

Situation and Outlook for the Global Economy and for Spain

6 November 2012

Key themes

- 1 After the slowdown in 2012, **global growth will gradually speed up** from the end of the year and during 2013, thanks to the monetary measures in developed economies and those supporting growth in emerging economies
- 2 **The risk scenarios are less likely that they were three months ago, if the agreements are upheld and the measures are applied in the developed countries**, although there are still considerable challenges to be faced in the Eurozone and in the US.
- 3 **Emerging economies** face the challenge of managing **inflows**
- 4 **Spain: Spain is still expected to contract** in 2012 and 2013, but the decline has been less intense in the third quarter
- 5 The **fiscal measures are bearing fruit** but the recession is delaying meeting the target
- 6 Implementation of **structural reforms** is more necessary than ever before

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Section 1

Global economy: gradual acceleration backed by economic policies

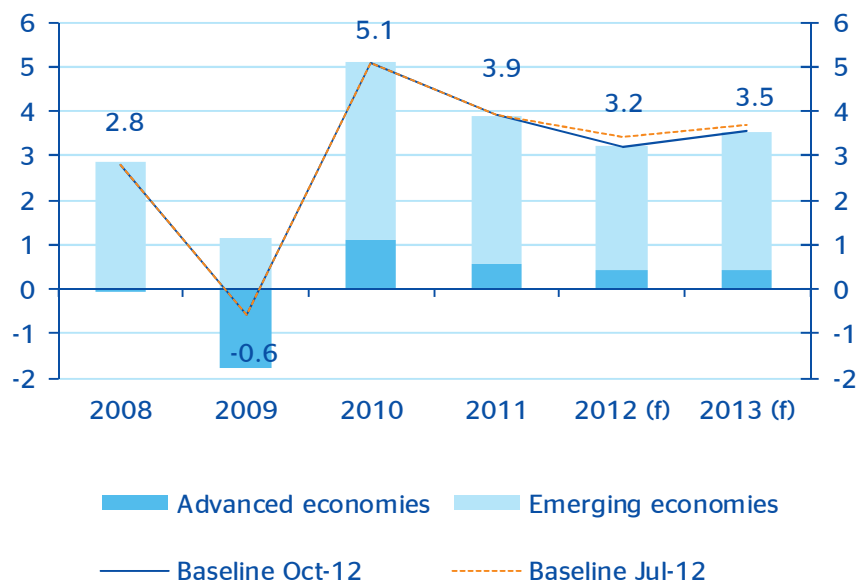
Section 2

Spain: the economy continues to adjust, fiscal efforts are bearing fruit and the agenda of reforms is more necessary than ever before

Gradual acceleration of the global economy

Global GDP growth (%)

Source: BBVA Research



Global growth is gradually picking up thanks to economic policy measures

In particular, due to monetary measures in developed economies and those supporting growth in developing countries

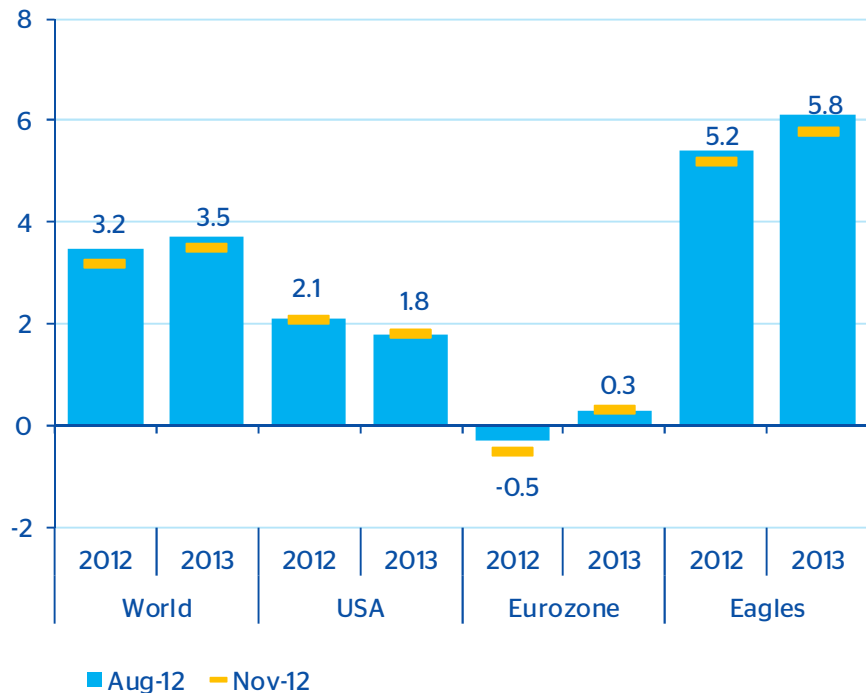
The tail risk scenarios are currently less probable than three months ago...

... if the agreements are upheld and the proposed measures are applied, although there are still serious risks

Growth remains very heterogeneous

GDP growth by area (% yoy)

Source: BBVA Research



A three-speed world



Risk factors

ECB: “whatever it takes” to preserve the euro (Outright Monetary Transactions, or OMT)



Base scenario



Risk scenario (lower likelihood)

The ECB's decision means that the base scenario is rather more probable provided that the agreements are implemented efficiently

Other global risks

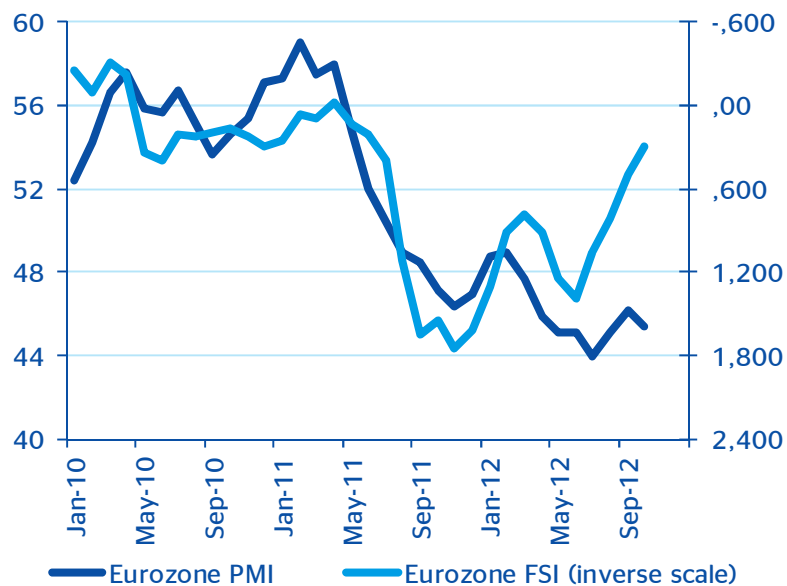
“Fiscal precipice” in the US

Slowdown in China and in other emerging economies

The potential of monetary policies in the US and EMU

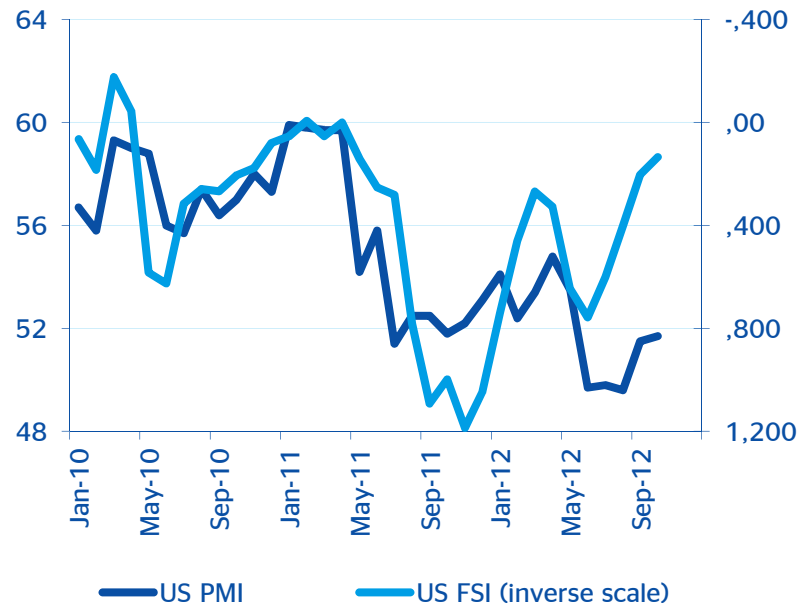
Eurozone: business expectations and financial stress*

Source: BBVA Research and Markit



US: business expectations and financial stress*

Source: BBVA Research and Markit



BBVA Research financial stress index (FSI): credit risk (5-year CDS, CDS and financial debt of non-financial companies), volatility (shares, interest rate and exchange rate) and liquidity tension (interbank rate spread and the 3-month risk-free rate) measures.

