

# Global Weekly Flash

## Spanish risk premium surged, while EU leaders advocated for further integration in Europe

- **Risk-off strategies intensified all around as concerns over Spain grew in spite of signs of advance on European governance; and some growth-supporting measures announced by China**
  - Uncertainties around banks' recapitalization process weighed in Spanish risk premium. Spanish troubled Bankia asked for a sizable amount (EUR19bn) for its recapitalization, sparking doubts about how the recapitalization process is going to be implemented. Additionally, the European Commission (EC) released this week its recommendations to Member countries regarding the Stability and Growth Programs and the National Reform plans for 2012. The recommendations to Spain imply the government would have to 1) announce additional cuts of about 0.4% of GDP in order to meet this year's deficit target, 2) deepen structural reforms in fields in which important steps have already been taken (pensions, financial sector, labor) but that according to the EC need further action. As one can note in recent data released by the Bank of Spain, the country's main concerns are reflected in its balance of payments: the outflow of capital has accelerated in the first three months of the year, amounting to EUR 97bn in the 1Q12 (in net terms and excluding the Bank of Spain). The current account deficit cumulated over the 12 months up to March has fallen significantly with respect to February, standing at EUR 35.8bn.
  - In the governance front, however, there are some mildly encouraging signals. The EC advocated for further steps towards integration, in particular on the banking sector, a common deposit guarantee scheme and the stability bonds. This is a positive step, though the decision power on these issues remains at European Council, where Germany and other countries have so far firmly opposed movements in this direction. Furthermore, ECB's president M. Draghi insisted on the need of a centralized authority for the supervision of banks representing a risk to the entire EZ financial system. He also supported that the direct recapitalization of banks by the European Stability Mechanism in the near future, as well as the creation of a pan-European deposits insurance for bank customers. Also in the direction of further integration, the Irish people backed the fiscal compact in a referendum held this week, while elections polls in Greece showed increasing support to "pro-bailout" parties (namely the New Democracy and the PASOK). In trying to rein financial strains, this week we knew that Greece's four largest banks received a EUR 18bn transfer on Monday from the Hellenic Financial Stability Fund. Thanks to this capital injection in the Greek banking system, Hellenic banks can now resume "normal" borrowing from the ECB.
  - Mirroring a complicated week in the old continent and maybe the expectations on the crucial weeks we have ahead, the Spanish risk premium surged 29bp to 529bps as 10Y yields hit 6.6%. Short-term yields suffered an even bigger pressure, increasing by 66bp this week. As usual, Spanish fears spread to Italy, just as the reversal happened months ago: Italian spreads against German Bunds widened by 69bps for 10Y maturities. Furthermore, Italy failed to achieve its maximum selling target in one of its bond auctions, while the downward trend in the eurodollar intensified after breaking the 1.25 support (closing on Friday at 1.242).
  - Contributing to the widening of peripheral spreads is the outperforming of safe-haven assets. German 10Y yields dropped 19.6bps to 1.17% (2Y operated in negative terrain today), while the 10Y Treasuries fell by 26bps to 1.48% affected also by a wave of weak macro data in the US. Surprisingly, French government bonds improved over the week, with 10Y yields contracting by 18bps. Safe-haven flows also took shelter in the Japanese Yen, which appreciated against the major currencies during week. Commodity prices behaved as expected, with crude and metals being hit by the compromised growth perspectives (and by some relief on the Iranian front).

- **Financial strains weighed on European economic data, while the employment weakness took a toll in the US confidence data. In China, the authorities announced measures to spur growth, trying to contain downside risks**

