

# Global Weekly Flash

## EU summit surprises a bit on the positive side (for a change); markets respond

**Expectations for the EU summit were low. Short-term measures to bring down financing costs of countries under pressure were not expected. It was assumed that only a roadmap for the eurozone in the long-term (banking and fiscal union) was going to be traced. But up to now, with the second day of the summit still ahead, proposals are already above expectations and therefore are comforting markets.**

- An official statement following the first day of the Summit (click here for details) includes proposals that are likely to have an immediate on financial markets: 1) the ESM could recapitalize banks directly, when an effective single supervisory mechanism is established (expected by the end of 2012 and "involving the ECB"). This would rely on appropriate conditionality (institution specific, sector specific or economy-wide through a MoU; 2) for the case of the financial assistance to Spain, provided by the EFSF until the ESM becomes available, the ESM will not gain the seniority status; 3) commitment to use the existing EFSF/ESM in a flexible and efficient manner to stabilise markets. The conditionality attached to this will be reflected in a MoU but does not go beyond of ensuring the commitments included in the SGP and European semester. The Eurogroup will implement these decisions by 9 July 2012. The intervention of the EFSF/ESM is expected to be ready in summer. Regarding the roadmap for the eurozone in the long-term (banking and fiscal union), the concrete proposal will be presented in October 20.
- Our assessment is, on the positive side: a) the agreement on a single supervisory is welcome as it will be implemented relatively quickly and helps to reduce doubts on the European banking system; b) direct bank recapitalization by the ESM is a positive surprise and it will help break sovereign-banking vicious circle. It will apply to Spain and probably Ireland once common supervision is established; c) withdrawal of ESM preferred status for recapitalization plan. However it seems to apply only to Spain; d) the conditions attached to flexible EFSF/ESM intervention, that probably will be focused on the primary market, do not seem to go beyond ensuring current targets. On the negative side: a) the funds of EFSF/ESM remain unchanged (and therefore limited). No banking license has been given to the ESM; and b) it is now clear that conditionality attached to bank recapitalization can be applied not only to specific banks or the whole sector, but also to the whole economy.
- Unease ahead of the EU summit on the possibility that European policymakers would again come short of a solution to tackle the crisis hit peripherals' borrowing costs during the week. Spain had to paid steeply higher interest rates in its short-term debt auction (eg, 2.362% from 0.846% on May 22 for 3m bills) while Italy also had to sharply increase the interest paid on 6m bills (to 2.957% from 2.104% on May 29). The downgrade by Moody's of the rating of 28 Spanish banks did not help either as spreads of Spanish and Italian bonds were rising again this week following last week's decline. However, EU summit proposals' marked a turning point in this week's dynamics, bringing relief to markets. Risk premiums are narrowing sharply. Spanish 10y and 2y spreads are falling 45bp and 86bp to 489bp and 429 bp, respectively, while Italian spreads are also declining markedly (-37bp and -62bp to 428bp and 348bp, respectively). The risk-on mood is pushing up safe haven yields 10y German Bunds and US Treasuries are up 11bp and 6bp to 1.62% and 1.64%, respectively. The US dollar index is falling around 1.0%, also reflecting market optimism. The euro is up 1.2% to 1.259.

### • ECB meeting preview: any help is better than none at all

- Following last Friday's easing in the collateral rules, the ECB is likely to cut the refi rate by 25bp next week and to bring the deposit facility rate to zero. On 22 June the ECB announced a relaxation of collateral rules (ie, increased collateral availability for banks to improve their access to ECB's refinancing operations) reflecting the Governing Council's concerns on the potential lack of collateral availability for some banks in the case of further downgrades, both on sovereigns and banks, as highlighted by Benoit Coeure in a recent interview with the FT: "...the collateral buffer – which is very substantial at the aggregate level in the euro area – has become more strained in some places."