Europe on the move

Three positive events have opened a new window of opportunity

The ECB announced a new bond purchase programme (OMT): an “European-style” lender of last resort that will operate under fiscal conditionality

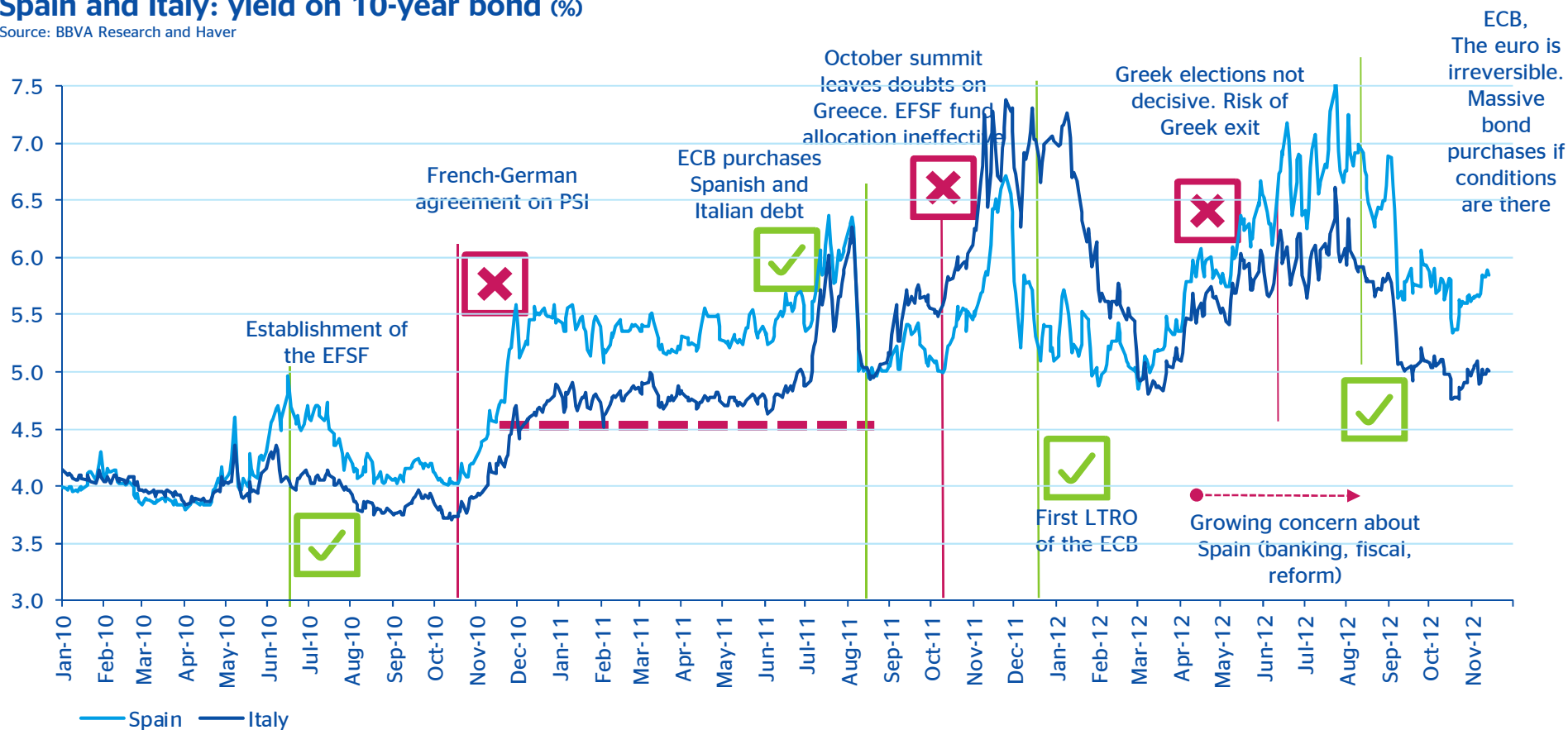
The German Constitutional Court backed the commitment to the ESM, which is now ready to intervene (with up to EUR200Bn)

Single banking supervision is pressing ahead, although slower than expected

Will Europe seize this opportunity?

Spain and Italy: yield on 10-year bond (%)

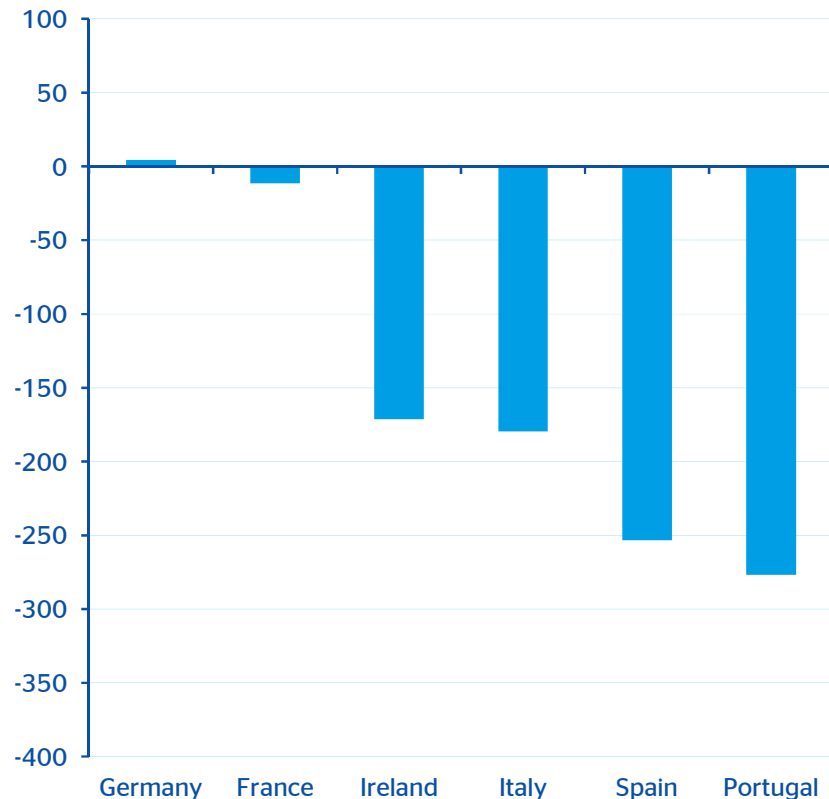
Source: BBVA Research and Haver



The European financial scenario has improved ...

