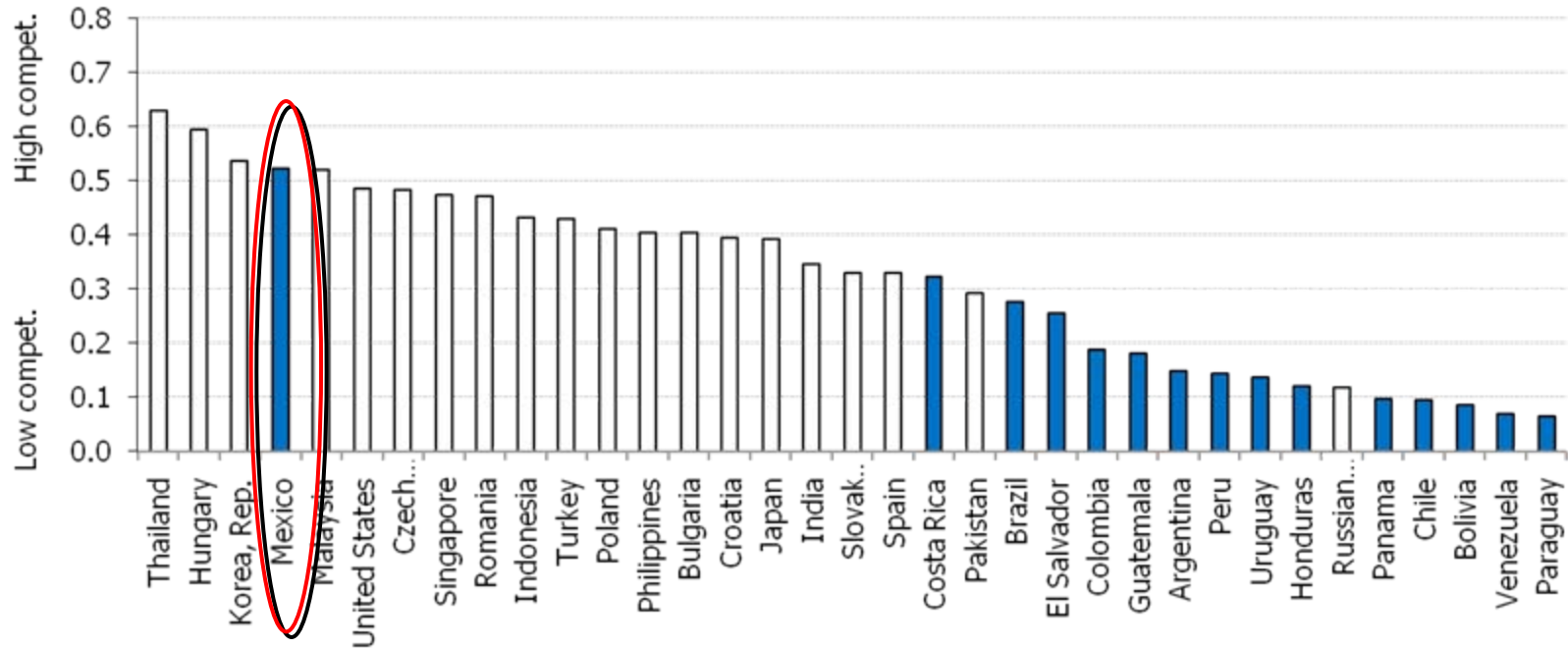
Still many trade opportunities untapped...

**Unsatisfied Chinese demand for Latam products
(as share of bilateral Latam exports)**



...thanks to a high complementary rather than competitive export structure, except for Mexico

Export competition with China for selected countries (2000-2005)

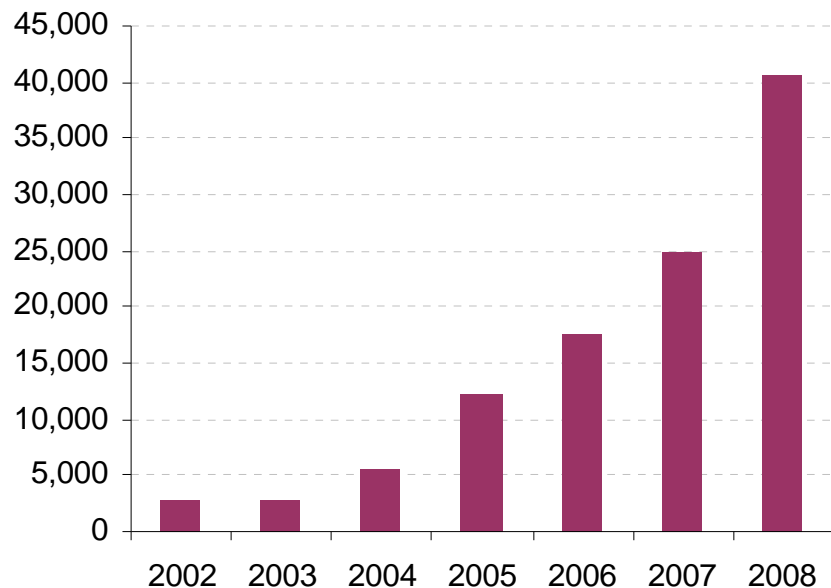


Note: CS and CC coefficients calculated with exports of country *i* and exports of country *j* (China, India).