- Taking into account the latest weak data, the ECB's officials' dovish rhetoric (highlighting that the 1.0% level might not be a floor to policy rates and that there is no risk on the inflation side), and lending data (lending to households remained flat in June), we now expect the ECB to cut the refi cut by 25bp to 0.75% (and the deposit facility rate to 0.0%) at its July meeting. The rate cut would come as no surprise and although the impact is likely to be small (the credit channel of monetary policy is not functioning properly), the signalling effect could be positive, and this adds to the recent actions and dovish tone from other major central banks. The aim is to reduce bank's funding costs at the ECB operations for banks (especially the peripheral ones that at present rely much more on the ECB liquidity). However, the main challenge remains on the normal functioning of the interbank market.
- We still think that a resumption/new round of SMP bond-buying/very long LTRO is unlikely as the ECB wants governments to "fill the gap" and believes that it would not be right to fill "for other institutions' lack of action". Only if/when meaningful progress towards a European fiscal and banking union is achieved, ECB's willingness to take additional non-standard measures might increase. Regarding SMP, as previous bond-buying has not proved persistently effective (ie, as risk-premiums have tended to return to excessive levels shortly after the ECB has bought sovereign bonds), and given that "it is not an instrument that can be used to fix fiscal difficulties or to help insolvent banks", a resumption still seems unlikely but less so following the proposals of the EU summit. The most likely scenario is for the EFSF/ESM to intervene to reduce financial strains in some peripheral bond markets. However, we cannot discard the possibility of the ECB reinforcing any EFSF/ESM action, if the ECB were to judge that the effects on such buying are going to be permanent this time. The attached conditionality for any intervention reflected in a MoU could give the ECB the alibi to buy bonds in the secondary market.

- **Mixed but positively received US data along with China stimulus speculation slightly reduced concerns about global growth and thus, also contributed to lift sentiment a bit. Eurozone data continues to point to weakness**

- In the US, strong housing related data boosted hopes that the housing sector is bottoming-out. S&P Case-Shiller's house price index showed that prices increased for the third-month in a row in a seasonally adjusted basis. The 0.7% monthly rise was above consensus estimates of a 0.4% increase. New home sales rose to the highest annual rate since April 2010 in May (to 369K). Also, the US Pending Home Sales Index (a leading indicator of existing home sales) reverted April's decline and rose 5.9% mom in May (above consensus forecasts), pointing to a further stabilization in demand.
- US data outside the housing sector were not as strong. Durable goods orders rebounded in May (1.1% increase vs. consensus of 0.5%) while capital goods orders increased 1.6% mom. The weak soft consumer data was dismissed (June's consumer confidence at 62.0, below expectations of 64.0 and from a downwardly revised 64.4 in May) as markets gave more importance to the positive signals from the housing sector. The third estimate of Q1 GDP was unchanged at 1.9% q/q (saar), confirming that the economy did slow down in Q1.
- Meanwhile, the latest China's leading indicators showing that the slowdown may be on the process of bottoming out, together with persistent rumors that China may announce additional initiatives to bolster its economy increased hopes that the growth slowdown will not deepen. All in all, hopes on a possible bottoming-out of the recent slowdown in both the US and China lifted sentiment. As concerns about global growth lessen during this week, risky currencies were rebounding a little more. Gains were rising after EU summit proposals surprised markets on the positive side. Yet, a significant reversion of Q2's weakness still seems unlikely as European problems are not going to be solved quickly and concerns about a global slowdown will likely linger for longer.
- The EC Business and Consumer Survey for June declined by 0.6pp to 89.9, the third consecutive monthly decline. Germany's unemployment rate remained stable at 6.8% in June, from the upwardly revised reading for May. Unemployment remained stable over H112. With the latest data, which includes consumers as well as industry and service confidence, our MICA-BBVA model now points to a -0.2% q/q GDP decline in Q2I, a 0.1pp larger contraction than previously estimated.

**Key events next week:** attention will remain in Europe with ECB's July meeting (expectations of a rate cut increased further today after following the advances from the EU summit), the Spanish auctions of 2y, 3y and 5y bonds and the meeting between Mario Monti and Angela Merkel in Rome on Wednesday. Later in the week the focus will shift to the US with the release of June's job creation numbers on Friday.

# Calendar: Indicators

## Eurozone: Unemployment rate (May, July 2nd)

Forecast: 11.1%	Consensus: 11.1%	Previous: 11.0%
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We expect the unemployment rate to have stepped up in May to 11.1%, from 11% in April, thus continuing the upward trend observed since mid-2011 and cumulating a 1.1pp 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 suggest that activity is contracting again in Q2, the unemployment rate is likely to increase slightly further along 2012. Confidence surveys for June also point in this direction, with firms' hiring intentions declining further at a significant pace. Across countries, the worsening in employment expectations also was widespread, although the labour market in Germany remains resilient.

