Too Slow For Comfort

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28th Economic Outlook Symposium

Global growth continues to slump

- US: Same story, but improving
- Europe: Muddling through
- EMs: From growth drivers to risk generators

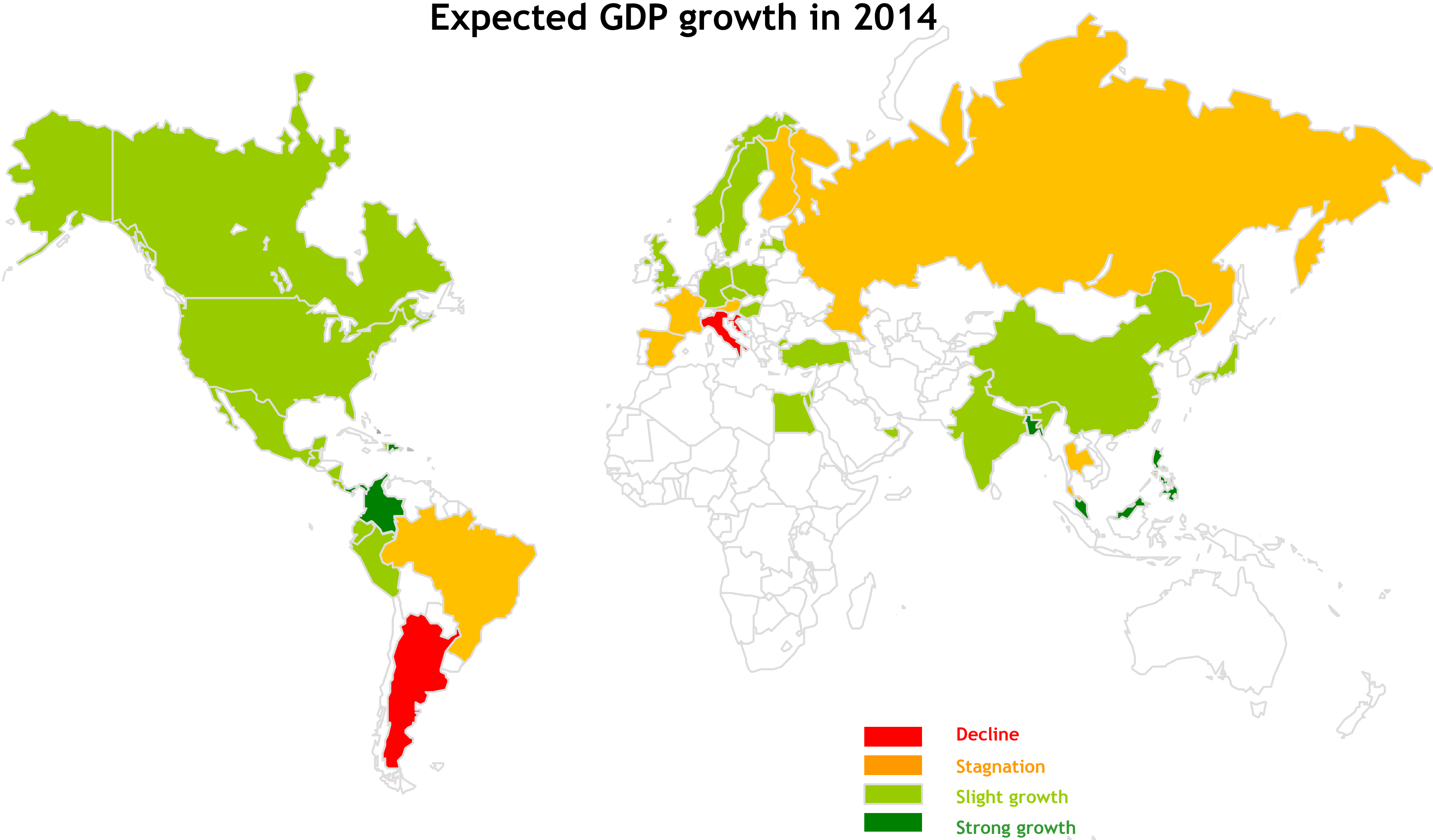
Hyperactive Central Banks

Shocking oil developments

	IMF GDP Forecast		*Difference from July IMF Report*	
	2014	**2015**	*2014*	*2015*
US	2.2	3.1	*0.5*	*0.0*
UK	3.2	2.7	*0.0*	*0.0*
GER	1.4	1.5	*-0.5*	*-0.2*
FRA	0.4	1.0	*-0.4*	*-0.5*
SP	1.3	1.7	*0.1*	*0.1*
ITA	-0.2	0.8	*-0.5*	*-0.3*
EURO ZONE	0.8	1.3	*-0.5*	*-0.2*
JAP	0.9	0.8	*-0.7*	*-0.2*
CHINA	7.4	7.1	*0.0*	*0.0*
INDIA	5.6	6.4	*0.2*	*0.0*
RUS	0.2	0.5	*0.0*	*-0.5*
BR	0.3	1.4	*-1.0*	*-0.6*
MX	2.4	3.5	*0.0*	*0.1*

Global growth disappoints

Expected GDP growth in 2014



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Source: CEMEX, Consensus Forecast

2015, somewhat better but not much

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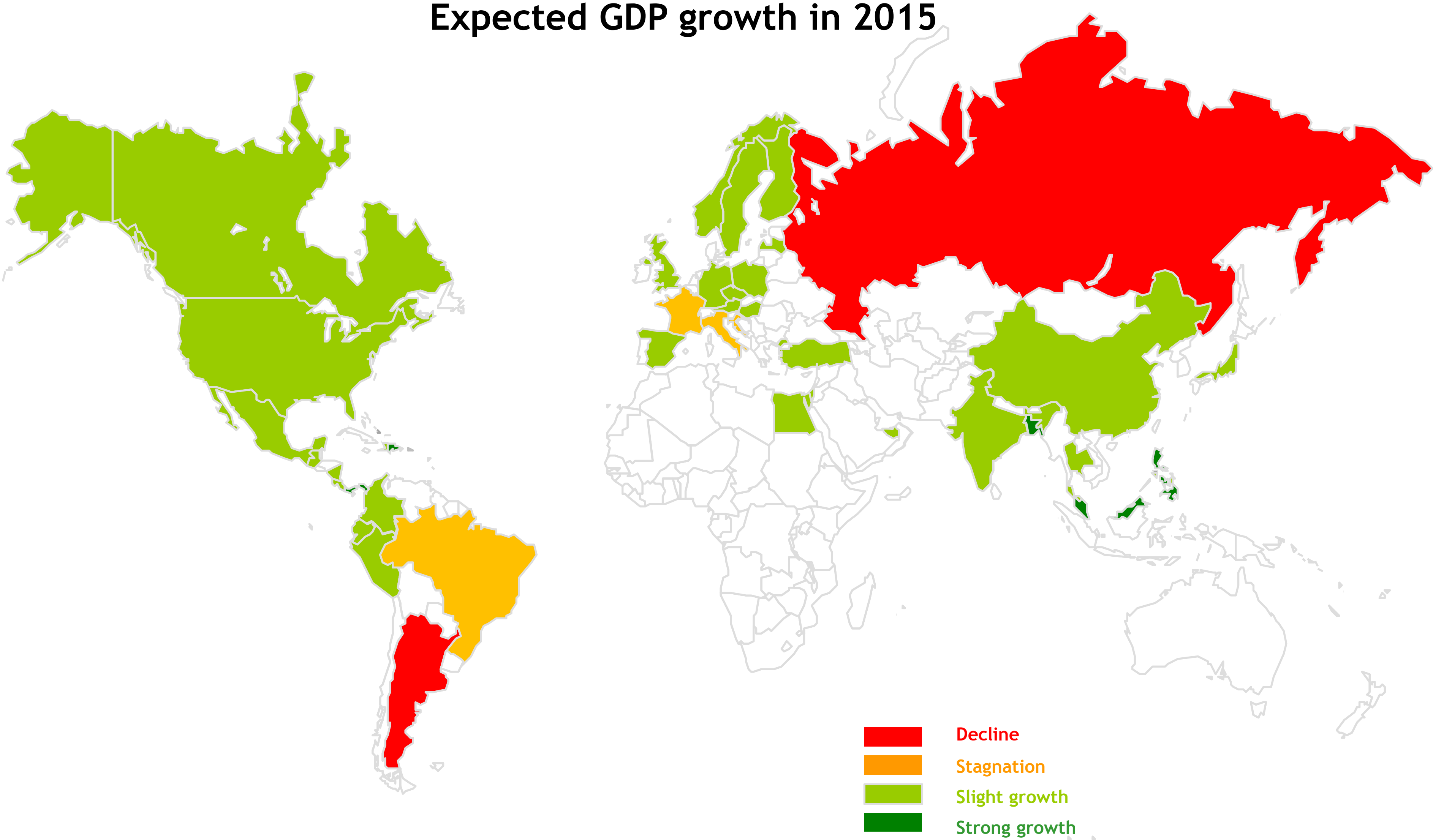

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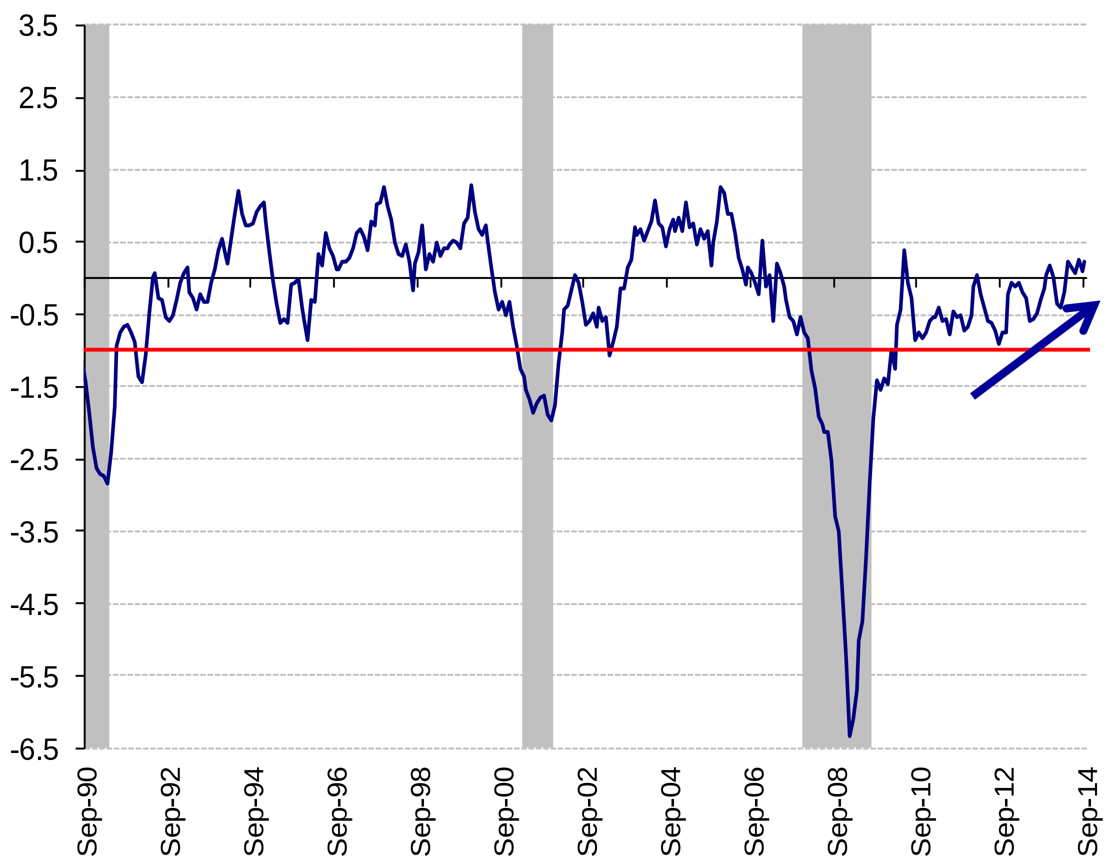
US: same story, but slowly improving

Growth trending up



Activity Index.