Change in two-year public debt yields since Draghi speech (bp)

(Last data: 5 November 2012)
Source: BBVA Research and Bloomberg



- There are capital inflows into the Eurozone, for both fixed income and equities
- The lower risk aversion has encouraged some corporate debt issues in the Eurozone
- Demand for Spanish public debt on the secondary market by non-residents is reappearing
- Spanish banks and non-financial companies have again issued debt

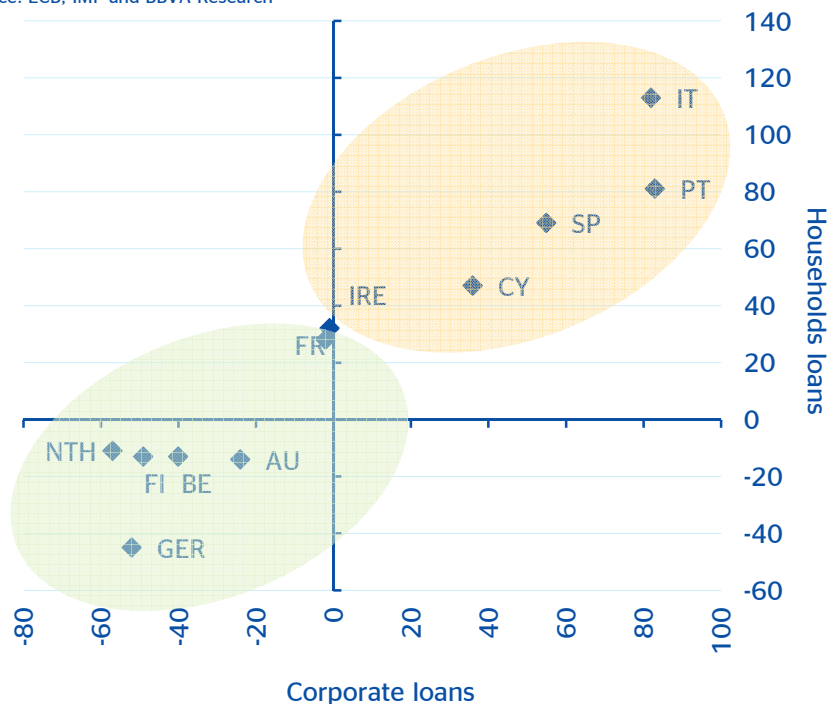
... although there are still considerable challenges

The fragmentation of the financial markets is stimulated by national legislation, which must be avoided with banking union

Change in the interest rate on new bank loans

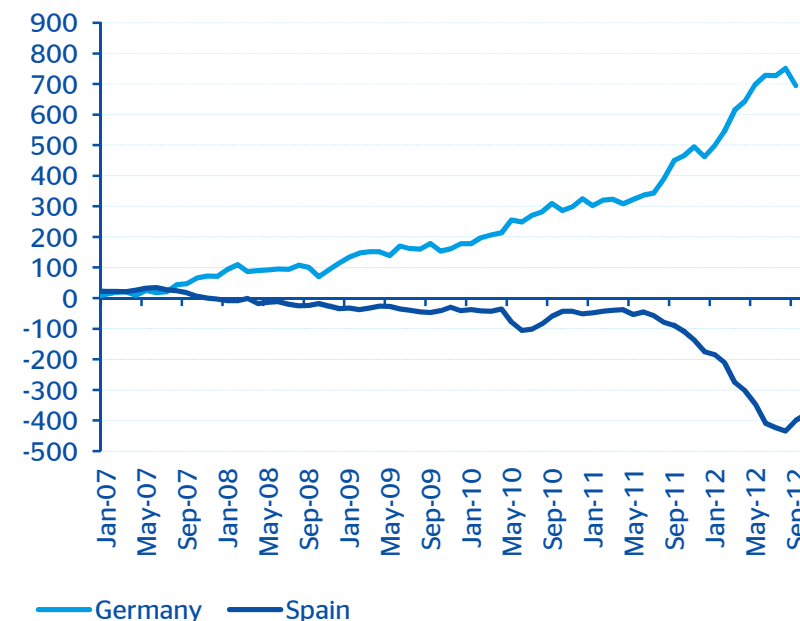
(pb, December 2010 to July 2012)

Source: ECB, IMF and BBVA Research



TARGET2 position with respect to the Eurosystem asset position(+) and liability position(-) (EUR Bn)

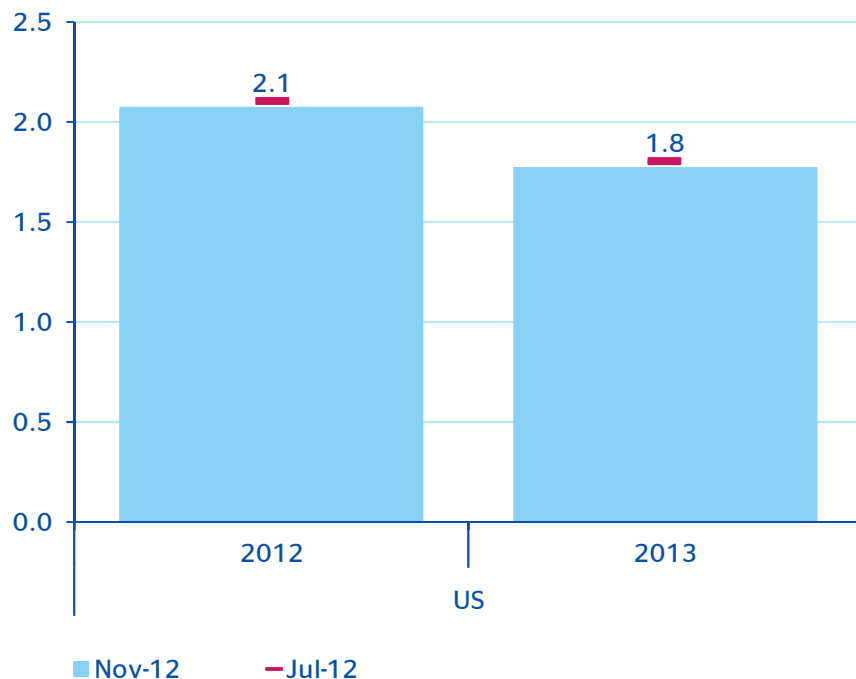
Source: BBVA Research and Central Banks



US: QE3 offsets downside risks

US: GDP growth (yoy)

Source: BBVA Research and BEA



US is trying to tackle political and fiscal uncertainty with monetary policy

Growth close to 2%. The “moderate” fiscal adjustment is offset by QE3, while the effects of hurricane Sandy will be relatively small

The improvement in conditions in the real estate sector does not counter weak external demand

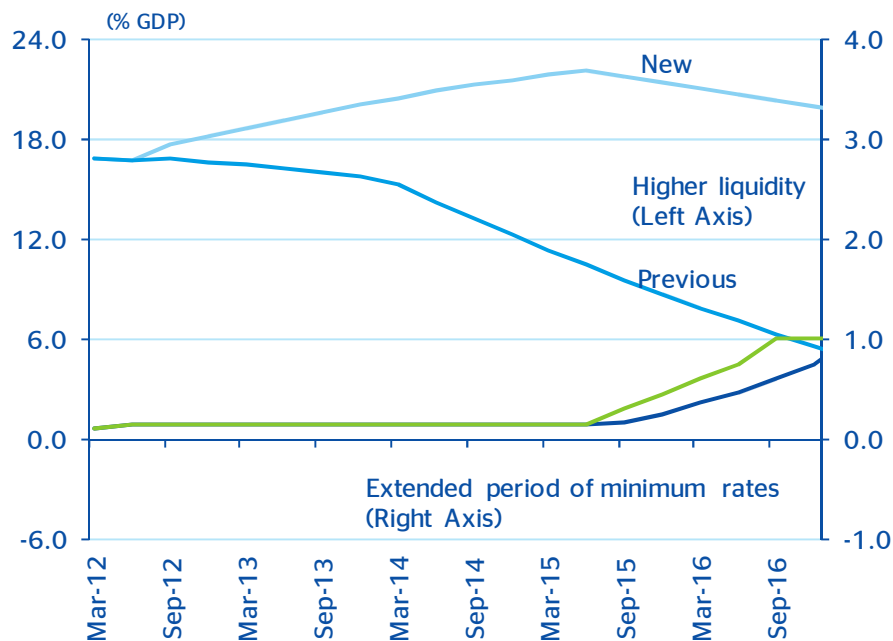
The “fiscal precipice” and the European crisis are the main concerns for the US

