

Global Weekly Flash

Policy driven rally loses steam on unconvincing macro data

- **The “risk on” response to the ECB OMT programme -which reduces global risk by removing euro area tail risks- and Fed’s decision to restart QE -which improves risk appetite- lost steam this week in the context of a still weak global economy yet to show signs of bottoming out. With these important decisions behind, market’s focus is increasingly shifting to the state of the global economy, hoping for signs that a rebound of growth is around the corner**
 - The release of flash PMI indices in China and the euro area pointed to continued weakness. A glass half full view is that weakness is not deepening, while a glass half empty view is that clear signs of a rebound are yet to show up. China’s HSBC/Markit flash manufacturing PMI for September increased slightly from the previous month (to 47.8 from 47.6), suggesting that growth, while still weak, may be stabilizing. For Q3 overall, the index was 48.2, down from 48.6 in Q2.
 - Eurozone composite PMI eased further down in September to 45.9, the weakest level since mid 2009, driven by the sharp decline in the French PMI. In contrast, the German PMI suggested that the downturn eased (ie, it surprised to the upside but the manufacturing reading remains below 50). September’s figures are broadly in line with expectations, although we had hopes to see an increase in confidence, as recent positive news in Europe (ECB’s Outright Monetary Transactions) could have lifted the mood of respondents. Overall, PMIs showed further evidence that the Eurozone GDP expected fall in Q3 should be larger than that observed in Q2, in line with our MICA-BBVA indicator that projects a -0.35% q/q decline.
 - Germany’s private sector output was close to stabilization in September and surprised to the upside drove by improvement in the services sector. In contrast, the French services and manufacturing PMI data surprised to the downside and showed the sharpest decline in French private sector output since April 2009, arising concerns about the worsening of domestic demand, the mainstay of the French economy. Finally, the Italian government downwardly revised its GDP forecast. Now they expect 2012 GDP to decrease by 2.4% against a previously expected fall of 1.2%.
 - Meanwhile, Japan’s exports declined by -5.8% y/y (consensus: -7.3% y/y) in August, further evidence showing the economy has paused due to the global downturn and the strong yen. Notably, exports to China fell by 10% y/y - China, accounting for 20% of Japan’s total exports, is Japan’s biggest trade partner, while exports to the EU fell 22.9% y/y. The recent flare-up in tensions between China and Japan over disputed islands further raises concerns regarding Japan’s exports outlook. In light of these headwinds, we expect Japan’s growth to stall in the second half of the year.
 - In the US, we had another week with mixed data. Regional manufacturing indexes suggested that the sector remains weak. The Empire State manufacturing index fell to -10.4 in September, down from -5.9 in August, surprising to the downside. The Philadelphia Fed index came in better than expected, but remains in contraction territory (-1.9). In contrast, both demand and supply indicators showed that the gradual housing recovery continues. Existing home sales rose a stronger-than-expected 7.8% MoM in August, to 4.82 million units from 4.47million in July. Housing starts rose to 750k in August, slightly below expectations, while building permits fell to 803k, but the 3mma of 791k is well above the averages of Q1 and Q2 (720k and 756k, respectively).

- **Impact of the QE policy in financial markets**

- Fed's reasoning for the QE3 move is that its expansionary monetary policy will be needed until the outlook for the labor market improves "substantially" ie, it will continue well into the recovery. Judging by the jump in inflation expectations measures derived from financial instruments, the (initial?) market reaction over the past week could be summed up as follows: the employment objective of Fed's dual mandate might be gaining weight relative to its inflation objective. All market measures of inflation expectations soared following Fed's QE3 announcement eg, the 5y5y US inflation breakeven widened by 25bp (and has widened around 30bp since mid August). If markets continue to expect wider breakeven rates, USD long positions could reverse even in a context of continuing uncertainty. As a consequence, other countries might also pursue monetary easing (such as Japan this week) or increase its market interventions (such as Brazil this week) trying to offset appreciation pressures. In light of cyclical concerns, the BoJ followed the Fed with QE.
- The BoJ eased monetary policy more-than expected to support the slowing economic recovery. In concluding its two-day policy meeting, the BoJ announced an expansion of its asset purchase program by ¥10 trillion (\$127 billion) to ¥80 trillion, aimed at purchases of government bonds and treasury bills. By extending the purchase period by six months, to end-2013, the BoJ's easing was more aggressive than many market participants expected, which drove the yen to depreciate to around 79 per USD.
- In Brazil, the Central Bank announced a reduction in its reserve requirements that should result in an injection of R\$ 30 Mm (about 0.5% of GDP) in the economy. The BCB stated that the aim was to increase inter-bank liquidity moderating investors' concerns after last week two small banks were liquidated. After this new step of monetary expansion, we expect a final cut of 25bps in the SELIC in October to 7.25% remaining in this level for an extended period.
- The extra-liquidity provided by central banks will lead flows toward emerging countries but unlike the QE1 episode, this time, cyclical driving assets are unlikely to attract most inflows. According to EPFR data, most inflows continue going into bond funds, mainly in emerging markets. Yet inflows toward Equity funds in developed countries and Latin American funds have accelerated in the last two weeks since the QE was announced and euro area tail-risks decreased. Nevertheless, it is important to note that inflows toward Asian equity funds were very subdued; amounting to 0.08% of the total asset under management (AUM) in the last week compares with inflows in Latin American equity funds of 2.1% of AUM. It seems that China's growth concerns are taking its toll on Asian markets. As long as global growth concerns linger it may continue to weigh on equities in emerging markets. Besides, peripheral bond funds registered outflows over the last week, suggesting a wait-and-see approach until further decisions are taken in the euro area.

