

Global

Weekly Watch

Madrid, 1 October 2010

Economic Analysis

Financial Scenarios
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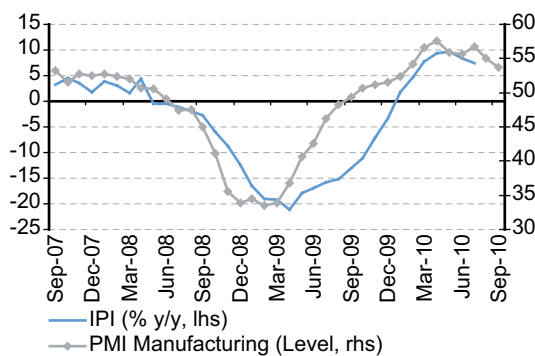
ECB remains cautious...

The different approaches of central banks are weighing on currencies. The Fed and the BOE seem to be more willing to resume its quantitative easing policy while the ECB is in a very gradual process of phasing out of exceptional measures. In this context, the Euro effective exchange rate has achieved April 2010 levels, a comfortable level for the ECB? Regarding the cycle, we see no compelling reasons to change the bias of monetary policy. Euro area economic data continue to suggest that the recovery remains on track in Q3, though far from the impressive quarterly GDP growth observed in the previous quarter. Headline and core inflation were at 1.7% y/y and 1% y/y respectively. Regarding liquidity, the low demand in the ECB liquidity tenders could be seen as a sign that funding tensions are easing and in this context the central bank could feel more comfortable with its process of phasing out of exceptional measures. But two main factors should be considered: there is still a high dependency from the banking system on ECB liquidity and, most importantly, the sovereign risk in some peripheral countries has reappeared. On top of that, the ECB should maintain a very cautious approach regarding liquidity policy. Next week there is the ECB meeting, we do not anticipate major changes.

... while the FED is still watching economic data

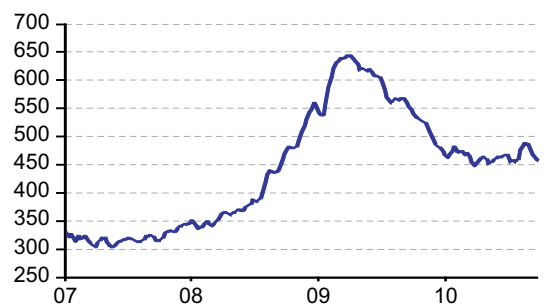
The US data released this week has been somewhat disappointing. On Tuesday S&P Shiller-Case Home Prices Index in July increased from June but at a slower pace, reflecting the downward trend in home sales following the end of the fiscal stimulus. Consumer confidence in September decreased significantly from 53.2 to 48.5. September ISM manufactory index was in line with market expectations decreased from 56.3 to 54.4. There are several important activity indicators, next week: Factory order, pending home sales and ISN non-manufacture, but all eyes will be focus on payrolls data for September which will give us more clues about FED next movements.

Chart 1
Eurozone: Industrial sector



Source: Markit Economics and Eurostat

Chart 2
Initial Jobless Claims (4-week moving average)



Source: DOL

Markets



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ECB's liquidity policies

After the limited amount demanded by banks in September's 3-M and fine tuning auctions, it is expected that liquidity in the Euro area will be lower. This could move Eonia to the 1% level but won't be immediate while the liquidity remains at these high levels.

Portugal announces the third wave of measures to reduce deficit

Facing increasing market pressure, the measures are credible and sizeable enough to meet the 2011 deficit target, ahead of the presentation of the budget for 2011.

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Further contrasting performance by euro assets, but for how long?

In recent days euro assets have once again shown some decoupling from other OECD economies, primarily through interest rates with more upward bias in relative terms and further strength in the euro. These two factors are essentially a reflection of the same issue: the market still sees the ECB as the OECD central bank which is least likely to implement new monetary laxity policies. Although this situation may persist in the short term, in the medium term it may end up having adverse effects: the tightening of rates may become uncomfortable in the middle of a phase in which financial risk in the region is being measured. Moreover, an overly strong euro may reduce the foreign sector's contribution to the region's growth (which until now has been significant), and also hinder funding for sectors which need flows of capital from abroad. The relative performance of the European equity market itself has been worse of late (partially due to financial risk factors), but this is also a reflection of the counterproductive effect of a euro which has the potential to become too expensive.

And on equity markets we will soon be discussing corporate earnings again...

