

Global Weekly Flash

Waiting for Draghi: a lot of hope is priced in

- **Stronger data, less chance of QE3**

- The wait for Bernanke's speech at Jackson Hole will end later today. The question is whether Bernanke will offer any hints on the likelihood of QE3, particularly after saying that there is "scope for further action" from the Fed. However, although there is increasing uncertainty regarding the sustainability of the recovery, supportive US data is reducing expectations of imminent QE3. Moreover, the latest FOMC minutes show that internal debate remains intense and do not signal for additional quantitative easing but rather a change in policy guidance in September. There is not enough evidence of weakness in data to sway the opposition. The Fed has used the Jackson Hole meeting to pre-announce its previous two rounds of QE, but this time we do not believe that Bernanke will send a clear signal of the possibility of QE3 for the September meeting.

- **Whatever happens at Jackson Hole, what really matters is what the ECB is about to announce...**

- This time, the focus is on the ECB meeting to be held next Thursday. Mario Draghi's speech in late July sparked a risk rally and since then, all attention has been paid on the form that the new ECB bond buying programme will take. Given that a lot of hope is priced in, the ECB may disappoint. Yet, the ECB is likely to back Mario Draghi's pledge to do "whatever it takes to save the euro". Notwithstanding that expectations have been running high and that a lack of detail may increase uncertainty, not all that has been hoped for is likely to be announced.

- **An agreement on ECB intervention should be expected, but ambiguous enough to get the needed backing**

- The details could somewhat disappoint considering Weidman's strong opposition to the plan and differing views among Governing Council members on some operational details mainly on: a) how the ECB can enforce conditionality; b) whether there should be a target announced on yield spreads or caps; and c) how to estimate "convertibility" risk premia.

- **What do we expect next week? (i) the ECB will only act after countries' official request for aid to the rescue funds, (ii) Explicit targets for yields or spreads will not be released; (iii) purchases will only take place in the short-end of the curve and in the secondary market; (iv) a neutral wording that allows for flexibility is likely; and (v) no preferred creditor status for the ECB**

- The main restriction for the ECB is the prohibition of monetary state financing as stated in the Treaty. In our view, strong fiscal conditionality is essential. Accordingly, the ECB will only act after countries request for aid to the rescue funds, the EFSF/ESM approves the corresponding programme and the instrument for intervention and, finally, the country commits to the required conditionality.
- The potential negative consequences to setting a specific and public target for yields or spreads are likely to dominate at this stage. An explicit cap will be seen as weakening the pressure on governments towards reform; ECB's conclusion is that "when you take away the market pressure, you take away the pressure on politicians to act". Moreover, it would be difficult to agree on a target given that it is difficult to calculate the "convertibility risk" now present in current spreads. Besides, if the cap is set too high, the plan of attracting private demand back to Spanish and Italian bonds might not work, whereas if it is set too low, it could be difficult for the ECB to guarantee it unless there is a pledge to unlimited intervention.
- And we expect the ECB to refrain from signaling "unlimited" purchases (which might be judged as closer to monetary financing) but will stop indicating that bond purchases are "neither eternal nor infinite". Accordingly, the wording will likely be neutral to give flexibility to the ECB to act forcefully when judged appropriate eg, "[...] of a size adequate to reach its objectives". Finally, to reduce fears that investors will continue to be subordinated debtors, the ECB will carefully weigh whether to announce that it waives its status as preferred creditor; but such an announcement might be seen as premature until the request for financial aid is filed.