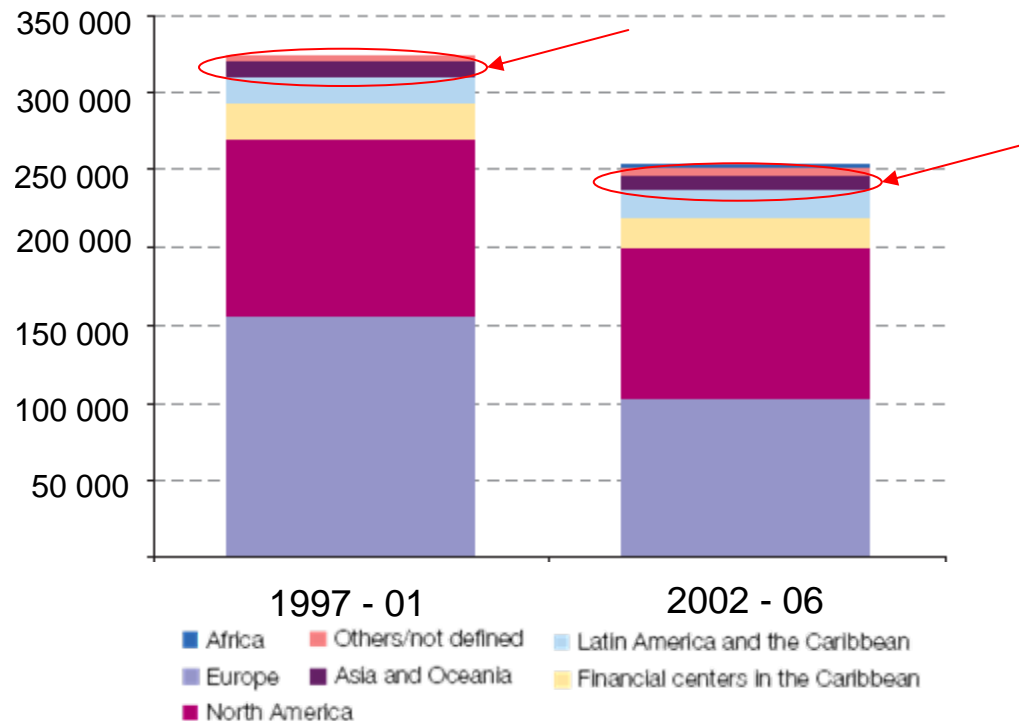
Source: OECD Development Centre, 2008; based on WITS Database, 2007.

FDI opportunities may help boost trade. China's FDI into Latin America grew 80% per year since 2003, but it is still low and there are huge room to increase...

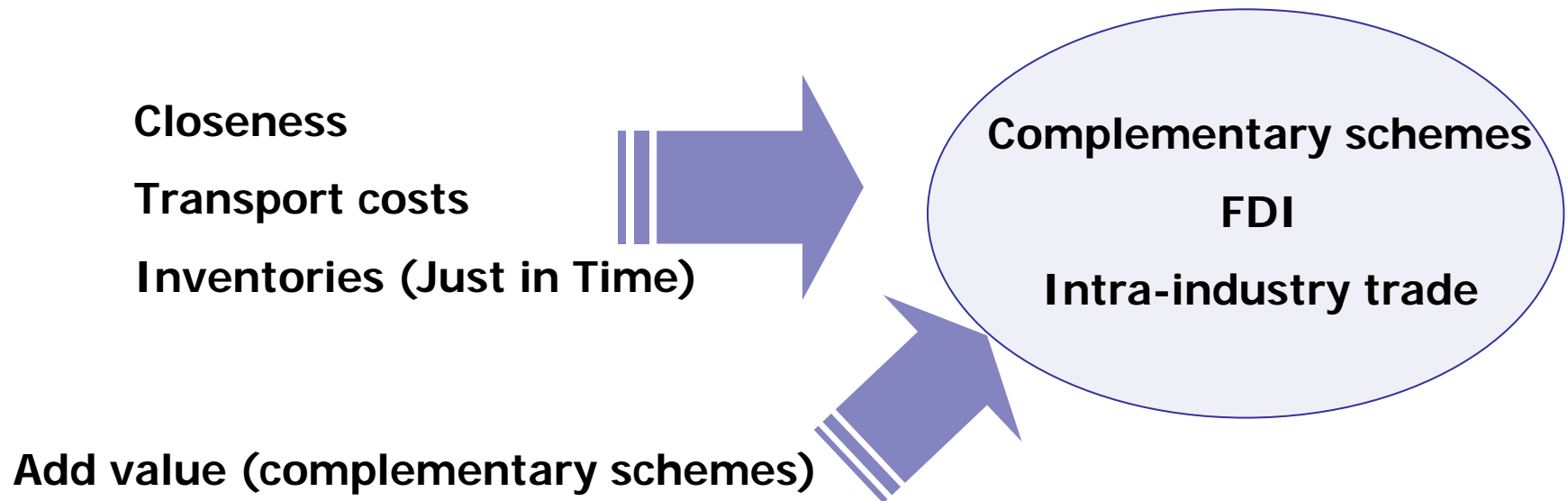
Chinese FDI into Latin America (non-finance sector)
(US\$ millions)



Latin America's inward FDI, 1997-2001 vs 2002-2006
(stock in US\$ millions)



As Latin America could exploit its geographical proximity to the North American market to attract Asian FDI...