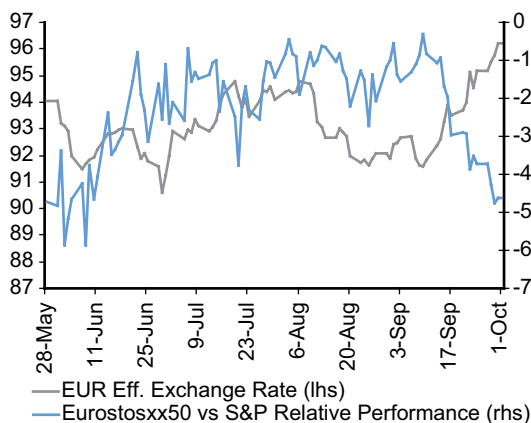
Next week the 3Q10 earnings season kicks off in the US, unofficially launched by Alcoa on Thursday 7 October. The first aspect that we must mention is the fact that yet again consensus estimates for the S&P 500 have not undergone major changes in the weeks running up to results, and still show growth on 3Q09 of 23.6% (ex. financials 20.4%), resulting in forecasted operating profit growth for 2010 of 35.4% and 15.1% for 2011. This third quarter still has an undemanding comparable quarter, due to the depressed earnings of 2009, but as we move forward and comparable quarters are from 2010, meeting consensus forecasts will be difficult but not impossible.

We are also in the period when companies are able to provide details of their results in advance, and what we have heard so far has been mixed. We take a positive view of this, since expectations are not low and macro indicators in the US have been showing some lack of momentum for several months now: in the week of 13 September of 44 companies 8 upgraded their guidance, 9 downgraded, 20 left it unchanged and 7 announced one-off charges. In the week of 20 September, the figures were 39, 6, 5, 19 and 9 respectively.

In terms of the market's direction, as we can see in the attached chart, the S&P 500 has hit a key resistance, at 1,150 points, the bearish trend line formed since 2007. We think at least two factors must come together for us to see a breach: controlled sovereign risk in Europe, i.e. no further contagion of Spain, and corporate earnings at least meeting expectations. These are two feasible, or even probable occurrences.

Chart 3

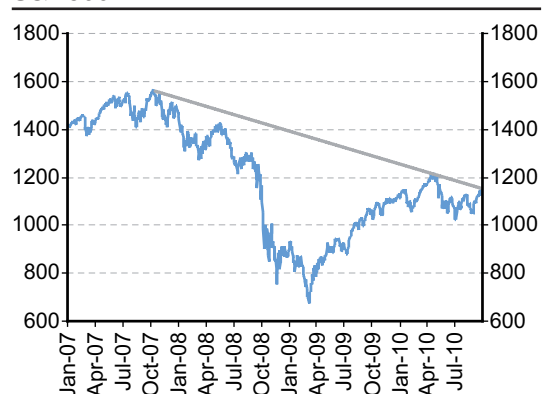
EUR Strength and Relative Weakness in Equity Market



Source: Bloomberg

Chart 4

S&P500



Source: Datastream

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ECB's liquidity policies

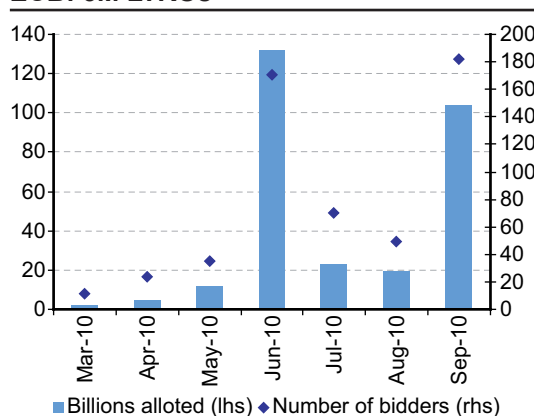
This week Euro zone banks repaid the largest amount at ECB since July, (when EUR 442bn of one-year loans matured) EUR 224.9bn which were injected in 12M, 6M and 3M LTROs (EUR75 bn, EUR18 bn and EUR132 bn respectively). This amount was partially offset by the ECB auctions this week. In September's 3M LTRO the funds allotted were €104 bn, with a total number of bidding institutions of 182 and in the six-day fine tuning operation the demand for liquidity was EUR 29.4 bn and bids came from only 50 institutions. As we expected, the results of the 3M LTRO and 6 day fine-tuning operation showed that banks rolled over only 60% of the EUR 225 bn, mainly due to the fact that largest banks in Europe and those from countries that are having smaller difficulties in accessing to the repo markets and debt markets didn't participate in these auctions. We consider that these figures are worrying because they show that differentiation among European banks is increasing. From our point of view, the low demand in these auctions means that the ECB could see in these results that signs of funding tensions are easing and the central bank could feel more comfortable with its process of phasing out of exceptional measures. Regarding Eonia implications we consider that the normalization of Eonia to the 1% level won't be immediate, because liquidity provision will remain in high levels due to most vulnerable banks will probably increase or at least maintain their demands in weekly auctions in a context in which markets remain closed for the most affected countries of EMU.

