

Global

Weekly Watch

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Economics Analysis

Financial Scenarios

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Global growth under suspicion

The underlying theme of the strength in the global recovery came to the fore this week. Most macro indicators came on the positive side and, at some points, helped contain negative market currents. However, on Friday, the US labor report was a negative surprise –admittedly after several positive news in previous months– and highlighted the fragility of the situation. This report is so far the most relevant piece of evidence that the cycle is losing momentum. This was to be expected but, against the background of very negative financial conditions, markets had probably turned increasingly reliant on good economic indicators to sustain confidence.

All eyes on the strength of the US recovery

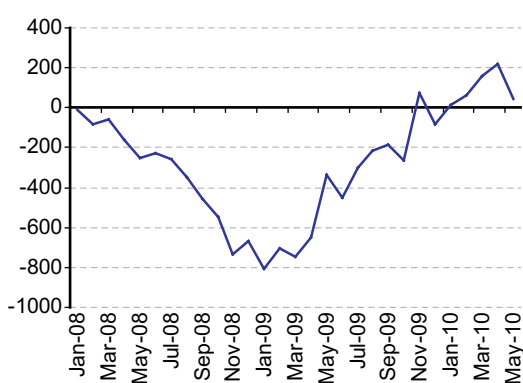
In the US, retail sales and consumer confidence gain particular relevance after the slowdown in the labor market. In Europe, industrial production and exports are worth watching, but given the dependence on external demand, US data will be more important than domestic indicators.

China on track for soft-landing

Chinese PMIs came mostly in line with our forecast of a moderation, but they increased market fears of an abrupt slowdown. Hopefully, we see some upside risks to Friday's loan growth data.

Chart 1

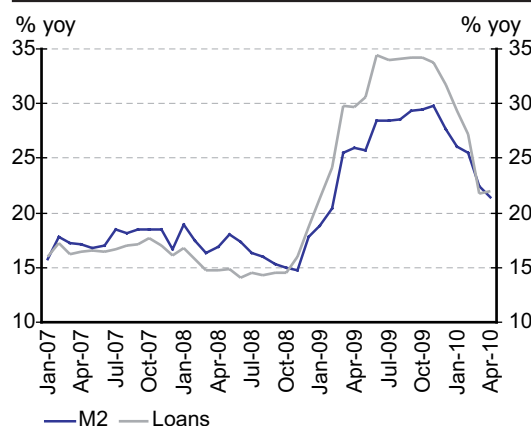
United States: change in total private employment (thousands)



Source: Datastream

Chart 2

China: Money and credit growth



Source: CEIC

Markets



Highlights



Calendar



Markets Data



Highlights

US and EMU labour market: looking inside the figures

The most recent labor market releases show weaknesses in the US, where markets had discounted too much improvement over the short term.

EMU: liquidity issues to dominate ECB meeting

Liquidity issues are likely to stay at the centre of the debate as long-term auctions expire and bond purchases a clear focus of market attention. Regarding the macro outlook, the ECB will barely lift its growth projections.

China: growth moderating as expected

China's PMI declined as expected, signaling the authorities are successfully cooling the economy. Further tightening measures are likely, but only as authorities gauge the impact of previous ones and of global risks.

Markets Analysis

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Financial fragility continues

The ECB's financial stability report released at the beginning of the week, warning of the damaging effects of high tax deficits on risk premiums and economic growth received a far from warm welcome, especially in the case of the banking sector. The market interpreted the slight drop seen in China's PMI as a sign of European economic difficulties being passed through to the global economy. Nonetheless, in our view, China's figures suppress concerns about "overheating". However, markets reinforced their negative sentiment on Friday following a lower-than-expected non-farm US payroll and comments from Hungarian warning that the previous Hungarian government left a worse-than-reported fiscal situation, having not included some expenditure in the budget deficit and having set out a difficult to achieve revenue target.

The Portuguese and Spanish 3-year auctions (June 9, 10) will focus attention

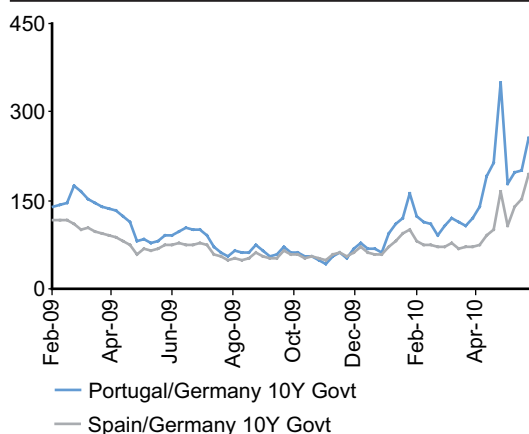
Recent days have seen a resurgence in pressure on certain sovereign spreads. Spain stands out here, not only because its spreads have already widened to new highs around 200bp, but because it has been the worst-performing issuer. All of which shows that the market is still a long way from reversing its perception of risks to Spain, amid a wave of less than positive news: recent downgrade by Fitch, bank restructuring and its relationship with the refinancing of the sector and the global impact of Hungarian events. Looking ahead, we see valuation risks to these assets remaining high given scheduled issuance, particularly given the precedent set by Portugal's bill issue last week (rate of 1.6% compared to a previous average of 0.73%). Tomorrow, market participants' attention will turn to the 3-month bill auction by Hungary.