QE3: monetary expansion "as long as is necessary"

Monetary stimulus until the unemployment rate drops by close to 6%*

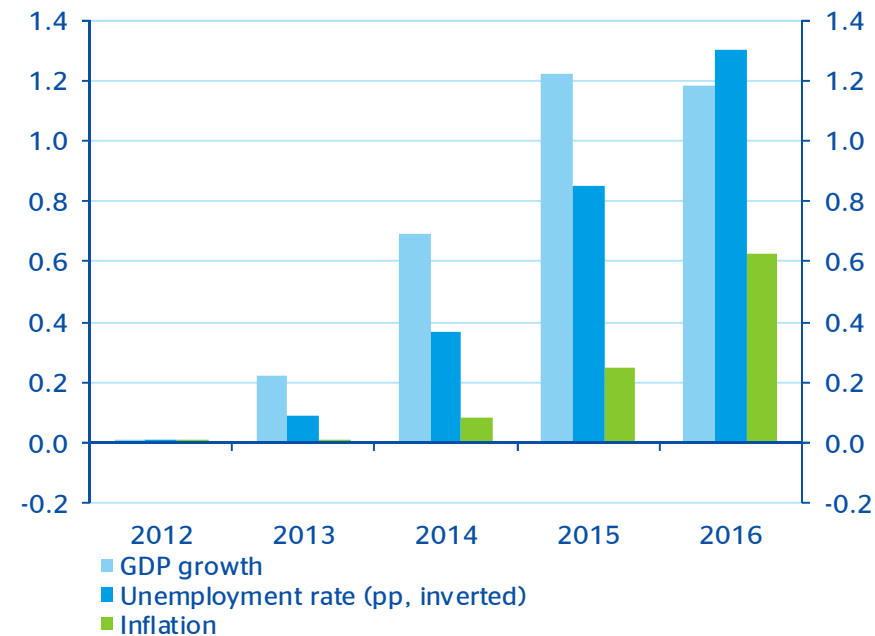
QE3 and extension of the period of interest rates at minimum levels

Source: BBVA Research



US: estimated impact of QE3 and extension of the monetary policy forecast

(p.p., with respect to the scenario without policy changes by the Fed. OEF model)
Source: BBVA Research



The global impact of QE3

Global impact of QE3 and extension of the period of low rates in the US (commerce)

Source: BBVA Research

World	2012	2013	2014	2015	2016
Growth	0.0	0.1	0.2	0.4	0.3
Inflation	0.0	0.0	0.1	0.2	0.4

Ranking of impact by area

Ranking	GDP growth	Inflation
1	Emerging Asia	Emerging Asia
2	Latin America	Latin America
3	Eurozone	Eurozone

Note: with no change in the global risk premium. Deviations in p.p., with respect to the scenario without policy changes by the Fed. OEF model.

The positive momentum of activity in the US is transmitted to the rest of the world not only through commerce

It also encourages greater capital inflows and falls in the risk premium in emerging economies

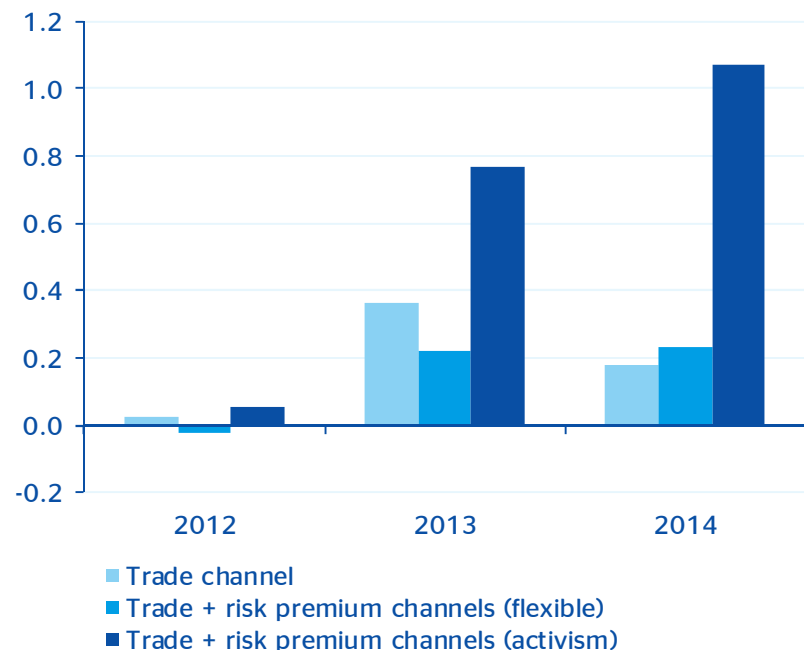
The challenge for Europe is to avoid lagging behind this improvement in global growth

The impact of QE3 on a typical emerging economy*

Impact on economic growth

(pp on base case scenario)

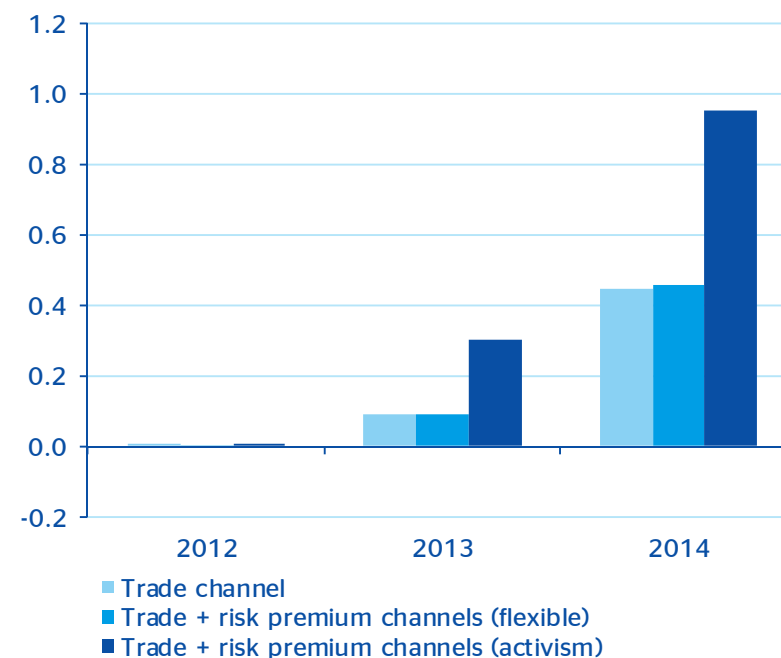
Source: BBVA Research



Impact on inflation

(pp on base case scenario)

Source: BBVA Research



* Used as a benchmark to calculate the impact on an emerging economy that is sufficiently open to the outside world both commercially and financially

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Section 1

Global economy:
gradual acceleration backed by economic policies

Section 2

Spain: the economy continues to adjust, fiscal efforts are bearing fruit and the agenda of reforms is more necessary than ever before