- The ECB is also likely to give details of its review to its collateral framework. The ECB could take further steps to accept more assets as collateral and could drop rating eligibility for sovereigns that are engaged in an EFSF/ESM programme. Finally, we do not expect a refi rate cut to 0.5% but there might be a hint of one forthcoming as the economy is weakening ie, the need of more expansionary policy is rising.
- In this context, Spanish financial tensions have increased slightly since the last week, as the 10Y bond yield has increased around 20bps to 6.6% while European equity markets have remained almost flat over the week.
- This week markets were focused on the results of Italy's and Spain's sovereign auctions, where costs decreased and demand improved. Spain managed to sell EUR3bn in 3M and 6M T-bills, reaching its issuance target and decreasing the average yield from the previous auction, 3M 0.946% from 2.43% and 6M 2.17% from 3.69%. Also, Italy sold EUR3bn of zero-coupon 2014 debt to yield 3.064%, down from 4.86% at the previous auction. Besides, the Italian government sold EUR4bn in 10-year bonds and EUR2.5bn in 5-year bonds auction at an average yield of 5.82% and 4.73% respectively, improving from previous auction (5.96% and 5.29%). Bidders increased from last auction, being the bid to cover ratio 1.42x compared with 1.28x previous and 1.46x from 1.34x, respectively. Yields of these auctions, mainly in the short term part of the curves, plunged on expectations on ECB intervention in debt markets. Next week the Spanish Tesoro will also have another market's test selling 2 and 3-year bonds.

- **Data from Germany continued showing weakness while data from US were somewhat positive as the US economy slowed less than expected in the 2Q12**

- In the Eurozone, there were not many news this week. In Germany, the IFO Business Climate Index for industry and trade fell again in August. Companies' assessments of the current business situation fell further to 102.3 after last month's sharp downturn. (BBVA: 102.5, Consensus: 102.6). Business expectations also disappointed and dropped to 94.2 (BBVA: 95.4, Consensus: 95.3). The current business situation deteriorated slightly to 111.2 (BBVA, Consensus: 111.0), but companies expressed greater pessimism regarding future business developments. This IFO report, along with last week's PMI release, indicates increasing downside risks to growth. In the Eurozone, in August the Economic Sentiment Indicator (ESI) decreased markedly by 1.8 points to 86.1 (BBVA: 87.6, Consensus: 87.5). The loss in confidence was particularly strong among consumers, retail trade and construction managers, and in the services sector the loss in confidence was also marked. On the contrary, confidence in industry remained broadly stable. A majority of Member States witnessed a drop in economic sentiment.
- In the US macro data came from the positive side, however consumer confidence remains subdued. The U.S. economy expanded more than previously estimated in the second quarter, reflecting improvements in the underlying data mostly reflected upward revisions to personal consumption expenditures (PCE) and net exports. The second estimate for real GDP growth in 2Q12 came in at 1.7% on a QoQ seasonally-adjusted annualized basis, slightly higher than the initial figure of 1.5% released last month. Overall, the revised data are mostly positive and keep us on track to reach our baseline scenario of 2.1% growth for the year, even with the slowing momentum in 2H12. Moreover, home prices in 20 U.S. cities climbed in July from a year earlier, the first gain in almost two years. The S&P/Case-Shiller index of property values in 20 cities increased 0.5% from June 2011, the first gain since September 2010. Additionally, the consumer spending climbed in July for the first time in three months. Purchases increased 0.4% after being little changed in June (0.0%). Meanwhile, consumer confidence fell in August by the most in 10 months. The Conference Board's index decreased to 60.6 from a revised 65.4 in July, the 4.8-point decrease was the biggest since October.
- In Brazil, the SELIC rate was cut by 50bps to 7.50%, in line with expectations. The tone of the communiqué was more hawkish than expected, which reinforces the claim that the monetary easing cycle will end soon. We now expect a final 25bps cut –and not a 50bps anymore- to be announced in October.

Next week: Investors will keep interest on ECB meeting. In the Eurozone, GDP figures for 2Q and PMI indexes will be published. In China, the focus will be on the release of the HSBC manufacturing PMI. In the US, the ISM Manufacturing Index, nonfarm payrolls and unemployment rate will be published.

