



# Weekly Observatory

December 7, 2009

## Financial markets: the euro to remain strong in the short-term, but medium-term forces favor the dollar

The euro appreciation does not appear to be sustained in carry trade operations as opposed to what occurs in Brazil or Australia. Thus, the strong euro is based on (i) differences in non-standard monetary policies between the ECB and the Fed; (ii) increasing reserve diversification of central banks; (iii) M&A flows starting to favor the EMU and; (iv) the low adjustment of Asian currencies so far. These forces should sustain a strong euro in early 2010. However, in the rest of the year the dollar should appreciate mainly because of (a) growth differentials would favor the US; (b) the ECB exit strategy could be more gradual than already announced; (c) China might allow some appreciation of the renminbi and; (d) technical reasons. Finally, the BoJ announced more liquidity to fight deflation and stop yen appreciation, Australian Central Bank raised rates for the third month in a row, and the ECB announced the beginning of its exit-strategy from non-traditional monetary policies. For further information, see [Flow Watch](#).

## US: consumption and manufacturing activity pick-up further

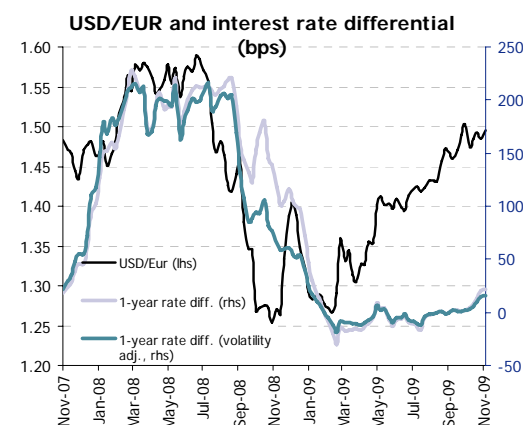
The Federal Reserve's beige book reported that economic activity has improved modestly since the last report in October, which is in line with our baseline scenario of GDP growth in 4Q09. The report cited improvement in consumer spending and manufacturing activity, which is supported by this week's latest data. Auto sales, which are currently playing an important role in the overall movement of PCE, rose by \$400,000 to \$10.9 million in November. As a result, consumer spending could increase again in November, indicating that total PCE will rise in 4Q09. Furthermore, the ISM came in above the benchmark of 50 for the fourth consecutive month, signifying that manufacturing activity continued to increase. For further information, see [US Weekly Observatory](#).

## Euro area: exit by the ECB somewhat faster than expected

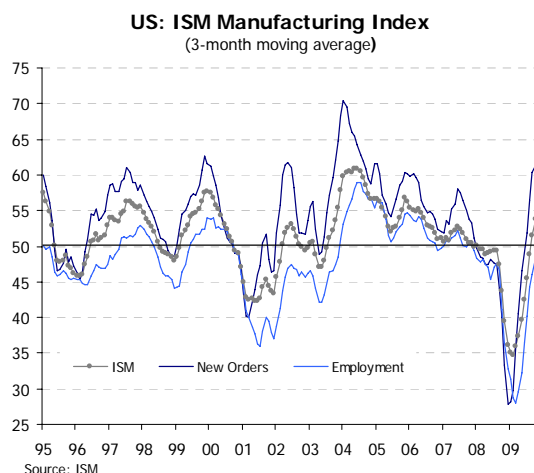
GDP growth in 3Q09 was confirmed at 0.4% in the Eurozone. The main items of domestic demand remain very weak, although the process of restockage has finally started after the deep falls in the recession. The contribution of external demand was positive, as expected, although growth of both exports and imports were high. Retail sales in October confirmed that consumer demand remains subdued in Q4, while unemployment figures showed some resilience in the labor market. On inflation, the flash for November was back to positive territory at 0.6%, driven by base effects, and we expect stable core inflation at 1%. The ECB started to implement its exit strategy somewhat more rapidly than we expected, although rates are projected to remain very low for the rest of the year, at least. For further information, see [Europe Weekly Observatory](#).

## Asia: encouraging signs of recovery in Asia

The Asia-Pacific region gave further signs of recovery this week when both Purchasing Managers' Indexes as well as Industrial Production expanded across the region. Furthermore, exports have continued improving and in some economies have even begun expanding over the previous year while



Source: ERD-BBVA and Bloomberg



Source: ISM

### EURO AREA GDP GROWTH (% q/q)

	Q209	Q309	Q309 BBVA
GDP	-0.2	<b>0.4</b>	0.4
Private Consumption	0.0	<b>-0.2</b>	0.0
Public Consumption	0.6	<b>0.5</b>	0.5
Gross Fixed Capital Formation	-1.7	<b>-0.4</b>	-0.6
Change in inventories (*)	-0.6	<b>0.3</b>	0.2
Domestic Demand (*)	-0.8	<b>0.2</b>	0.2
Exports	-1.3	<b>2.9</b>	1.6
Imports	-2.9	<b>2.6</b>	0.9
Net Exports (*)	0.6	<b>0.2</b>	0.3

(\*) Contributions to GDP growth

Source: Eurostat

consumption seems to be recovering as higher retail sales reveal. Meanwhile, inflation is starting to accelerate though it remains subdued. India posted better-than-expected growth figures for the third quarter while Korea revised upwards its earlier estimate of economic growth. On the policy front, Australia raised interest rates while Thailand and Indonesia left theirs unchanged. Next week, China will release its Industrial Production and exports for November and Korea will set its policy rate. For further information, see [Asia Weekly Observatory](#).