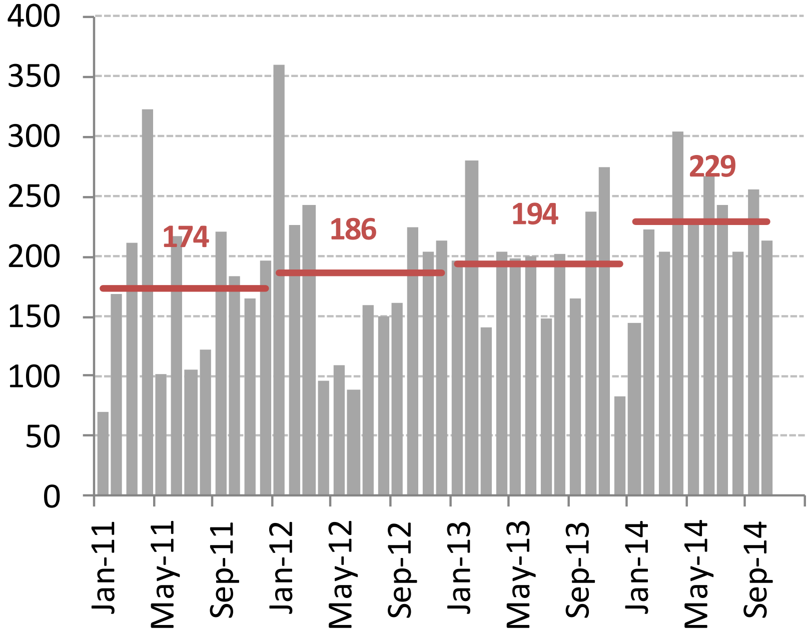
Source: Cemex

- Households with room to spend
- Corporate sector in good shape
- Lower fiscal drag
- Loose financial conditions
- Pent up housing demand

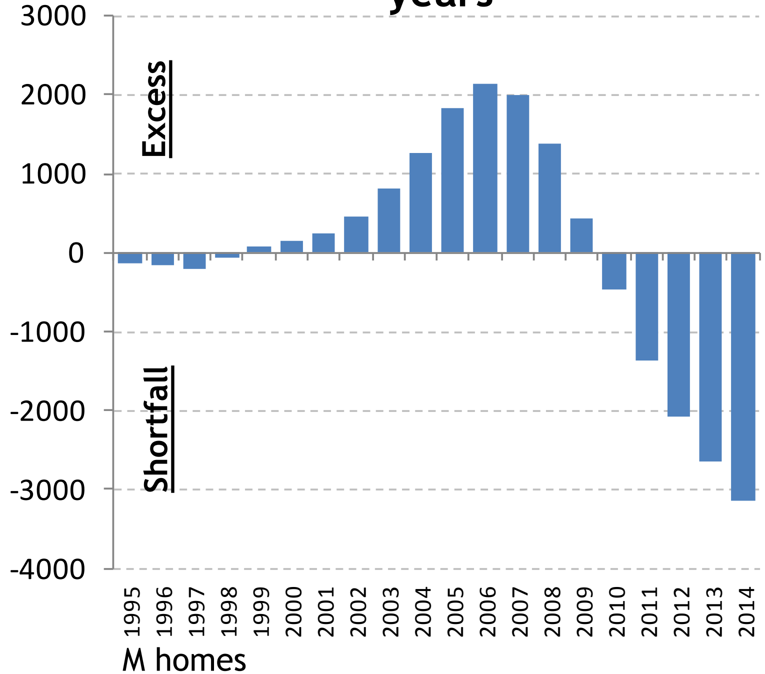
Fed willing to risk inflation to assure growth

US: drivers for growth

Job creation continues to be the key driver



Huge Pent up Housing Demand should boost housing market in the coming years



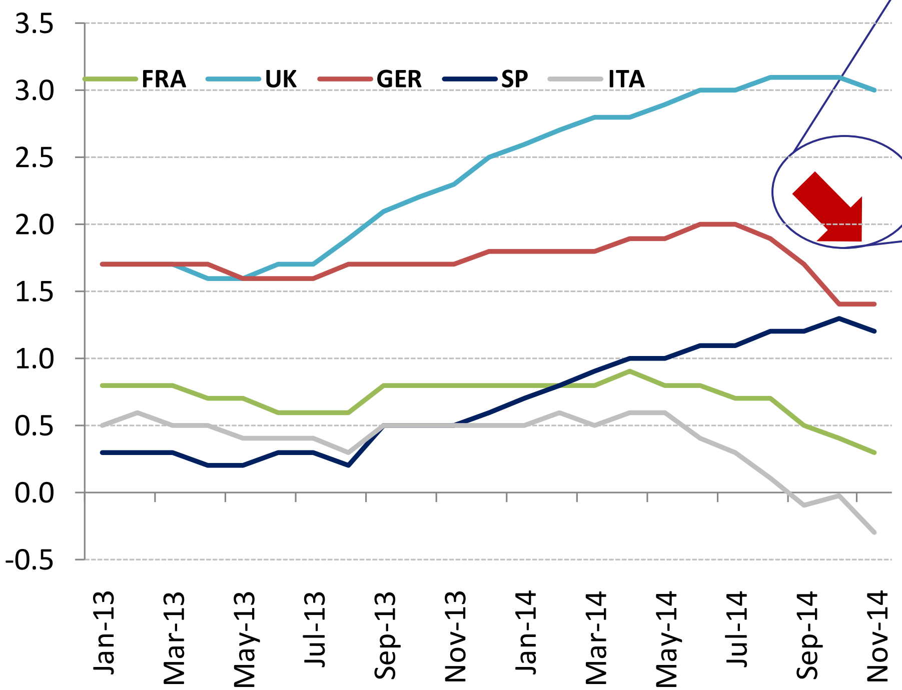
Assuming 1.5 M in equilibrium

Households formation	1.20
Second homes	0.15
Replacement	0.35
Manufactured homes	- 0.20

Europe: disappointing expectations once again …

Some recovery expected for 2015, but with lower rates of growth and higher uncertainty.

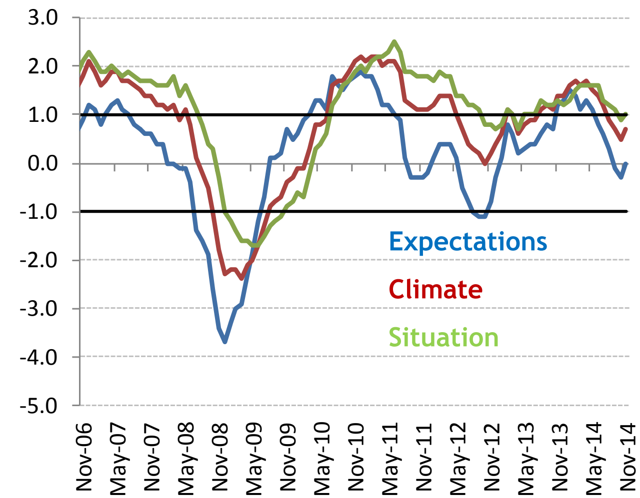
Growth expectations downgraded in the core



GDP growth for 2014 according to CF

Source: CF

German IFO cooled off significantly



Source: IFO

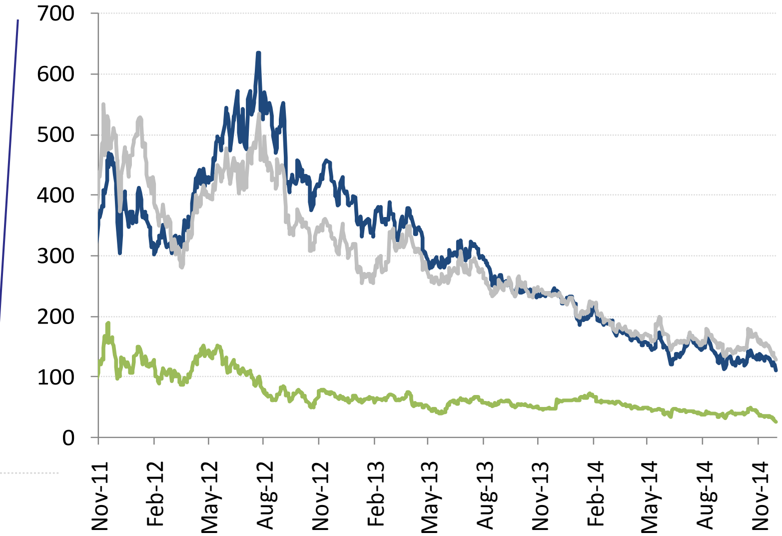
- **Germany: shock to business confidence expected to be transitory.**
- **France: increasing fears on the mid-term outlook.**
- **Spain: not quite self-sustained growth yet**

No recession, but no growth

	2013												2014										
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dic	Ene	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct	Nov
EUROPE																							
GERMANY																							
FRANCE																							
SPAIN																							
ITALY																							
UK																							

Reasons for some optimism

- Financing costs at lowest levels ever …
- … and spreads back to pre-crisis levels.
- Exchange rate depreciating
- Lower fiscal drag
- Oil prices below $70/barrel

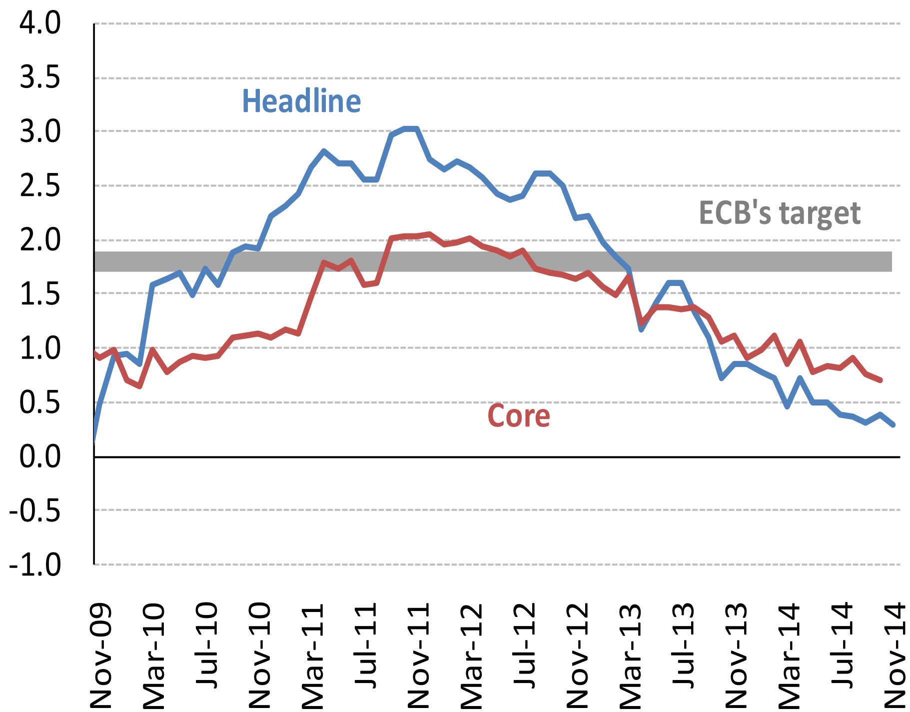


Monetary policy action growingly likely

And don't forget about falling oil prices

Inflation remains at "dangerous levels"

