Global Weekly Flash

Still waiting for policy decisions in Europe -unlikely until early September-; FOMC minutes do not signal for QE3

Crucial stages in the eurozone sovereign debt crisis are approaching, but policy decisions are not likely to be taken until early September at the earliest. Recent data points to continued weakness in Europe and growing concerns that the German economy is weakening, and further concerns about slowing growth momentum in China. Meanwhile, the FOMC minutes were dovish and suggest that a change in policy guidance might be Fed's first choice.

- With respect to the challenge of putting Greece on a sustainable fiscal path and reducing the probability that Greece will exit the euro area (ie, Grexit), optimism at the beginning of the week that region leaders would allow an extension of Greece's fiscal adjustment program faded with signs that Germany is unlikely to soften its approach. First, Schäuble, Germany's finance minister, rejected Samaras's request of a two year extension of the austerity program (saying that the existing "must be implemented, and in case of doubt more time means more money [..] and more money would require a new programme"). Then, and before meetings with Merkel, in Berlin on Friday and Hollande, in Paris on Saturday, Samaras, was given little hope after the meeting between Merkel and Hollande on Thursday. No decision will be taken until after the troika report in late September/October.

- Regarding the other near-term challenge, namely pushing Spanish and Italian yields permanently lower, policy surprises are unlikely over the next week and no actual news should be expected until September 6 ECB meeting or even later as Spain's finance minister said this week that before Spain asks for assistance the ECB should commit to unlimited bond buying. Any decision on this issue is unlikely to be taken until at least the September 14 Eurogroup meeting.

• On the ECB intervention, a lot of rumors have come this week

- Der Spiegel reported that the ECB was considering capping yield spreads but an ECB spokesman said that reports were "misleading" and that no decision has been taken yet. Joerg Asmussen, the German representative on the ECB executive board, backed Draghi's plan to eliminate the convertibility risk and also said that the new bond-purchase program would address the issue of seniority. Given that the ECB is "only" aiming at removing the convertibility risk (ie, the risk associated with a euro breakup), and thus that the credit (ie, default) risk will remain, addressing the "concerns of private investors about seniority […]" is key to improve the chances of being successful. It is key for the ECB to outline a clear solution of how the seniority issue will work. To attract back private investors into Spanish and Italian bonds they cannot be subordinated (as was the case with Greek bonds). Meanwhile, the Bundesbank stepped up its criticism to ECB's new purchase plan by saying that it is "particularly opposed" to yield caps and that potentially far greater sharing of solvency risks should be taken by governments or parliaments, not by central banks. Besides, there were reports that "many central bankers" would prefer not to adopt an explicit target for bond yields or spreads, but rather to adopt an unpublished target or range. All in all, the ECB intervention is very challenging, considering the restrictions (mainly conditionality and the overwhelming support needed), while market expectations seem to be running quite high at the moment. Uncertainty is never good for markets, and this week was another reflection of that. For instance, 2y Spanish yields increased by around 25bp this week, while European equity markets partially reversed the increase seen recently (eg, the IBEX drop around 5% this week).

- All these reports came in a context of growing concerns that the German economy will slump too. The Eurozone PMI Composite Output Index was broadly unchanged at 46.6 in August, from a final reading of 46.5 in July. The index has now signalled a contraction of the Eurozone private sector for seven successive months. The decline in total activity was widespread across the currency union. Flash readings for France and Germany pointed to contractions, with the rate of decline easing in France but gathering pace in Germany (at 47 from 47.5 in July). The good news is that business confidence in the euro area seems to be stabilising (ie, at least it is not deteriorating further).

- **Not only Europe's economy continues to show signs of weakness, a weak flash PMI outturn in China added to concerns about slowing growth momentum, as it shows that growth momentum is not yet rising in China**
  - The Markit flash PMI manufacturing outturn for August showed a decline to 47.8%, the lowest since November 2011. The moderation was broad-based, with weakness in both the new orders and exports sub-components. We await the release of August official PMI on September 1st, which should provide a broader reading of output trends (the Markit PMI tends to focus more on smaller, export-oriented firms). We expect further policy easing in the months ahead, including stepped up infrastructure spending and further cuts in the RRR and interest rates.