Portugal announces the third wave of measures to reduce deficit

The Portuguese government reacted with new and detailed measures to restore market confidence, ahead of the presentation of the budget for 2011. The measures announced (cut in civil servant wages by 5% on average, freezing of new hirings instead of substituting one of every 2 retiring worker, VAT increase from 21% to 23% and additional expenditure reductions) are bold and enough to meet the deficit target presented to the European Commission of 4.6% in 2011, provided that implementation risks and political hurdles to approve the budget are not a problem. The detailed measures for 2011 amount to 3% of GDP, more than enough to fill the required structural consolidation and withdrawal of fiscal stimuli, and also compensate for the fact that the cyclical deficit will not improve in 2011 over 2010. Clearly, these figures try to make sure that even in a very weak growth scenario, the target will be met. We think that these additional fiscal adjustments will only have a moderate effect on growth and the deficit can achieve a 4.3% of GDP next year, marginally below the target and leaving some room for compensating eventual negative shocks.

Chart 5

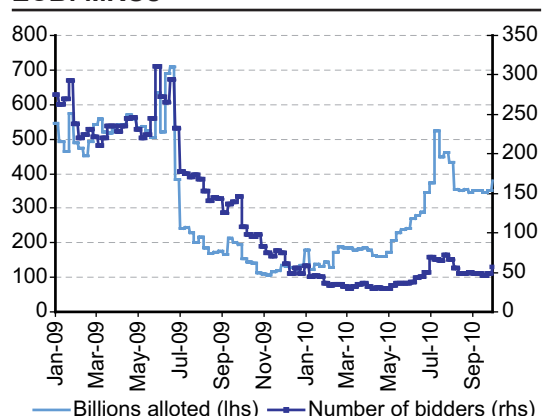
ECB: 3M LTROs



Source: Datastream and BBVA Research

Chart 6

ECB: MROs



Source: Datastream and BBVA Research

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Economic Analysis

Calendar: Indicators

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Eurozone: Retail sales (August, October 5th)

Forecast: 0.1% m/m	Consensus: 0.2% m/m	Previous: 0.1% m/m
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Comment: We see retail sales virtually flat or growing slightly in August in monthly terms, characterized by some recovery in households' consumption but a moderate pace. Following the sharp decline recorded in April, these data imply that retail sales would grow around 0.5% over Q2, when private consumption increased also by 0.5% q/q. Recent soft data on consumption has also pointed in the same direction, as the consumers' confidence improved further in August and held steady in September. **Market Impact:** A negative surprise could be seen as a sign of weakness in households' spending, raising more doubts about a further slowdown in the current quarter, although a positive surprise is not ruled out in view of improved consumers' confidence in most eurozone countries.

Germany: Industrial new orders (August, October 6th)

Forecast: 0.9% m/m	Consensus: 1.0% m/m	Previous: -2.2% m/m
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Comment: Following the sharp decline observed in July, industrial new orders are likely to post a slight rise in August. Looking forward, orders are expected to moderate substantially in coming months, after the strong increase recorded over the last year, and in line with managers' perception reported in PMI surveys. Overall, these data, coupled with industrial production figures, are showing further evidence of the slowdown in the industrial sector. **Market Impact:** In part due to the volatility of orders and partly because a significant moderation in orders growth is expected, a negative surprise should not affect the markets greatly, but it could raise concerns about a more severe slowdown by the end of the year.

US: Nonfarm Payrolls (September, Friday 08:30 ET)

Forecast: -5K	Consensus: 5K	Previous: -54K
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Comment: Private sector added only 67K jobs in August and 763K in total in 2010, which is lower than previous post-recession periods. Contrary to private sector, government sector lost 173K jobs on average in the last three months. With the end of census employment in nonfarm payrolls, we expect ongoing layoffs in government sector to continue but at a lower pace while employment growth in private sector will be higher in September. Furthermore, several regional Fed manufacturing indices indicate a slowdown in manufacturing industries which signal that the employment situation will remain weak throughout the year. **Market impact:** Market participants are waiting for the release to understand where the US economy is heading. Any significantly lower-than-expected nonfarm payroll employment data would increase uncertainty over the pace of the recovery and intensify the debate on a second round of quantitative easing.