Main changes in the scenario

Drivers of the economic scenario

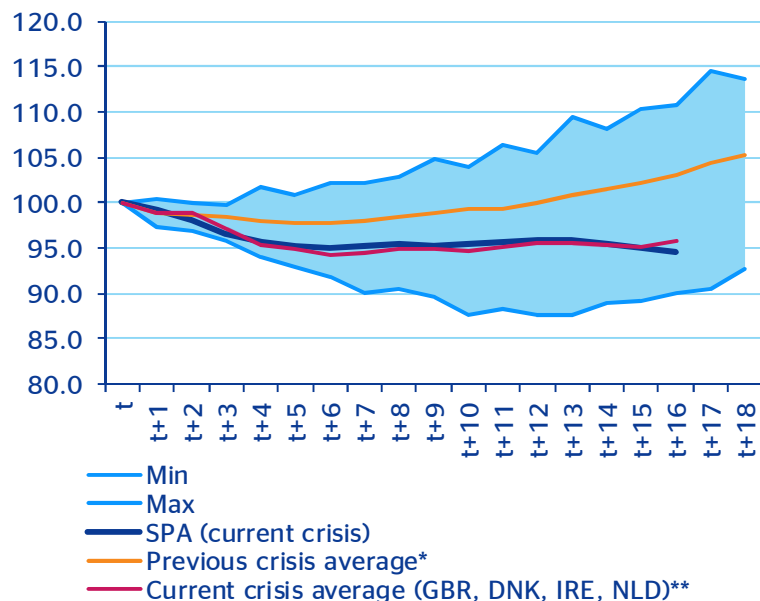
Source: BBVA Research



1. Adjustment of the imbalances continues

Trends in GDP in real terms during periods of property market crisis (t=100)

Source: BBVA Research from Haver data



- The Spanish economy is correcting accumulated imbalances
- The largest of these imbalances is found in the real-estate sector
- The downturn in activity in Spain (and in other European countries) seems to have been greater and recovery slower than in other occasions

Note: t is the period in which the price hit its peak

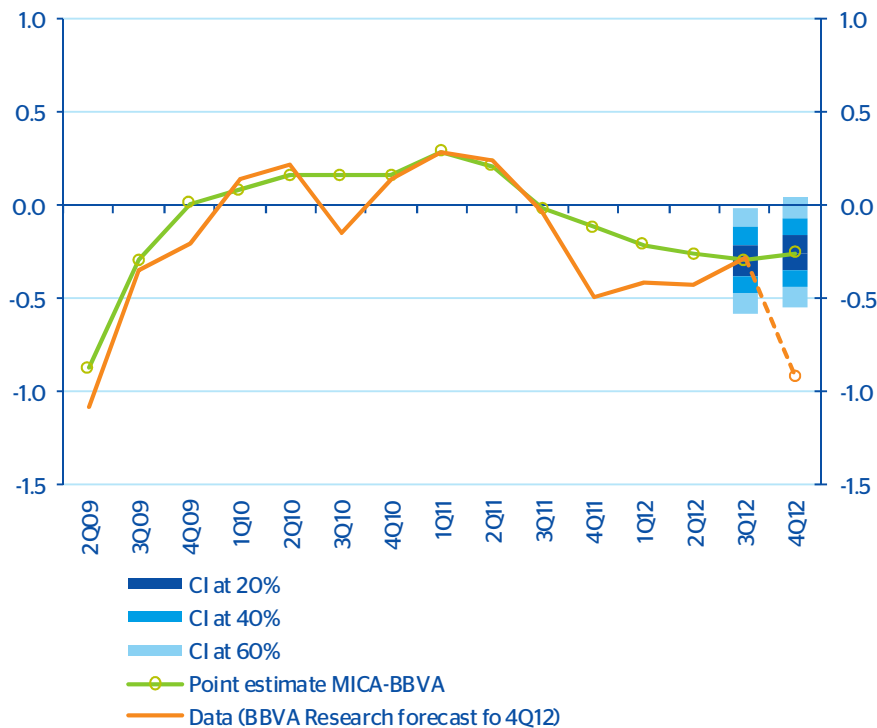
* Refers to real estate market crises in the sample that have already concluded

** Refers to real estate market crises in the sample that are still ongoing

2. Still in recession but the decline is stabilising

Spain: real GDP growth and forecasts based on MICA-BBVA model (% qoq)

Source: BBVA Research
Current forecast: 5 November



In 3Q12, the Spanish economy remains in recession...

... although the contraction was smaller than was forecast three months ago

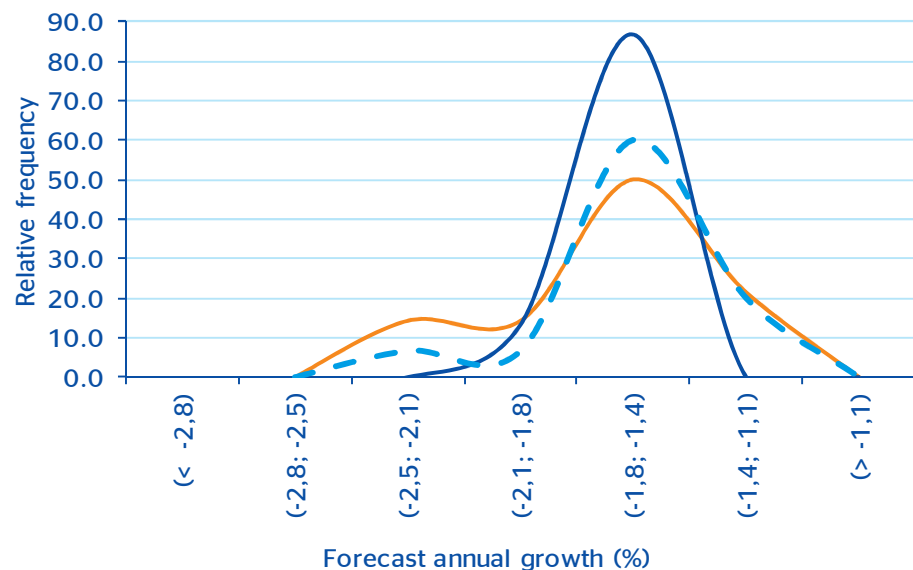
Available data indicate that growth in 4Q12 is likely to remain negative, although not as severely as we had foreseen

Employment will continue to be hindered by the negative outlook for growth

2. Still in recession but the decline is stabilising

Spain: changes in the breakdown of the growth forecasts for 2012 and 2013

Source: BBVA Research, using Consensus Forecast data



- 2012: June-2012 (Average: -1,6%)
- 2012: October-2012 (average: -1,6%)
- - 2013: October-2012 (average: -1,6%)

The uncertainty about growth prospects in 2012 has decreased

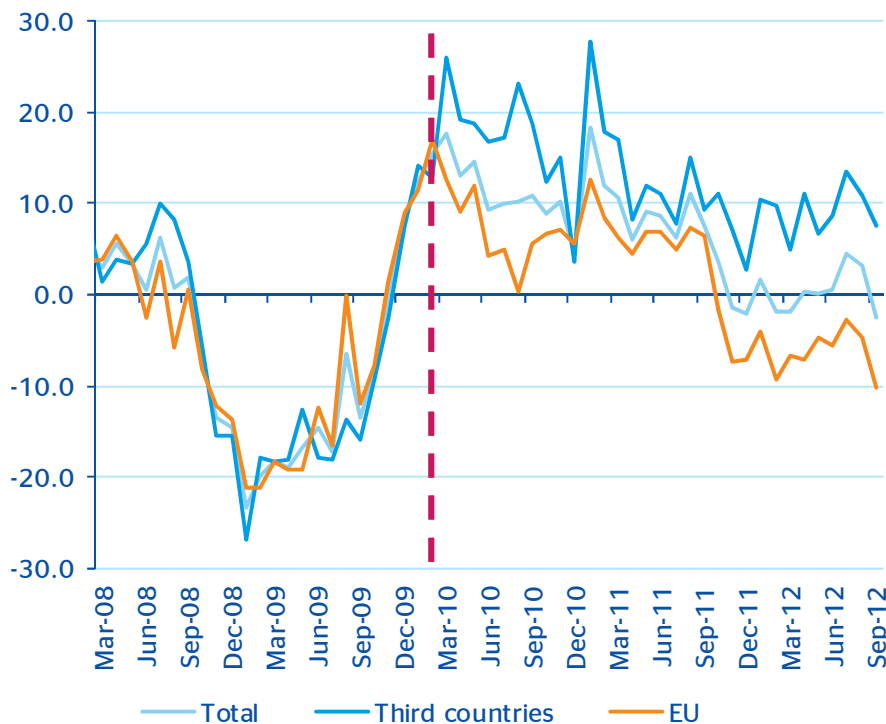
Before the summer, 28.6% of institutions expected a contraction of over 2.1% in 2012 (50% between 1.4% and 1.8%)