- **In the US, following the recent improvement seen in data, it was mixed this week, with existing home sales and jobless claims a bit worse than anticipated, while flash PMI, home prices, and new home sales were a bit better**
  - However, the main news came from the release of the FOMC minutes which were dovish and point to a possible change in policy guidance. Given prolonged weakness in economic data and increasing uncertainty regarding the sustainability of the recovery, the FOMC continues to discuss appropriate monetary policy action. In the meeting, members touched upon the idea of extending policy guidance by extending the period over which the Fed expected to keep its fed funds target rate between 0.0 and 0.25%. The minutes highlight some arguments that this strategy could be more effective if implemented in coordination with stronger expression in the statement: "a highly accommodative stance of monetary policy likely to be maintained even as the recovery progressed." The Committee decided to wait until the September meeting to make any sort of decision. Pressures have been mounting for the Fed to implement QE3, but the details of the meeting suggest that the internal debate remains intense. Come September, there may not be enough evidence to sway the opposition. In summary, the minutes do not signal for additional quantitative easing but rather a change in policy guidance in September. Given than an extension of forward guidance by the Fed seems likely (ie, that policy could remain accommodative for longer), 10y Treasury yields reversed some of the increase seen recently, decreasing by around 15bp. Further declines are likely as currently the market is pricing in two Fed hikes by Q4 15.

Next week: in the US, the first personal consumption data for Q3 will be released, as well as consumer confidence data and regional manufacturing surveys for August. In Europe, Germany's IFO business confidence index will grab market's attention given concerns that the German economy is weakening. Meanwhile, Italy will test financial markets on Thursday selling 5Y and 10y bonds. It will be a week transition prior to the next big events for markets being the September 6 ECB meeting and the rule on the ESM by the German court on September 12, followed by September 14 Eurogroup meeting.

Calendar: Indicators

Eurozone: Flash HICP inflation (August, August 31st)

Forecast: 2.5% y/y	Consensus: 2.4% y/y	Previous: 2.4% y/y

Headline inflation is expected to increase by around 0.1pp to 2.5% in August, mainly driven by higher energy inflation after interrupting last month the downward trend observed in the first half of the year. In addition, the significant increase in fuel prices recorded in recent weeks prompts that some upside risks to our August's forecast must not be ruled out. Regarding core inflation, we expect it to remain stable at 1.9% y/y, after last month 0.1pp increase. Looking forward, oil prices higher than expected last month combined with inflationary pressures stemming from certain fiscal measures in the periphery also raise doubts about our previous forecast that headline inflation will return to 2% by year end, pointing now a slower deceleration.

Eurozone: Unemployment rate (July, August 31st)

Forecast: 11.3%	Consensus: 11.3%	Previous: 11.2%

We expect the unemployment rate to have stepped up in July to 11.3%, from 11.2% in June, continuing the upward trend observed since mid-2011 and cumulating a 1.3pp increase since then. Given that the employment performance tends to follow activity fluctuations with a time lag of two to four quarters, and considering that recent data suggests that activity is contracting again in Q3, the unemployment rate is likely to increase slightly further along 2012. Confidence surveys for August also point in this direction, with firms' hiring intentions declining further at a significant pace. Across countries, the worsening in employment expectations was also widespread, although the labour market in Germany remains resilient.

US: GDP, Second Estimate (2Q12, August 26th)

Forecast: 1.6%	Consensus: 1.7%	Previous: 1.5%

The second estimate of GDP growth for 2Q12 is likely to show a slight upward revision due to some better-than-expected data released for the end of the quarter. Most importantly, the trade deficit in June narrowed to the lowest level since December 2010, reflecting an increase in exports for the second consecutive month. Imports declined throughout the entire quarter which should help GDP but point to an uncertain future in terms of domestic demand conditions. Personal consumption expenditures remained weak in June, declining 0.1% in real terms, which may offset some of the positive influence from trade data. Finally, business inventories increased slightly less than expected in June, with no revision to the previous months, but should remain relatively neutral in terms of the contribution to a revision in GDP.

