Global Weekly Flash

Europe begins to debate on a "growth compact"

- European economies are suffering of both the negative impact from financial strains and the near-term effects of fiscal consolidation imposed to regain market's confidence. In spite of fiscal consolidation processes already underway, financial tensions have not only receded but also have spread to other European countries, mainly due to bleak growth perspectives and on concerns that some economies might not show a return to sustainable growth anytime soon . This week, for instance, Standard & Poor's downgraded the Spain's credit rating by two notches to BBB+/A-2 from A/A-1, maintaining its negative outlook on debt concerns. The rating agency believes that Spanish deficit is likely to deteriorate further, due to the contraction of the economy and given that the government will need to provide further assistance to the banking sector.
- In this context, with austerity as a near-term drag for growth, the debate about how to tackle the European debt crisis is slowly and gradually leaning toward growth-facilitating measures. Last week, the IMF signaled the European debt crisis as the major threat for the global outlook, urging European leaders to cut interest rates further, use the European stabilization mechanism to help banks directly and give time to recover peripheral countries. With presidential elections in France, whether the new president is Francois Hollande or Nicolas Sarkozy, France might end up backing a little bit further away from Germany and try to re-focus the debate on growth-related policies. Meanwhile, in the Netherlands, on Monday the government fail to secure parliamentary support for additional budget cuts after the Party for Freedom withdrew its support to the minority government, albeit later this week an agreement to slash the Dutch budget deficit to meet eurozone targets was reached by a five-party coalition. Furthermore, several political and official leaders, notably Mario Draghi among them, have called for a "growth compact" in Europe. That Mr Draghi called for a "growth compact" on Wednesday as he sounded more concerned with the growth outlook is notable considering that he was the first to call for a "fiscal compact" before being rapidly implemented by the Eurogroup. Amid these calls for growth-oriented measures, rumours about the possibility of a European Summit in May begin to emerge.
- This may spur some optimism about possible supporting growth policies in Europe. However, according with recent comments from chancellor Merkel, Germans might lead this debate to structural reforms, which foster growth in the long run but not in the short-term.

• Good demand at European peripherals' auctions but with higher borrowing costs

- Despite the increase in financial strains, European Treasuries had good demand in this week's auctions. Most of the European Treasuries sold debt close to the maximum targets, with the exception of Germany, given that exceptionally low yields at the 30-year bond auction failed to attract investors. Even the Netherlands held a successful debt auction. However, borrowing costs in Spain and Italy rose sharply. In Spain, average yields at the 12-month bill auction jumped by 74 bp to 1.58%, while in Italy average yields surged 60pb in the 10-year bond auction. Next Thursday, investors will closely follow the Spanish bond auction after the S&P downgrade of the Spanish rating.

• Bernanke/Draghi signal QE3/SMP re-activation unlikely; policy rates are set to remain low for long

- This week, both the Fed and the ECB gave signs that they are not set to ease but also signalled that policy rates are likely to remain substantially low for long. Both Ben Bernanke and Mario Draghi were careful not to rule out additional steps if needed, but in different ways set the bar higher for further unconventional policy easing.

- ## A slightly more centrist FOMC with lower QE probability
  - Concerning the Fed, FOMC's statement contained a few wording changes compared to March which can be summarized as representing a slight upgrade in the economic assessment (eg, adding the phrase that growth is expected to "pick up gradually" after remaining moderate over coming quarters). Reinforcing this, the FOMC upgraded 2012 growth prospects, as well as 2012 and 2013 unemployment rate forecasts. The forward guidance reflected this, with some members bringing forward their expectations of a rate hike: the major change was a retreat of two participants away from a 2016 policy firming. This reveals gravitation towards the centrist view of the FOMC. That said, given ongoing risks to the outlook and persistent drags on growth (for example, US fiscal consolidation and a depressed housing sector), conditions still warrant low interest rates for a long period of time. However, given a "gradual" decline in the unemployment rate and a "pickup" in economic activity, the probability of additional large-scale asset purchases has declined (even if QE3 remains "on the table" as a policy option). Our expectation remains unchanged for a first Fed Funds rate increase in October 2014. We expect Operation Twist to end as scheduled in June.

