Global

Weekly Watch

Madrid, 30 July 2010

Economics Analysis

Financial Scenarios
Sonsoles Castillo
s.castillo@grupobbva.com
(+34) 91 374 44 32

Marcos Dal Bianco
marcosjose.dal@grupobbva.com
+34 91 538 63 49

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

Ignacio González-Panizo
ignacio.gonzalez-panizo@grupobbva.com
+34 91 538 63 50

Financial tensions recede giving sovereigns a break

Recent data, as the drop in consumer confidence in July (for the 2nd consecutive month) and in durable goods orders in June, and Fed's Beige Book keep on remarking the weaker-than-expected US recovery, while in Europe the releases are still better than expected, as most of EMU countries had improvements in confidence with Germany showing the most significant increase. However, the main news this week is the easing in financial tensions. Next week there are the ECB and BoE meetings, we do not anticipate major changes, but we will monitor the Q&A after the ECB gave signs of normalization laying out tougher lending rules today.

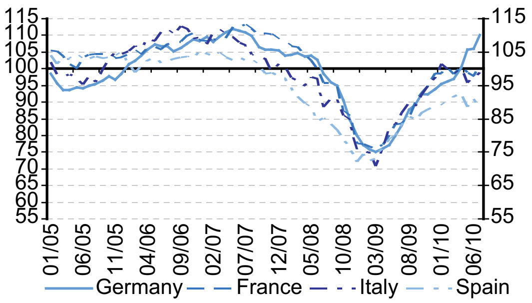
Sovereign risk premiums are reduced in peripheral Europe…

Financial tensions eased from their highs in May strongly promoted by the publication of European stress test results, especially for Spain for which the exercise has been differentially wide and credible, and it is undertaking a strong fiscal adjustment. However, risk premiums are still high in most vulnerable countries and the real watershed will be the re-opening of funding markets as in the coming moths they face a large amounts of debt maturing.

… and the monetary tightening cycle continues in Asia

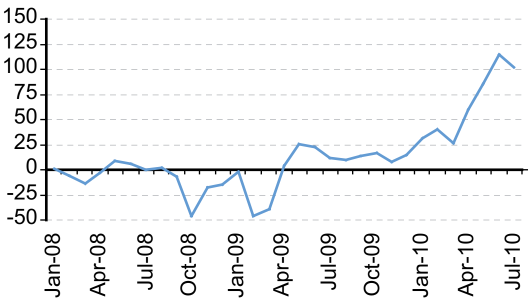
Increasing signs of rising inflation in Asia call for further monetary tightening, as shown by India's decision to raise again its official rates. Next week, the releases of inflation data in several Latin American countries will give us hints of how will the pace of policy normalization continue in that region.

Chart 1
EC Survey: economic sentiment by country



Source: European Commission Survey

Chart 2
Spain: Degree of market overvaluation in country risk indicators



The line depicts the spread between the current value (CDS 5Yr Sov.) and estructural CDS derived (Estimate through a econometric model based on fundamentals).
Source: BBVA Research

Markets
Highlights
Calendar
Markets Data

Highlights

Positive events for the banking system: European Stress Tests and Basel agreement

The results of the EU-wide stress test exercise revealed a strong resilience of the Spanish Banking system. Also this week the Basel Committee on Banking Supervision finally reached an agreement on the capital and liquidity reform package.

Is it too soon to pull back the fiscal stimulus in developed countries?

As recent data increasingly shows that the recovery will remain subdued in developed countries, there is a renewal debate about the pros and cons of early fiscal retrenchment.

Markets Analysis

Nicolás Trillo
nicolas.trillo@grupobbva.com
+34 91 537 84 95

Exchange Rates Europe
Chief Strategist
Pablo Zaragoza
pzaragoza@grupobbva.com
+34 91 374 38 64

Strategy
Chief Strategist
Joaquín García Huerga, CFA
jghuerga@grupobbva.com
+34 91 374 68 30

Credit Europe
Chief Analyst
Javier Serna
javier.sernaa@grupobbva.com
+34 91 537 61 08