US: Personal Income and Outlays (July, August 27th)

Forecast: 0.2%, 0.4%	Consensus: 0.3%, 0.5%	Previous: 0.5%, 0.0%

Data on personal income and outlays are expected to show positive monthly growth in July, reflecting a modest rebound in consumer activity. Consumer spirits are slightly brighter, but now gas prices are rising again and the unemployment rate has jumped back up to 8.3%, suggesting that the optimism may be short-lived. Personal income has grown in recent months, up 0.5% in June, but a deceleration in average earnings in July points to a weaker contribution to income from the wages and salaries component. Improvements in household finances have not boosted personal consumption expenditures, which declined in May and were flat in June. However, a jump in retail sales for July suggests that personal outlays will improve at least slightly upon prior weakness. Given that inflation was flat in July, growth should also be positive in real terms.

India: Q2 GDP Growth 2012 (Q2-12,August 31st)

Forecast: 5.1% y/y	Consensus: 5.3% y/y	Previous: 5.3% y/y

India's economy continues to be plagued by slowing growth and elevated inflation. The outturn for Q2 GDP growth will be a key input for the Reserve Bank of India's next monetary policy decision in September, and another weak outturn, dragged down by waning fiscal support and slowing industrial and services activity, could raise the likelihood of an imminent interest rate cut, in line with our expectations of an additional 50bps in cuts by end-year. Wholesale price inflation (6.9% in July), however, remains a constraint, exacerbated by a sub-par monsoon and supply bottlenecks. Overall, we expect India's GDP growth to decline to 5.6% for full year 2012, down from 7.5% in 2011.

Markets Data

				Close	Weekly change	Monthly change	Annual change
Interest rates	(changes in bps)	US	3-month Libor rate	0.42	-1	-2	10
			2-yr yield	0.26	-3	4	7
			10-yr yield	1.66	-15	26	-53
		EMU	3-month Euribor rate	0.30	-4	-13	-125
			2-yr yield	-0.02	2	4	-68
			10-yr yield	1.34	-16	8	-82
Exchange rates	(changes in %)	Europe	Dollar-Euro	1.252	1.5	3.0	-13.6
			Pound-Euro	0.79	0.6	0.8	-10.8
			Swiss Franc-Euro	1.20	0.0	0.0	2.7
		America	Argentina (peso-dollar)	4.62	0.0	1.1	10.3
			Brazil (real-dollar)	2.02	0.4	-0.5	26.2
			Colombia (peso-dollar)	1809	-0.6	0.6	0.8
			Chile (peso-dollar)	480	-0.6	-2.3	3.1
			Mexico (peso-dollar)	13.23	0.8	-2.7	6.2
			Peru (Nuevo sol-dollar)	2.61	0.1	-0.9	-4.3
		Asia	Japan (Yen-Dollar)	78.53	-1.3	0.5	2.5
			Korea (KRW-Dollar)	1134.15	0.0	-1.5	4.8
			Australia (AUD-Dollar)	1.040	-0.2	0.9	-1.7
Comm.	(chg %)		Brent oil ($/b)	114.8	0.9	9.9	3.0
			Gold ($/ounce)	1666.1	3.1	3.8	-8.9
			Base metals	517.4	1.6	4.3	-8.9
Stock markets	(changes in %)	Euro	Ibex 35	7250	-4.1	20.7	-11.4
			EuroStoxx 50	2423	-2.0	12.2	10.6
		America	USA (S&P 500)	1402	-1.1	4.8	19.1
			Argentina (Merval)	2443	-0.7	1.8	-15.3
			Brazil (Bovespa)	58512	-1.0	11.2	9.7
			Colombia (IGBC)	14198	-0.3	6.2	7.5
			Chile (IGPA)	20372	-1.0	-1.6	3.0
			Mexico (CPI)	39879	-1.6	-1.4	17.1
			Peru (General Lima)	20178	0.4	3.2	1.9
			Venezuela (IBC)	292357	5.4	19.6	192.6
		Asia	Nikkei225	9071	-1.0	8.4	3.1
			HSI	19880	-1.2	5.3	1.5
Credit	(changes in bps)	Ind.	Itraxx Main	145	1	-34	-23
			Itraxx Xover	588	5	-97	-128
		Sovereign risk	CDS Germany	61	5	-22	-24
			CDS Portugal	682	-53	-201	-341
			CDS Spain	485	9	-140	107
			CDS USA	40	-1	-10	---
			CDS Emerging	249	3	-26	-49
			CDS Argentina	1160	63	-48	329
			CDS Brazil	128	-1	-24	-35
			CDS Colombia	113	-2	-22	-50
			CDS Chile	94	-5	-20	-11
			CDS Mexico	109	-3	-20	-54
			CDS Peru	118	-4	-24	-53