- **Regarding the European debt crisis news flow was quite little this week and investors are waiting for the activation of the ECB's new government-bond purchasing programme, called Outright Monetary Transactions (OMT)**

- Important to note, is that European authorities welcomed the ECB's OMT programme. However, is up to the eurozone member state to activate it (OMT). Additionally, the German chancellor also supported the OMT but she insisted on fulfilling fiscal consolidation target in peripherals, reaffirming the investors' worries about the halt in the OMT whenever the countries suffered a delay in their deficit reduction process.
- Although improving market conditions for peripherals retreated somewhat this week, the Spanish and Portuguese government auctions were successful. The Spanish Tesoro issued 3 and 10Y bonds, raising a total of EUR4.8bn, well above the initial issuance target (EUR3.5-4.5bn). The auctions attracted good demand, especially in the 3Y bond where the ECB's OMT will focus. Portugal also showed encouraging signs in its funding programme. It managed to sell a 18M bill which was the longest maturity Portugal has sold since April 2012. The borrowing cost at this reference was the lowest since 2010.

Next week 2013's Spain Budget will be presented to Parliament on September 28. The Spanish government is also expected to announce new reform package. Additionally, Spanish banking sector's stress test will be released. Finally, investors are still waiting for Moody's decision on the Spanish sovereign rating. Also next week Spain will sell bills in a very busy debt issuances' week in which Germany and Italy are expected to sell around EUR20bn in bonds while France, Germany and Italy plan to sell EUR 18bn in bills.

Calendar: Indicators

Eurozone: M3 (August, September 27th)

Forecast: 3.1% y/y	Consensus: 3.2% y/y	Previous: 3.8% y/y
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We expect M3 to have slowed down in August, after the sharp increase observed in the previous month. Across its counterparts, our estimate is that loans to private sector could have remained flat. Looking beyond the month-on-month volatility, loans to private sector continue to grow at steady low rates, while those to non-financial corporations have been contracting since the beginning of the year, although at a slower pace than the one observed in Q1. Looking forward, we expect lending to remain very subdued, not only due to hard credit conditions but also to worsening demand, suggesting that both private consumption and investment could fall again in coming quarters.

Eurozone: Flash HICP inflation (September, September 28th)

Forecast: 2.6% y/y	Consensus: 2.4% y/y	Previous: 2.6% y/y
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Headline inflation is expected to have remained stable at 2.6% in September, after rebounding in August driven by higher energy prices. Unlike last month, energy inflation is likely to have declined marginally due to the slower increase in oil prices observed in recent weeks. Although the flash estimate will not reveal information about core inflation, our models project that it should have also remained stable at 1.7%, after the unexpected slowdown recorded in August. The Spanish tax hike in September could pose some upside risks to our forecast, although we expect a limited pass through to consumer prices due to the weakness of the domestic demand. Looking forward, headline inflation is likely to hover around 2.5% y/y during Q4.

US: GDP, Final Estimate (2Q12, September 27th)

Forecast: 1.7%	Consensus: 1.6%	Previous: 1.7%
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The final GDP estimate for 2Q12 is expected to be unchanged from the second release last month. Data on personal consumption expenditures and businesses inventories reflected no revision to June's figures following the second estimate for GDP. On the other hand, the trade deficit for June was revised down significantly due to a larger-than-expected increase in exports. However, export growth for May was actually revised lower, so the total revision for 2Q12 is likely to have very little impact on the final GDP estimate.