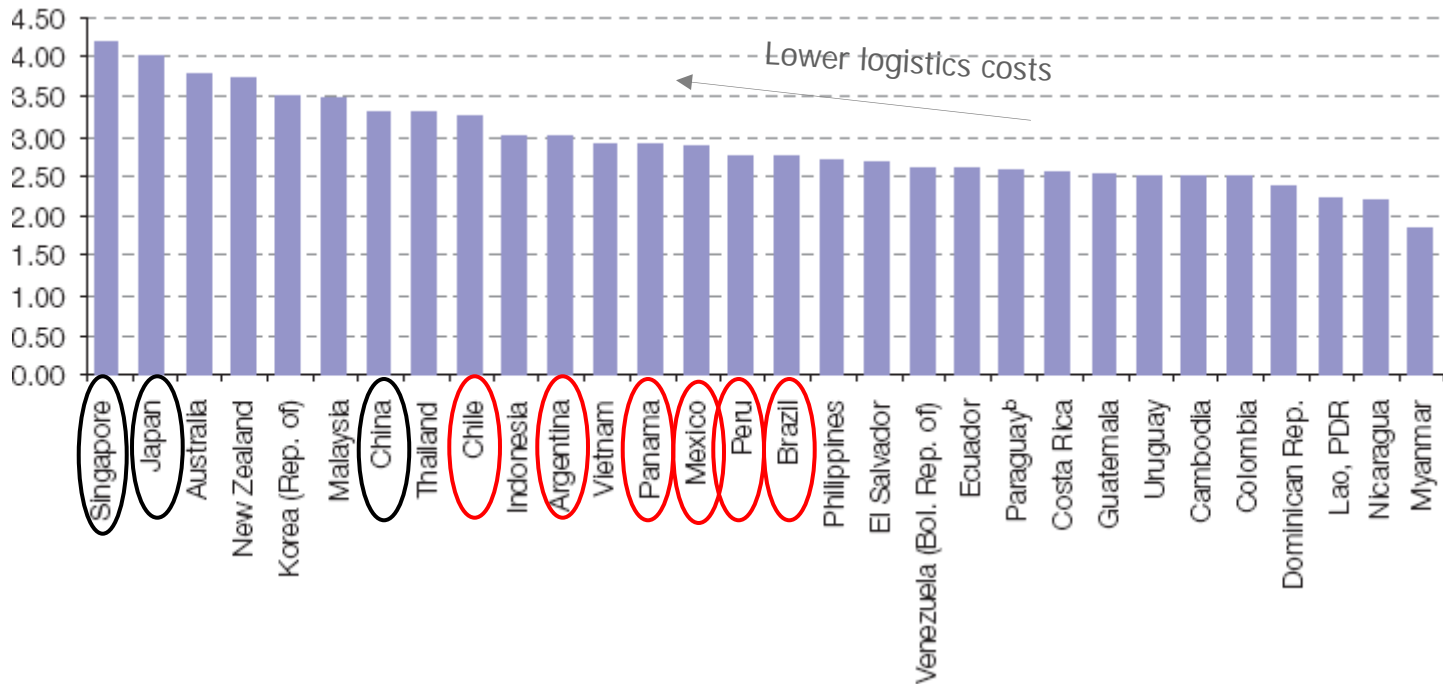


In order to attract FDI, Latin American countries still has much work to do in improving their institutions and infrastructure

Latin America is and will continue to be an important market for Asia leveraging on export diversification and provision of services.

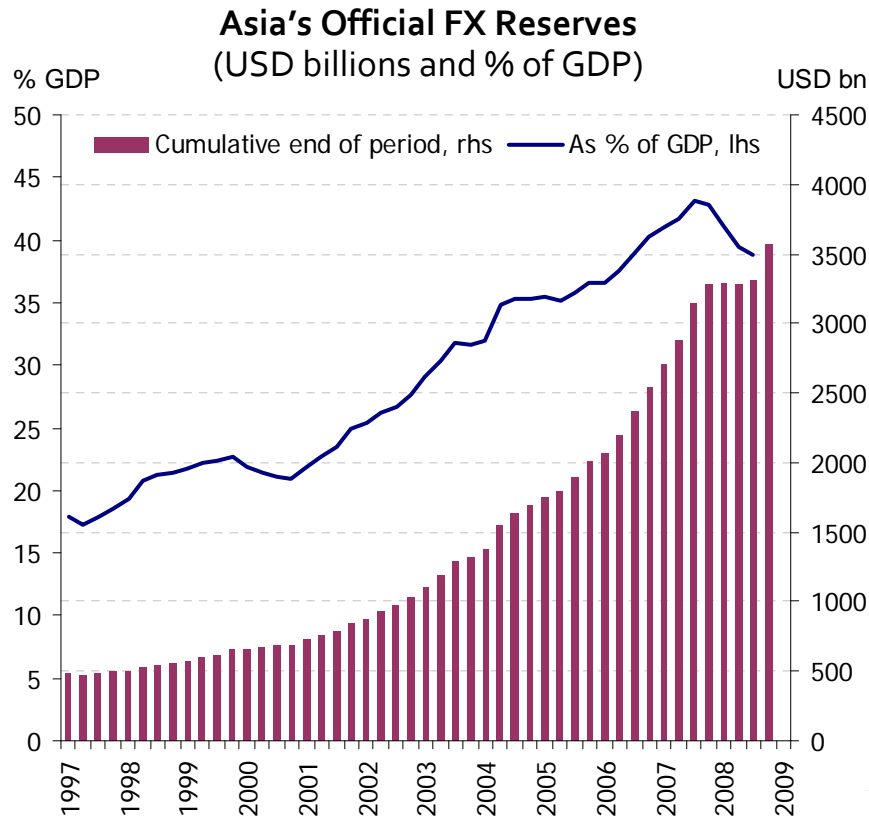
... which will require Latin America to significantly improve its trade logistics in order to lower re-export/transit costs

Logistics performance index (score in the range of 0-5)