- Economic sentiment in the Eurozone (EC ESI index) fell sharply in May, losing 2.3p to 90.6, with a deterioration in all sectors, especially in industry and retail. By country, all four largest euro area members registered falls (Germany -1.4, France -1.5, Italy -4.3, Spain -1.0). Business confidence in the Eurozone also decreased in May (0.26p), as all components were assessed more negatively. The depressed confidence could be felt in hard data as well: industrial production fell by 7.4% y/y in April (better include monthly data), while price pressures moderated on demand weakness and a sharp fall in crude prices. Completing the gloomy picture, EZ credit to households eased in April, increasing by only 2.5% y/y from a 3.1% gain in March and below the 3.5% anticipated by surveys, suggesting that liquidity injected in the banking system through the 3Y LTROs did not pass through to household or firms.
- On the other side of the Atlantic, the US economy fragility is becoming evident. Downbeat US payroll in May suggest further weakness in the US economy. Besides, the 1Q12 GDP growth was revised down from 2.2% saar to 1.9% on smaller inventories' build-up, higher imports and lower demand from state and local governments. Regarding soft indicators, the Chicago PMI dropped sharply to 52.7 in May from 56.2 in April, while the consumer confidence index fell to 64.9 from 68.7 in April, negatively affected by the moderation in employment trends in the last months.
- In China, manufacturing activity continued slowing down in May as the official PMI fell by 2.9 points to 50.4 (53.3 in April), its lowest level in five months. The drop in the new orders index suggests this weakness may last. These outturns suggest that, despite a recent reserve requirement ratio cut (of 50bps) and an increase in growth-supportive fiscal policies since mid-May, domestic demand remains weak, while at the same time external demand also remains sluggish. That said, the benefits from the previously mentioned policy support should start to have a gradual effect on growth in the coming months, and we would not rule out further policy easing; in particular, we expect another 100-150bp in cuts in the RRR in the coming quarters, and up to two interest rate cuts. Hence, growth momentum may be close to bottoming out, although there is now downside risk to our full-year GDP growth projection of 8.3%, given the weak external environment.

**Next week:** the ECB meeting on Wednesday will focus investor attention, particularly considering the increasing financial strains. . Thursday's Spanish bond auction may be watched closely as well. In China also important economic indicators will be released.

# Calendar: Indicators

## Eurozone: Retail sales (April, June 5th)

Forecast: -0.3% m/m	Consensus: -0.1% m/m	Previous: 0.5% m/m
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Retail sales are expected to have declined in April, after the rebound seen during the first quarter. Despite this anticipated fall, April's forecast implies that sales will remain broadly flat over the Q1 average. Nevertheless, renewed fears about the European crisis combined with an increasing unemployment rate have ended up adversely affecting consumers' confidence, pointing to a more downbeat outlook for coming months. Our scenario envisages very a subdued household spending that should have remained virtually flat over the first half of the year, although risks remain tilted to the downside, thus failing to substitute foreign demand as a driver of economic activity.

## Germany: Industrial production (April, June 8th)

Forecast: -1.6% m/m	Consensus: -1.0% m/m	Previous: 2.8% m/m
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Industrial output is expected to fall significantly in April, partly offsetting the strong rebound observed in the previous month and thus remaining virtually flat over Q1. In particular, last month reading stemmed from the sharp rebound in construction output, after the negative effect of winter weather in previous months, and that increase should be temporary. Looking forward, as manufacturing confidence dropped in recent months, especially in May, we foresee gloomier prospects for coming months. Given the high correlation between the industrial sector and economic cycle, all these data suggest that GDP could have lost momentum in the second quarter, after the strong and unanticipated rebound recorded in the first quarter.

## US: ISM Non-Manufacturing Index (May, June 5th)

Forecast: 54.5	Consensus: 54.0	Previous: 53.5
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The ISM Non-Manufacturing Index is expected to increase following a slight decline in the previous month. New orders and business activity weighed on the services sector in April, with the respective index components suggesting the slowest rate of expansion in nearly six months. The employment index also declined in April and remains weaker than the corresponding component of the manufacturing sector, and we do not expect a significant rebound in the near term. On the bright side, easing input prices should help stimulate activity in May.

## US: International Trade Balance (April, June 8th)

Forecast: -\$49.0B	Consensus: -\$48.5B	Previous: -\$51.8B
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The international trade balance deteriorated more than expected in March, closing out 1Q12 as one of the weakest trading quarters throughout the recovery period. The underlying data were more encouraging, noting a fourth consecutive month of export growth, and for April, the ISM indices suggest a surge in new export orders. However, with conditions worsening throughout April and May, it is likely that European factors will have a stronger influence on the trade balance in the coming months.

## China: Industrial output for May (June 9th)

Forecast: 10.5% yoy	Consensus: 9.8% yoy	Previous: 9.3% yoy
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China's growth momentum moderated further in April, prompting the government to increase policy support recently. New measures have been geared towards increasing consumption and investment in infrastructure, while the central bank also decided to cut the reserve requirement ratio by 50bps on May 12th. Taking these supportive policies into account, we expect the industrial production index, a key gauge of China's growth momentum, to improve slightly in May to 10.5% in year-on-year terms, up from 9.3% in April. In addition to IP, several other important indicators will also be released next week, including inflation, retail sales, investment, and credit aggregates. Headline inflation is expected to remain low at 3.3%/y in May (from 3.4%/y in April) due to easing food and fuel prices, providing room for further policy easing in the coming months, if necessary.

