

Global

# Weekly Watch

Madrid, 3 September 2010

## Economics Analysis

Financial Scenarios

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## U.S. remains the focus...

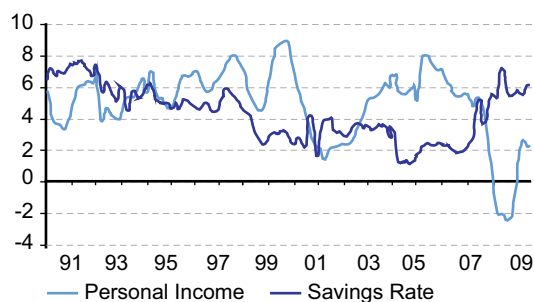
After a summer where the concern about the growth of developed countries (especially US growth), has been on the forefront, markets awaited Bernanke's words at the Jackson Hole meeting. The chairman said that the Fed is ready to do whatever it takes to support the economy if growth prospects deteriorate significantly. Still, while he remarked that the economy has lost track, he considers that growth is likely to pick up next year. Macro data this week was better than expected, albeit still indicating a slowdown in economic recovery in 3Q10. In this context, the Fed's Beige book will be of special interest next week to figure out whether the economic recovery is running out of steam. It is expected that the report would indicate consumer spending continues to pick up modestly and the labor market improves only gradually. A better-than-expected picture of regional economic outlook would ease some of the concerns about the pace of the economic recovery.

## ... while emerging markets are a step ahead

While central banks in developed countries have shown a cautious tone in their recent meetings, in emerging markets central banks continue tightening policy, as did the Bank of Indonesia by raising the reserve requirements or Indonesia's decision to introduced a third wave of measures to cool the private residential property market. The Central Bank of Brazil, in turn, decided to maintain unchanged rates at 10.75% closing the current monetary tightening after 200 bp of raises. Next week we expect the Bank of Korea will keep rates unchanged.

Chart 1

### Personal Income and Savings Rate (yoy % change of 3m ma, % 3mma)



Source: BEA

Chart 2

### Pending Home Sales (Annual % change)



Source: NAR

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### Developed countries' central banks in charge again

Central banks are on the centre of the stage again. In general, the tone of the ECB statement and of the Q&A was more cautious in comparison with August's meeting. In a context of high uncertainty, the ECB joined the club of "more cautious core central banks" with the Fed and the Bank of Japan.

### Asia-Pacific growth remains robust

Indicators released this week helped allay fears of abrupt growth slowdown in non-Japan Asia. China's PMI rose slightly in August.

## Markets Analysis

## Markets

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Global Interest Rates

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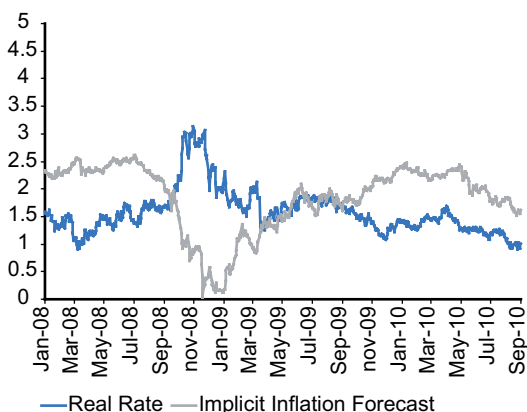
aurora.galan@grupobbva.com  
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The (occasionally aggressive) upwards reaction seen at the long ends of both the US and European curves (15-20bps) should be put in the context of the level reached following the downward rally in August. In our view, this movement was not only a reaction to the increase in cyclical risk, but also to the reduction in expected prices. In fact, of the 50bps correction in nominal rates over the last month, real rates have contributed just 12 to 15bps, and the rest (20-30bps) has come from lower price expectations. These two factors will therefore determine the extent of the reversal: in real rates, the levels reached (below 1%) were lows similar to those seen during the crisis in 2008, which act as something of a floor (a breach of which would be pricing in a much greater deterioration of the scenario). Meanwhile, it does not seem that many more reasons for reductions in price expectations will be found in data (above all in view of the confidence shown by the FED that real deflationist risk will not occur, and its vigilance in preventing this). We therefore reach two conclusions: i) we have probably already seen the low in rates; ii) corrections as a reaction to any improvement in data may even be aggressive occasionally (short-term volatility), but will remain limited (a reversal but without breaching the levels seen in June/July).