We find a positive sign in the market: volatility

Despite current spread levels and although there have been no rises in either equity markets, or the eurodollar market... implied volatility levels have in fact fallen. Albeit NPF and Hungary news are increasing the pressure again, the VIX (S&P volatility index) well above 40% two weeks ago, is currently around the 35% zone, 3m IV of the eurodollar has decreased from 17% to 15%. The short term in swaptions have also recorded modest declines in normalised volatility... However, even though levels are not at highs, they remain fairly extreme as is to be expected in the current climate of heavy uncertainty. Basically, current scenario is similar to having a theta-positive position in derivatives: the mere passing of time, all other things being equal, is positive and will allow us to continue seeing drops in volatility.

Chart 3

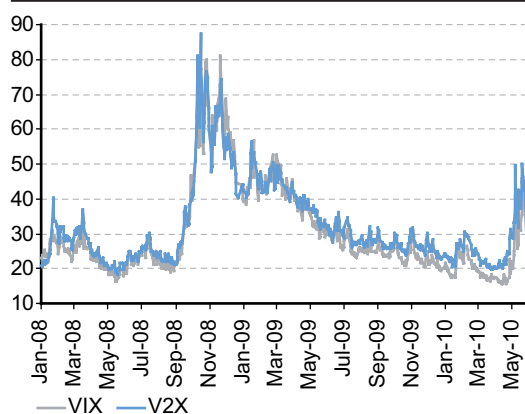
European debt Spreads (bps)



Source:

Chart 4

Implied volatility: S&P500 & Eurostoxx50



Source:

Economics Analysis

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Highlights

US labor market: slow recovery confirmed

May's non-farm payroll data raised questions about the pace of the recovery of the labor market. While total payrolls rose 431K, they were driven by the hiring of 411K temporary Census workers. The concern in May's report lies in the private sector, which added only 41K jobs, well below consensus expectation of 180K jobs, and April's 218K jobs. Of the 37K jobs created in the private services providing sector, 31K came from temporary help services, illustrating that private companies are still hesitant to commit to permanent employees. The construction sector dropped 35K jobs following two months of increases, which highlights that this sector is not out of the woods yet. The unemployment rate dropped 2pp to 9.7%, but it was primarily due to a decline in the labor force participation rate. May's data is a reality check after two stronger than expected months. This release confirms our expectation that the employment situation will continue to improve at a slow pace and the unemployment rate will remain above 9% for the duration of 2010.

EMU: liquidity issues to dominate ECB meeting

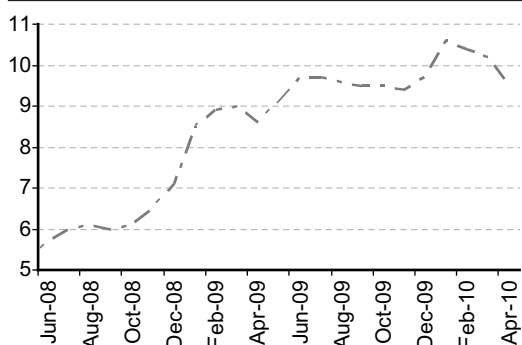
The focus of ECB's June meeting will be what Trichet says about bond purchases, as recent declarations among council members have been far from uniform on this issue, with some suggesting that it is a key element for financial stability, and others clearly against the program. On the key issue of liquidity after the expiration of the € 442bn 1 year auction at the end of this month, we do not foresee the ECB taking further action (apart from the 3m auction planned for June 30th), and therefore quantities in the deposit window will fall sharply, which could make more difficult the sterilization of bond purchases. The meeting will also bring new quarterly projections for the Eurozone. Although Trichet has recently suggested that growth is coming out better than expected in the second quarter and we think euro depreciation will lift exports even further, we think the ECB will put enough weight on the effect of the sovereign crisis on confidence and on financing costs for domestic demand and will barely lift its growth projections.

China: Monetary tightening pulls down signs of overheating

China's PMI for May fell to 53.9 in May from 55.7 in April, in line with expectations, signaling that the authorities' tightening measures to prevent risks of overheating may be successfully cooling the economy. We view the slowdown as a healthy sign given risks of overheating, and it is consistent with our 2010 growth projection of 9.8%. Together with the recent moderation in credit growth, slowdown in fixed asset investment, and rapid fall in property sales, the PMI reading suggests that recent tightening measures are having an effect. Further tightening measures are possible during the remainder of the year. These could include additional quantitative measures to rein in credit growth such as hikes in reserve requirements, open market operations, and modest interest rate hikes. We continue to expect currency appreciation, although the timing appears likely to be delayed until later in the year due to uncertainties in the global environment. A property tax is under discussion for large cities, but further actions will depend on the assessment of the impact of existing measures and global risks.