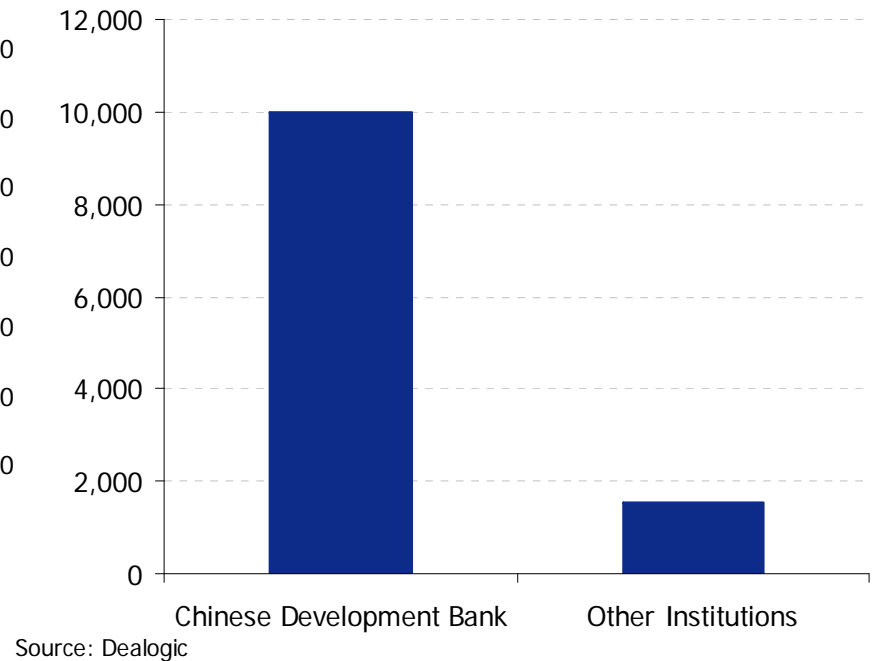


Source: ERD BBVA, ECLAC (2008), World Bank (2007)

Increasing financial integration between the two regions should also help develop trade. Japan and, since recently also China, has been funded investment projects in Latam (sometimes in exchange of guaranteed supply in the future sometimes for profitability reasons)

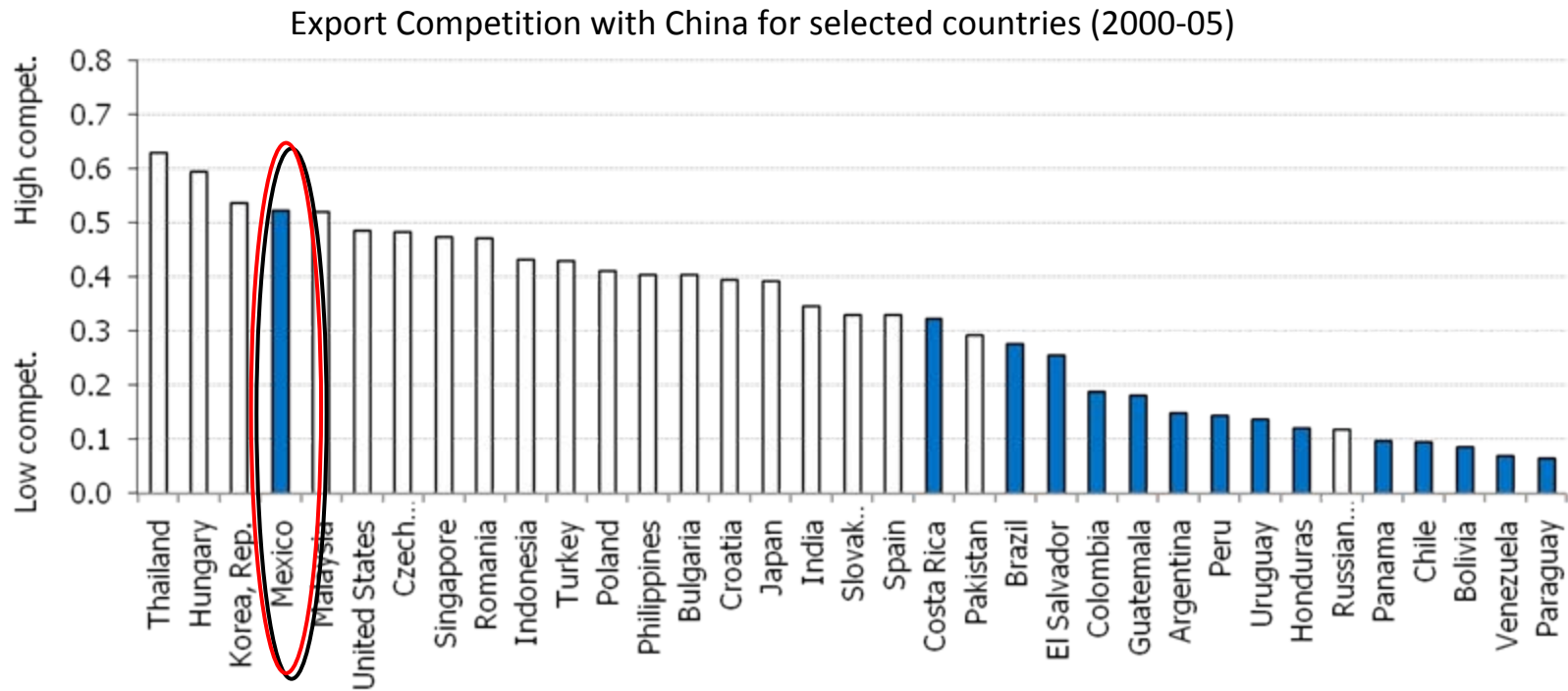


Trade Finance in LATAM Chinese Development Bank vs Other Foreign Sources - First Half of 2009 (USD millions)



- 1. Regarding exports of goods**
 - **Negative impact of China's competition concentrated in**
 - **Textiles**
 - **Telecommunication equipment**
 - **Electronic equipment**
 - **And also in a few countries**
 - **México**
 - **To a lesser extent, Central America**

2. Regarding exports of services
 - Not much impact of China's competition
 - More coming from India and only in some sectors:
 - Industrial engineering
 - Other business, professional services
 - Legal services
 - Research & development and technical services
 - LAC is performing relatively well on :
 - Tourism
 - Health



Note: CS and CC coefficients calculated with exports of country *i* and exports of country *j* (China, India).