Calendar: Indicators

Eurozone: Retail sales (July, September 5th)

Forecast: -0.6% m/m

Consensus: -0.2% m/m

Previous: 0.2% m/m

Retail sales are expected to have declined in July, as the steady deterioration in the labour market combined with the intensification of the European crisis weigh significantly on consumers' confidence. This implies that the downward trend in sales continue, suggesting that private consumption is likely to contract again in Q3, in line with our macro scenario. Nevertheless, we think that divergence in households' spending performance will remain across member states in coming quarters, falling sharply in the periphery (linked to fiscal adjustments and households deleveraging) and supporting economic growth in core countries.

Eurozone: GDP (Q2-12, September 6th)

Forecast: -0.2% q/q

Consensus: -0.2% q/q

Previous: 0.0% q/q

Eurostat is expected to confirm that the eurozone GDP dropped by -0.2% q/q in Q2, slightly smaller than our central estimate (-0.3% q/q), while the main novelty will be the release of the figures on demand composition of growth. Our models suggest that domestic demand would have continued to be the leading drag on the economy, draining 0.3pp to quarterly growth, as both private (consumption and investment) and public spending would have contracted again driven by harsh adjustments in the periphery and the collapse of confidence stemming from the upsurge of the European crisis. However, the latter would be offset by a small positive contribution from the external sector (+0.1pp), despite the slowdown in global demand reflected in lower export growth. The limited data published for the current quarter, mainly from confidence surveys, are discouraging, as they point that GDP fall could be even larger than in Q2.

US: ISM Manufacturing Index (August, September 4th)

Forecast: 49.9

Consensus: 50.0

Previous: 49.8

According to the ISM Index, manufacturing activity is the weakest in nearly three years, having contracted for two consecutive months. For August, we expect that the index will confirm the slowing trends as highlighted in various Federal Reserve surveys for the month. In fact, most major regional Fed manufacturing reports have shown decelerating rates of activity, with continued weakness in new orders. Surprisingly, manufacturing output has remained positive despite indications of falling demand. Employment has fared relatively well in the manufacturing sector, although increasing demand uncertainties could limit the sector's hiring in the coming months.

US: Nonfarm Payrolls and Unemployment rate (August, September 7th)

Forecast: 130K, 8.3%

Consensus: 120K, 8.2%

Previous: 163K, 8.3%

The employment situation has been mixed to start the third quarter. In July, nonfarm payrolls increased significantly compared to growth rates seen in the previous months, but the unemployment rate ticked back up to 8.3%. In August, we expect that payrolls will increase at a slightly slower pace than in July, given that the monthly average for initial jobless claims is slightly higher for this month. Still, we expect that average job growth in 3Q12 should be higher than in 2Q12. However, it is unlikely that nonfarm payroll gains will be strong enough to bring down the unemployment rate, unless we also see another drop in the participation rate and shift in labor force flows.

China: PMI (August, September 1st)

Forecast: 49.6

Consensus: 50.0

Previous: 50.10

In contrast to previous expectations, we expect growth momentum to show a further slowdown in August. The flash estimate for the private sector PMI (Markit) was disappointing in August, registering a significant decline to 47.8% from 49.5% the previous month as production and new orders weakened. We expect the official manufacturing PMI (which has a greater composition of larger, domestic-oriented firms) to fall below the 50% expansion-contraction threshold for the first time since November 2011. We expect further policy easing during the remainder of the year to support growth in line with our full-year 7.8% GDP growth projection, including stepped up infrastructure spending and further cuts in the RRR and interest rates. Upcoming monthly data on retail sales, investment, and industrial production due to be released on September 9 will be key to assessing the pace of current growth momentum.