**Equity markets remain tied to US macro data**

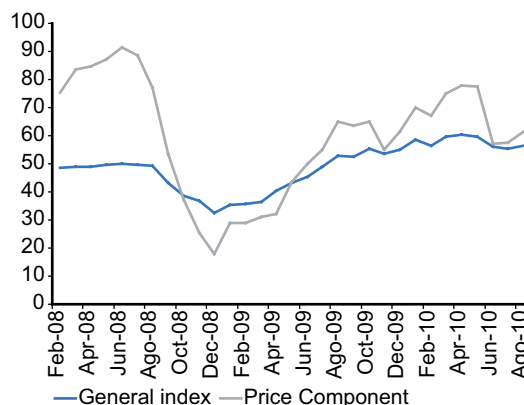
The main Western equity markets remain tied to the cyclical slowdown in the US, and therefore also globally. However, they are at attractive valuation levels (PER 12m fw S&P 500 11.8x, EuroStoxx 50 9.4x and Ibx 35 9.7x), and unless earnings enter a new down leg – which would only happen in a second recession – we think that they will find important support levels in the region of the levels reached at the end of August. Every piece of US economic data that comes out better than expected, such as August's ISM in the US, triggers rises of more than 3%. Since our outlook is of a future economic scenario of a slow recovery (but not another recession), we think that equity markets should accumulate value and levels at the end of the year may be significantly better than they are now. Also, as we have been saying, resilient earnings, high dividends, numerous M&A deals, and the gradual reopening of credit markets in countries such as Spain (issues by BBVA, La Caixa, Banco Popular, Sabadell) point in this direction. Nonetheless, investors' scepticism is clear, since there are still no clear capital inflows into Western equity markets.

Chart 3

**Real US 10Y Govt. Rate and Implicit Inflation Forecast**

Source: Bloomberg and BBVA Research

Chart 4

**US PMI and Price Component**

Source: Bloomberg and BBVA Research

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**Developed countries' central banks in charge again**

Central banks are on the centre of stage again. This week, and as it was widely expected, the ECB announced not only that it kept the official interest rates at the historical low minimums, but also – and more importantly – that it will provide liquidity to the financial system with the full-allotment tender operations “for as long as necessary and at least until” January 2011. As the ECB decided to extend the 3-M LTRO operations until December 2010, it guarantees enough liquidity at least until March 2011. Meaningfully, the extension of liquidity was taken “by consensus”, in contrast with the unanimity on keeping interest rates unchanged. In any case, the extension of these non-standard measures had been anticipated on recent declarations of Mr. Weber and did not surprise markets. In spite that this decision constitutes, in our view, a continuation of the QE policies, the ECB intends to present it just as a part of the normalization of the liquidity situation and says that it just aims to smooth the replacement of the maturities of 6- and 12-M full allotment tenders. However, this normalization is occurring at a very slow pace, as it is evident in the continued spread between the official refi rate and the Eonia rate which is very high in comparison with historical levels. Moreover, the provision of liquidity in the LTRO and MRO has remained in very high levels in the last two months (after the substantial decrease when the first 12-Month FA matured). Furthermore, the concentration of the ECB liquidity provision on some of the most vulnerable countries is increasing, showing their dependence on the liquidity provision of the ECB. The openness of credit markets for EMU financial institutions is, hence, the key event to monitor in the coming months.

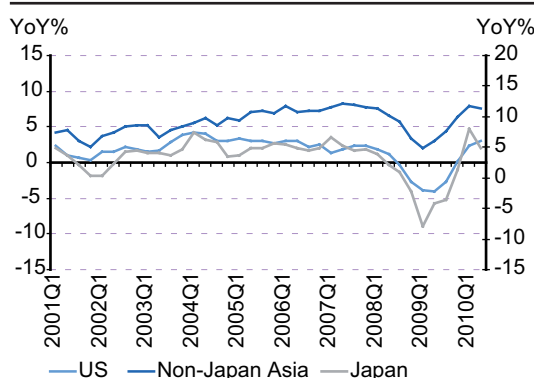
In general, the tone of the ECB statement and of the Q&A was more cautious in comparison with August's meeting. In a context of high uncertainty, the ECB joined the club of “more cautious core central banks” with the Fed and the Bank of Japan. In this vein, the minutes from the last August FOMC meeting signal that in a context of increased uncertainty –dispersion among FOMC members' forecasts rose over the inter-meeting period– the Fed will keep on providing liquidity: a constant balance sheet reflects a continuation of liquidity provision, rather than a second round of quantitative easing. The Fed will likely remain on a wait-and-see mode as conditions unfold before shifting policy.