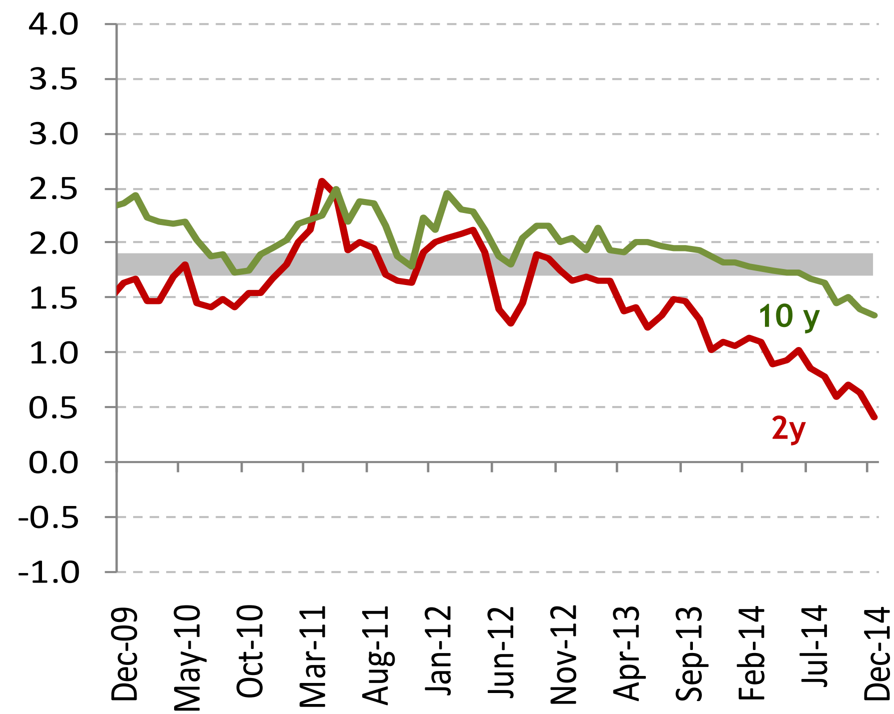
Inflation below ECB comfort zone



Inflation (% yoy)

Source: Eurostat

Disanchoring inflation expectations



Inflation swap related (% yoy)

Source: DS

Deflation, collateral damage in Europe

- Higher increase in *spreads*
- "*Sudden stop*" risk
- Credit crunch
- *Economic* contraction and necessity of restoring public finance

Deflation

Break-up risk

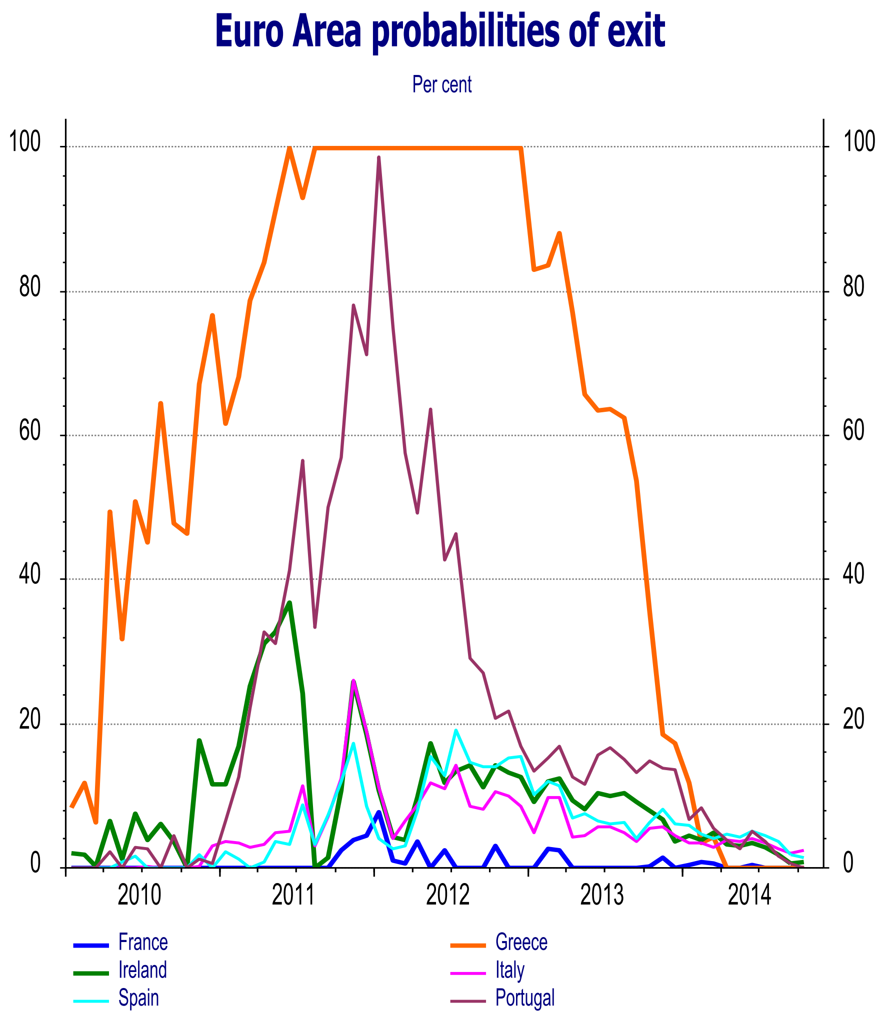
- More difficult to repay debt
- Fiscal adjustment more severe
- Contraction of activity (shy consumption and investment)

Risk of default

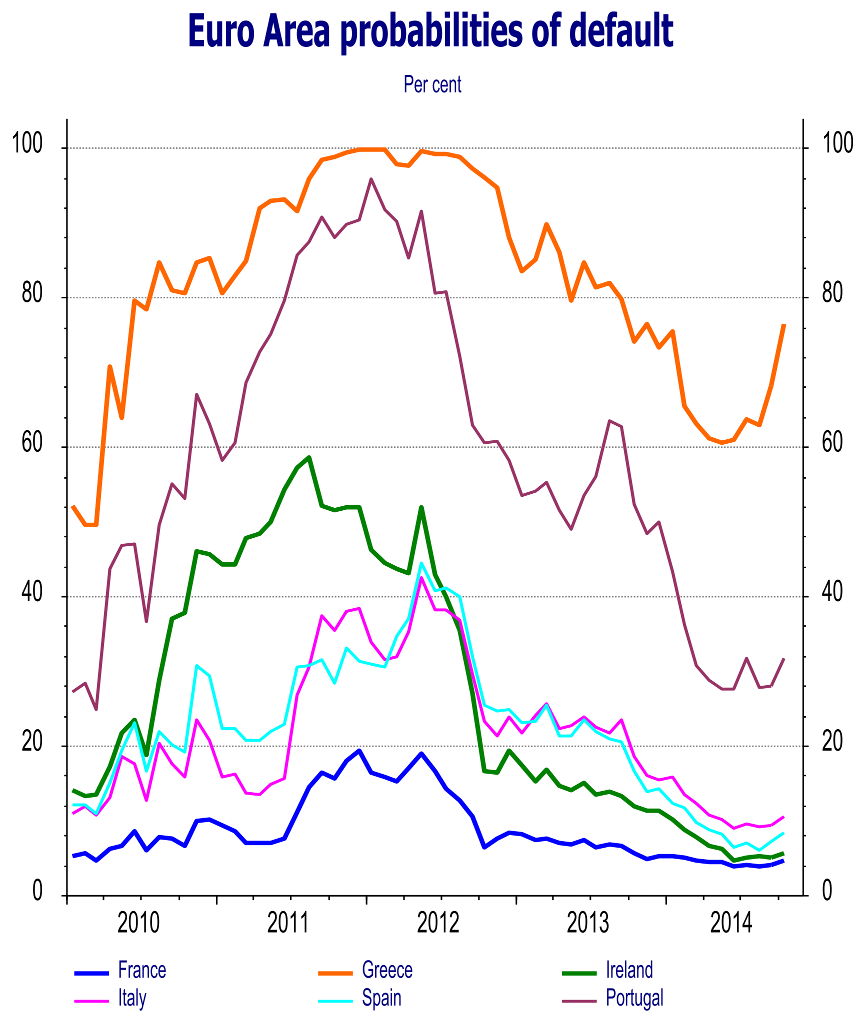
- Increase in spreads
- More necessity of real adjustment (fall in demand)
- Social unrest reignites (austerity fatigue in periphery - rescue fatigue in the core)

Maybe not in the death bed anymore, but not yet cured

The risk of break-up seems to have vanished. More Europe is needed



Source: Thomson Reuters Datastream



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The risk of break-up seems to have vanished. More Europe is needed

Have the European authorities really understood that we cannot stay in the grey zone?

Disintegration

Discarded

Resort to traditional tools (devaluation, strong monetary support) to alleviate the real effect (unemployment) of the needed adjustment. <u>High costs </u>(default, banking linkages, fear of floating)

Enhanced integration

- Short-term easing
- Mid-term reforms
- Long-term integration and redistribution

<u>Implies loss of sovereignty</u>

Current crisis, the necessary trigger to push forward the European Project

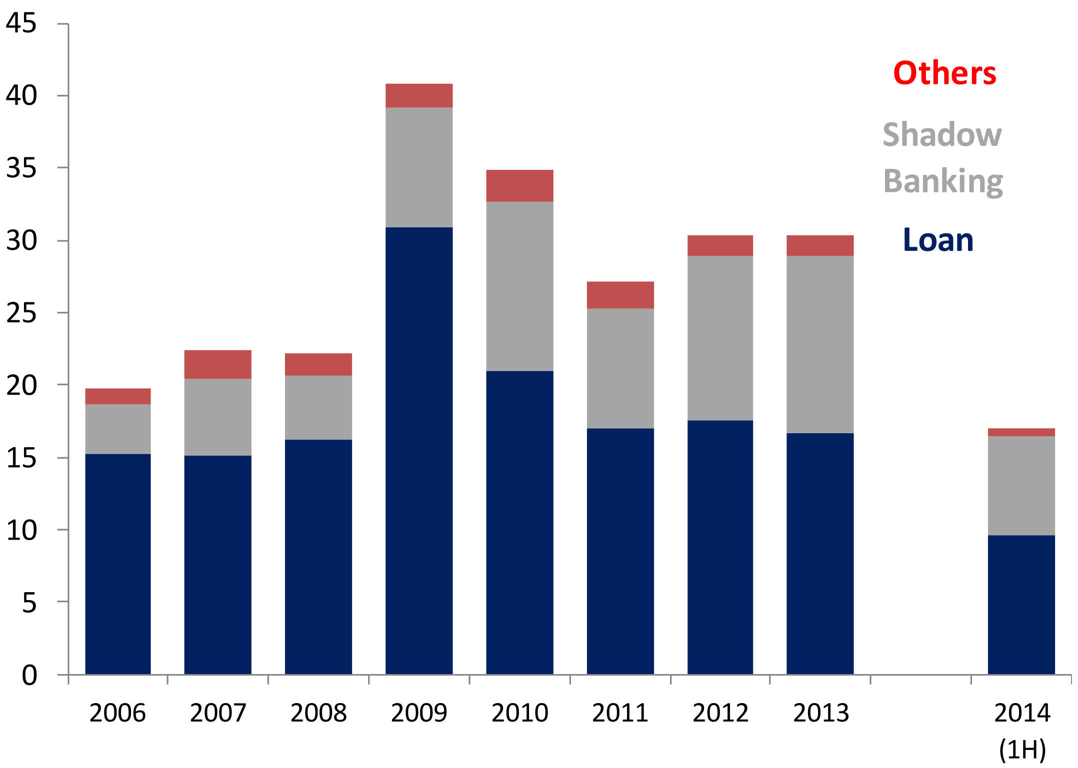
European crisis is primarily institutional, Eurozone is an unfinished project