Global Interest Rates
Aurora Galán
aurora.galan@grupobbva.com
+34 91 537 78 41

Markets

Gradual re-opening of the credit market after the stress test

Credit markets continued to improve this week especially in non-core countries after the publication of stress test results, with Portugal and Spain taking the lead and easing somewhat (the Spanish sovereign debt continued to significantly narrow for the third week in a row). Hints of a gradual re-opening of credit markets led by the two large Spanish banks, which issued senior debt after releasing their results with strong foreign demand and establishing the new benchmarks for Spanish institutions (BBVA: EUR1.25bn at 5 years MS+170 and Santander: EUR1.5bn at 4 years MS+160). In the short/medium term, we expect a gradual re-opening of funding markets for the Spanish entities with the best credit ratings based on the detailed information (including a greater differentiation by issuer) of the stress tests.

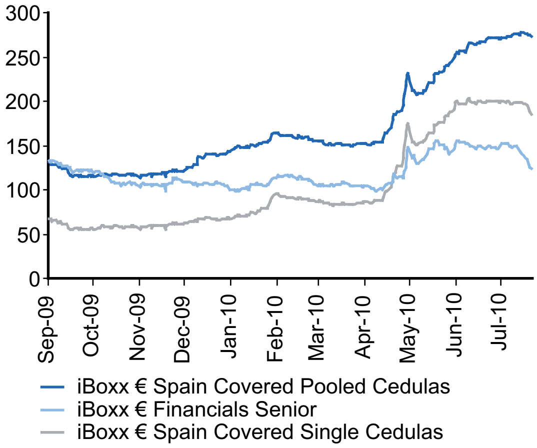
The normalization of US/Euro spreads should put a break on dollar's punishment

The depreciative dynamic the dollar has continued to show, even probing levels in the 1.30 dollar/euro zone, is still mainly a reflection of a change to a less optimistic outlook for the US economy, and therefore US asset valuations as well, in absolute and relative terms.

The main symptom of this adjustment is the significantly lowered outlook for rates: in line with our own revision of the first rate hike by the FED (which we do not expect before September 2011), the September expiry 3M Libor future has plummeted by around 60bps since the end of May, and is now hovering just above the 0.80% zone (a hike of just 25bps priced in to this point). The implications of this curve profile for the dollar are accentuated if we take into account that this coincides with a rise in monetary rates in other currencies such as the pound or the euro (not only for liquidity adjustment factors, but also improved expectations for rates for the region). The Sep 2011 Euribor 3M future has jumped 20bps in this period, and has even breached the upper limit of a range it had respected since late April: this is particularly relevant in view of the recent trend in the dollar/euro.

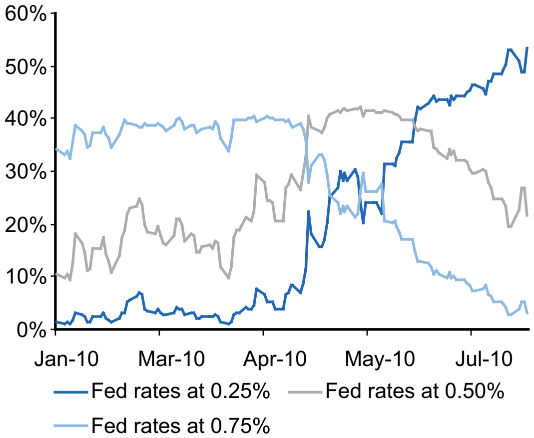
In our view, although these factors are unlikely to revert sharply in the short term, above all in view of the market's sensitivity to US data which may continue to "disappoint", they may become less significant: we do not consider aggressive decoupling between the outlooks for the Eurozone and the US to be sustainable, either in terms of the cycle (the ECB may decide to remind markets this week that the region's capacity for recovery is not risk-free) or in terms of relative rates. Therefore, with no guaranteed global recovery, an outlook of a growing dovish dollar market cannot be maintained without affecting the euro: the trend of spreads which favour the euro should start to hit limits, resulting in dollar/euro cross which is not so markedly biased towards to upper limits of ranges. Although this may not happen immediately, we still expect a return to levels closer to 1.25 dollar/euro in the medium term.