- ## Draghi seems more concerned, but no signs of re-activation of the SMP
  - Speaking in the European Parliament on Wednesday, Mario Draghi sounded more downbeat about the economic outlook (presumably, influenced by Monday's flash April PMI release which points to the risk of spread and intensification of weakness in southern economies) and somewhat less concerned about potential inflation risks. In the Q&A, Mr Draghi called for a "growth compact", while in his address he dropped 4 April statement reference to a gradual recovery this year (the sentence ""a moderate recovery in activity is expected in the course of the year" was not repeated), and adjusted to a more concerned tone the reference on survey indicators (from "have broadly stabilised at low levels in the early months of 2012" to " [...] are mixed highlighting prevailing uncertainty". On inflation, the risk assessment was unchanged (risks are "broadly balanced") but dropped the "still seen" used in 4 April statement. Additionally, he observed that "[...] underlying price pressures should remain modest" while adding in the Q&A that , which sounds a bit more relaxed than in the last statement when the word "limited" was used. In the Q&A Mr Draghi added that he believed that inflation risks are "subdued".
  - Together, these shifts on the wording reflect the ECB is a bit more relaxed about risks of pass-through and more concerned about eurozone growth prospects. Despite this, and although Mr Draghi did not rule out further policy steps, when asked on whether to re-activate the government bond-purchasing programme (SMP) he answered that the ECB has "[...] to walk this delicate balance where we want to preserve the credibility of the ECB because it is one of the few things left now which means we have to act within the limits of the treaties". It seems clear that the ECB will not re-activate the SMP unless Spanish and/or Italian yields were to move significantly higher.
  - Next week we think Draghi's address will reflect in next week's ECB monetary policy statement: a) the inflation risk assessment is likely to remain unchanged but the wording might show that the ECB is a bit more relaxed about risks; b) the ECB will probably sound more concerned on growth; and c) Mr Draghi will signal that neither a re-activation of SMP nor the possibility of a new round of liquidity measures are likely unless conditions worsen substantially. That said if asked again he will state that any exit talk is premature.

- ## Mexico: Banxico still on hold
  - Banxico kept the overnight target rate on hold at 4.5%, as we expected. The wording of Banxico's announcement emphasizes an improvement of global and domestic activity. It also stresses the higher risks coming from an increase of financial markets volatility resulting from doubts about the Euro zone measures to tackle their debt crisis. Regarding domestic inflation, that surprised analysts to the downside, they consider that its balance of risks has not changed. All in all, Banxico stresses the evolution of international financial markets as a factor for a rate cut.
  - In our opinion, the most probable Fondeo scenario is a monetary pause with a rate hike in the middle of 2013, given our activity and inflation scenario. However, the higher uncertainty coming from Europe and, to a lower degree, an inflation that reaches the 3% target and consolidates, biases our fondeo perspective downwards (higher probability of a sooner cut than an increase).

- ## Financial tension and fiscal consolidation process are taking toll on European growth. Meanwhile economic data came in somewhat weaker in US this week, while Asia is showing signs of bottoming out
  - Soft data released this week in the Eurozone points to a further deterioration in confidence in Q2. ESI indicator in April lost 1.7 points, reaching 92.8, mainly due to weakening industrial and services sectors. At the same time, flash PMI figures suggested a deeper fall in contraction territory, with the Eurozone Composite index reaching 47.4,bb after 49.1 in March. These figures confirm that the upsurge of financial strains are weighing on confidence, arising concerns about the economic performance in the current quarter, especially regarding the weakness of foreign orders. By country, Germany is the only in expansionary territory, while French PMI fell deeper in contraction and the deterioration of the private sector activity in the periphery was even stronger. In Spain, unemployment rate increased to 24.4% in the 1Q12, 1.66 pp higher than in 4Q11, while the employment fell by 4% y/y.

- In the meantime, the UK entered into recession, with a surprise GDP contraction of -0.2% q/q in Q1, driven by the weakness of the construction and production sectors. However, soft data improved considerably in March.
- In the US, this week durable goods orders and jobless claims were somewhat disappointing but new home sales were stronger than expected in March and notably data of prior months were revised upwards significantly. On a non-seasonally adjusted basis, new home sales have climbed steadily in the first quarter, which supports our affirmation that record affordability is boosting new home sales.
- China's flash PMI (Markit) increased to 49.1% in April from 48.3% in March, signaling a pickup in momentum but still remaining below the 50 threshold. However, the improvement for the month is yet another indication that that a supportive policy stance is beginning to reverse the economy's moderating growth momentum. There are also signs of bottoming out in other Asian countries. In both Singapore and Taiwan industrial output showed a sequential improvement, while in Singapore new export orders have also edged higher. Meanwhile, albeit Korean 1Q12 GDP growth was weaker-than-expected, several leading indicators are pointing towards a gradual rebound in the economy over the second half of the year. On the other hand, Thailand posted a record trade deficit in March; yet, its recovery remains relatively on track given exports' strong rebound since bottoming out in November, and the surge in imports may signal an increase in intermediate inputs.