Markets Data

			Close	Weekly change	Monthly change	Annual change
Interest rates (changes in bps)	US	3-month Libor rate	0.42	-1	-2	9
		2-yr yield	0.24	-3	2	5
		10-yr yield	1.62	-6	10	-36
	EMU	3-month Euribor rate	0.28	-2	-10	-126
		2-yr yield	-0.02	-1	6	-54
		10-yr yield	1.37	1	0	-64
Exchange rates (changes in %)	Europe	Dollar-Euro	1.261	0.8	3.1	-11.2
		Pound-Euro	0.79	0.4	1.0	-9.3
		Swiss Franc-Euro	1.20	0.0	-0.1	7.2
	America	Argentina (peso-dollar)	4.63	0.1	1.1	10.2
		Brazil (real-dollar)	2.04	0.7	-0.2	24.4
		Colombia (peso-dollar)	1823	0.5	2.0	2.3
		Chile (peso-dollar)	481	-0.1	-0.6	4.4
		Mexico (peso-dollar)	13.31	1.0	-0.6	7.3
		Peru (Nuevo sol-dollar)	2.61	-0.2	-0.5	-4.3
	Asia	Japan (Yen-Dollar)	78.38	-0.4	-0.1	2.1
		Korea (KRW-Dollar)	1134.63	0.0	0.7	6.7
		Australia (AUD-Dollar)	1.032	-0.8	-1.3	-3.0
Comm. (chg %)		Brent oil (\$/b)	113.8	0.2	7.4	1.3
		Gold (\$/ounce)	1661.7	-0.5	3.9	-11.7
		Base metals	516.9	-0.2	4.2	-9.5
Stock markets (changes in %)	Euro	Ibex 35	7351	0.6	9.4	-13.1
		EuroStoxx 50	2436	0.1	4.4	9.7
	America	USA (S&P 500)	1409	-0.1	2.5	20.1
		Argentina (Merval)	2424	-1.4	1.0	-15.6
		Brazil (Bovespa)	57496	-1.6	2.1	1.7
		Colombia (IGBC)	14047	-0.8	2.7	4.4
		Chile (IGPA)	20105	-1.0	-0.6	-1.1
		Mexico (CPI)	39885	-0.8	-2.3	13.5
		Peru (General Lima)	20198	-0.1	3.8	-1.2
		Venezuela (IBC)	287986	-2.6	16.5	187.6
	Asia	Nikkei225	8840	-2.5	2.3	-1.2
		HSI	19483	-2.0	-1.7	-3.6
Credit (changes in bps)	Ind.	Itraxx Main	152	6	-3	-13
		Itraxx Xover	597	9	-23	-97
		CDS Germany	63	-1	-8	-15
	Sovereign risk	CDS Portugal	673	-9	-174	-302
		CDS Spain	510	12	-23	119
		CDS USA	40	0	-6	---
		CDS Emerging	252	2	5	-30
		CDS Argentina	1185	20	63	369
		CDS Brazil	133	3	1	-17
		CDS Colombia	116	1	-3	-33
		CDS Chile	94	-2	-9	-2
		CDS Mexico	112	1	-1	-37
		CDS Peru	121	-2	-4	-33