- Institutional reform/Fiscal reform
  - Lender of last resort (ECB)
  - Fiscal integration (European Treasury) and Eurobonds
- Incentive mechanisms (fiscal, regulatory, etc.)
- Banking Union
  - Pan-European banking resolution
  - European Deposit Insurance Institution
  - Regulation and supervision
- Structural reforms across Europe, predominantly in the periphery (competitiveness) but not only

Dominance of domestic politics
Diminishing returns to the “buying time” strategy
Increasing social risk

EMs: from growth drivers to risk generators

China’s Shadow Banking too big to control

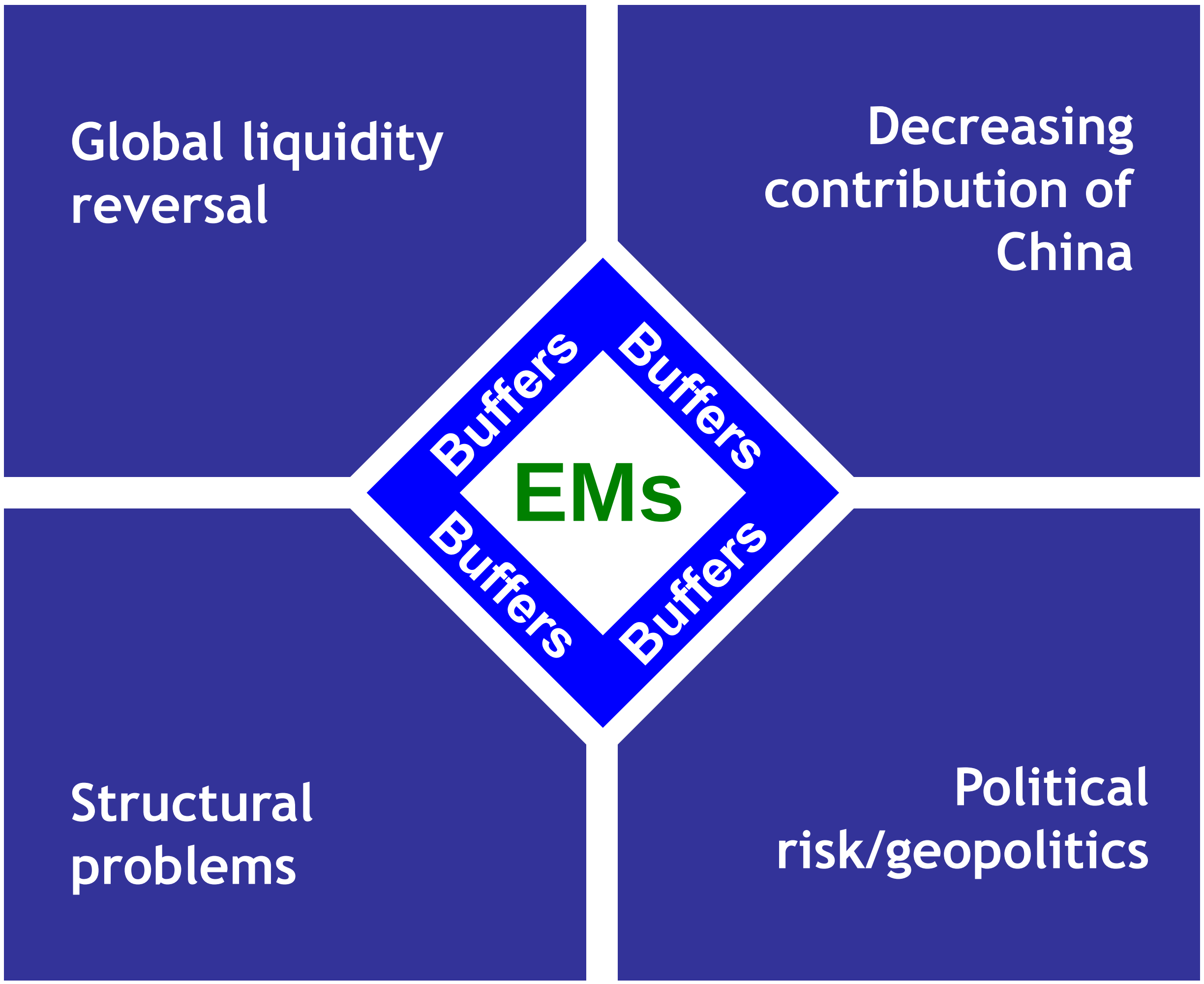


Total social financing flows and breakdown, as % of GDP
Source: People´s Bank of China

- China:
  - Limited risk from Shadow Banking: no Western style connection with formal banking and China can afford the rescue
  - Soft landing, but how “soft” the landing?
- Brazil perspectives worsened significantly: stagflation, policy uncertainty, deteriorating fiscal and current account position, persistent supply constraints.
- Russia stagnating: conflict with Ukraine taking its toll, oil dependency.

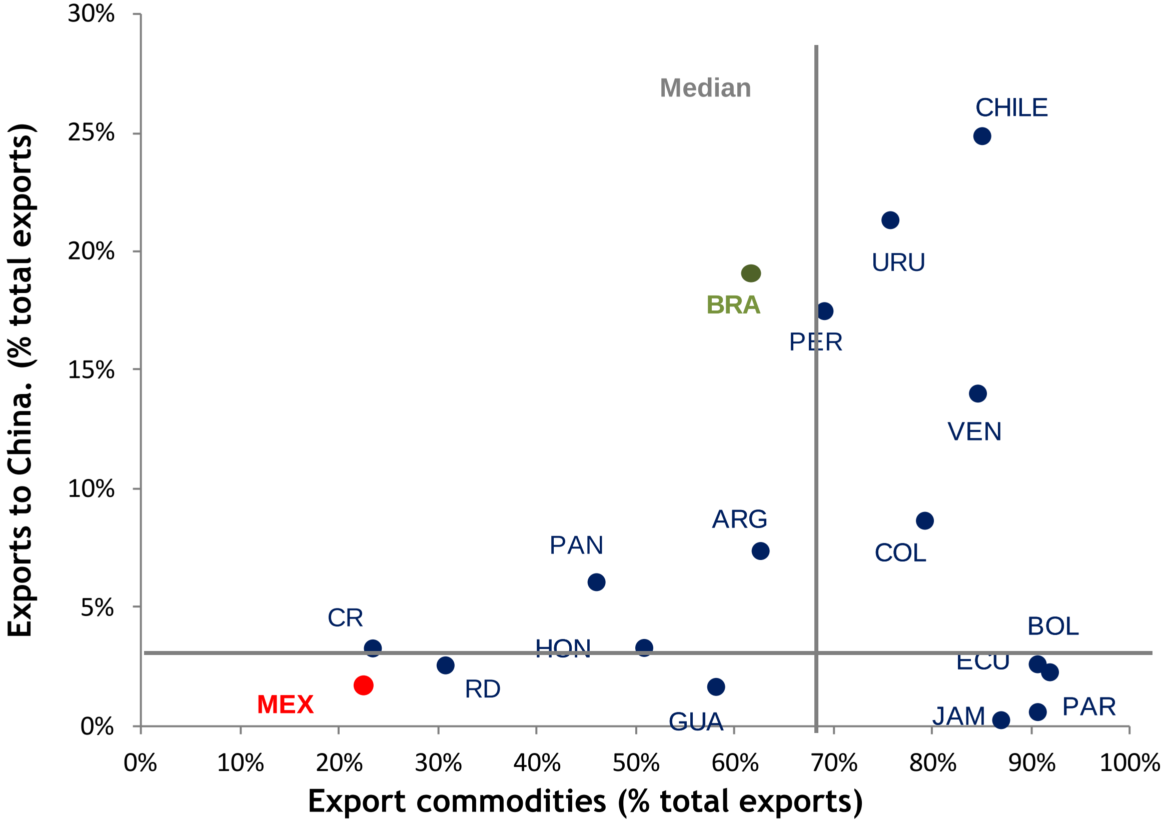
Cuestionado el crecimiento de Emergentes

A tough environment for emerging markets



Impact of China slowdown/commodity prices drop on commodity producers (LatAm)

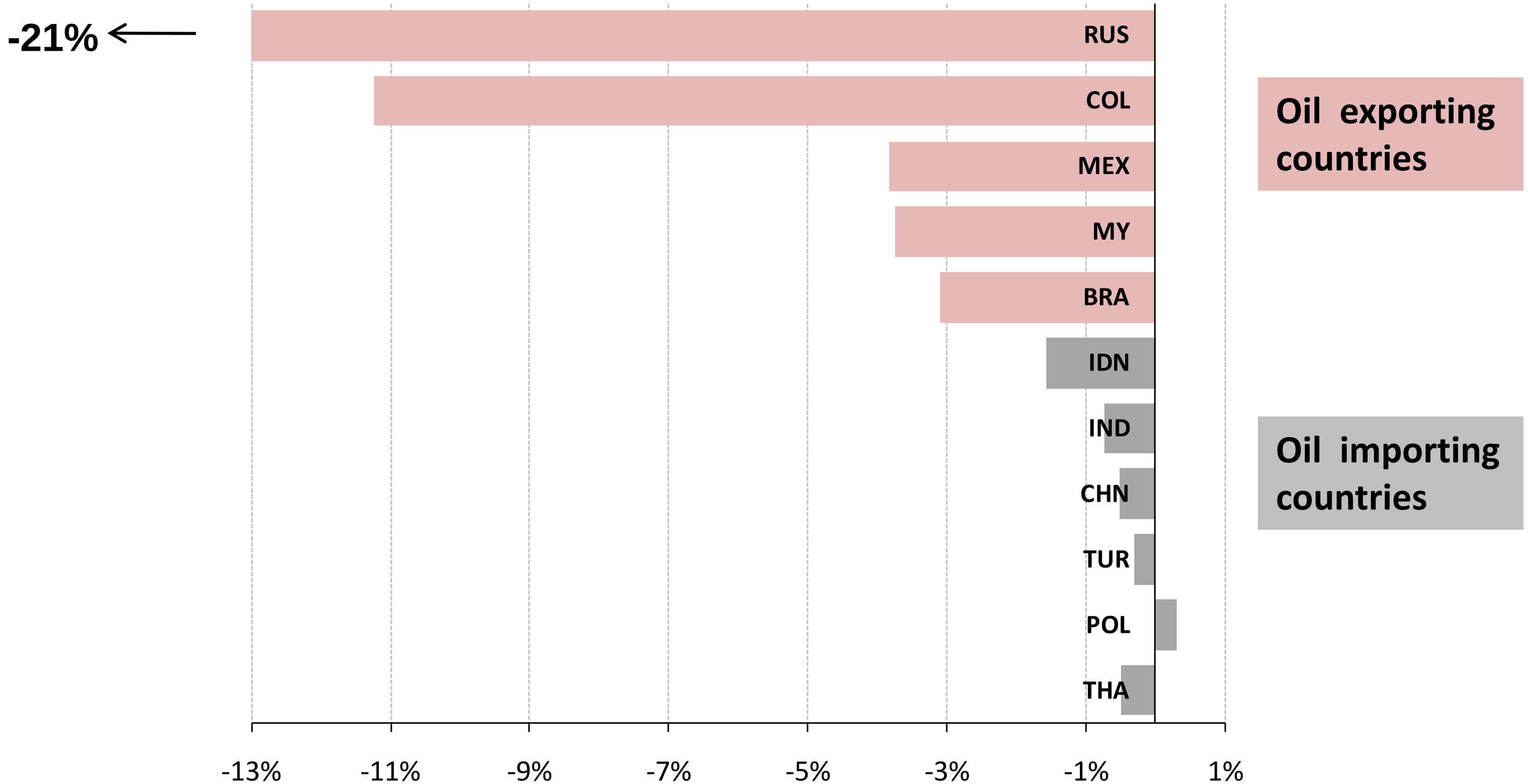
China affects LatAm countries not only by the direct trade channel but also by their impact on commodity prices



Source: IMF, UNTACD

General depreciation of EM currencies, thought more so in oil exporting economies

Oil prices plunge weigh on commodity currencies



Depreciation vs the USD from one month ago.