Main events next week: The ECB monetary policy meeting and the Spanish bond auction on Thursday, the Chinese March PMI on Wednesday, the US payroll figures on Friday and France and Greece election on Sunday.

Calendar: Indicators

Eurozone: Flash HICP inflation (April, April 30rd)

Forecast: 2.6% y/y	Consensus: 2.6% y/y	Previous: 2.7% y/y

Headline inflation is expected to ease by 0.1pp to 2.6% y/y in April driven by lower growth of energy prices, still resulting from a favorable base effect after high energy inflation observed a year ago (around 13% y/y). Regarding inflation of other components, our forecast suggests that they should remain broadly unchanged, resulting in the stabilization of core inflation at 1.9% y/y. Looking forward, recent increases in oil prices combined with the continuous depreciation of the euro and a milder slowdown in activity point to a slower moderation of headline inflation in coming months. As a result, it should remain above the ECB target during 2012, although reversing to 2% at the end of the year. Core inflation is likely to remain hovering around 1.9% y/y in coming months to moderate timidly in the second half of the year. Upside risks continue to come from geopolitical tensions related to oil prices, as well as potential tax hikes to meet fiscal targets, while the depressed domestic demand could offset partly these effects.

Eurozone: Unemployment rate (March, May 2nd)

Forecast: 10.9%	Consensus: 10.9%	Previous: 10.8%

We expect the unemployment rate to have stepped up in March to 10.9%, from 10.8% in February, and thus continuing the upward trend observed since mid-2011 and cumulating a 0.9pp increase since then. Given the employment performance tends to follow activity fluctuations with a time lag of two to four quarters, the unemployment rate is likely to increase further along 2012. In addition, confidence surveys for April also point in this direction, with firms' hiring intentions declining again in both manufacturing and service sector. Nevertheless, divergences across countries might continue to remain, with the largest increases in the unemployment rate to be recorded in countries with ongoing severe macroeconomic adjustments.

US: Personal Income and Outlays (March, April 30th)

Forecast: 0.2%, 0.4%	Consensus: 0.3%, 0.4%	Previous: 0.2%, 0.8%

Personal income and outlays are expected to increase in March at a similar rate as in February. Despite slowing improvements in the employment situation, average earnings growth is steady and suggests that personal income will follow suit. High gas prices have been driving personal spending throughout the past few months, which increased in February at the fastest rate since August 2009. In real terms, personal spending has surprised to the upside and has thus far increased at a faster pace than the 4Q11 average. However, real income levels have declined in the past two months and support recent consumer concerns regarding future income. Still, we expect that nominal income and spending will finish off the first quarter of 2012 on a positive note.

US: Nonfarm Payrolls and Unemployment Rate (April, April 4th)

Forecast: 150K, 8.2%	Consensus: 175K, 8.2%	Previous: 120K, 8.2%

Nonfarm payrolls are expected to accelerate slightly in April after the disappointing growth in March but still remain below growth rates seen earlier in the year. Recent manufacturing surveys have noted particular strength in employment, suggesting that the sector will likely give a healthy boost to private payrolls. Although initial jobless claims in April have remained below the 400K mark, they have thus far surpassed the average for March. Furthermore, mixed consumer confidence reports hint at a deteriorating outlook for employment and future income. The unemployment rate declined to 8.2% in March, primarily due to a drop in the labor force, but is expected to remain unchanged in April. However, the extremely low participation rate highlights the potential for an increasing unemployment rate throughout the coming months if more individuals enter (or re-enter) the workforce.

China: PMI for April (May 1st)

Forecast: 53.9	Consensus: 53.6	Previous: 53.1

The official manufacturing PMI prints continue to be closely watched for signs of the pace of China's economic slowdown. The reading for April will be no exception, following the weaker-than-expected Q1 GDP outturn of 8.1% y/y. This past week, a flash estimate for the private sector PMI (Markit) registered an upturn (to 49.1% from a 48.3 outturn in March), but still remains below the 50-threshold. In contrast, recent official PMI outturns have been rising, and remain above 50. We expect a slight pickup in the official PMI for April, partly due to seasonal effects, as well as a pickup in domestic demand from fiscal and monetary stimulus. A strong April outturn, if confirmed, would be evidence that growth momentum has bottomed out in Q1, adding to other positive indicators, such as strong credit growth in March.