Source: Bloomberg and Datastream

Weekly Publications

Country	Date	Description
Asia	08/30/2012	<p>➤ Asia Daily Flash 30 August 2012: Philippines posts strong 2Q GDP; Hong Kong announces measures to contain property prices</p> <p>Equity markets in Asia continued to trend downwards today for a fourth straight day, as strong US data is reducing expectations of imminent QE3.</p>
	08/29/2012	<p>➤ Asia Daily Flash 29 August 2012: Thailand's July exports fall</p> <p>Equity markets in Asia finished mixed today, ahead of key upcoming events, including the Fed chairman's speech on Friday. Meanwhile, Thailand's exports fell again in July.</p>
	08/28/2012	<p>➤ Asia Daily Flash 28 August 2012: Japan cuts economic assessment; Hong Kong to join ASEAN-China FTA?; Hong Kong exports improve</p> <p>Japan's government lowered its assessment of the economy today for the first time since October 2011. Meanwhile, ASEAN considers whether to add Hong Kong to ASEAN-China FTA.</p>
	08/27/2012	<p>➤ Asia Daily Flash 27 August 2012: Moody's upgrades Korea's sovereign rating; China's Premier addresses slowdown</p> <p>Moody's upgraded Korea's sovereign rating to Aa3 from A1 today, a move which places Korea at the same ratings threshold as China and Japan.</p>
Global	08/30/2012	<p>➤ Presentation: "Macroprudential policy"</p> <p>Presentation delivered by Santiago Fernández de Lis, Chief Economist, Financial Systems and Regulation BBVA Research at ITAM Summer Camp August 24th 2012</p>
USA	08/29/2012	<p>➤ U.S. GDP Flash. Revisions to Real PCE and Net Exports Boost 2Q12 GDP</p> <p>Real GDP growth for 2Q12 was revised up to 1.7%, mostly due to PCE and net exports. Despite 2H12 slowing, we maintain our baseline scenario of 2.1% annual growth</p>
	08/28/2012	<p>➤ U.S. Banking Watch. FDIC Banking Profile 2012Q2</p> <p>Improvements in Industry Performance Vulnerable to Risks (Spanish version)</p>
	08/27/2012	<p>➤ U.S. Economic Watch. State Activity Indexes July 2012</p> <p>In July, state activity increased in 41 states, was unchanged in 5 states and declined in 4 states (Spanish version)</p>
	08/27/2012	<p>➤ U.S. Weekly Flash. FOMC Meeting Minutes: Discussions Ignite Over Additional Policy Tools</p> <p>As mentioned in the meeting statement a few weeks ago, the FOMC revised down their growth outlook in the near-term but remained confident that policy accommodation would prevent a downgrade to activity in the medium-term (Spanish version)</p>
EMU	08/30/2012	<p>➤ Europe Flash: "Confidence declined further in August, in contrast with PMI data."</p> <p>The EC confidence survey for August exacerbates concerns about the eurozone economic outlook in the current quarter.</p>
Spain	08/30/2012	<p>➤ Flash España: "Avance del IPC de Agosto"</p> <p>El indicador adelantado del IPC de agosto sorprende nuevamente al alza con una aceleración de los precios hasta el 2,7%.</p>
	08/30/2012	<p>➤ Flash España: "Confianza industrial y del consumidor en agosto"</p> <p>Los datos cualitativos observados en agosto señalan un deterioro significativo de las expectativas tanto de los productores como de los consumidores.</p>
	08/28/2012	<p>➤ Eventos: Conferencia "The Economic Value of Higher Teacher Quality."</p> <p>La Cátedra FEDEA - BBVA tiene el placer de invitarle a la conferencia. The Economic Value of Higher Teacher Quality (ver invitación-aforo limitado).</p>
	08/28/2012	<p>➤ Flash España: "Contabilidad Nacional Trimestral del 2T12."</p> <p>Tal y como se adelantaba en el último número de la revista Situación España, la economía española permaneció en recesión durante el 2T12.</p>
Latam	08/27/2012	<p>➤ Latam Economic Watch: "Brazil and Mexico: changing perspectives and remaining challenges."</p> <p>Changing perspectives: Mexico's turn? Remaining challenges: the ability to adopt reforms reducing their weaknesses will help to determine Brazil and Mexico's outlook. (Spanish version) (Chinese version)</p>

Brasil	08/30/2012	➤ Brazil Flash: "CB signals more clearly the easing cycle is near the end" The SELIC rate was cut by 50bps to 7.50%, in line with expectations. We now expect a final 25bps cut and not a 50bps anymore- to be announced in October.
	08/30/2012	➤ Brazil Flash: "Impaired loans remain at high levels" After having declined in June, non-performing loans (NPL) remained relatively stable and still around high levels- in July.
Chile	08/30/2012	➤ Flash Chile: Fuerte contraste entre bajo crecimiento manufacturero y dinamismo de ventas minoristas
México	08/30/2012	➤ Flash Migración México. ¿Pueden perder impulso las remesas hacia México? El Banco de México publicará el próximo lunes 3º de septiembre las cifras sobre flujos de remesas familiares que se recibieron en México durante el pasado mes de julio
	08/30/2012	➤ Liberando el potencial de la infraestructura en México. Parte 1: los motores Demografía, urbanización y capacidad de consumo elevarán las necesidades de infraestructura en los próximos años. A escala global, las presiones más importantes vendrán en los países emergentes.

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