US: Unemployment Rate (September, Friday 08:30 ET)

Forecast: 9.7%	Consensus: 9.7%	Previous: 9.6%
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Comment: Labor market conditions continue to remain weak despite moderate growth. Private sector has been creating jobs for the last eight months, but its pace is not enough to decrease unemployment rates. Although we expect total nonfarm payroll is likely to return positive in October, with higher participation rate unemployment rate is expected to rise in September. **Market impact:** We expect no significant surprise in unemployment rates. However, any negative surprise would intensify discussion on the effectiveness of the previous stimulus program and whether the economy needs an additional stimulus.

Brazil: Inflation - IPCA (September, October 7th)

Forecast: 0.4 m/m	Consensus: 0.5 m/m	Previous: 0.0 m/m
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Comment: After coming out at 0.0% m/m in the last three months, inflation will be in the positive terrain again in September. Yearly rates, currently at 4.5% y/y, are expected to trend up to 4.65% y/y in September and to 4.9% y/y by the end of the year. **Market Impact:** Unless the figure surprises to the downside, the release of September's inflation should move future interest rates upward.

Taiwan: Exports for September (October 7th)

Forecast: 27.3% y/y	Consensus: 28.7% y/y	Previous: 26.6% y/y
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Comment: Taiwan's exports are expected to sustain their momentum in September (1.3% m/m, s.a.), in line with other recent positive export readings elsewhere in Asia. Strong export performance, although in a moderating trend, has added to strong growth momentum in Taiwan, underscored by another interest rate hike of 12.5bps this past week. **Market impact:** A strong export reading in September under the shadow of a sluggish external environment should help support market confidence in Asia's growth outlook.

Markets Data

			Close	Weekly change	Monthly change	Annual change
Interest Rates (changes in bps)	US	3-month Libor rate	0.29	0	0	1
		2-yr yield	0.42	-2	-7	-44
		10-yr yield	2.56	-5	-6	-66
	EMU	3-month Euribor rate	0.94	6	6	19
		2-yr yield	0.87	14	26	-33
		10-yr yield	2.33	-1	5	-79
Exchange Rates (changes in %)	Europe	Dollar-Euro	1.374	1.9	7.2	-5.9
		Pound-Euro	0.87	1.9	4.3	-5.5
		Swiss Franc-Euro	1.34	1.3	3.6	-11.0
	America	Argentina (peso-dollar)	3.96	0.1	0.3	3.1
		Brazil (real-dollar)	1.68	-1.7	-3.1	-5.5
		Colombia (peso-dollar)	1796	-0.6	-0.8	-6.3
		Chile (peso-dollar)	482	-1.0	-3.2	-13.1
		Mexico (peso-dollar)	12.54	-0.1	-4.0	-8.3
		Peru (Nuevo sol-dollar)	2.79	0.0	-0.3	-3.4
	Asia	Japan (Yen-Dollar)	83.35	-1.2	-1.1	-7.0
		Korea (KRW-Dollar)	1125.97	-2.0	-4.6	-4.3
		Australia (AUD-Dollar)	0.972	1.4	6.9	12.2
Comm. (chg %)		Brent oil (\$/b)	83.4	5.7	8.4	22.5
		Gold (\$/ounce)	1316.4	1.6	5.2	31.3
		Base metals	528.5	0.5	3.5	24.4
Stock Markets (changes in %)	Euro	Ibex 35	10513	-2.0	-0.2	-7.2
		EuroStoxx 50	2757	-1.3	1.6	-0.1
	America	USA (S&P 500)	1147	-0.1	5.3	11.9
		Argentina (Merval)	2643	2.5	9.4	30.6
		Brazil (Bovespa)	69717	2.2	4.4	14.0
		Colombia (IGBC)	14711	4.1	5.2	31.9
		Chile (IGPA)	22417	1.2	4.1	41.9
		Mexico (CPI)	33330	0.1	2.8	16.2
		Peru (General Lima)	17860	3.1	16.2	21.7
	Venezuela (IBC)	65283	-1.2	0.8	29.2	
	Asia	Nikkei225	9404	-0.7	3.8	-3.4
HSI		22358	1.1	7.1	9.7	
Credit (changes in bps)	Ind.	Itraxx Main	111	-2	2	13
		Itraxx Xover	510	-6	18	-99
		CDS Germany	39	-1	0	17
	Sovereign risk	CDS Portugal	409	8	104	358
		CDS Spain	230	5	6	159
		CDS USA	46	0	1	---
		CDS Emerging	227	-4	-15	-48
		CDS Argentina	750	-13	-143	-314
		CDS Brazil	116	-1	-6	-18
		CDS Colombia	118	-5	-8	-44
		CDS Chile	77	2	-6	1
		CDS Mexico	122	-10	-16	-44
		CDS Peru	121	2	13	-21

Source: Bloomberg and Datastream

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