Markets Data

				Close	Weekly change	Monthly change	Annual change
Interest rates	(changes in bps)	US	3-month Libor rate	0.47	0	0	19
			2-yr yield	0.25	-1	-9	-35
			10-yr yield	1.93	-3	-27	-135
		EMU	3-month Euribor rate	0.72	-2	-7	-67
			2-yr yield	0.10	-4	-11	-167
			10-yr yield	1.68	-3	-15	-156
Exchange rates	(changes in %)	Europe	Dollar-Euro	1.324	0.2	-0.5	-10.7
			Pound-Euro	0.82	-0.4	-2.7	-8.1
			Swiss Franc-Euro	1.20	0.0	-0.3	-6.4
		America	Argentina (peso-dollar)	4.41	0.2	1.0	8.2
			Brazil (real-dollar)	1.89	1.1	3.3	19.8
			Colombia (peso-dollar)	1762	-0.4	-0.7	-0.4
			Chile (peso-dollar)	484	-0.4	-1.0	5.1
			Mexico (peso-dollar)	13.18	0.5	3.0	14.4
			Peru (Nuevo sol-dollar)	2.64	-0.3	-1.0	-6.4
		Asia	Japan (Yen-Dollar)	80.74	-1.0	-2.5	-0.6
			Korea (KRW-Dollar)	1132.45	-0.5	-0.4	6.0
			Australia (AUD-Dollar)	1.042	0.4	0.5	-4.8
Comm.	(chg %)		Brent oil ($/b)	119.6	0.7	-3.7	-5.0
			Gold ($/ounce)	1656.0	0.8	-0.5	5.9
			Base metals	542.4	1.2	0.5	-12.5
Stock markets	(changes in %)	Euro	Ibex 35	7071	0.4	-11.4	-35.0
			EuroStoxx 50	2322	0.5	-7.0	-22.9
		America	USA (S&P 500)	1400	1.6	-0.4	2.7
			Argentina (Merval)	2271	-2.9	-15.4	-33.3
			Brazil (Bovespa)	62198	-0.5	-4.4	-5.9
			Colombia (IGBC)	15086	0.5	0.5	4.9
			Chile (IGPA)	21798	-0.7	-1.7	-4.3
			Mexico (CPI)	39212	-0.4	0.8	6.1
			Peru (General Lima)	22799	-2.0	-3.1	16.1
			Venezuela (IBC)	257652	10.8	30.3	263.9
		Asia	Nikkei225	9521	-0.4	-6.5	-3.3
			HSI	20741	-1.3	-0.7	-12.6
Credit	(changes in bps)	Ind.	Itraxx Main	143	-1	22	47
			Itraxx Xover	663	-10	71	310
		Sovereign risk	CDS Germany	86	0	15	43
			CDS Portugal	980	-87	-81	327
			CDS Spain	473	-29	50	236
			CDS USA	38	8	9	---
			CDS Emerging	256	-10	9	56
			CDS Argentina	957	-35	126	370
			CDS Brazil	124	-3	2	18
			CDS Colombia	113	-2	3	12
			CDS Chile	96	2	4	37
			CDS Mexico	121	-4	2	22
			CDS Peru	125	-2	3	-29