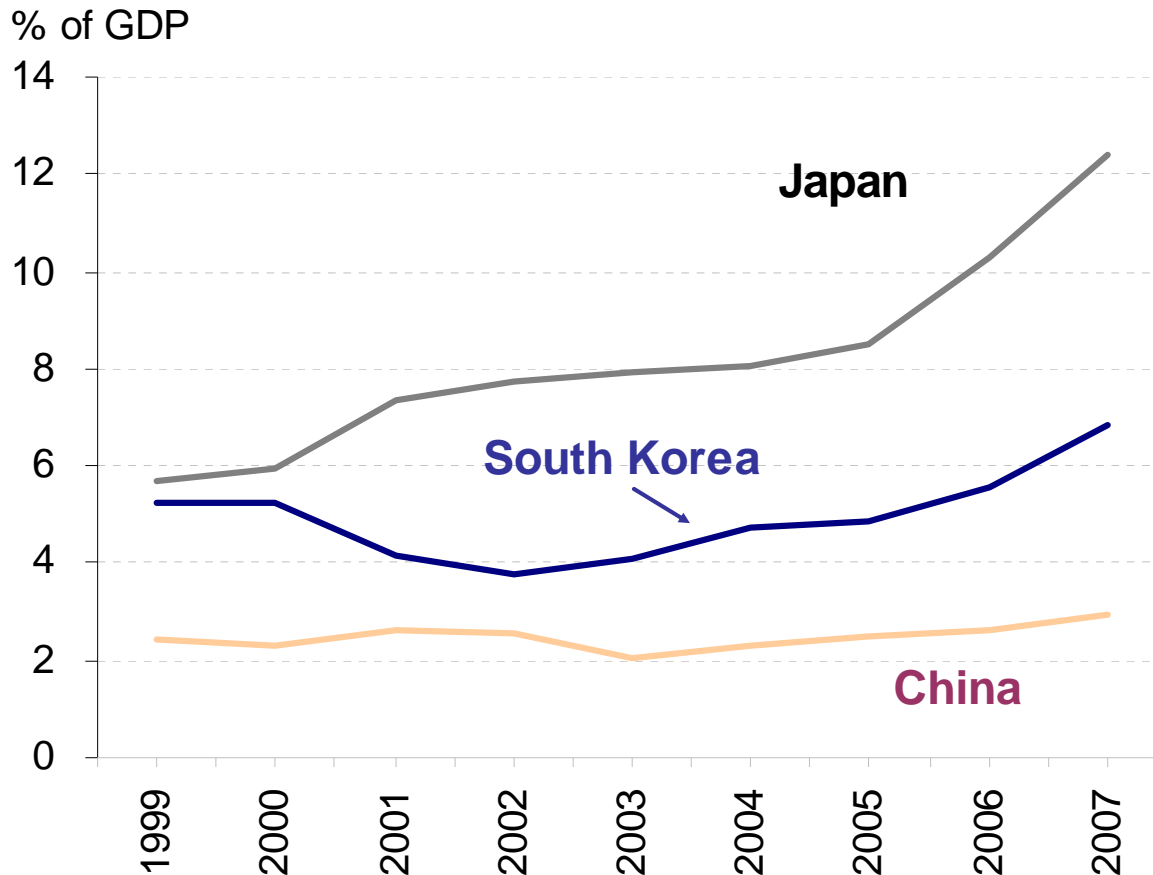
Source: OECD Development Centre, 2008; based on WITS Database, 2007.

1. What has characterized the global crisis?
2. The developed versus the emerging world
3. Heterogeneity among emerging countries:
 - a. Emerging Europe's drama
 - b. Latin America's hopes
 - c. Asia's emergence
4. Growing links between Latin America and Asia
 - a. Trade
 - b. FDI**

- Not really much except for some countries, according to existing studies (Lederman, Perry and Oleorruga 2008), Garcia Herrero and Santabarbara (2007)