# Markets Data

			Close	Weekly change	Monthly change	Annual change	
Interest rates (changes in bps)	US	3-month Libor rate	0.47	0	0	22	
		2-yr yield	0.25	-4	-1	-17	
		10-yr yield	1.47	-27	-46	-152	
	EMU	3-month Euribor rate	0.67	-1	-4	-77	
		2-yr yield	0.01	-4	-7	-168	
		10-yr yield	1.17	-20	-44	-189	
	Exchange rates (changes in %)	Europe	Dollar-Euro	1.240	-0.9	-5.8	-15.3
			Pound-Euro	0.81	1.0	-0.7	-9.5
			Swiss Franc-Euro	1.20	0.0	0.0	-1.6
America		Argentina (peso-dollar)	4.47	0.0	1.1	9.3	
		Brazil (real-dollar)	2.04	2.5	6.0	29.3	
		Colombia (peso-dollar)	1832	-0.1	4.2	2.7	
		Chile (peso-dollar)	518	1.7	7.0	10.7	
		Mexico (peso-dollar)	14.39	2.5	11.2	23.3	
		Peru (Nuevo sol-dollar)	2.71	0.5	2.8	-1.9	
Asia		Japan (Yen-Dollar)	78.11	-2.0	-2.5	-2.8	
		Korea (KRW-Dollar)	1177.83	-0.6	4.5	9.1	
		Australia (AUD-Dollar)	0.969	-0.7	-6.2	-9.6	
Comm. (chg %)		Brent oil (\$/b)	98.6	-7.7	-16.6	-14.9	
		Gold (\$/ounce)	1613.6	2.6	-2.4	4.6	
		Base metals	513.2	-0.4	-5.3	-15.7	
Stock markets (changes in %)	Euro	Ibex 35	6065	-7.3	-11.2	-41.0	
		EuroStoxx 50	2069	-4.3	-9.7	-25.8	
	America	USA (S&P 500)	1288	-2.3	-8.2	-1.0	
		Argentina (Merval)	2206	-5.7	-1.6	-30.3	
		Brazil (Bovespa)	53763	-1.3	-13.9	-16.4	
		Colombia (IGBC)	14255	-1.5	-7.8	-1.3	
		Chile (IGPA)	20688	0.5	-5.2	-10.1	
		Mexico (CPI)	37509	0.1	-5.3	6.8	
		Peru (General Lima)	20888	0.7	-6.7	-1.6	
	Asia	Venezuela (IBC)	240107	0.0	-12.7	198.3	
		Nikkei225	8440	-1.6	-10.0	-11.1	
		HSI	18558	-0.8	-12.9	-19.1	
	Credit (changes in bps)	Ind.	Itraxx Main	180	5	40	76
Itraxx Xover			719	4	78	333	
CDS Germany			102	3	16	65	
Sovereign risk		CDS Portugal	1185	-8	223	519	
		CDS Spain	599	49	117	362	
		CDS USA	48	1	9	---	
		CDS Emerging	332	12	88	112	
		CDS Argentina	1477	162	566	858	
		CDS Brazil	171	10	49	63	
		CDS Colombia	162	11	52	60	
		CDS Chile	129	9	36	59	
		CDS Mexico	162	13	49	57	
		CDS Peru	173	9	50	27	