Source: Bloomberg and Datastream

Weekly Publications

Country	Date	Description
USA	04/26/2012	**Expectations for 1Q12 GDP Growth** Real GDP growth is expected to be slightly slower than 4Q11, at 2.4% QoQ annualized. Improving PCE and trade data point to stronger activity than previously predicted
	04/25/2012	**FED Watch: FOMC Statement: April 24-25** A slightly more centrist FOMC with lower QE probability
	04/25/2012	**Economic Watch: Common Factors in FX Volatility Term Structures** Our principal component model suggests that one factor explains 93% of EURUSD and USDJPY volatility. The data suggests the level shift factor has increased in importance *(Spanish version)*
	04/25/2012	**Economic Watch: State Activity Indexes March 2012** In March, state activity in the majority of the country was either average or above. Although growth was positive in all 50 states, it slowed in a majority of the country as 35 states decelerated
	04/26/2012	**Banking Watch: Bank Credit and Deposits: Monthly Situation Report** Total loan growth surpassed 3.0% YoY in March, suggesting that real bank credit is finally expanding. The pace is expected to strengthen, with continued support from CI and consumer lending
	04/24/2012	**U.S. Flash: New Home Sales Data Reveal Strengthening Market** Census figures released today indicated stronger than expected new homes sales in March and prior months' data were revised upward significantly
	04/23/2012	**U.S. Weekly Flash. Consumer Activity Healthy in March, Future Gains May be Limited** Retail sales beat consensus expectations in March, up 0.8% for the tenth consecutive month of gains. Auto sales surprised to the upside, increasing 0.9% despite a drop in unit sales data released in the previous week *(Chinese version) (Spanish version)*
	04/23/2012	**U.S Flash. FOMC Preview: April 24-25** The Waiting is the Hardest Part. We expect a wait-and-see attitude until a clear direction emerges in the data. FOMC to evaluate progress of new communication, release of forecasts
EMU	04/26/2012	**Europe Flash: "ESI confirms lower confidence at the beginning of Q2"** After the improvement observed during Q1, economic confidence as reflected in the ESI indicator declined in April, was in line with disappointing PMI data released earlier this week.
	04/24/2012	**Portugal Economic Watch: "Outlook for Portugal still dull, but somewhat improved"** Confidence remains very weak, though it is improving
	04/24/2012	**Europe Flash: "April's PMI worse than expected, raising doubts about foreign demand support"** Flash PMI figures for Eurozone came in worse than expected, as reflected in a deeper fall in contraction of all indices, affected by the upsurge of financial strains.
Spain	04/26/2012	**Flash España: "Confianza industrial y del consumidor en abril"** Los datos cualitativos observados en abril continúan evidenciando la debilidad de la actividad económica.
	04/25/2012	**Flash España: "Ejecución presupuestaria del Estado a marzo 2012"** El déficit acumulado por el Estado hasta marzo de 2012 se elevó al 1,9% del PIB, 0,7pp más que hace un año.
	04/24/2012	**Flash España: "Hipotecas sobre vivienda febrero 2012"** La firma de hipotecas volvió a contraerse en el mes de febrero de manera importante al firmarse 26.415 préstamos hipotecarios sobre vivienda.
	04/23/2012	**Observatorio Económico Regulación y Sistemas Financieros: "Recorrido de mejora en las provisiones dinámicas: el ejemplo español"** En el debate regulatorio internacional, el capital ya está incorporado en la regulación internacional como herramienta contracíclica.

Mexico

04/25/2012 **Mexico Flash: o change in fondeo rate. We expect a more dovish statement that will open the door to a rate cut**
The recent inflation figures support the stance of the majority of the Board members that regard a rate cut as advisable *(Spanish version)*

04/24/2012 **Mexico Inflation Flash: April's biweekly inflation**
Volatile prices produce a new downwards surprise that lowers inflation to 3.4%. General: Actual: -0.42% f/f vs. BBVA:-0.08% Consensus:-0.07%. Core: Actual: 0.03% f/f, vs. BBVA:0.03% Consensus:0.09% *(Spanish version).*

04/23/2012 **Banking Flash Mexico: Bank savings: double-digit growth continues**
In February 2012 the annual nominal growth rate of traditional bank savings (demand fixed term) was 10%. This rate was lower than for the preceding month (12.4%) and for the same month of 2011 (12.2%) *(Spanish version).*

Asia

04/26/2012 **Daily Flash | Asia | 26 April 2012: Is South Korea on the verge of a rebound?; China: more signs of tightening in the property sector; Singapore's IP declines; Thailand posts trade deficit**
Korea's first quarter GDP growth showed a pickup sequentially, though going forward the outlook remains challenging.

04/23/2012 **RMB Internationalization: What is in for Taiwan?**
Along with the steady pace of RMB internationalization, this paper proposes Taiwan as a potential candidate to become the next RMB offshore center.
Author(s): Alicia García-Herrero, Yingyi Tsai and Xia Le
Number: 12/06
Keywords: RMB Internationalization, Offshore RMB market.
JEL Code: F33, F36, F42.
Abstract

04/23/2012 **Working Paper 12/04: "Trade in services: East Asian and Latin American Experiences"**
This paper investigates the trend and characteristics of trade in services in two fertile regions where different forms of trade integration have taken place: East Asia and Latin America.
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Number: 12/04
Keywords: Service trade, East Asia, Latin America, foreign direct investment.
JEL Code: F14, F15, O53, O54, O57.
Abstract

04/23/2012 **Daily Flash | Asia | 23 April 2012: China's flash PMI rises in April; Time to begin focusing on Myanmar?; Inflation stays high in Singapore and Hong Kong**
The release of China's flash private sector (Markit) PMI today provided further evidence that growth momentum is gradually picking up after bottoming out in Q1.

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