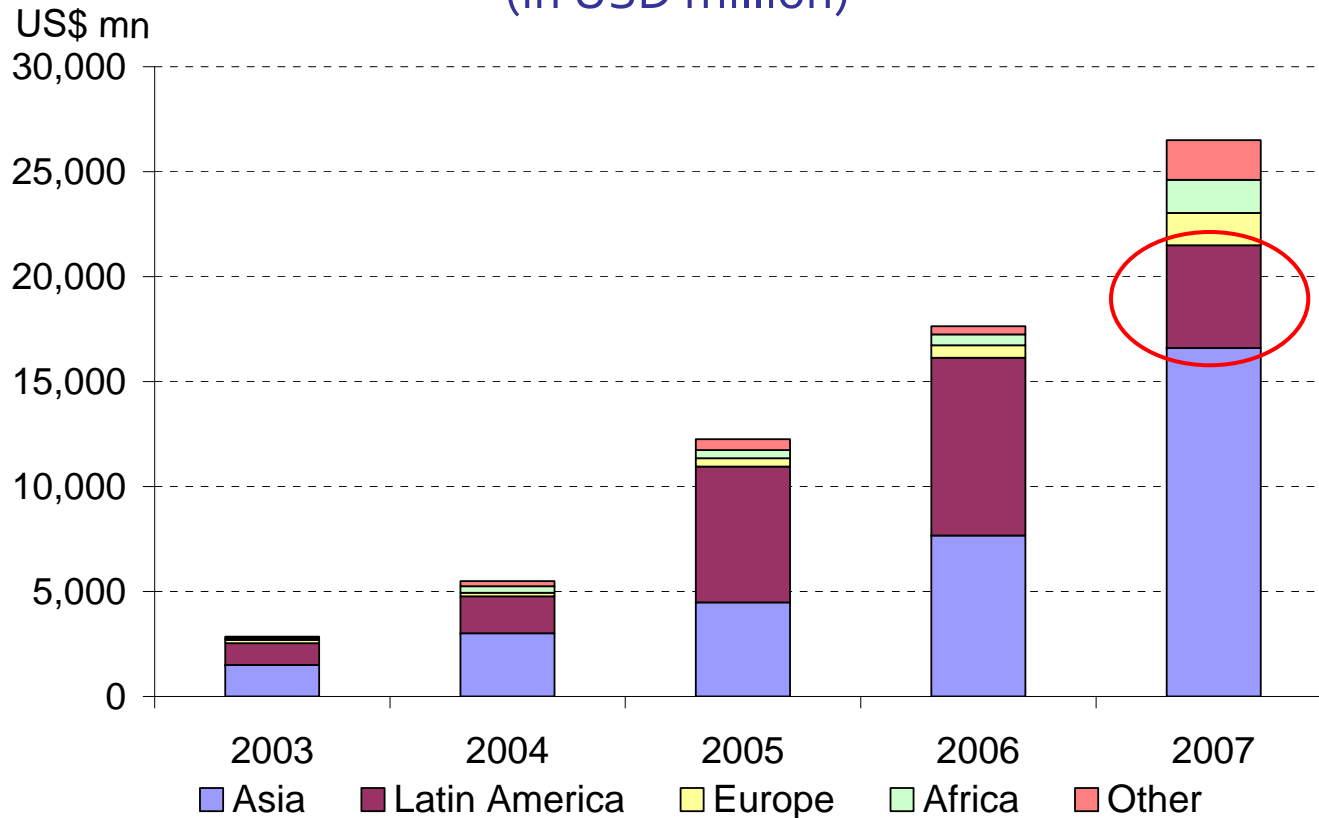
	China's Effect	India's Effect
Central American Countries	-0.33 (0.03)**	0.86 (0.00)**
Andean Countries	0.07 (0.73)	-0.03 (0.94)
Southern Cone's Countries	0.24 (0.12)	-0.37 (0.13)

Chinese FDI stock vs Selected Asian Peers (outward FDI stock as % of GDP)



Source: ERD BBVA, UNCTAD (2008)

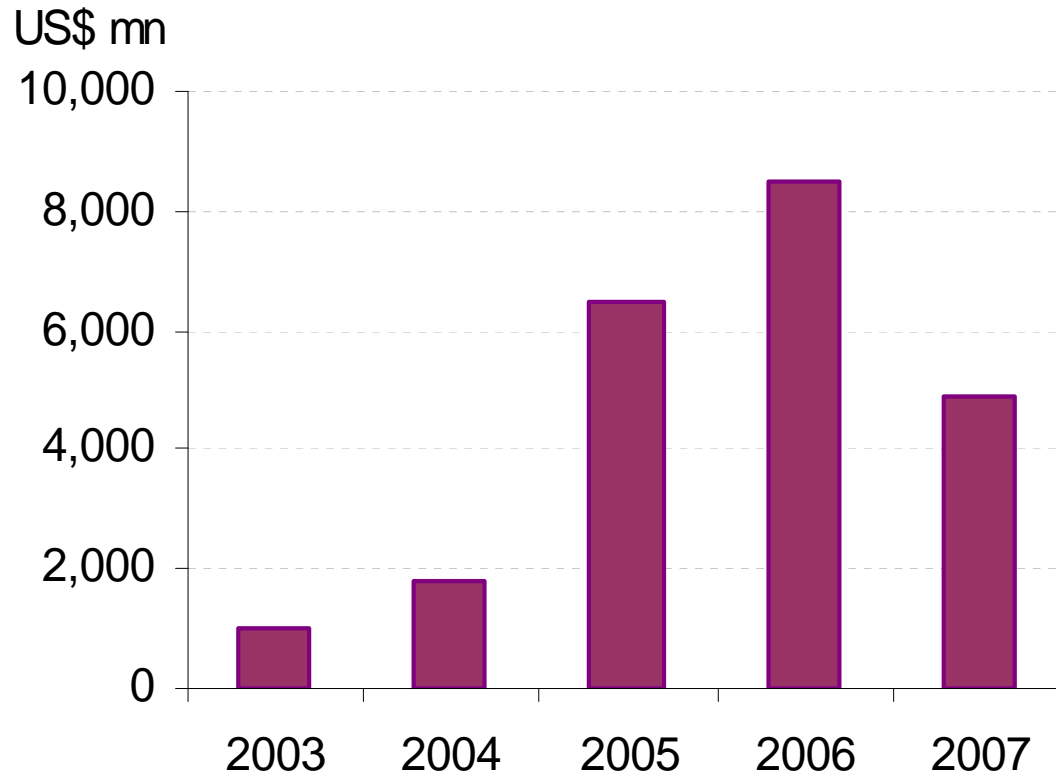
Chinese FDI flows by destination (non-finance sector), 2003-2007
(in USD million)