Chart 3
Credit spreads: senior financial debt vs Spanish Covered Bonds (bps)



Source: Markit and BBVA Research

Chart 4
Implied probability of Fed Fund hikes in March 2011



Source: Bloomberg

Home
Highlights
Calendar
Markets Data

Economics Analysis

Financial Scenarios
Marcos Dal Bianco
marcosjose.dal@grupobbva.com
+34 91 538 63 49

Regulation and Public Policy
María Abascal
maria.abascal@grupobbva.com
(+34) 91 534 70 15

Tatiana Alonso
tatiana.alonso@grupobbva.com
(+34) 91 534 61 67

Highlights

Positive events for the banking system: European Stress Tests and Basel agreement

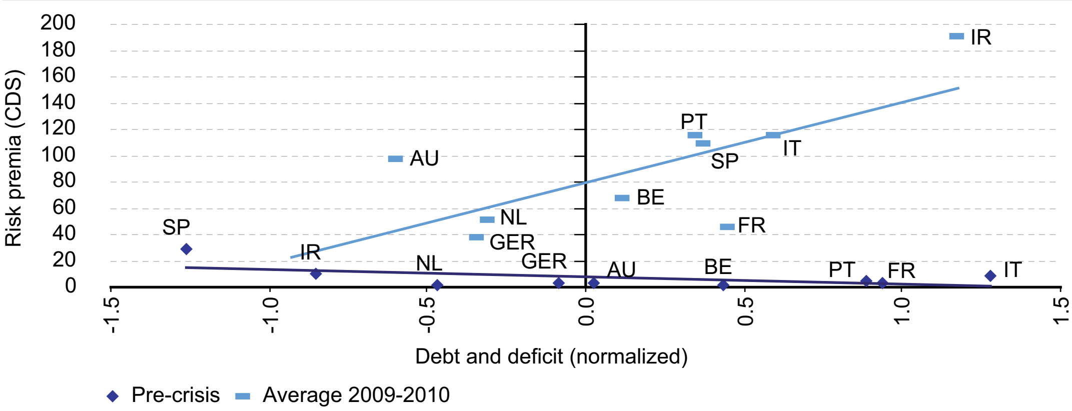
The results of the EU-wide stress test exercise revealed a strong resilience of the Spanish Banking system as only 5 institutions would need extra capital under the stressed scenario (€2bn on top of the €14.6bn already granted by the FROB and DGS). These are credible results as the Spanish exercise covered almost 100% of the system (65% European average), provided more information of credit portfolios in a bank by bank basis, had a differentiate severe macroeconomic scenario especially in the Real Estate sector, and has been outstandingly rigorous in the analysis of pre-impairment incomes. Henceforth, these results will help to clarify the real situation of the Spanish banking system and remove uncertainties regarding its soundness.

Other important news to the financial system is that the Basel Committee on Banking Supervision finally reached an agreement on the capital and liquidity reform package. It maintains most of the definitions of capital proposals but does not clarify the limits to be applied or the grandfathering period. It also includes a softening of capital deductions acknowledging that full deductions of certain categories could have potentially adverse consequences; notably, partial recognition of minority interests in a subsidiary that is a bank. The same is true for investments in other financial institutions, Mortgage Servicing Rights and Deferred Tax Assets. There are also some changes which benefit banks in the treatment and calculation of liquidity and leverage ratios. Regarding liquidity, there have been some revisions to the definition of liquid assets to extend the category of assets to consider. The Committee also recognizes that the Net Stable funding ratio should be modified to avoid a penalization of the retail banking.

Is it too soon to pull back the fiscal stimulus in core countries?

As recent data increasingly shows that the recovery will remain subdued in developed countries, there is a renewal debate about the pros and cons of early fiscal retrenchment. Undoubtedly, when financial markets start to doubt about the sustainability of a country's fiscal accounts the incentives for an early fiscal consolidation exponentially rises as the positive effect on market confidence counterweigh the negative effects on aggregate demand of an early retirement of fiscal stimulus. For EMU countries, we believe that the effect from the fiscal adjustment on growth will be lower than usually assumed and the positive impact on credibility will almost compensate the negative effect from reduced public demand. The question is if it is necessary that countries that are not (still) on markets' focus as the US which is issuing debt at record-low cost need to embark in fiscal consolidation efforts that might undermine the recovery, specially given the weaknesses on the labor market. The beneficial effects from increased confidence are not so clear in this case, and their support for global demand is important when peripheral countries are forced to restrict their own stimulus. However, fiscal variables should be closely monitored as medium-term risks should not be underestimated, as the effect of lax fiscal policy on interest rates is highly non-linear and there can be sudden increase in long-term rates with a displacement of private demand; exactly the opposite effect intended by the fiscal stimulus packages. You can find much more elaboration on these themes in the next BBVA Research Global Outlook that will be published next week.