LatAm countries: our medium term assessment reaffirmed

Venezuela	"Alternative routes"
Argentina	"Alternative routes"
Brazil	The giant with feet of clay
Colombia	Growing up with criteria
Peru	Growing up with criteria
Mexico	The US anchor
Chile	Well known quality

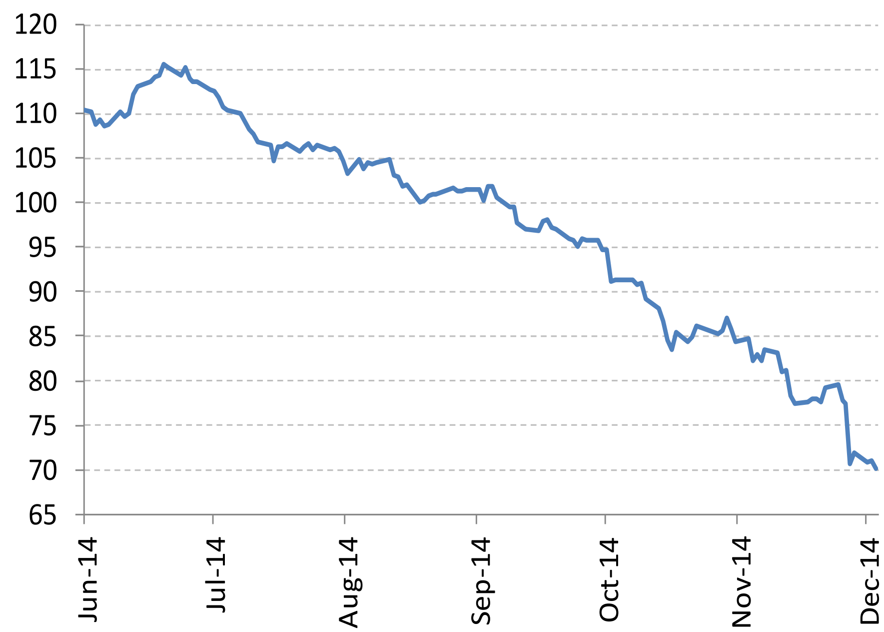
Worse MR Outlook

Better MR Outlook

Dynamics of oil and Central Banks behind the evolution of activity and markets

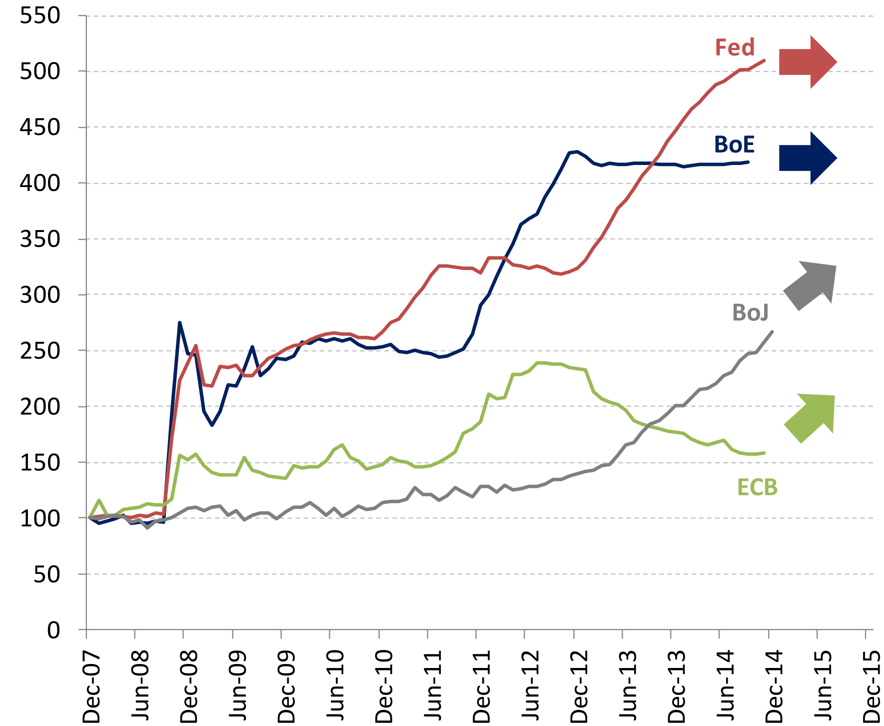
Brent oil price

(USD per barrel)



Source: Datastream

ECB and BoJ joined the party late but will continue injecting liquidity



Central Banks balance sheet (Dec.07=100)

Source: Central banks and CX

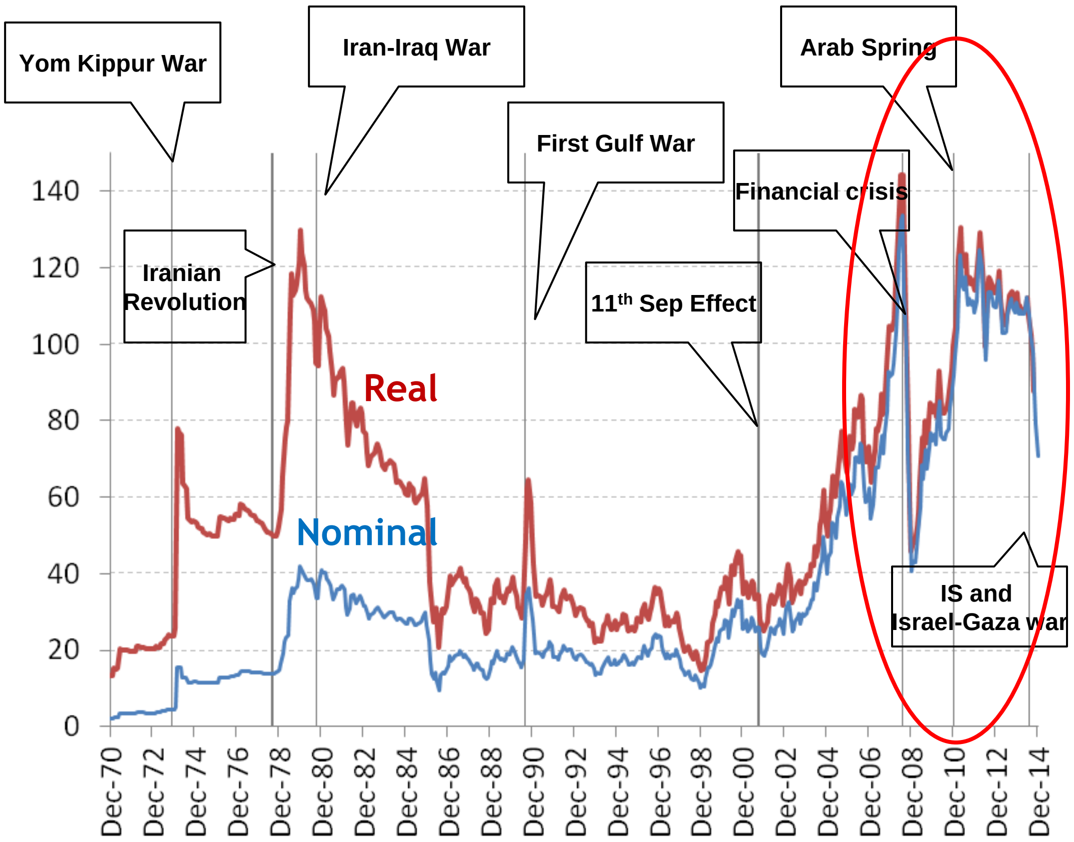
Falling oil prices → **Even less pressure on Central Banks to begin policy normalization**

Oil prices impact different countries in different ways

Positive supply shock for importing countries, including the US.

Impact on EMs, depending on their commodity dependence, particularly oil.

Oil prices and selected geopolitical events

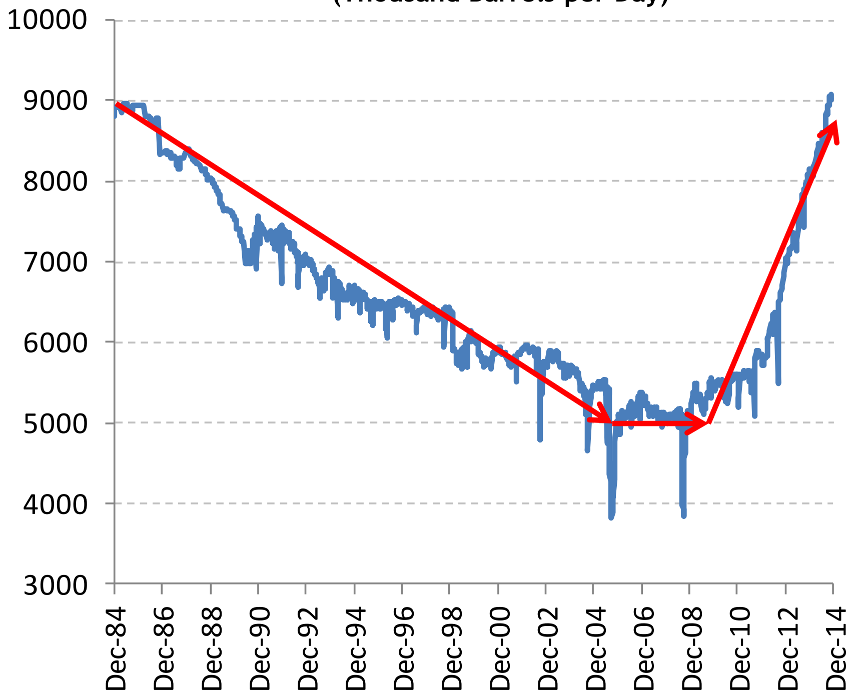


Source: CX-Economics

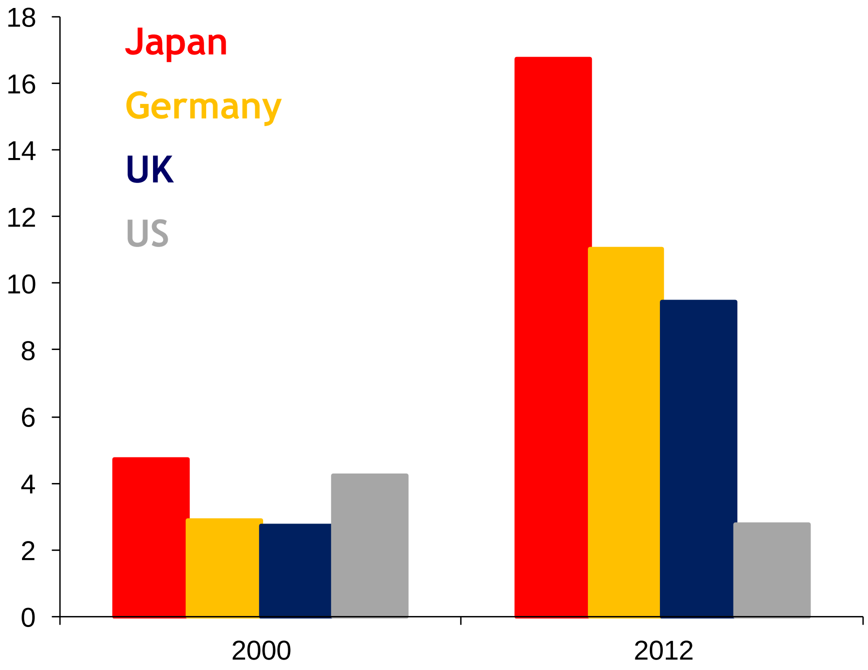
US becoming self-sufficient in energy, but oil price drop reduces returns to investments