## Eurozone: Retail sales (May, July 4th)

Forecast: 0.4% m/m	Consensus: 0.3% m/m	Previous: -1.2% m/m
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Retail sales are expected to have increased slightly in May, but not enough to offset the significant fall registered in April. As a result, the April-May average sales level could have declined by around -0.8% over the Q1 when they remained virtually flat. Consumers' confidence also declined further in June, stemming from the increasing unemployment rate and renewed strains in the eurozone. These figures point to a more downbeat outlook for the current and coming quarters than anticipated previously. In particular, private consumption is likely to contract again in Q2, after flattering in the previous quarter, and thus failing to substitute foreign demand as a driver of economic activity.

## US: ISM Manufacturing Index (June, July 2nd)

Forecast: 53.0	Consensus: 52.0	Previous: 53.5
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The ISM Manufacturing Index is expected to decline slightly in June but remain above 50 to indicate continued economic expansion in the sector. In May, the index dropped on account of weaker production and employment components, however, new orders increased to the highest level since April 2011. Slowing inventories combined with rising new orders suggest the need for future inventory build and production, which will likely keep the index in expansionary territory. However, other manufacturing reports for June were mixed, and new export orders are likely to continue slowing on account of weakening demand from Europe and China.

## US: Nonfarm Payrolls and Unemployment Rate (June, July 6th)

Forecast: 90K, 8.2%	Consensus: 96K, 8.2%	Previous: 69K, 8.2%
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The June employment report is expected to show little improvement over May given that economic activity has remained relatively weak. On average, initial jobless claims have approached 385K in June, the highest monthly average since November 2011 and up from 376K in May. In addition, consumer confidence reports for the month suggest more pessimistic attitudes toward improvements in business conditions, job availability, and income in the next six months. On a positive note, most employment indices from various manufacturing surveys indicate an increase in the sector's number of employees for June, which should give some lift to total payrolls.

## Korea: CPI (June, July 2nd)

Forecast: 2.5%	Consensus: 2.5%	Previous: 2.5%
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In recent months Korea's inflation has slowed sharply and now lies towards the bottom of policymakers' target range of 2%-4%. Along with the decline in inflation, recent activity indicators have been weakening, especially in trade, as Korea has been one of Asia's economies most affected by the global slowdown. The Bank of Korea has been reluctant to ease policy rates thus far given still-high inflation expectations (3.7% in May) and tight labor markets (unemployment: 3.2%). However, given that both growth and inflation are likely to remain subdued in the coming months, we expect authorities will cut rates at least once before the end of the year in order to support the economy.

# Markets Data

			Close	Weekly change	Monthly change	Annual change
Interest rates (changes in bps)	US	3-month Libor rate	0.46	0	-1	21
		2-yr yield	0.31	1	4	-16
		10-yr yield	1.64	-4	1	-155
	EMU	3-month Euribor rate	0.65	0	-2	-90
		2-yr yield	0.14	0	13	-151
		10-yr yield	1.62	4	35	-141
	Europe	Dollar-Euro	1.259	0.1	1.8	-13.3
		Pound-Euro	0.81	0.0	0.9	-10.8
		Swiss Franc-Euro	1.20	0.1	0.1	-2.4
Exchange rates (changes in %)	America	Argentina (peso-dollar)	4.52	0.3	1.2	10.0
		Brazil (real-dollar)	2.08	0.5	3.1	33.5
		Colombia (peso-dollar)	1807	0.9	-1.1	2.5
		Chile (peso-dollar)	509	1.3	-1.6	9.5
		Mexico (peso-dollar)	13.42	-3.2	-5.1	15.6
		Peru (Nuevo sol-dollar)	2.66	0.5	-1.5	-3.0
	Asia	Japan (Yen-Dollar)	79.49	-1.2	0.5	-1.7
		Korea (KRW-Dollar)	1145.40	-1.0	-2.6	7.4
		Australia (AUD-Dollar)	1.019	1.3	5.0	-5.4
Comm. (chg %)		Brent oil (\$/b)	94.2	3.5	-9.0	-15.7
		Gold (\$/ounce)	1579.6	0.5	1.0	6.2
		Base metals	499.5	-1.9	-2.8	-16.8
Stock markets (changes in %)	Euro	Ibex 35	6906	0.4	13.4	-34.2
		EuroStoxx 50	2218	1.4	4.8	-22.9
	America	USA (S&P 500)	1329	-0.4	1.2	-0.8
		Argentina (Merval)	2268	-3.1	0.1	-33.2
		Brazil (Bovespa)	52652	-5.0	-2.1	-16.9
		Colombia (IGBC)	13213	-1.7	-8.2	-6.1
		Chile (IGPA)	20821	-0.4	1.0	-8.3
		Mexico (CPI)	39638	1.4	4.1	7.7
		Peru (General Lima)	20207	-1.5	-3.2	5.2
		Venezuela (IBC)	250723	-0.4	5.1	211.5
	Asia	Nikkei225	9007	2.4	4.3	-8.7
		HSI	19441	2.3	4.0	-13.2
Credit (changes in bps)	Ind.	Itraxx Main	178	8	0	74
		Itraxx Xover	702	21	-18	318
		CDS Germany	104	5	2	62
	Sovereign risk	CDS Portugal	823	4	-343	87
		CDS Spain	590	26	2	322
		CDS USA	49	0	1	---
		CDS Emerging	305	14	-24	101
		CDS Argentina	1303	5	-121	724
		CDS Brazil	164	13	0	56
		CDS Colombia	151	10	-4	44
		CDS Chile	123	6	2	49
		CDS Mexico	147	5	-7	39
		CDS Peru	169	13	3	37