Source: Bloomberg and Datastream

Weekly Publications

Country	Date	Description
Asia	08/23/2012	Asia Daily Flash | 23 August 2012: Weak flash PMI in China adds to concerns; Singapore inflation falls; Taiwan posts better-than-expected IP A weak flash PMI outturn in China today added to concerns about slowing growth momentum.
	08/22/2012	Asia Daily Flash | 22 August 2012: Japan's exports in July slump After a strong rally over the past month, stocks were broadly lower today across Asian markets.
	08/21/2012	Asia Daily Flash | 21 August 2012: Hong Kong's inflation declines sharply on one-off measures; India's CPI eases; Korea's external short-term debt increases Hong Kong¿s headline inflation increased by a lower-than-expected 1.6% y/y in July (consensus: 3.4% y/y), sharply below the 3.7% y/y rate posted in June.
	08/20/2012	Asia Daily Flash | 20 August 2012: China's property prices rise; Export orders slump in Taiwan; Thailand's Q2 GDP growth beats estimates Data released over the weekend provide further confirmation of a rebound in China's residential property prices.
USA	08/22/2012	Fed Watch. FOMC Minutes: July 31 - August 1 Discussions Ignite Over Additional Policy Tools. (Spanish version)
	08/20/2012	U.S. Weekly Flash. Consumer Price Index Unchanged in July, Core Pressures Muted Consumer prices remained unchanged in July for the third time in four months. Food inflation actually slowed for the month but we expect to see a bigger impact from this component throughout the rest of the year. (Spanish version)
Spain	08/22/2012	Spain Economic Outlook. Third Quarter 2012 Financial stress extend to 2013 the decline in GDP. Recovery will depend on the credibility of the fiscal adjustment, the effectiveness of the reforms and the support of the European institutions.
Latam Chile	08/20/2012	Flash Chile: El desacople ataca de nuevo
Colombia	08/22/2012	Flash Colombia. Producción industrial retoma un crecimiento moderado en junio En junio, la producción industrial creció 2,8% anual, revirtiendo tendencia negativa de meses recientes, en los cuales la desaceleración estuvo asociada con menor dinámica de exportaciones del sector.
México	08/23/2012	Flash Inflación México. Inflación de la 1QAgo: ligeramente mejor a lo esperado: sin embargo persisten los choques de oferta General: Observada: 0.14% q/q vs. BBVA: 0.2% q/q Consenso: 0.19% q/q. Subyacente: Observada: 0.16% q/q vs. BBVA: 0.12% q/q Consenso: 0.15% q/q.
	08/23/2012	Mexico Inflation Flash. August's bi-weekly inflation: slightly better than expected, however external shocks persist General: Actual: 0.14% f/f vs. BBVA: 0.2% f/f Consensus: 0.19% f/f. Core: Actual: 0.16% f/f, vs. BBVA:0.12% f/f, Consensus:0.15% f/f. (Spanish Version)
NPAB	08/22/2012	Economic Watch:New Pacific Alliance Bloc: Mexico and Andeans look towards Asia Mexico, Colombia, Peru and Chile new strategy for the XXI Century.

Publications on August 24th, 2012 to 11:30, Madrid time

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