Now, just 13.0% forecast a contraction of over 2.1% (86.7% between 1.4% and 1.8%)

3. Exports continue to be the main support

Spain: exports of goods and services of large firms (in real terms, % yoy)

Source: BBVA Research based on Datacomex data



What can be behind this positive surprise?

Positive trend in Spanish exports, especially to emerging countries

Lower impact of fiscal consolidation or greater bringing forward of spending due to VAT increase

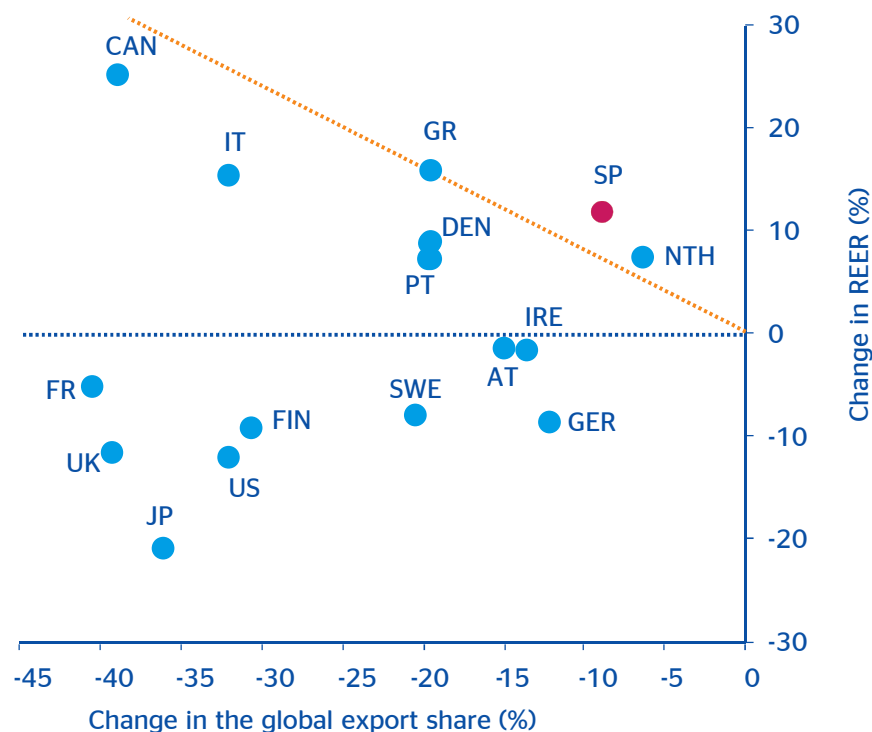
Results of the Supplier Payment Plan better than expected

Short-term impact of the labour market reforms greater than expected

3. Exports continue to be the main support

Cumulative change in global export share and relative export prices

Goods and services, 1999-2011. Source: BBVA Research based on European Commission and OMT data



The Spanish puzzle: factors linked to the business environment

Unlike other countries, between 1999 and 2011 Spain's share of exports barely fell by 8.9%

If the effect of relative export prices were eliminated, the Spanish share would have increased

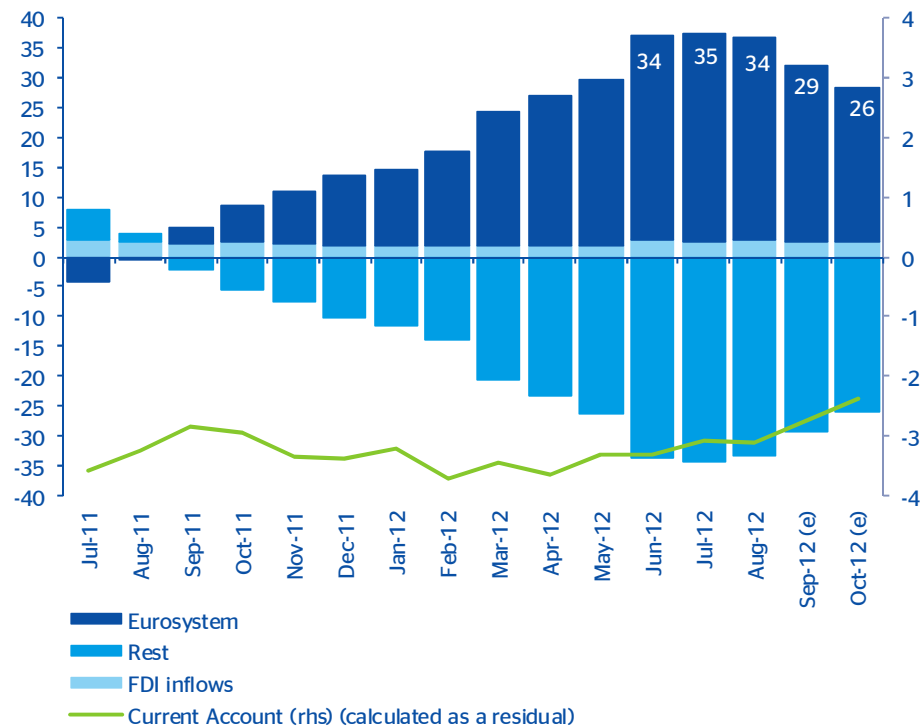
The prices are important, but other factors in the business environment are more so

4. Improvement in risk premium and capital flows

Spain: Balance of payments and capital flows

(Cumulative 12-month, % of GDP)

Source: BBVA Research, based on Bank of Spain data



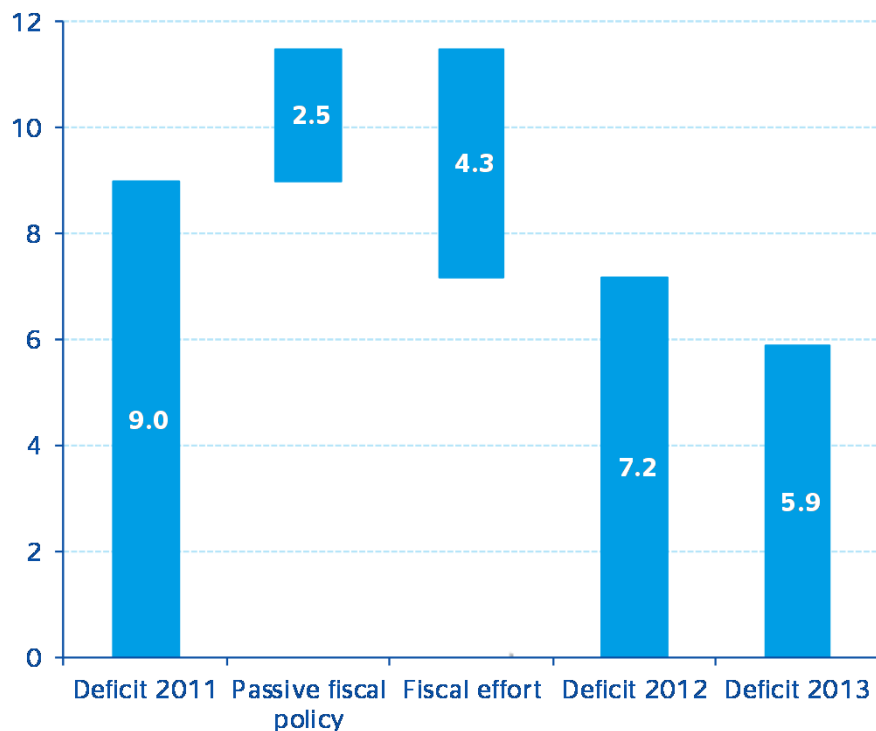
The announcements by the ECB have contributed to:

- Preventing a systemic risk event from occurring
- Ensuring the functioning of the monetary policy in the Eurozone
- Reducing the upward pressure on the risk premium and capital flows in Spain
- Reducing risk aversion: there has been a limited reopening of private debt markets

5. A significant fiscal adjustment

Public Administrations: breakdown of the public deficit excluding aid given to the financial system (% GDP)

Source: BBVA Research, based on MINHAP data



Fiscal consolidation is working: fiscal efforts in 2012 will be over 4pp of GDP

The economic downturn is invariably delaying the achievement of the nominal target ...

... although at the current pace and with consistent fiscal adjustment, structural balance would be achieved in 2014

Overall, there are still major reforms to be undertaken, that would increase the efficiency of the public authorities

5. A significant fiscal adjustment

Spain: fiscal adjustment and GDP growth

Source: BBVA Research based on INE data



In 2011, the Spanish economy grew 0.4% despite the contractionary fiscal policy

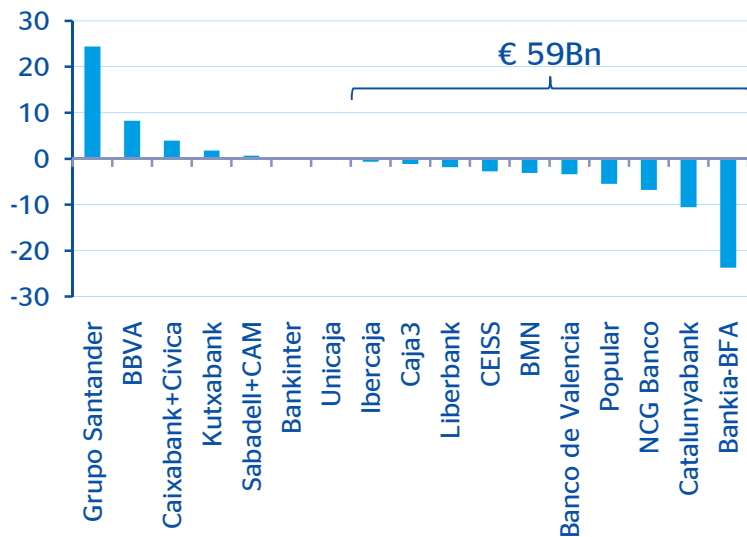
Despite the unprecedented adjustment to public accounts in 2012 (fiscal efforts of 4.3pp of GDP), the economy will contract around 1.4%

Debate on fiscal multipliers

6. The restructuring of the financial system

Capital requirements of financial institutions in the adverse scenario* (EUR Bn)

Source: Bank of Spain



* Does not include mergers under way or fiscal credit (with it EUR54Bn)

One more step has been completed in the bank restructuring

Recapitalisation plans: EUR40Bn euros in forecast public capital injections

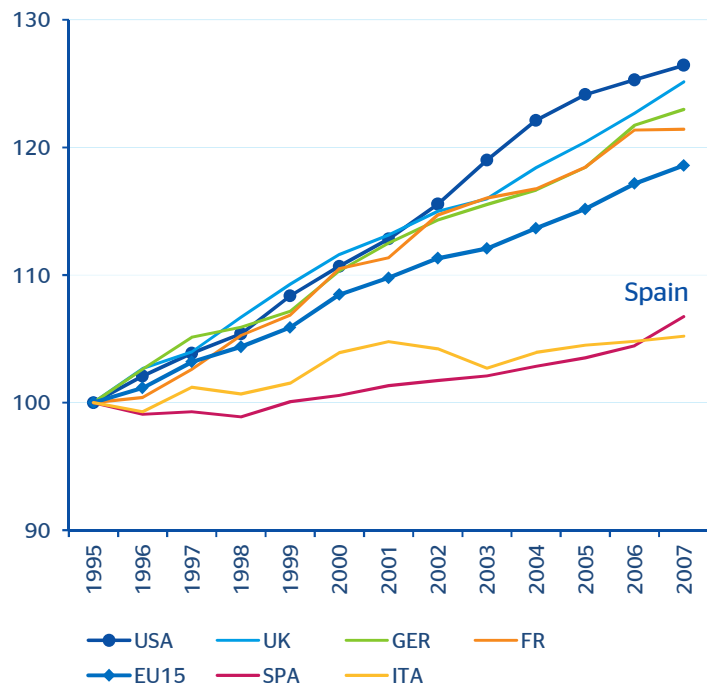
The diverse nature of the system has been confirmed: the solvent institutions have 70% of the assets

Process of transferring assets to the Asset Management Company (Sareb), with discounts to attract private capital and not consolidate as public debt

7. Agenda of reforms: more necessary than ever

Productivity: gross added value by hour worked, indicators by volume, 1995=100

Source: BBVA Research, using EU KLEMS data



The challenge is to create jobs and reduce the productivity gap

In the expansion, Spain increased its productivity gap compared to the main economies

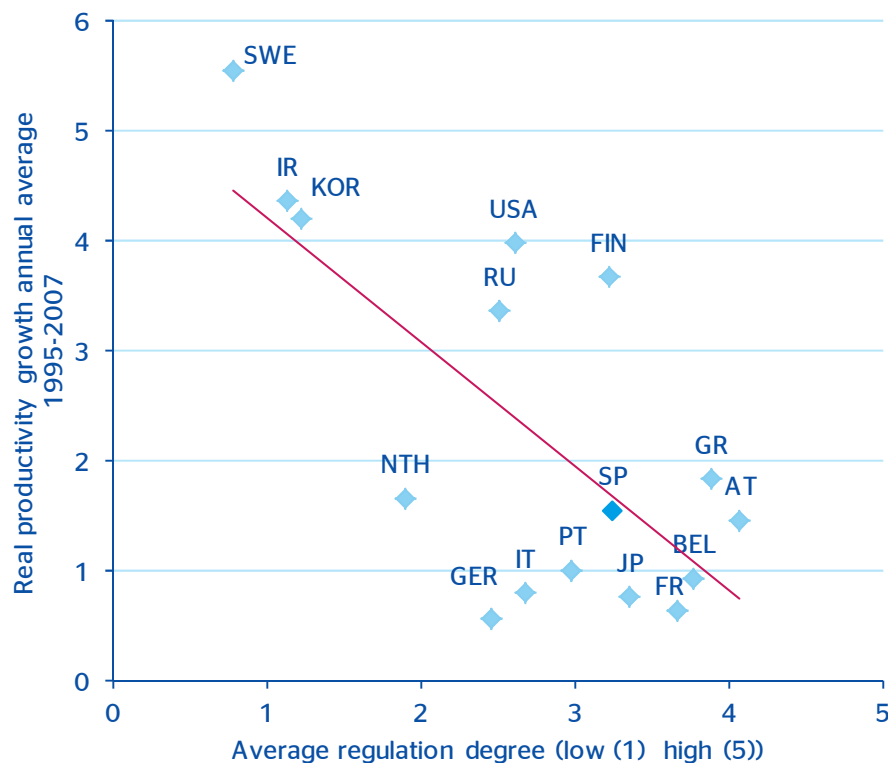
Until the current economic crisis, aggregate productivity barely grew by an average of 0.6% per year