Source: ERD BBVA, China's Ministry of Commerce

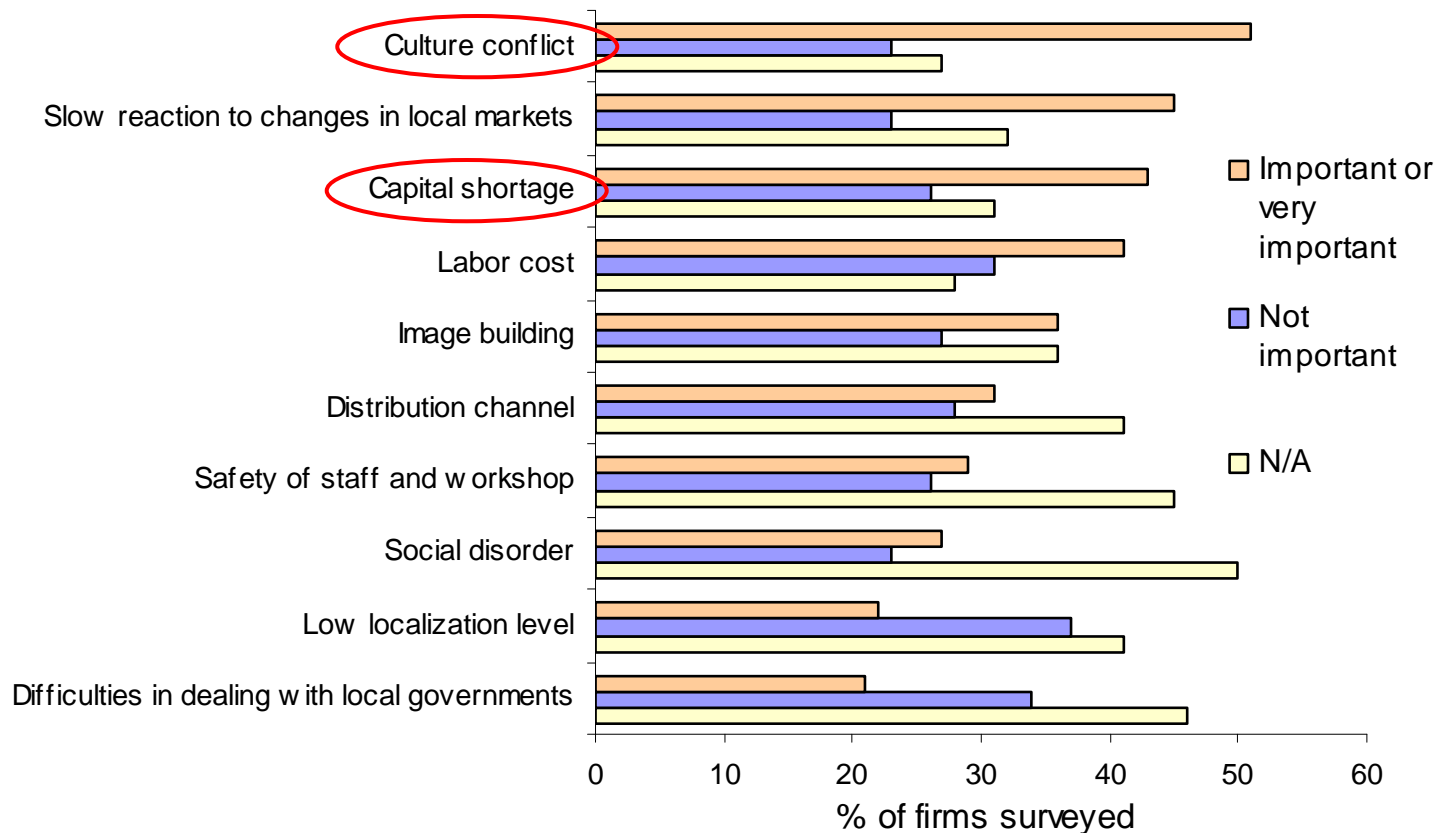
Latin America has become China's largest foreign investment destination outside the Asian region.

Chinese FDI into Latin America (non-finance sector) (US\$ millions)