- Energy independency => reindustrialization
- Significant geopolitical implications

Weekly U.S. Field Production of Crude Oil
(Thousand Barrels per Day)



Natural gas prices
(USD Mill. Per Btu's)

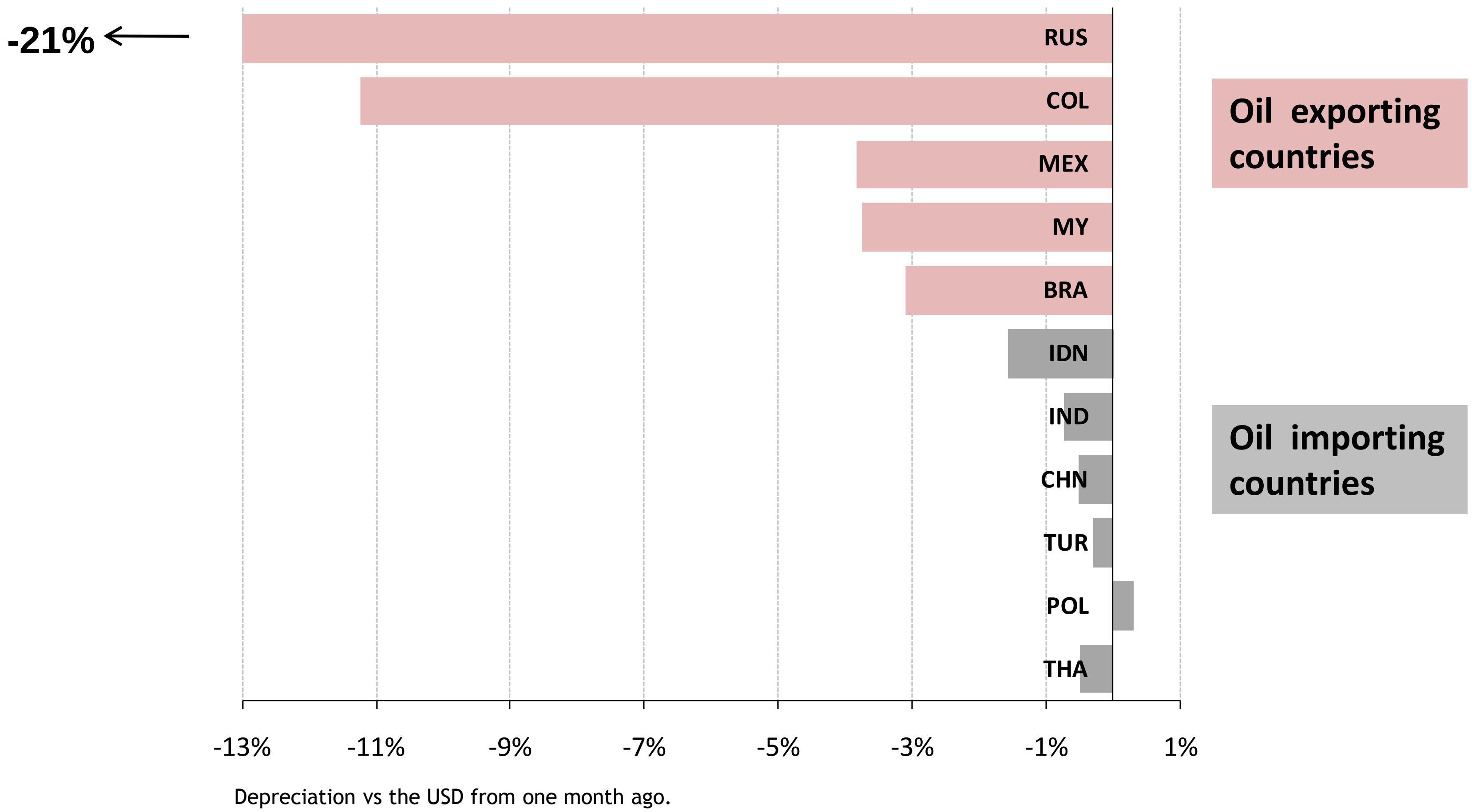


Falling oil prices diminishes growing US advantage

Source: EIA and BP

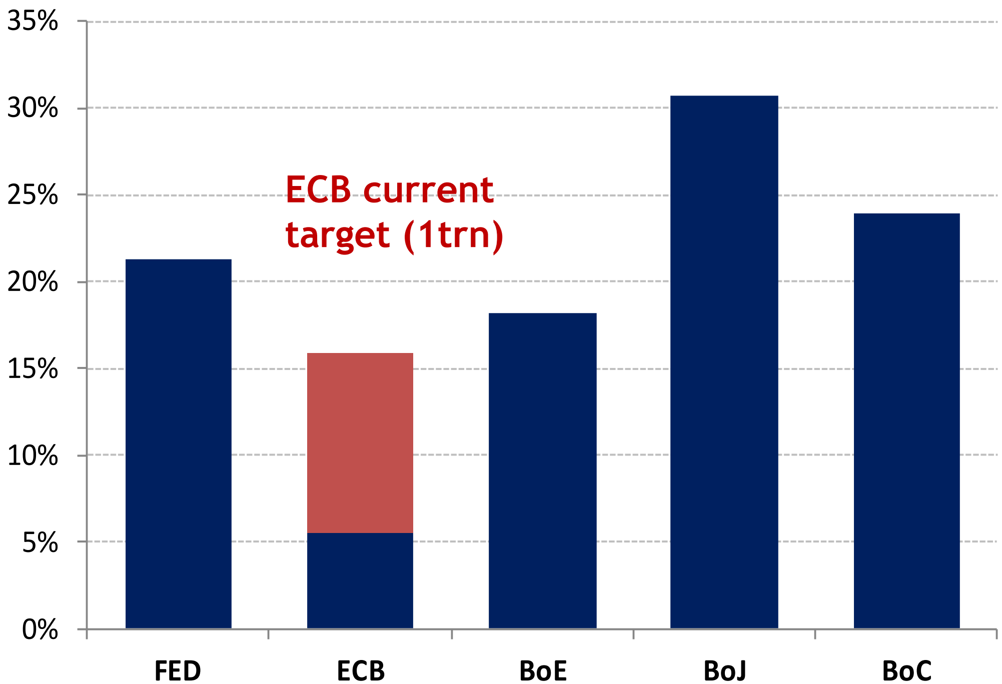
Currencies of oil exporting countries strongly affected

Oil prices plunge weigh on commodity currencies



Central Banks: pulling in different directions

Central Banks have expanded their balance sheets aggressively in last few years

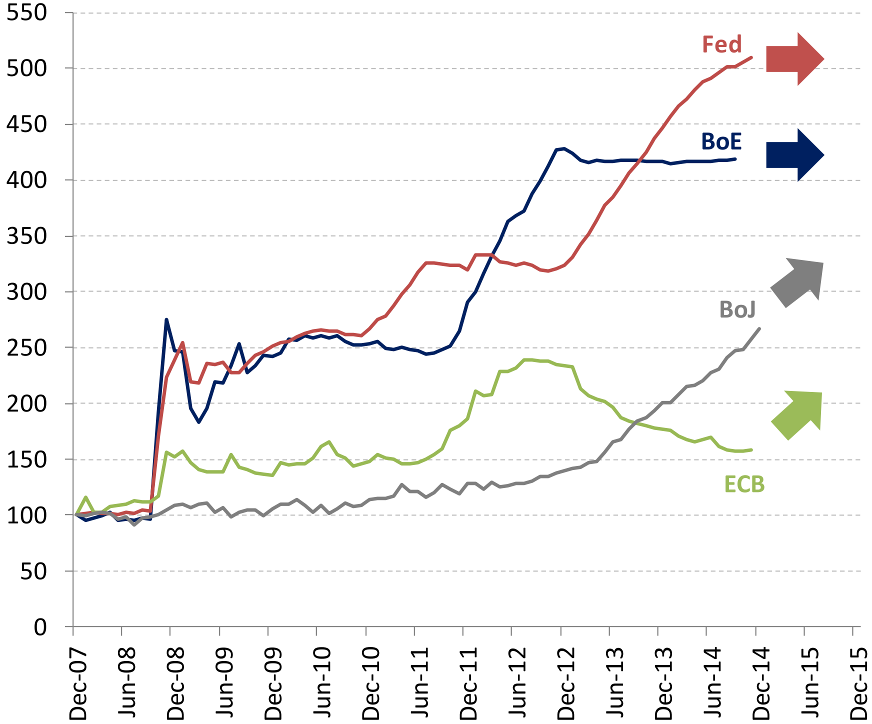


- Even adding the QE announced by the ECB, the monetary impulse in Europe would be much lower than that in the US or UK.
- Balance sheet reduction is not yet on the table.
- More stimulus needed in Europe? How aggressive?
- Hidden agenda of exchange rate depreciation (currency war?).
- Central Banks prioritizing growth over inflation or financial stability

What is the "new" role of Central Banks?
Assuming too many responsibilities?