### Latin America: mixed activity news raises recovery doubts

On several fronts, activity data continues to produce an unclear message over the strength of the recovery in the region. In this fashion, favorable retail sales in Argentina, and industrial production in Chile contrast with worsening consumer confidence in Peru, and an employment path that remains sluggish in Colombia and Chile. Next week, we expect the November inflation report for Brazil and the monetary policy meeting of the Central Bank of Peru, where we expect no changes in the reference rate. For further information, see [Latin America Weekly Observatory](#).

### Spain: some improvements in the labor market

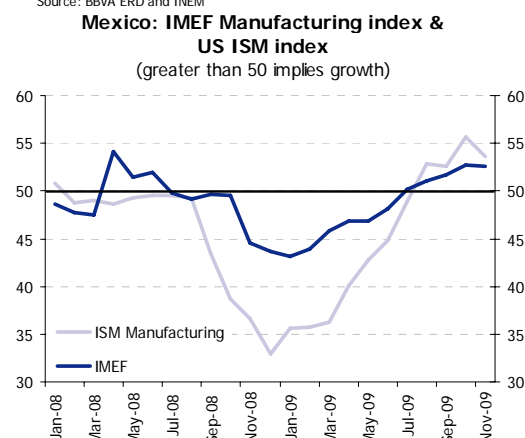
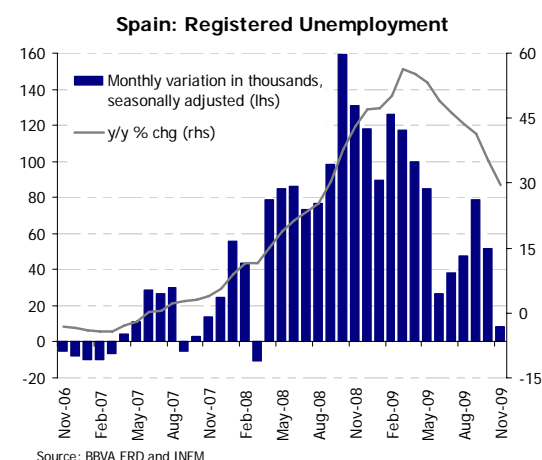
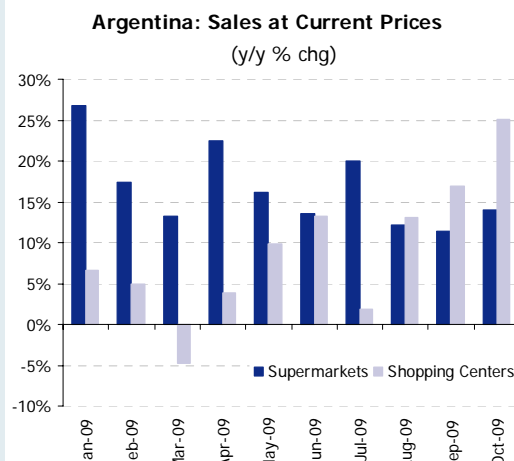
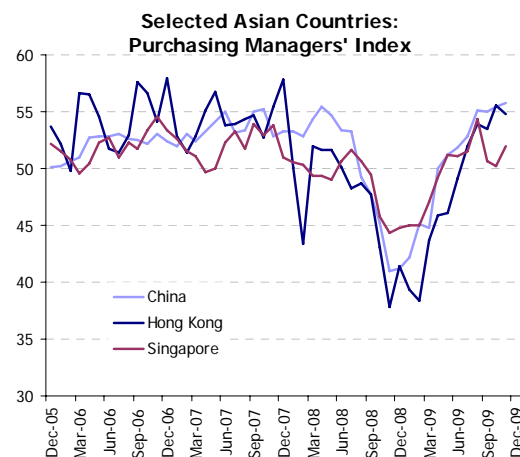
Social Security affiliation fell by 61,000 in November, with Construction and Services comprising most of the drop with -19,000 and -24,000 people, respectively. Seasonally adjusted, Social Security affiliation fell by 35,000, below the average of the past months (-55,000). Furthermore, the number of unemployed increased by 61,000 in November, 8,000 seasonally adjusted, remarkably below previous monthly increases. Overall, in 4Q09 the labor market is performing better than expected, despite the negative effects of the gradual termination of the Local Investment Fund program. However, the largest projects integrated in the plan will finish in 1Q10 and so the uncertainty over labor market behavior in 1H10 remains. On the other hand, industrial production dropped by 9.2% y/y wda in October (-12.5% in September), showing some deceleration in the activity decline rates. Finally, the current account deficit showed a new reduction in 3Q09, recording an annual accumulated deficit of €65.3bn (6.1% of GDP vs. 7.4% in 2Q09). For further details, see [Labor Market Observatory](#).

### Mexico: manufacturing growth is on track in November

November's IMEF manufacturing index registered 52.6 pts, above the expansion threshold, and similar to October's value (52.7). All components contributed positively to this path, but New Orders (54.8 vs. 56.4 Oct) and Inventories (47.7 vs. 49.7 Oct) reduced their performance somewhat. This growth is consistent with the improvements in industrial production in the past few months, both in the US and in Mexico, even though the recovery is slowing its pace. Next week, November inflation will be published, given the lower-than-expected bi-weekly CPI registered in the first fortnight, the monthly estimation has been revised slightly downwards. For further information, see [Mexico Weekly Observatory](#) (in Spanish).

### Commodities: base metals prices at 2009 highs

Increasing production in Russia and a large building-up of US oil inventories weighed on oil prices this week but a depreciation of the dollar ended up driving prices upwards. Copper, aluminum, lead and zinc prices reached their highest levels in 2009 as Chinese demand and a weaker dollar continue providing support. For more information, see [Commodities Observatory](#).



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