Growth in productivity facilitates the sustainability of public accounts, private sector deleveraging and internationalisation

7. Agenda of reforms: more necessary than ever

Regulation and growth in productivity in the retail sector

Source: BBVA Research based on EUKLEMS and OECD data



Productivity in the services sector is key

Competitive services are a necessary condition to achieve productivity gains

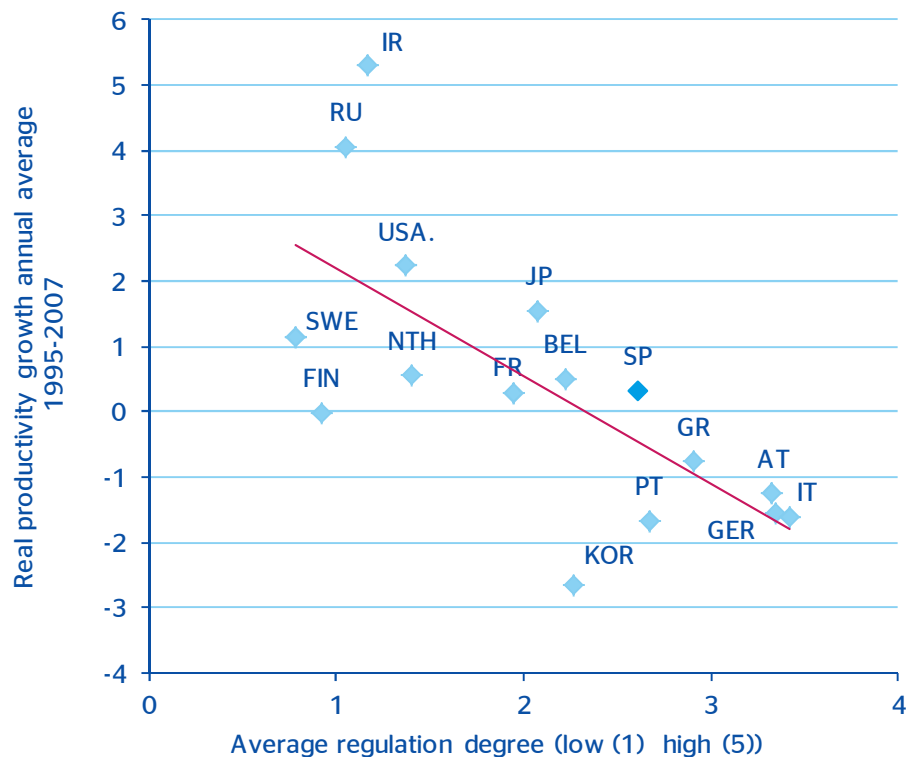
The indicators of regulation in the retail sector take into account entry barriers, operating restrictions and price control

Better sectorial regulation is associated with greater productivity gains

7. Agenda of reforms: more necessary than ever

Regulation and growth in productivity in the business services sector

Source: BBVA Research based on EUKLEMS and OECD data



Productivity in the services sector is key

Regulatory improvement and the professionalisation of business services (programming, information services and other business services) ...

... would not only foster the productivity of the sector but would also have a significant external impacts ...

... on the productivity and internationalisation of companies in the other sectors

Key themes

- 1 After the slowdown in 2012, **global growth will gradually speed up** from the end of the year and during 2013, thanks to the monetary measures in developed economies and those supporting growth in emerging economies
- 2 **The risk scenarios are less likely that they were three months ago, if the agreements are upheld and the measures are applied in the developed countries**, although there are still considerable challenges to be faced in the Eurozone and in the US.
- 3 **Emerging economies** face the challenge of managing **inflows**
- 4 **Spain: Spain is still expected to contract** in 2012 and 2013, but the decline has been less intense in the third quarter
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Situation and Outlook for the Global Economy and for Spain

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Outlook for 2012-2013

Spain and Europe: macroeconomic forecasts

Source: INE, Bank of Spain, Eurostat and BBVA Research forecasts

(Yoy growth rate)	2009		2010		2011		2012 (f)		2013 (f)	
	Spain	EMU	Spain	EMU	Spain	EMU	Spain	EMU	Spain	EMU
FCE, Homes	-3.9	-0.9	0.6	0.9	-0.8	0.1	-2.1	-1.0	-2.9	0.0
G.C.F AA.PP	3.7	2.6	1.5	0.7	-0.5	-0.1	-3.6	-0.1	-6.9	-0.5
Gross fixed capital formation	-18.0	-12.7	-6.2	-0.3	-5.3	1.6	-9.7	-3.6	-7.5	-0.6
Equipment, machinery and cultivated asset	-23.9	-18.7	2.6	6.3	2.3	4.2	-7.6	-5.3	-3.7	-0.8
Equipment and machinery	-24.5	-18.8	3.0	6.4	2.4	4.3	-7.7	-5.3	-3.8	-0.8
Construction	-16.6	-9.9	-9.8	-4.4	-9.0	-0.2	-11.8	-3.4	-10.0	-1.4
Housing	-23.1	-12.5	-10.1	-2.9	-6.7	0.9	-6.8	-1.9	-8.4	0.4
Other buildings and other construction	-9.1	-7.0	-9.6	-5.9	-11.0	-1.4	-16.3	-5.1	-11.7	-3.3
Change in inventories (*)	0.0	-0.9	0.1	0.6	-0.1	0.1	0.0	-0.5	0.0	0.0
Domestic demand (*)	-6.6	-3.6	-0.6	1.2	-1.9	0.5	-4.0	-1.8	-4.7	-0.3
Exports	-10.0	-12.4	11.3	11.0	7.6	6.4	3.8	3.1	8.2	3.2
Imports	-17.2	-11.0	9.2	9.4	-0.9	4.2	-4.7	0.1	-1.8	2.2
Net trade balance (*)	2.9	-0.8	0.3	0.7	2.3	1.0	2.6	1.3	3.3	0.5
GDP at mp	-3.7	-4.3	-0.3	1.9	0.4	1.5	-1.4	-0.5	-1.4	0.3
Pro-memoria										
GDP w/o housing investment	0.5	-3.8	0.5	2.2	1.0	1.5	-1.0	-0.4	-0.9	0.3
GDP w/o construction	1.6	-3.6	1.6	2.7	2.1	1.7	0.3	-0.2	-0.2	0.4
Employment (LFS)	-2.3	-1.8	-2.3	-0.5	-1.9	0.5	-4.4	-0.8	-3.4	-0.3
Unemployment rate (% active pop)	20.1	9.6	20.1	10.1	21.6	10.2	25.0	11.4	26.1	11.8
Current account balance (% of GDP)	-4.5	0.1	-4.5	-0.1	-3.5	0.0	-1.4	1.2	-0.5	1.2
Debt (% GDP) (**)	61.3	79.6	61.3	85.5	69.1	87.3	85.2	89.5	96.2	90.4
Public sector balance (% of GDP) (**)	-9.7	-6.3	-9.7	-6.2	-9.0	-4.1	-7.2	-3.2	-5.9	-2.3
CPI (average period)	1.8	0.3	1.8	1.6	3.2	2.7	2.5	2.5	2.3	1.8
CPI (end of period)	3.0	0.4	3.0	2.0	2.4	2.9	3.5	2.4	1.3	1.6

(*) contribution to growth

(**) excluding in Spain aid to the banking sector