Source: Bloomberg and Datastream

# Weekly Publications

Country	Date	Description
USA	06/28/2012	➤ <b>U.S. Economic Watch. Real Profits Rise by Leaps &amp; Bounds</b> Will Slowing Productivity Pose a Problem for Future Growth?
	06/28/2012	➤ <b>U.S. GDP Flash. 1Q12 Real GDP Growth Stands at 1.9%</b> The final estimate for 1Q12 real GDP growth was unchanged at 1.9%. Upward revisions to nonresidential fixed investment and net exports offset downward revisions to consumption and inventory investment
	06/26/2012	➤ <b>U.S. Economic Watch. State Activity Indexes May 2012</b> Excluding Wyoming and Kansas, the activity indexes of states in the West realized exceptional expansion in May ( <a href="#">Spanish version</a> )
	06/25/2012	➤ <b>U.S. Weekly Flash. FOMC Maintains a Highly Accommodative Stance</b> As expected, the pace of reduction in the unemployment rate is progressing insufficiently quickly for the FOMC and they extended Operation Twist until the end of the year by \$267bn ( <a href="#">Spanish version</a> )
EMU	06/26/2012	➤ <b>Cuatro citas y una solución para el euro</b> En estas dos semanas se han concentrado cuatro citas importantísimas que pueden, y deben, cambiar el presente y el futuro de la eurozona
	06/25/2012	➤ <b>Europe Economic Watch: "A Solution to the Euro Debt Crisis: Back from the Future"</b> The Eurozone is living the most crucial time since its establishment
Spain	06/28/2012	➤ <b>Flash España: "Confianza industrial y del consumidor en junio"</b> Los datos cualitativos de junio muestran señales mixtas: mientras que la confianza industrial retrocedió significativamente, la de los consumidores repuntó pese al incremento de la incertidumbre
	06/28/2012	➤ <b>Flash España: "Avance del IPC de junio"</b> El indicador adelantado del IPC confirma la estabilización esperada del crecimiento de los precios al consumo durante el mes de junio
	06/28/2012	➤ <b>Flash España: "Visados de construcción de vivienda de obra nueva abril 2012"</b> Durante el mes de abril se firmaron 3.801 visados de vivienda de obra nueva, lo que supone una reducción del 6,7% m/m tras corregir la serie de variaciones estacionales y efectos de calendario (cvec)
	06/27/2012	➤ <b>Flash España: "Ventas reales del comercio al por menor de mayo: ligeramente mejores de lo esperado"</b> Una vez corregidas las variaciones estacionales propias del mes, las ventas reales del comercio minorista aumentaron un 1,4% en mayo, más de lo esperado
	06/27/2012	➤ <b>Flash España: "Ejecución presupuestaria del Estado a mayo 2012"</b> El déficit acumulado por el Estado hasta mayo de 2012 se ha situado ya en 3,4% del PIB, tan sólo una décima del PIB por debajo del objetivo fijado para final de año (-3,5%)
	06/27/2012	➤ <b>The Spanish economy and the European crisis</b> Overview of the European crisis and the current Spanish economic situation and challenges
Latin America		
Brazil	06/28/2012	➤ <b>Brazil Flash: "CB now expects lower growth and higher inflation".</b> According to the Q2 12 Inflation Report released today, the Central Bank reduced its GDP forecast for 2012 to 2.5% from 3.5%.
Peru	06/28/2012	➤ <b>Observatorio Económico Perú. Sector eléctrico peruano: ¿Riesgos de corto plazo?</b> Entre 2012 y 2016 se añadirán 3,500 MW de potencial al sistema eléctrico peruano. Esta nueva potencia será suficiente para cubrir la demanda adicional por 2,000 MW que estimamos hasta esa fecha
	06/25/2012	➤ <b>Gobierno lanzó un nuevo paquete de medidas fiscales</b> El estímulo adicional es equivalente a 0,4% del PIB e incluye medidas para facilitar las exportaciones, extender créditos y garantías a las microempresas, y ampliar los programas de asistencia social