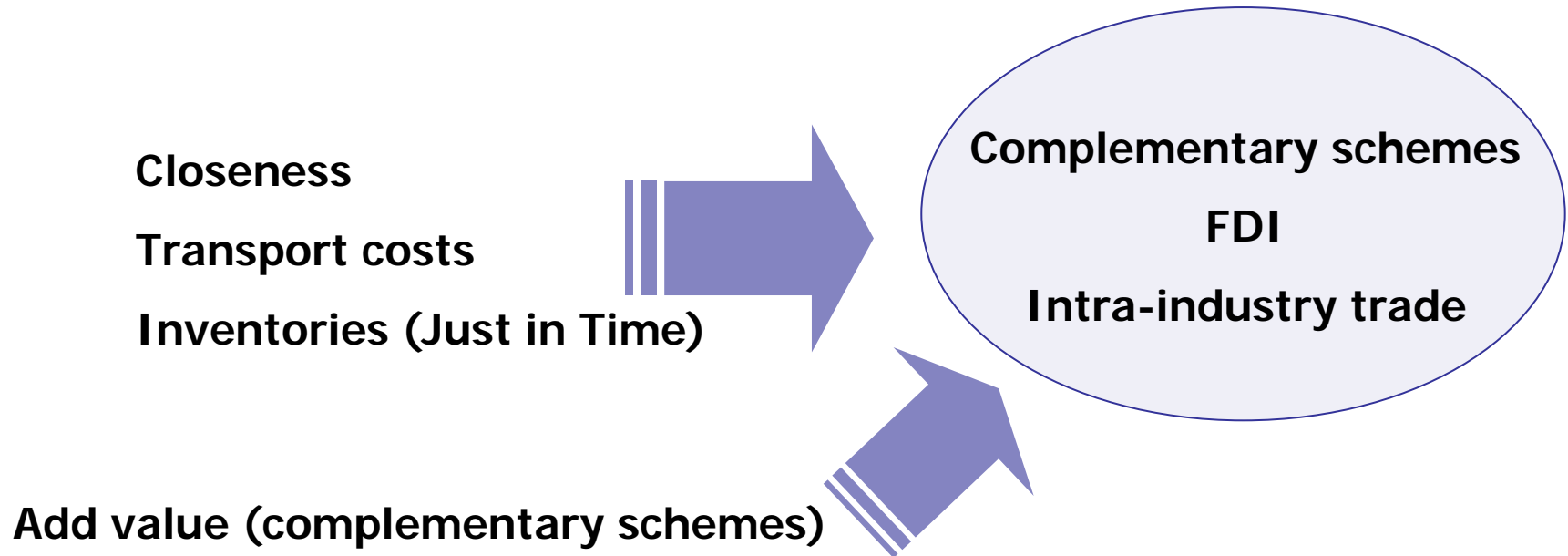


Source: ERD BBVA, CEIC

Main Challenges Faced in International Operations (in % of responses, firm survey)



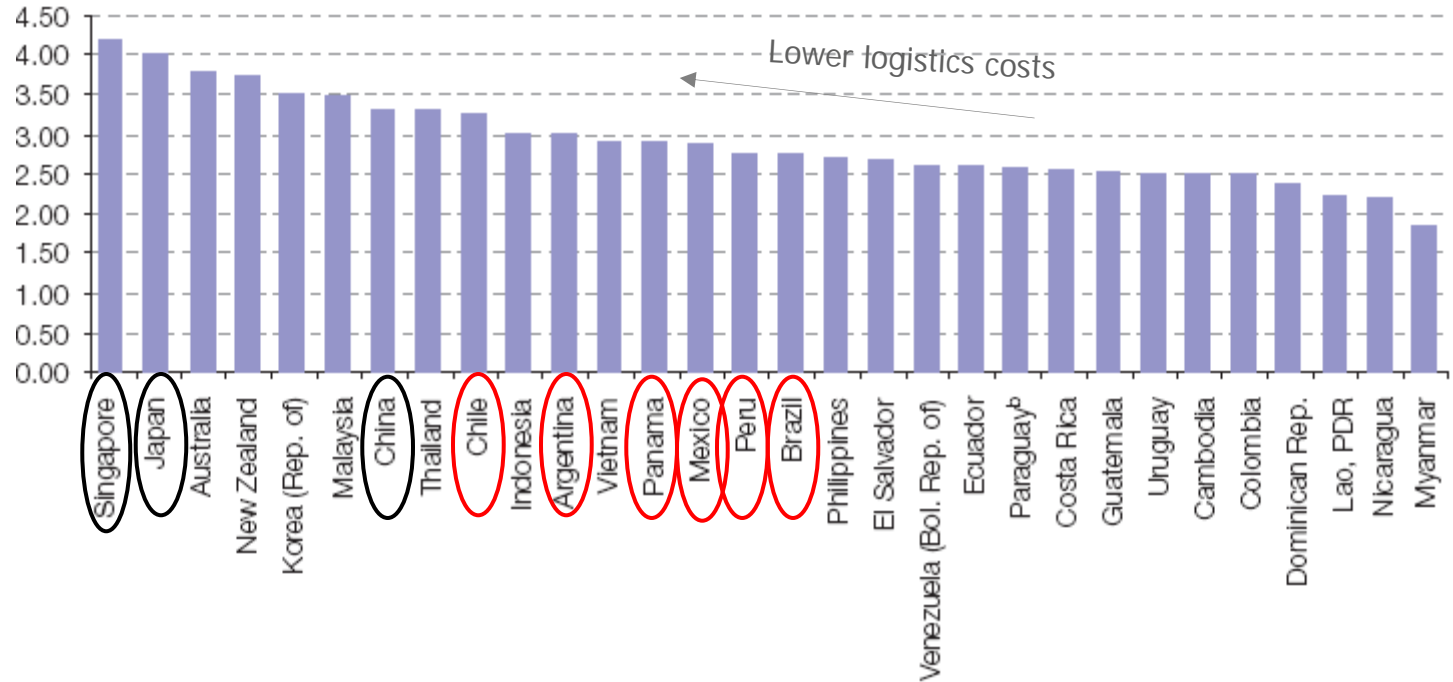
Source: Battat, Joseph, FIAS/ MIGA Firm Survey (April 2006)



In order to attract FDI, Latin American countries still has much work to do in improving their institutions and infrastructure

Latin America is and will continue to be an important market for China/HK (export diversification and provision of services).

Logistics performance index (score in the range of 0-5)



Source: ERD BBVA, ECLAC (2008), World Bank (2007)

- Asia and Latin America have clear **complementary roles** in endowments, which is increasingly reflected in growing trade relations
- The relative scarcity of natural resources, made more acute by rapid urbanization, has made **Asia** into an important **commodity importer**.
- **Latin America** 's endowment is such that **commodity exports** constitute their natural comparative advantage. From being curse in the past, commodities are now turning extremely useful for Latin America's growth thanks to Asia's insatiable and, probably stable, appetite for commodities.
- Based on these well-defined roles in commodity markets, Asia and Latin America are becoming **important trade partners**. However, there is still ample room to benefit from a deeper and more comprehensive economic integration –specially in **FDI** but also in **financial investment**, given the large untapped opportunities.

Thank you