Chart 5
EMU: fiscal variables and risk premia



Source: BBVA Research

Home
Markets
Calendar
Markets Data

Economics Analysis

Europe
Miguel Jiménez
mjimenez@grupobbva.com
(+34) 91 537 37 76

Agustín García Serrador
agustin.garcia@grupobbva.com
+34 91 374 7938

Elvira Prades
elvira.prades@grupobbva.com
(+34) 91 537 79 36

US
Kristin Lomicka
kristin.lomicka@bbvacompass.com
+1 713 881 0655

Asia
Stephen Schwartz
stephen.schwartz@bbva.com.hk
+852 2582 3218

Mexico
Javier Amador
javier.amador@bbva.bancomer.com

Julián Cubero
juan.cubero@bbva.bancomer.com
+52 5556214143

Home →

Markets →

Highlights →

Markets Data →

Calendar: Indicators

USA: Personal Income and Spending (June, August 3rd)

Forecast: 0.1%, 0.2%	**Consensus:** 0.2%, 0.1%;	**Previous:** 0.2%, 0.4%

Comment: Personal income is expected to rise for the eleventh consecutive month, but at a slower pace given the decline in June's non-farm payrolls. As income firms, so will personal spending, but June's decline in retail sales points to slow growth in this arena. **Market Impact:** A negative surprise in personal spending would be an indication that 2Q10 GDP could be revised down in the next release. Furthermore, an unexpected decline in personal income could point to slow spending growth in 3Q10.

USA: Non-Farm Payrolls (total, private) (July, August 6th)

Forecast: -112K, 113K	**Consensus:** -100K, 98K	**Previous:** -125K, 83K

Comment: Total non-farm payrolls will drop for the second consecutive month in July due to the termination of temporary Census jobs. Private payrolls, on the other hand, are expected to rise, but at a slow pace. In sum, the private sector has added 593K jobs in 2010, but the pace has not been strong enough to significantly move the unemployment rate. **Market Impact:** The market will look for surprises in the private payrolls figure. A negative surprise would feed market fears about weak economic growth in 2H10.

Germany: Industrial Production Index (June, August 6th)

Forecast: 0.5 % m/m	**Consensus:** 1.0% m/m	**Previous:** 2.6 % m/m

Comment: This week Industrial Production Index for June will be released for two of the biggest economies in the Euro Area, Germany and Italy. In Germany we expect a mild increase 0.5% m/m after April and May data recorded sharp increases. **Market Impact:** A positive surprise in Germany could imply a strong closing for Q2 and could lead to a better than expected GDP figure for the quarter, to be published in two weeks time.

Eurozone: Retail Sales (June, August 4th)

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

Comment: After the negative surprise with May data, we expect retail sales to print in June a slight positive record so as to confirm the improvement in recent consumer confidence surveys. **Market Impact:** A second negative surprise in a row would just confirm the current weak outlook for private consumption, but would not be a major surprise.

China: PMI (July, August 1st)

Forecast: 51.2	**Consensus:** 51.4	**Previous:** 52.1

Comment: China's Purchasing Managers Index is expected to ease in July for a third consecutive month due to seasonality factors, and following the moderating trend of 2Q GDP growth (10.3% yoy, released on July 15), in line with our baseline for a soft-landing in H2 as the government's measures to rein in rapid credit growth and property price increases have been bearing fruit and as export growth gradually weakens. **Market Impact:** global investor sentiment has been very sensitive to growth indicators in China, and an unexpectedly low reading, especially if below 50, could reignite fears of a hard landing and undermine sentiment.

