Global

Weekly Watch

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Economic Analysis

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Home prices are falling again

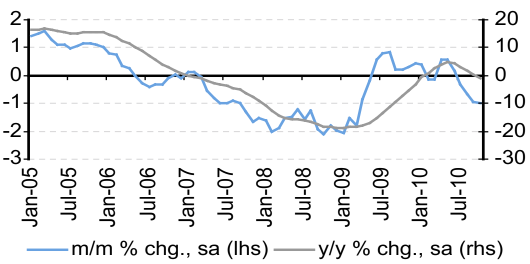
Despite there being signs of recovery in the US economy, this week's housing market data highlighted the downsize risks to growth. Home prices are falling again: the S&P/Case-Shiller 20-City Home Price Index was weaker than expected and fell 1.0% in October, the fourth consecutive monthly decline. In addition, mortgage foreclosures jumped in the third quarter. Meanwhile, for the second time since the bond-buying programme was launched in May, the ECB was not able to fully sterilize its bond purchases (the ECB intended to absorb €73.5bn, it was short by almost €13bn). The ECB is likely to reabsorb the required amount next week, after the year-end period, when bank's liquidity needs increase.

Highlights

China raises interest rates again

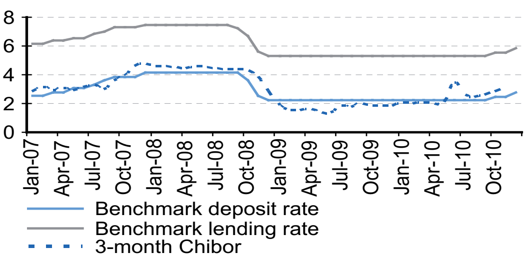
The Chinese authorities announced a 25bp interest rate hike on Christmas Day, the second such move since October. While the timing may have taken markets by surprise, the measure itself had been widely anticipated. The rate hike is part of an aggressive monetary tightening campaign in recent months. The campaign aims to rein in rapid credit growth and prevent economic overheating in light of continued strong activity indicators and an acceleration of inflation to 5.1% y/y in November. We anticipate further monetary tightening measures in 2011, including additional rate hikes of 75bps and increases in required reserve ratios (RRR) of up to 150bps by end-2011 (on top of the 300bp RRR increases already implemented). Given the current strength of economic momentum and a supportive fiscal stance, however, we do not expect the tightening measures to undermine the growth outlook materially, and we maintain our baseline scenario of 9.2% growth in 2011. Should higher interest rates encourage capital inflows, we would expect the authorities to tighten their already-stringent capital controls and, possibly, allow a marginal acceleration in the pace of currency appreciation.

Chart 1
S&P/Case-Shiller home price index



Source: Bloomberg and BBVA Research

Chart 2
China's Interest Rate Benchmarks, %, pa



Source: Haver and BBVA Research

Markets

The year draws to a close with latent sovereign risk

Sovereign risk, along with the rise in interest rates in China and the country's limit to vehicle sales have pushed stock markets down in Europe (especially the Auto and financial sectors). As for currencies, the slight rally seen in the euro and the pound vs. the dollar could have some life left in it, despite the fact that the ECB has not completely sterilised the accumulated sovereign debt purchases. However, the underlying trend is for dollar appreciation. As far as interest rates are concerned, bond auctions have set the trend. In Europe, Italian debt has been under some pressure due to the auctions. Moreover, we are starting to receive more information vis-à-vis sovereign financing needs for 2011. For example, Portugal announced that it will issue between EUR18bn and EUR20bn in 2011, with a large part of these issues taking place in the first quarter. This is combined with the fact that other countries also have their sovereign debt issues concentrated in the first quarter, which is why the schedule of Treasury bond issues will remain a market driver. In the USA, attention has been focused on the 2Y, 5Y and 7Y auctions, something which has led to yields rising throughout the curve in the US as well as a widening of the US/Germany spreads.

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Calendar: Indicators

Eurozone: Flash inflation estimate (December, January 4th)

Forecast: 2.2% y/y	**Consensus:** 2.0% y/y	**Previous:** 1.9% y/y

Comment: Headline inflation is expected to accelerate again to 2.2% y/y in December, as energy prices are projected to increase at a higher rate as a result of euro depreciation and a more expensive barrel of Brent. As a consequence the increase in headline inflation of around 0.3pp is expected to be mainly driven by a higher contribution of the energy component. Additionally the upward trend observed in non-processed food inflation is expected to continue. Regarding core inflation, it is expected to increase marginally, thus rising from 1.1% y/y to 1.2% y/y due to rounding. This marginal increase is expected to be caused by a slight acceleration of service inflation, while both non-energy industrial goods and processed food prices are projected to be stable. **Market impact:** We see some upside risks to our projection as fuel prices have been rising during the first few weeks of December. A positive surprise could significantly affect markets, as they may fear a more hawkish attitude from the ECB.

Eurozone: Retail sales (November, January 6th)

Forecast: 0.2% m/m	**Consensus:** 0.1% m/m	**Previous:** 0.1% m/m

Comment: Retail sales are expected to rise marginally in November, after their monthly growth was revised downwards in October (from 0.5% m/m to 0.1% m/m) and thus result in a slight deceleration in retail sales growth in these two months over Q3. Nevertheless, soft data showed that consumer confidence has remained slightly above its historical average in recent months, so retail sales are likely to increase further in December. Overall, the 3-month moving average of retail sales up until November shows more evidence that consumer spending remains modest but resilient, suggesting that private consumption should contribute positively, for the fifth quarter in a row, to quarterly GDP growth in Q4. **Market impact:** No major surprises are expected. A negative surprise would be interpreted as a sign of renewed downward pressure in economic activity.