## Mexico

- 06/28/2012 ➤ **Mexico Migration Flash. In May remittance inflow to Mexico may have reached its highest level for almost four years**  
On July 2nd, Banco de México will release figures on remittance inflow for the month of May. We estimate that remittances to Mexico in May could have exceeded the 2.3 billion dollars (Spanish version)
- 06/27/2012 ➤ **Flash Bancario México. Captación bancaria: ligera desaceleración de su crecimiento**  
En abril 2012 la tasa de crecimiento nominal anual de la captación bancaria tradicional (vista + plazo) fue 9.3%. Esta tasa fue menor a la del mes anterior (10.8%) y a la del mismo mes de 2011 (14%)
- 06/27/2012 ➤ **Mexico Migration Flash. Possible effects of Arizona immigration law: Some leave and others get citizenship**  
Unlike other major groups of immigrants in Arizona, the number of Mexican immigrants has decreased. Over the last 4 years, the number of Mexican immigrants in Arizona has fallen by 100 thousand (Spanish version)
- 06/25/2012 ➤ **Mexico Banking Flash. Lending to the private sector: positive double-digit growth**  
April 2012 was the 25th consecutive month (over 2 years) of positive annual growth in lending to the private sector by commercial banks (Spanish version)
- 06/25/2012 ➤ **Mexico Migration Flash. Immigrants rejuvenate the United States**  
The native US population is aging. By 2030, around 25% of the US total population will be aged 60 or over (Spanish version)
- 06/25/2012 ➤ **Turismo en México: ante el reto de un mayor dinamismo**  
La actividad turística en México muestra buenos resultados en los primeros meses de 2012, se fortalecen las expectativas positivas, sobre todo por el mayor dinamismo reciente

## Asia

- 06/28/2012 ➤ **Asia Daily Flash | 28 June 2012: Korea cuts 2012 GDP forecast, announces stimulus; Thailand's May IP increases**  
Politicians are taking center stage at the end of the week as European leaders began two days of summit meetings today. In Hong Kong preparations continue before President Hu Jintao's arrival tomorrow
- 06/27/2012 ➤ **Asia Daily Flash | 27 June 2012: China unveils the outline of Hong Kong's anniversary reform package; The change at India's finance ministry spurs hopes of renewed push for reform**  
European leaders are set to meet tomorrow for a two-day summit. Despite fading expectations that concrete actions will be taken at the summit, stock markets in Asia showed moderate gains today
- 06/26/2012 ➤ **Asia Daily Flash | 26 June 2012: India's measures to revive the rupee fall short of expectations; Japan's lower house passes consumption tax bill; Hong Kong exports surprise to the upside**  
The RBI announced new measures to boost economic growth and support the rupee yesterday, but they failed to match market expectations.
- 06/25/2012 ➤ **Asia Daily Flash | 25 June 2012: India prepares new reforms; Details on Indonesia's plans for domestic bank stakes**  
Over the weekend, India's finance minister noted that the government is likely to announce measures shortly in order to boost the country's economic growth as well as support the weakened rupee

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Sonsoles Castillo  
s.castillo@bbva.com  
+34 91 374 44 32

María Martínez Álvarez  
maria.martinez.alvarez@bbva.com  
+34 91 537 66 83

Cristina Varela Donoso  
cvarela@bbva.com  
+34 91 537 7825

Felipe Insunza Groba  
felipe.insunza@bbva.com  
+34 91 537 76 80

Javier Amador Díaz  
javier.amadord@bbva.com  
+34 91 374 31 61

### Indicators collaboration

Europe  
Agustín García Serrador  
agustin.garcia@grupobbva.com  
+34 91 374 79 38

US  
Kim Fraser  
Kim.Fraser@bbvacompass.com  
+1 713 881 0655

Asia  
Jeffrey Cantwell  
jeffrey.cantwell@bbva.com.hk  
+852 2582 3173

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