Central Banks: pulling in different directions

ECB took additional steps of unconventional monetary policy



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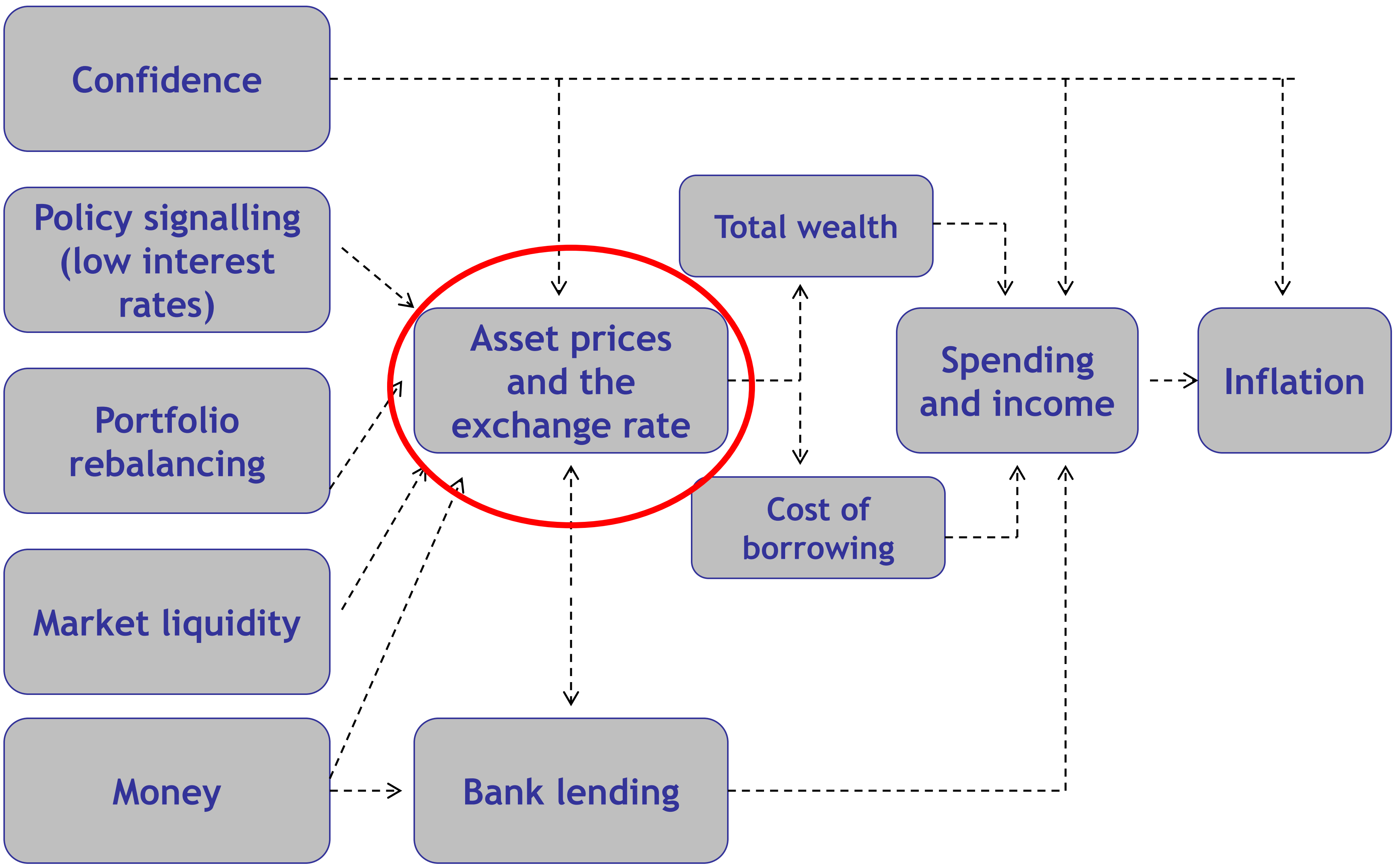
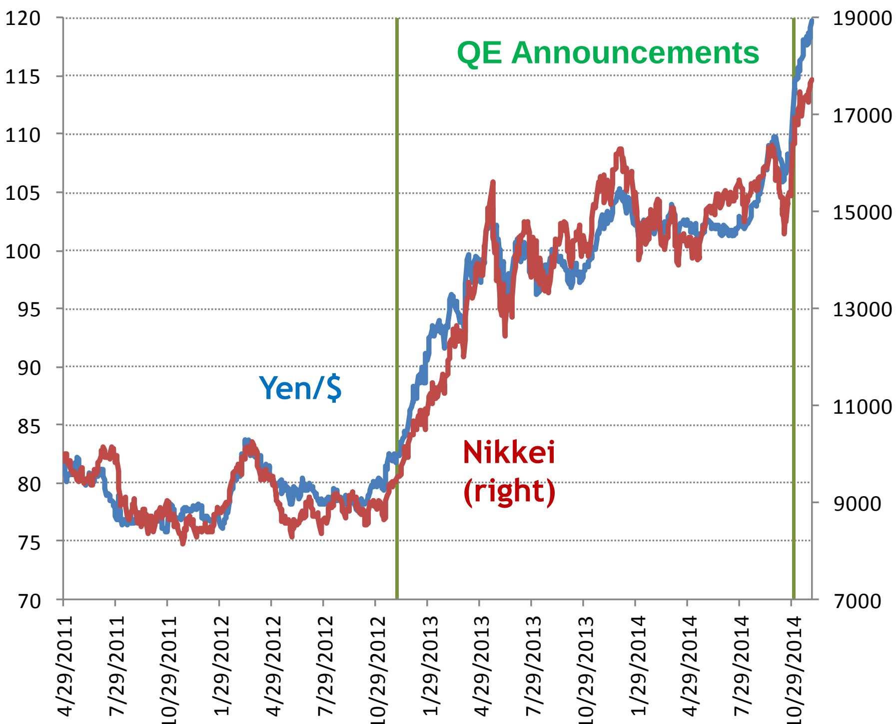
What is the "new" role of Central Banks? Assuming too many responsibilities?

Not all transmission mechanisms of QE work in every country



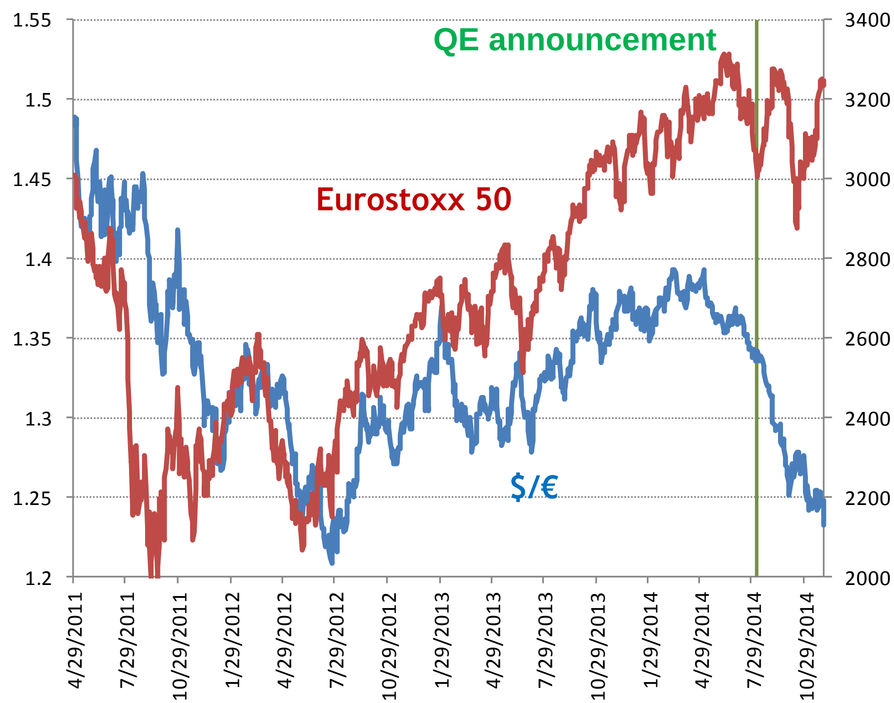
How the transmission channels worked in Japan and Europe?

QE announcements have had a rapid impact on exchange rates



Japan. Stock market index and exchange rate

Source: DS



Euro area. Stock market index and exchange rate

Source: DS

Impact on the economy not as clear

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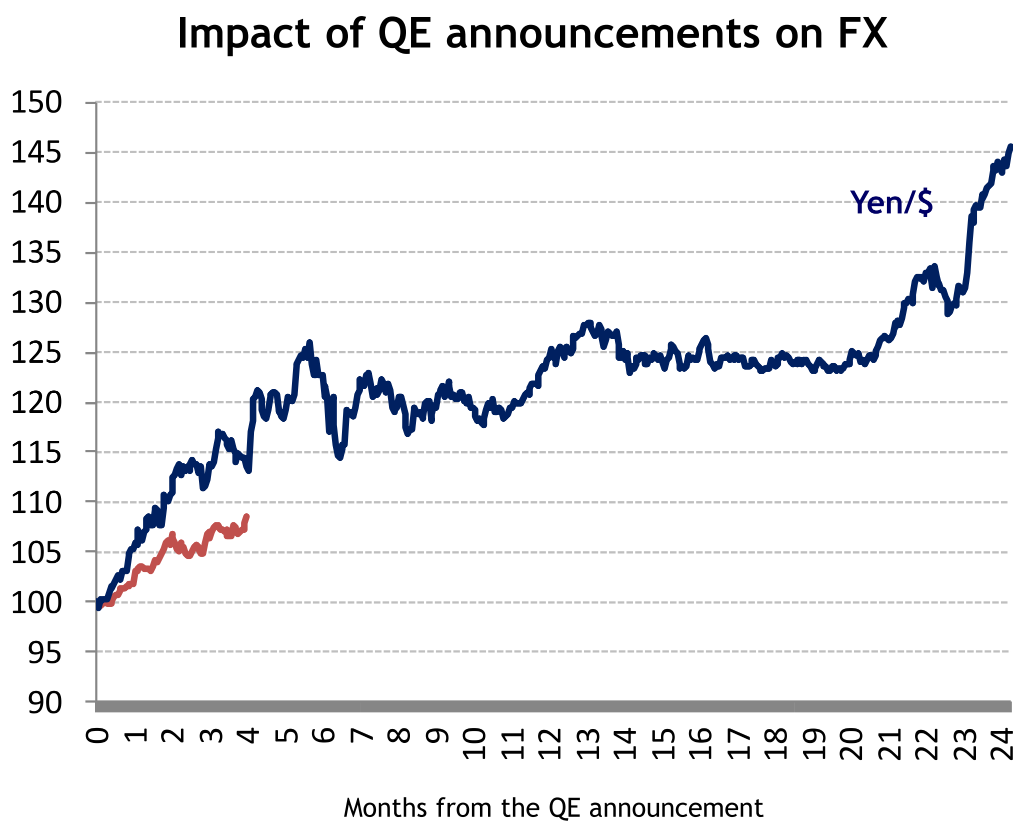
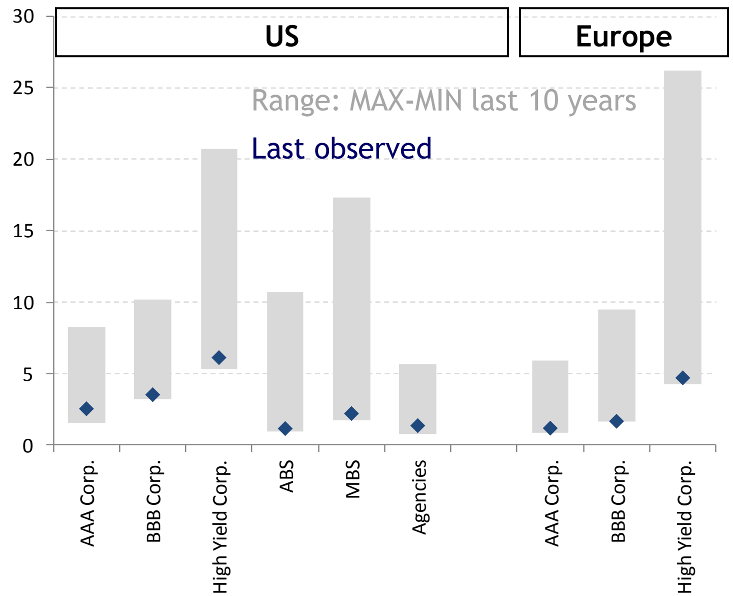


Euro and yen vs USD. 100 = date of the first mention to QE

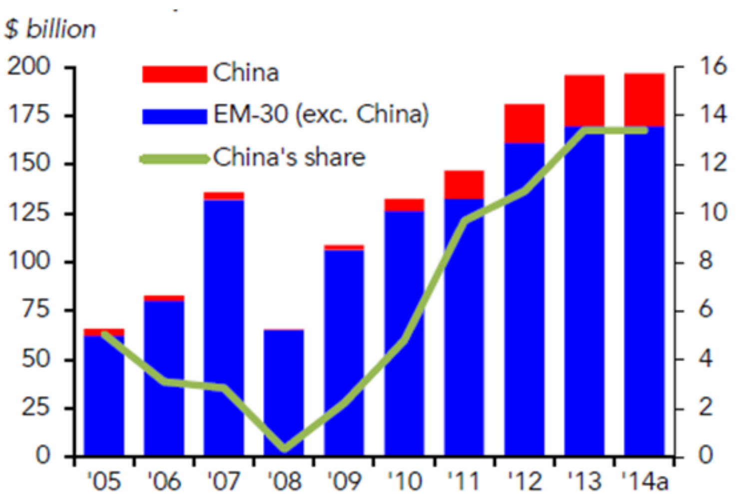
Source: DS and CX Economics

Diminishing returns of QE, risks of remaining at the ZLB and increasing potential of collateral damage