Indonesia: CPI Inflation for December (January 3rd)

Forecast: 6.5% y/y	**Consensus:** 6.7% y/y	**Previous:** 6.3% y/y

Comment: Indonesian inflation has been picking up, driven by increases in food prices. November inflation rose to 6.3%, well above Bank Indonesia' (BI) target range of 4% to 6%. BI has downplayed inflationary concerns, pointing to stable core inflation (ex-food and administered prices) at just 4.3% in November. We expect inflation to pick up in coming months, and for BI to begin raising interest rates in Q1 of 2011 (the next policy meeting is scheduled for January 5). **Market impact:** Indonesia has been one of the few countries in Asia (along with the Philippines) to have kept interest rates unchanged despite signs of rising inflation. A higher-than-expected inflation outturn would increase expectations of early rate hikes, and could weaken the stellar performance of Indonesia's bond and equity markets.

FOMC Minutes (December 14th, Tuesday 14:00 ET)

Forecast: -	**Consensus:** -	**Previous:** -

Comment: The Federal Open Market Committee (FOMC) held its final monetary policy meeting in 2010 on December 14, 2010. The statement indicated no major changes to the current monetary policy stance. As a result of the slow progress towards achieving its dual mandate, the FOMC decided to continue its November decision to purchase an additional $600bn in Treasury securities by the end of 2011Q2 and to hold the Fed Funds rate at 0 to 0.25 percent. Although the minutes may give more detail about the FOMC's decision, we do not expect any surprises in the minutes. **Market impact:** Any new information in the minutes indicating that the Fed may change its current monetary policy would increase volatility in the financial markets.

Nonfarm Payrolls (December, Friday 08:30 ET)

Forecast: 105K	**Consensus:** 111K	**Previous:** 39K

Comment: IIn November, the U.S. nonfarm payrolls rose 39K following a 172K increase the previous month. Private nonfarm payrolls also increased slightly by 50K. In 2010, the private sector has created an average of 106K additional jobs, but total non-payroll employment has increased by 86K per month on average since December 2009, a level which is lower than the historical averages in recovery periods. The unemployment rate jumped 0.2pp and reached 9.8% in November. This is the highest unemployment rate since April 2010. We expect the unemployment rate to remain high both in the short- and mid-terms due to a moderate recovery, weak real estate markets and an increase in the participation rate in the coming months. **Market impact:** Weak nonfarm payroll employment could upset the markets and further increase worries about the current conditions of labour markets.

Home ➔

Markets Data ➔

Markets Data

				Close	Weekly change	Monthly change	Annual change
Interest Rates	(changes in bps)	US	3-month Libor rate	0.30	0	0	5
			2-yr yield	0.66	1	20	-48
			10-yr yield	3.40	1	61	-43
		EMU	3-month Euribor rate	1.01	0	-2	31
			2-yr yield	0.87	-7	1	-46
			10-yr yield	2.97	-1	30	-41
Exchange Rates	(changes in %)	Europe	Dollar-Euro	1.328	1.3	1.9	-7.3
			Pound-Euro	0.86	1.5	3.1	-2.8
			Swiss Franc-Euro	1.24	-1.4	-4.6	-16.1
		America	Argentina (peso-dollar)	3.98	0.1	-0.2	4.7
			Brazil (real-dollar)	1.66	-1.6	-2.9	-4.5
			Colombia (peso-dollar)	1915	-1.2	-1.5	-6.3
			Chile (peso-dollar)	468	-0.4	-3.9	-7.8
			Mexico (peso-dollar)	12.38	0.2	-0.6	-5.3
			Peru (Nuevo sol-dollar)	2.81	0.4	-0.8	-2.6
		Asia	Japan (Yen-Dollar)	81.75	-1.4	-2.2	-12.2
			Korea (KRW-Dollar)	1130.15	-1.8	-2.4	-2.4
			Australia (AUD-Dollar)	1.012	0.8	5.4	12.7
Comm.	(chg %)		Brent oil ($/b)	93.3	-0.5	8.5	19.7
			Gold ($/ounce)	1406.3	1.8	1.5	28.2
			Base metals	579.7	0.3	5.2	19.9
Stock Markets	(changes in %)	Euro	Ibex 35	9865	-2.4	6.4	-17.4
			EuroStoxx 50	2805	-2.0	5.8	-5.4
		America	USA (S&P 500)	1259	0.2	6.6	12.9
			Argentina (Merval)	3510	1.0	7.6	51.2
			Brazil (Bovespa)	69423	1.4	2.5	1.2
			Colombia (IGBC)	15516	-1.0	3.9	33.7
			Chile (IGPA)	22979	0.3	0.2	38.2
			Mexico (CPI)	38345	0.7	4.2	19.4
			Peru (General Lima)	23250	2.0	11.5	64.1
			Venezuela (IBC)	65595	0.6	-0.8	19.1
		Asia	Nikkei225	10229	-0.5	2.9	-3.0
			HSI	22999	0.7	0.0	5.2
Credit	(changes in bps)	Ind.	Itraxx Main	106	0	-12	30
			Itraxx Xover	439	0	-83	7
		Sovereign risk	CDS Germany	58	0	2	31
			CDS Portugal	498	2	-45	407
			CDS Spain	350	5	-16	239
			CDS USA	41	0	-1	---
			CDS Emerging	202	-4	-42	-56
			CDS Argentina	602	-3	-133	-313
			CDS Brazil	112	-3	-12	-11
			CDS Colombia	114	-3	-12	-29
			CDS Chile	87	-2	-6	19
			CDS Mexico	115	-2	-11	-19
			CDS Peru	114	-5	-18	-9

Source: Bloomberg and Datastream

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