US: Personal Income and Outlays (August, September 28th)

Forecast: 0.3% m/m, 0.5% m/m	Consensus: 0.2% m/m, 0.5% m/m	Previous: 0.3% m/m, 0.4% m/m
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Personal income and spending are expected to increase in August at a similar pace as in the previous month. Income growth has been particularly strong in recent months despite weak employment reports and deteriorating consumer confidence. Most of the growth stems from components other than wages and salaries, which are expected to be limited in August given the slight drop in average earnings for the month. On the other hand, consumer spending has rebounded from weakness in 2Q12. Retail sales accelerated in August, suggesting positive PCE growth for the month, even though much of this gain was due to rising gas prices. Ultimately, consumers appeared to be more worried about income prospects in August than in previous months, and heightened uncertainty may limit real spending habits.

Singapore CPI inflation for August (September 24th)

Forecast: 3.7% y/y	Consensus: 3.8% y/y	Previous: 4.0% y/y
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Singapore's inflation has been stubbornly high in comparison to most other Asian economies, at around 5% y/y for most of 2012. However, it fell in July to 4.0% y/y on a combination of weakening demand and base effects. This month's outturn will be especially important, as it will be the last print before the next 6-month policy meeting of the Monetary Authority of Singapore's (MAS) in mid-October. Given the continued weakness in external and domestic demand, we expect the MAS to ease policy by slowing the appreciation path of the currency (the main instrument of monetary policy). However, the Fed's recent new round of QE may give the MAS some pause, as more capital inflows are likely, which could lead to asset bubbles in the property market and a pickup in inflation.

Markets Data

			Close	Weekly change	Monthly change	Annual change	
Interest rates	Interest rates (changes in bps)	US	3-month Libor rate	0.37	-2	-6	1
			2-yr yield	0.26	1	0	5
			10-yr yield	1.78	-8	9	-5
		EMU	3-month Euribor rate	0.23	-2	-8	-131
			2-yr yield	0.05	-6	4	-35
			10-yr yield	1.60	-10	14	-14
Exchange rates	Exchange rates (changes in %)	Europe	Dollar-Euro	1.304	-0.7	4.0	-3.4
			Pound-Euro	0.80	-1.1	1.4	-8.4
			Swiss Franc-Euro	1.21	-0.5	0.8	-0.9
		America	Argentina (peso-dollar)	4.68	0.2	1.4	11.4
			Brazil (real-dollar)	2.02	0.6	0.4	10.4
			Colombia (peso-dollar)	1794	0.0	-1.0	-5.8
			Chile (peso-dollar)	471	0.1	-2.3	-9.0
			Mexico (peso-dollar)	12.81	0.8	-2.0	-5.5
			Peru (Nuevo sol-dollar)	2.60	0.3	-0.4	-6.0
		Asia	Japan (Yen-Dollar)	78.21	-0.2	-0.5	2.1
			Korea (KRW-Dollar)	1119.23	0.2	-1.5	-4.1
			Australia (AUD-Dollar)	1.051	-0.4	0.0	7.5
Comm.	Comm. (chg %)		Brent oil (\$/b)	111.1	-4.7	-3.3	6.9
			Gold (\$/ounce)	1787.1	0.9	8.0	7.9
			Base metals	528.2	0.3	2.8	-2.8
Stock markets	Stock markets (changes in %)	Euro	Ibex 35	8125	-0.4	10.7	1.6
			EuroStoxx 50	2569	-1.0	4.8	26.8
		America	USA (S&P 500)	1460	-0.4	3.3	28.5
			Argentina (Merval)	2501	-1.7	2.7	0.7
			Brazil (Bovespa)	62114	0.0	4.6	16.7
			Colombia (IGBC)	14308	-1.3	0.4	10.3
			Chile (IGPA)	20501	0.1	0.4	11.5
			Mexico (CPI)	40500	-0.5	1.2	24.3
			Peru (General Lima)	21695	-1.2	6.9	15.3
			Venezuela (IBC)	303279	2.5	3.8	201.3
		Asia	Nikkei225	9110	-0.5	-0.2	6.4
			HSI	20735	0.5	4.3	17.4
Credit	Credit (changes in bps)	Ind.	Itraxx Main	127	9	-14	-69
			Itraxx Xover	527	66	-48	-312
		Sovereign risk	CDS Germany	47	-2	-12	-62
			CDS Portugal	484	29	-182	-675
			CDS Spain	370	27	-91	-45
			CDS USA	29	-1	-11	---
			CDS Emerging	212	19	-33	-156
			CDS Argentina	931	-4	-209	-103
			CDS Brazil	103	2	-24	-105
			CDS Colombia	94	3	-17	-118
			CDS Chile	76	-2	-18	-68
			CDS Mexico	91	3	-16	-123
			CDS Peru	100	1	-16	-116