Mexico: Employment (July)

Forecast: 0.3% m/m	**Consensus:** n.a.	**Previous:** 0.3%

Comment: the IMSS social security department will release its figures for job creation in the formal private sector. While in annual terms at 4.7% this will be the largest year-on-year change since February 2007, equivalent to 450 thousand new workers since the start of the year, the monthly pace of job creation will continue to show a slight deceleration against previous quarters (0.5% m/m on average during 1H10). **Market impact:** it could be limited, but considering that the risks to the US outlook, and thus Mexico's, have recently tilted somewhat to the downside, a negative surprise could potentially have an impact on markets.

Markets Data

				Close	Weekly change	Monthly change	Annual change
Interest Rates	(changes in bps)	US	3-month Libor rate	0.45	-4	-8	-3
			2-yr yield	0.57	-1	-6	-54
			10-yr yield	2.93	-6	-1	-55
		EMU	3-month Euribor rate	0.90	1	11	0
			2-yr yield	0.80	5	12	-47
			10-yr yield	2.68	-3	11	-63
Exchange Rates	(changes in %)	Europe	Dollar-Euro	1.303	1.4	4.8	-8.5
			Pound-Euro	0.83	-0.2	1.1	-2.4
			Swiss Franc-Euro	1.36	0.3	2.3	-10.8
		America	Argentina (peso-dollar)	3.94	0.2	0.2	2.8
			Brazil (real-dollar)	1.76	-0.3	-2.3	-5.8
			Colombia (peso-dollar)	1842	-1.4	-3.4	-9.6
			Chile (peso-dollar)	523	0.2	-3.5	-3.3
			Mexico (peso-dollar)	12.65	-0.8	-3.1	-4.3
			Peru (Nuevo sol-dollar)	2.82	0.0	-0.2	-5.4
		Asia	Japan (Yen-Dollar)	86.59	-0.8	-1.1	-8.5
			Korea (KRW-Dollar)	1181.75	-1.4	-3.7	-3.3
			Australia (AUD-Dollar)	0.905	1.2	7.8	8.8
Comm.	(chg %)		Brent oil ($/b)	76.7	-0.9	6.1	7.0
			Gold ($/ounce)	1172.2	-1.4	-2.2	22.9
			Base metals	484.9	1.9	2.3	13.7
Stock Markets	(changes in %)	Euro	Ibex 35	10552	1.6	15.0	-2.8
			EuroStoxx 50	2748	1.1	9.1	4.2
		America	USA (S&P 500)	1100	-0.2	7.1	11.4
			Argentina (Merval)	2398	1.0	8.5	39.4
			Brazil (Bovespa)	67135	1.2	9.6	22.6
			Colombia (IGBC)	13201	-0.5	6.6	27.8
			Chile (IGPA)	20263	1.2	8.4	32.5
			Mexico (CPI)	32366	-1.3	3.7	19.7
			Peru (General Lima)	14191	0.3	2.6	0.7
			Venezuela (IBC)	64273	-0.2	-1.4	40.6
		Asia	Nikkei225	9537	1.1	3.8	-7.9
			HSI	21030	1.0	4.5	2.2
Credit	(changes in bps)	Ind.	Itraxx Main	105	-7	-26	17
			Itraxx Xover	478	-28	-107	-135
		Sovereign risk	CDS Germany	38	-3	-6	13
			CDS Portugal	216	-52	-90	170
			CDS Spain	179	-23	-84	120
			CDS USA	34	-2	-3	---
			CDS Emerging	214	-17	-61	-114
			CDS Argentina	792	-54	-209	-910
			CDS Brazil	117	-3	-25	-17
			CDS Colombia	124	-4	-29	-48
			CDS Chile	83	-7	-22	-8
			CDS Mexico	116	-4	-23	-46
			CDS Peru	109	-4	-29	-38

Sources: Bloomberg, Datastream and JP Morgan

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document is based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates´ salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

This document is provided in the United Kingdom solely to those persons to whom it may be addressed according to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 and it is not to be directly or indirectly delivered to or distributed among any other type of persons or entities. In particular, this document is only aimed at and can be delivered to the following persons or entities (i) those outside the United Kingdom (ii) those with expertise regarding investments as mentioned under Section 19(5) of Order 2001, (iii) high net worth entities and any other person or entity under Section 49(1) of Order 2001 to whom the contents hereof can be legally revealed.

The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA and the rest of entities in the BBVA Group which are not members of the New York Stock Exchange or the National Association of Securities Dealers, Inc., are not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".