The Bank of Japan, in turn, took a more active position and moved to support the country's faltering economy by expanding a special bank lending program by half to Y30,000bn (6% of GDP), as persisting deflation risks and strong yen, affecting adversely domestic demand and exports respectively, may undermine the recovery.

**Asia-Pacific growth remains robust**

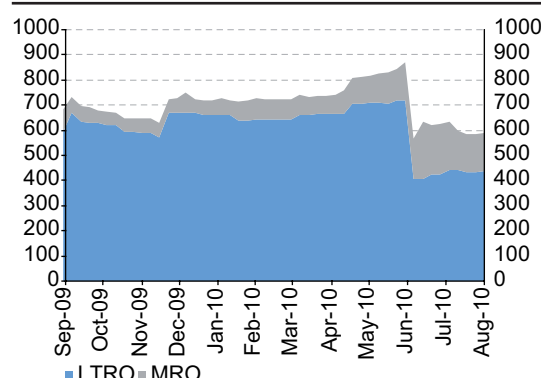
Indicators released this week helped allay fears of abrupt growth slowdown in non-Japan Asia. China's PMI, an indicator of its manufacturing cycle, rose slightly in August (at 51.7) after three monthly consecutive declines. The index stayed above 50, suggesting that manufacturing outputs were still expanding. Australia's 2Q GDP exceeded expectations thanks to faster export recoveries and strengthening domestic demand, much in the same way as what we have seen in other Asian GDP. Going forward, there are already signs of slower growth in the second half of the year, as suggested by July and August monthly indicators (e.g. Korea's exports, industrial production). But we view the moderation as a healthy transition back to trend after a sharp V-shape recovery. Besides, the growth pace is still relatively brisk, which is in a sharp contrast with the sluggish economic performance seen in Japan and US.

Chart 5

**Asian Growth remains fast**

Source: Bloomberg and BBVA Research

Chart 6

**ECB: liquidity provision to Euro area credit institutions (€bn)**

Source: Datastream and BBVA Research

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## Economics Analysis

## Calendar: Indicators

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## US: International trade (July, September 9th)

<b>Forecast:</b> 1.0% m/m	<b>Consensus:</b> 1.5% m/m	<b>Previous:</b> 3.7% m/m
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**Comment:** International trade deficit is expected to ease after increasing for the last three consecutive months. We expect an increase in exports yet a decrease in imports in July. Economic surveys, PMI Manufacturing index for instance, supports our view of a contraction in trade deficit in July. However, recent economic indicators imply that the trade deficit is likely to increase again in August. **Market impact:** The trade data will be important because of its implications for the 3Q10 GDP growth. Although the international trade data is released late, a better-than-expected international trade data would somewhat decrease pessimism about the US economic recovery. However, a worse-than-expected figure could intensify the debate on possibility of a double-dip in the US.

## Germany: Exports (July, September 8th)

<b>Forecast:</b> 0.4% m/m	<b>Consensus:</b> -0.3% m/m	<b>Previous:</b> 3.7% m/m
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**Comment:** After the strong recovery since mid-last year, German exports have reached pre-crisis levels, recovering from a cumulative drop of around 27%. Macroeconomic data from main partners, especially the U.S., suggest that the rapid pace of exports growth is unlikely to be sustainable, and thus the cyclical peak should be behind us. We expect exports to grow marginally in August. **Market Impact:** A negative surprise could raise concerns about a further slowdown of economic recovery, as exports remain the key driver of the German economy.

## Germany: Industrial Production Index (July, September 8th)

<b>Forecast:</b> 0.2% m/m	<b>Consensus:</b> 1.0% m/m	<b>Previous:</b> -0.6% m/m
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**Comment:** Industrial output is expected to be virtually flat in July, after having declined moderately in the previous month. Managers' confidence has continued to improve in recent months, though more moderately than in previous quarters, suggesting that the recovery of this sector remains on track, but slowing. In addition, despite the strong recovery of the industrial sector, output is still 25% lower than that recorded before the crisis. **Market Impact:** A very negative surprise would be interpreted as a sign that economic activity slowing in H2 2010 could be more severe than suggested by soft data.

## China imports (August, September 10th)

<b>Forecast:</b> 28.1%	<b>Consensus:</b> 26.2%	<b>Previous:</b> 22.7%
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**Comment:** China's imports have remained relatively strong on robust domestic demand, although growth is slowing, consistent with our baseline of a soft-landing in H2. **Market Impact:** a lower-than-expected reading could raise concerns on China's growth momentum and the outlook for the global recovery. Given China's role in boosting demand from other countries, an already healthy August PMI reading may allay such concerns.