Corporate yields at all time lows



Corporate issuances in EMs skyrocketed

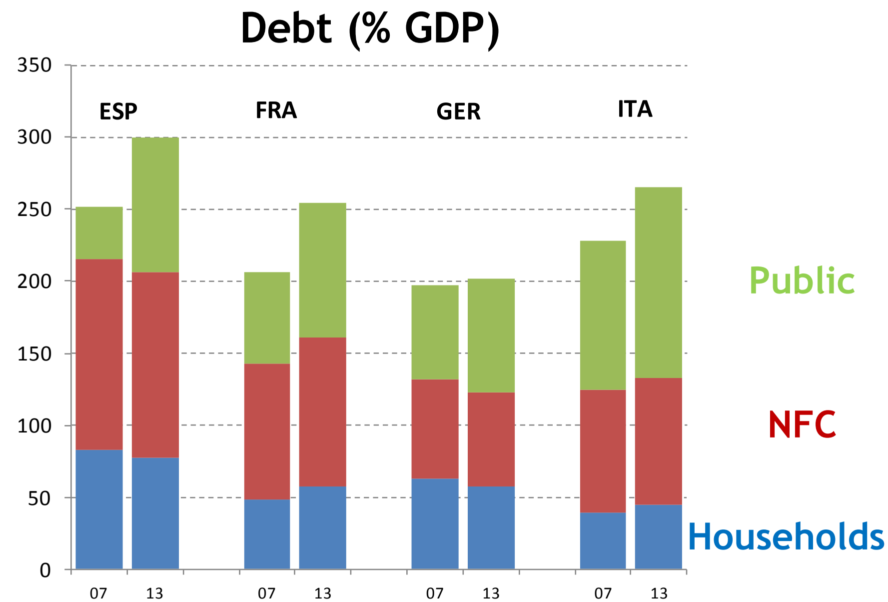


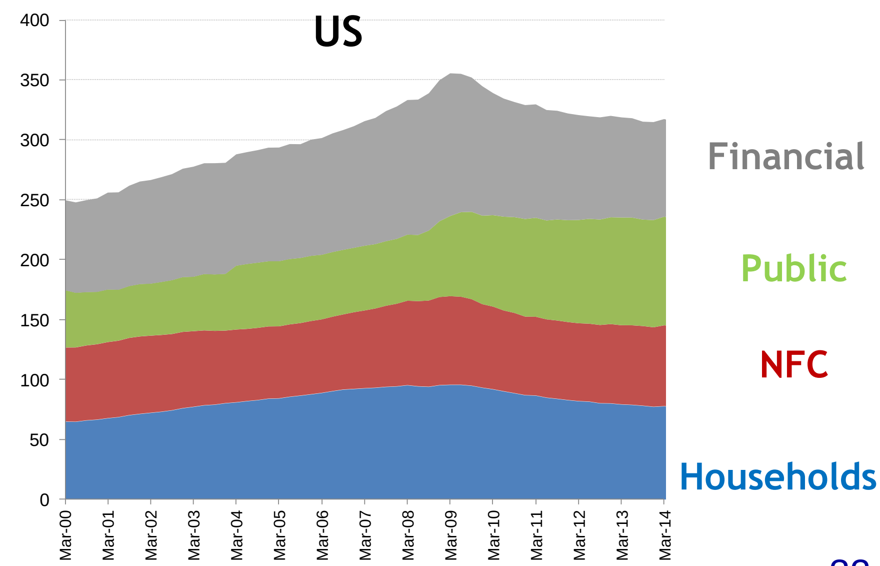
- Exchange rate volatility (disadvantage of being the first mover)
- Increased market risk: fixed income bubble? Corporate bond bubble? Over-valued stock market relative to fundamentals?
- Economic impact of rising rates or reducing balance sheet. Risk or remaining trapped at the ZLB
- Financial stability risk with very low rates (search for yield, magnified movements, unclear price signals)

Impact on EMs (exit of funds, exchange rate volatility, pressure on domestic rates, …)

Too many worries in the short term and Central Banks hide other pending issues

- ➢ Necessary deleveraging
- ➢ Pending fiscal consolidation
- ➢ Politics/Political economy
- ➢ Integration process in Europe / Banking Union
- ➢ Geopolitics





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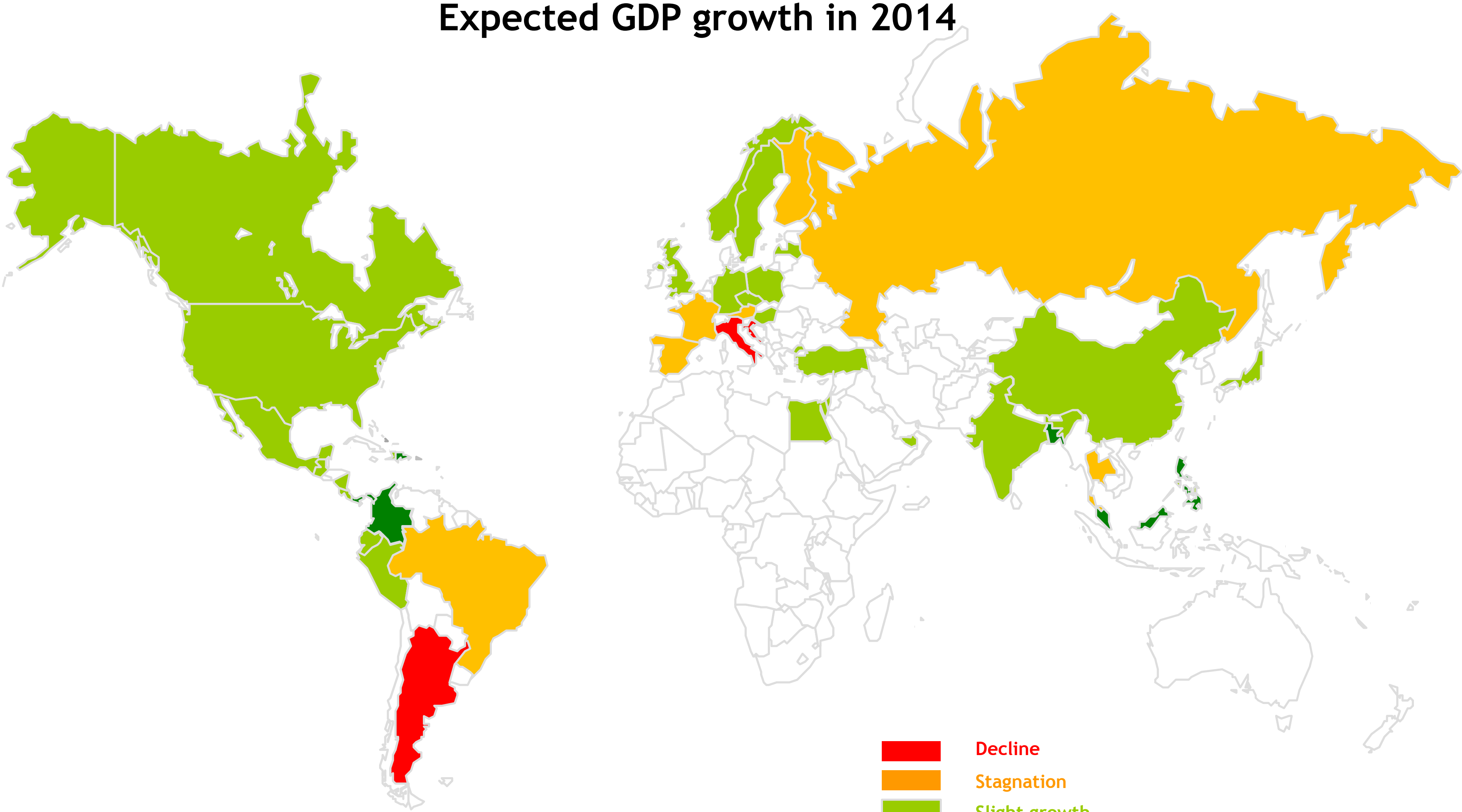
Global growth disappoints

Expected GDP growth in 2014



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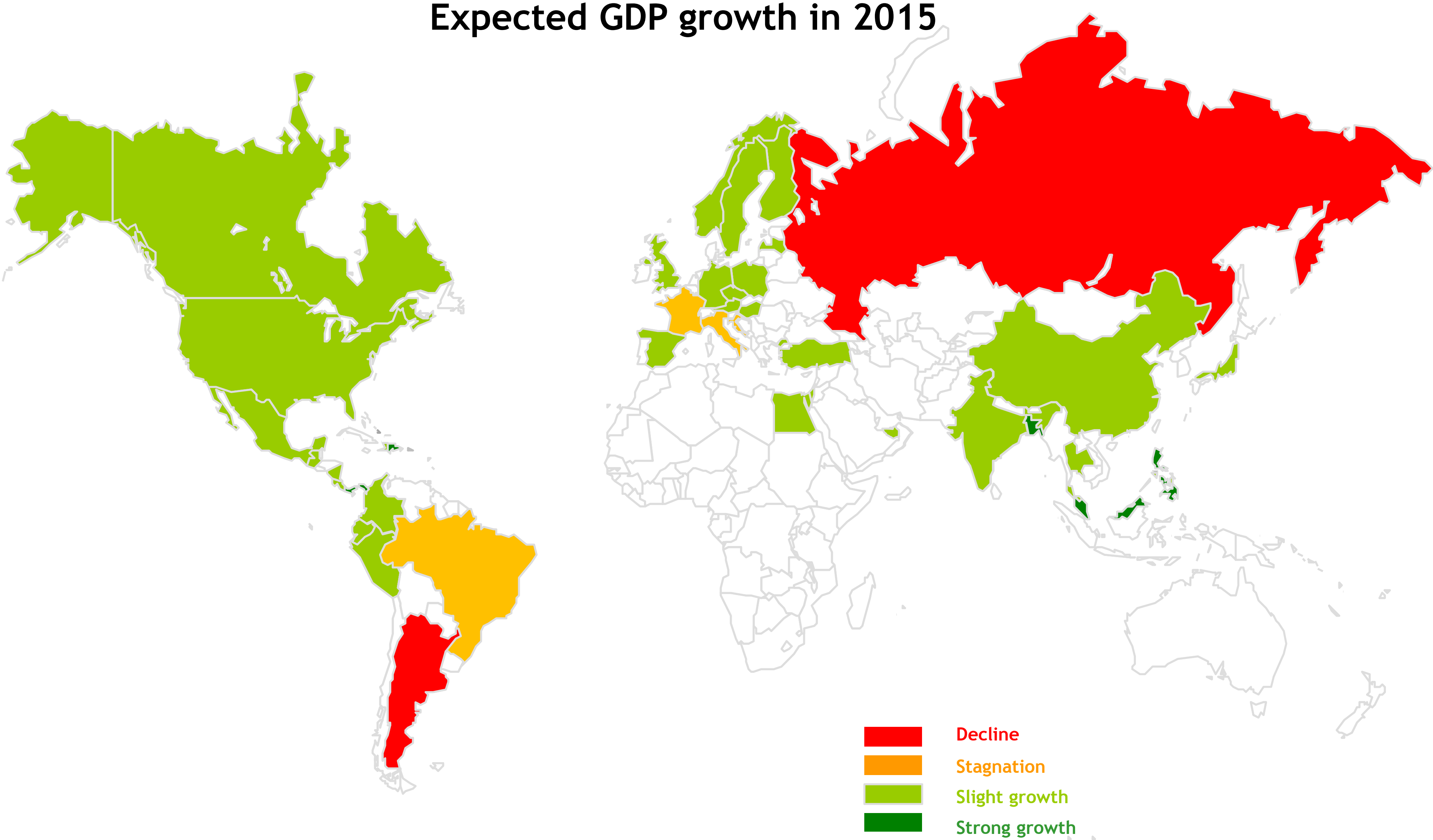

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