Source: Bloomberg and Datastream

# Weekly Publications

Country	Date	Description
USA	29/05/2012	<a href="#">▶ Banking Watch: Banking Rankings 2012Q1</a> State-by-State Commercial Bank Performance <a href="#">Spanish version</a>
	28/05/2012	<a href="#">▶ U.S. Weekly Flash. Home Sales Increase Gradually, Median Prices on the Rise</a> Existing home sales increased to an annual rate of 4.62M in April after declining in the prior two months. New home sales also increased to 343K following slight upward revisions to nine of the previous 13 months <a href="#">Chinese version</a> <a href="#">Spanish versión</a>
EMU	31/05/2012	<a href="#">▶ Europe Flash: "Eurozone flash inflation slowed in May somewhat more than expected"</a> Annual inflation eased by 0.2pp to 2.4% y/y, slightly more than expected. Our forecast suggest that this slowing stems from lower inflation in more volatile components, especially energy.
Spain	31/05/2012	<a href="#">▶ Flash España: "España: balanza de pagos de marzo 2012."</a> El déficit de la balanza por cuenta corriente en el acumulado a 12 meses de marzo se reduce notablemente con respecto al acumulado a 12 meses del mes anterior.
	30/05/2012	<a href="#">▶ Flash España: "Avance del IPC de mayo"</a> El indicador adelantado del IPC confirma la desaceleración del crecimiento de los precios al consumo durante el mes de mayo, por la moderación del precio de los carburantes y alimento:
	30/05/2012	<a href="#">▶ Flash España: "Confianza industrial y del consumidor en mayo"</a> Los datos cualitativos hasta mayo siguen evidenciando la debilidad de la actividad económica, reforzando nuestro escenario central en el que no se espera una mejora a corto plazo.
	29/05/2012	<a href="#">▶ Flash España: "Ejecución presupuestaria del Estado a abril 2012"</a> El déficit acumulado por el Estado hasta abril de 2012 se situó en el 2,4% del PIB, 0,8pp más que hace un año.
	29/05/2012	<a href="#">▶ Flash España: "Ventas reales del comercio al por menor de abril: significativamente peores de lo previsto"</a> Una vez corregidas las variaciones estacionales propias del mes, las ventas reales del comercio minoristadiminuyeron un 5,0% en abril, más de lo esperado.
	29/05/2012	<a href="#">▶ Observatorio Baleares. Primer semestre 2012</a> Aunque el turismo está sirviendo de soporte para Baleares, los retos de la consolidación fiscal y la mejora del capital humano son ineludibles <a href="#">Presentación de "Observatorio Baleares. Primer semestre 2012"</a>
	29/05/2012	<a href="#">▶ Situación Consumo. Primer semestre 2012</a> España: el deterioro de sus determinantes anticipa una caída del gasto en consumo durante 2012 y la primera mitad de 2013, especialmente de bienes duraderos. <a href="#">Presentación de "Situación Consumo. Primer semestre 2012"</a>
	Latin America	Brazil
Chile		
Chile		30/05/2012 <a href="#">▶ Chile Flash: Tasa de desempleo disminuye a 6,5% en abril</a>
Colombia	28/05/2012	<a href="#">▶ Colombia Flash: Banco central mantiene la tasa de referencia en 5,25%, destacando deterioro en el entorno externo</a> Como era previsto, el comunicado destacó el deterioro en la crisis de deuda soberana en Europa y el mayor riesgo que implica sobre la actividad global y local
Asia	01/06/2012	<a href="#">▶ China flash: May PMI surprises to the downside, still showing expansion</a> The official NBS Purchasing Managers Index (PMI) for May, released today
	01/06/2012	<a href="#">▶ China flash: China fiscal stimulus package: key takeaways</a> The new package has a similar composition to the post-Lehman one
	31/05/2012	<a href="#">▶ Asia Daily Flash   31 May 2012: India's 1Q GDP growth slows sharply; Hong Kong retail sales fall; Japan's IP slows</a> India's economy slowed sharply in the first quarter as real GDP growth fell to 5.3% y/y from 6.1% y/y in the fourth quarter, marking the slowest growth in over a decade.

- 31/05/2012 ➤ **India flash: 1Q GDP growth slows sharply; room for policy maneuver?**  
India's economy slowed sharply in the first quarter as real GDP growth fell to 5.3% y/y from 6.1% y/y in the fourth quarter, marking the slowest growth in over a decade.
- 30/05/2012 ➤ **Asia Daily Flash | 30 May 2012: India relaxes rules on foreign investors; Australia's retail sales unexpectedly contract**  
To help stem the rupee's recent losses and revive capital inflows, India announced it will allow foreign individuals to buy up to USD 1 bn worth of local corporate bonds
- 28/05/2012 ➤ **Asia Daily Flash | 28 May 2012: China to allow private capital to invest in SOE's, announces measures to boost consumption; Vietnam cuts rates**  
China issued guidelines urging SOEs to lift barriers currently blocking private investors from transactions involving SOEs' share-stakes and property rights.

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