## Mexico: Inflation, August

<b>Forecast:</b> 0.3% m/m	<b>Consensus:</b> n.a.	<b>Previous:</b> 0.2%
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**Comment:** 1st half of August figures gave us a clue on the whole month evolution: higher pressures from some agricultural prices pushed –slightly– yoy inflation against core decelerated evolution by the lack of demand pressures. **Market Impact:** global market attention on Mexico comes from its partnership with the US, but inflation surprises have been one of the main drivers behind expectations of monetary policy longer pause and lower long term rates.

## Peru: Monetary Policy Rate (September, September 9 th)

<b>Forecast:</b> 3.00%	<b>Consensus:</b> n.a.	<b>Previous:</b> 2.50%
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**Comment:** In its next monetary policy meeting, we expect the Central Bank Board (BCR) to raise the policy rate by 50bp, taking it to 3.0%. This would be the second time in a row in which the BCR makes a 50bp-hike since the monetary policy tightening cycle began last May. The faster stimulus removal takes place in a context of strong domestic demand (+14.0% yoy in 2Q10) and delays in fiscal policy moving to a more neutral stance.

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			Close	Weekly change	Monthly change	Annual change
Interest Rates (changes in bps)	US	3-month Libor rate	0.29	0	-13	-2
		2-yr yield	0.51	-4	-2	-42
		10-yr yield	2.70	6	-20	-74
	EMU	3-month Euribor rate	0.88	-1	-2	8
		2-yr yield	0.64	1	-11	-45
		10-yr yield	2.35	15	-22	-90
Exchange Rates (changes in %)	Europe	Dollar-Euro	1.287	0.9	-2.2	-10.1
		Pound-Euro	0.83	1.5	0.5	-4.5
		Swiss Franc-Euro	1.31	-0.2	-5.2	-13.8
	America	Argentina (peso-dollar)	3.94	-0.1	0.3	2.6
		Brazil (real-dollar)	1.73	-1.5	-1.7	-6.2
		Colombia (peso-dollar)	1808	-0.5	-0.5	-10.4
		Chile (peso-dollar)	496	-1.0	-3.8	-10.0
		Mexico (peso-dollar)	12.95	-0.7	3.1	-3.6
		Peru (Nuevo sol-dollar)	2.80	-0.1	-0.1	-4.6
	Asia	Japan (Yen-Dollar)	84.35	-1.1	-1.8	-9.3
		Korea (KRW-Dollar)	1171.65	-1.6	0.4	-5.4
		Australia (AUD-Dollar)	0.915	2.0	0.2	7.4
Comm. (chg %)		Brent oil (\$/b)	76.7	0.1	-6.0	14.8
		Gold (\$/ounce)	1242.2	0.3	4.0	24.9
		Base metals	509.4	1.2	2.5	13.3
Stock Markets (changes in %)	Euro	Ibex 35	10653	5.0	-1.7	-5.1
		EuroStoxx 50	2762	5.0	-2.0	0.7
	America	USA (S&P 500)	1098	3.2	-2.4	8.1
		Argentina (Merval)	2416	2.8	-0.7	35.8
		Brazil (Bovespa)	67100	2.3	-1.9	18.4
		Colombia (IGBC)	13986	0.6	3.0	34.2
		Chile (IGPA)	21653	3.0	4.6	42.7
		Mexico (CPI)	32780	3.2	-0.4	15.8
		Peru (General Lima)	15379	1.8	4.3	8.6
		Venezuela (IBC)	64769	0.0	1.4	26.3
	Asia	Nikkei225	9114	1.4	-5.6	-10.5
		HSI	20972	1.8	-2.7	3.2
Credit (changes in bps)	Ind.	Itraxx Main	109	-9	7	12
		Itraxx Xover	492	-35	20	-130
	Sovereign risk	CDS Germany	39	-5	2	15
		CDS Portugal	305	-27	78	246
		CDS Spain	224	-22	34	151
		CDS USA	45	-2	10	---
		CDS Emerging	242	-17	31	-72
		CDS Argentina	893	-49	97	-697
		CDS Brazil	122	-7	7	-9
		CDS Colombia	126	-6	6	-36
		CDS Chile	77	2	-6	1
		CDS Mexico	138	6	23	-33
		CDS Peru	108	-5	2	-33

Source: Bloomberg, Datastream and JP Morgan



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