Source: Bloomberg and Datastream

Weekly Publications

Country	Date	Description
Global	09/17/2012	➤ Educational Attainment in the OECD, 1960-2010 This paper describes the construction of series of educational attainment of the adult population in a sample of 21 OECD countries covering the period 1960-2010
UEM	09/20/2012	➤ Europe Flash: "Eurozone composite PMI eased down in September, dragged down by the sharp decline in France" The flash Composite index for the whole Eurozone fell from 46.3 to 45.9, with an improvement in manufacturing and worse figures for services
	09/20/2012	➤ Portugal Economic Watch: "The economy is set to contract further in 3Q" GDP fell 1.2% q/q in 2Q12 dragged down by the sharp decline in domestic demand. Our MICA-BBVA model, with the latest available data shows that GDP could contract by around 0.6% q/q in Q3 (Spanish version) (Portuguese version)
US	09/17/2012	➤ U.S. Banking Watch. Quarterly Credit Quality Update Residential delinquencies continue to be the weak spot in overall asset performance, yet the CRE delinquency rate has declined significantly (Spanish version)
	09/17/2012	➤ U.S. Weekly Flash. Fed Announces QE3 and Extends Policy Guidance Despite the fact that recent macroeconomic data were not a dead giveaway for QE3, the Fed decided to move forward with additional easing in order to stimulate the economy (Spanish version)
Latin America		
Brazil	09/17/2012	➤ Brazil Flash: "CB cuts reserve requirements" The Central Bank (CB) announced on Friday afternoon a reduction in banks' reserve requirements, which should inject R\$30bn (around 0.5% of GDP) in the economy (Spanish version)
Colombia	09/20/2012	➤ Flash Colombia. Resultado del PIB supera expectativas del mercado gracias al fuerte impulso de la inversión en obras civiles El PIB del 2T12 creció 4,9% anual, con un cambio en las contribuciones de sus componentes. Las obras civiles, que restaron al crecimiento al inicio del año, aportaron más de un punto porcentual
Peru	09/17/2012	➤ PIB mantuvo una fuerte expansión en julio La actividad económica se expandió 7,2% a/a en julio, lo que reflejó la fortaleza de la Construcción y una recuperación de la Manufactura No Primaria.
Asia	09/21/2012	➤ Asia Daily Flash 20 September 2012: China's flash manufacturing PMI shows signs of a rebound; Taiwan export orders improve, and the central bank leaves rates on hold; Japan's exports fall as econ... China's HSBC/Markit flash manufacturing PMI for September rebounded slightly from the previous month (47.8), suggesting that growth, while still weak, may be stabilizing.
	09/19/2012	➤ Asia Daily Flash 19 September 2012: Bank of Japan follows the Fed with quantitative easing; China's FDI inflows fall for a third straight month The liquidity-driven boost in Asian equities resumed today, on the Bank of Japan's announcement (see below) of a bigger-than-expected expansion in its asset purchase program (quantitative easing)
	09/18/2012	➤ Asia Daily Flash 18 September 2012: China housing prices rise for a third straight month; Indonesia's parliament to vote on electricity price increase; India's CPI inflation hits double digits ... Markets in Asia were broadly lower for a second day in a row, leading some observers to wonder what ever happened to the QE3 rally that appeared so strong just a few days ago?
	09/17/2012	➤ Asia Daily Flash 17 September 2012: Escalating island dispute between China and Japan poses risks; India's government seeks to reinvigorate reforms; China unveils five year financial sector plan... Fresh on the heels of the Fed's boost to investor sentiment last week with QE3, a flare-up in anti-Japan protests across China over the weekend

As expected, the Reserve Bank of India (RBI) today left its key repo rate unchanged at 8.0% in light of persistent inflation, but reduced the cash reserve ratio (CRR) by 25 bps to 4.5%

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