Chart 3

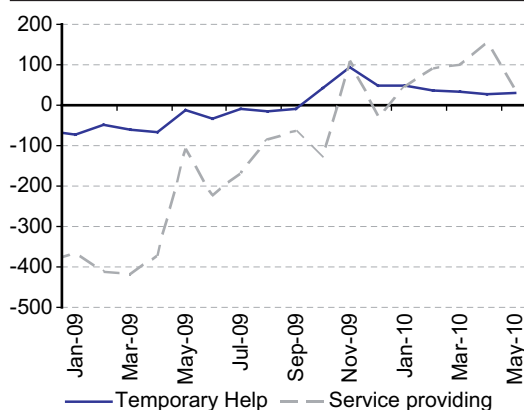
United States: Unemployment rate (in %)



Source: Datastream and BBVA Research

Chart 4

United States: private employment in the service-providing sector



Source: Datastream

Calendar: Indicators

USA: Retail Sales, Excluding Autos (May, June 10th)

Forecast: 0.4%, 0.3%

Consensus: 0.2%, 0.1

Previous: 0.4%, 0.4%

Commentary: The fundamentals for consumer spending are beginning to solidify; the job market is improving, consumer confidence and personal income from wages and salaries are improving. Market Impact: While risks are tilted to the upside, a negative surprise in the data would have the greatest market impact as it would raise questions regarding the strength of private demand and its ability to support the recovery.

Germany: Industrial Production Index (April, June 8th)

Forecasts: 0.6% m/m

Consensus: 1.5% m/m

Previous: 4.0% m/m

Commentary: German IP growth will moderate in April after the significant increase recorded in March. Nevertheless, we continue to expect the industrial sector to gain momentum in coming months, driven by strong exports that are being boosted by euro depreciation, while domestic orders should remain weak. Market impact: Risks are tilted to the downside, which could weigh on markets after manufacturing PMIs also fell in May.

Germany: Exports (April, June 8th)

Forecasts: -2.2% m/m

Consensus: -3.5 % m/m

Previous: 10.8% m/m

Commentary: Similar to IP, exports in Germany are expected to decline slightly in April after their strong increase in March. Market impact: Weak data could put under some stress the view that Germany (and Europe) will be able to benefit from global demand.

Mexico: CPI (May, June 9th)

Forecast: -0.3% m/m

Consensus: -0.4%

Previous: -0.3%

Commentary: Inflation will consolidate recent downside surprises. Agricultural prices and electricity tariffs are behind the fall in inflation, but core component will maintain a subdued path. Market impact: An (unlikely) upward surprise could have a relevant impact, given how good recent data have been.

Brazil: GDP (Q1, June 8th)

Forecast: 2.6% q/q

Consensus: 2.9% q/q

Previous: 2.0% q/q

Commentary: Brazil's growth has sped up instead of having moderated as expected some months ago. Market impact: risk of a positive surprise are limited in view of the adjustment in consensus expectations, but it would probably increase the bets of a 100bps hike in the SELIC rate in the next monetary policy meeting and the chances of new tightening measures (higher reserve requirements, cuts in public expenditure).

China: Loan growth (May, June 11th)

Forecast: Rmb 560 billion (21.3% y/y)

Consensus: Rmb 600 billion (21.4% y/y)

Previous: Rmb 774 billion (22.0% y/y)

Commentary: New loans are expected to fall in line with the full-year target of Rmb 7.5 trillion (18.8% y/y) as the authorities seek to prevent overheating. We also expect urban fixed asset investment to slow. Market impact: despite the deteriorating external environment, risks are tilted to the upside. This could raise market expectations of further tightening and alleviate recent concerns of an abrupt slowdown.

Table 1

Market movements

		Close	Weekly change	Monthly change	Annual change	
Interest rates (changes in bps)	US	3-month Libor rate	0,54	0	16	-10
		2-yr yield	0,72	-5	-7	-57
		10-yr yield	3,21	-8	-18	-62
	EMU	3-month Euribor rate	0,71	1	3	-56
		2-yr yield	0,47	-5	-5	-121
		10-yr yield	2,57	-12	-23	-116
Exchange rates (changes in %)	Europe	Dollar-Euro	1,201	-2,6	-5,7	-14,3
		Pound-Euro	0,83	-2,7	-2,9	-5,4
		Swiss Franc-Euro	1,39	-2,2	-1,2	-8,2
	America	Argentina (peso-dollar)	3,92	0,2	0,6	4,5
		Brazil (real-dollar)	1,85	1,4	0,5	-5,5
		Colombia (peso-dollar)	1968	-0,3	-2,0	-4,3
		Chile (peso-dollar)	541	1,9	2,5	-4,4
		Mexico (peso-dollar)	12,88	-0,1	0,3	-2,8
	Asia	Peru (Nuevo sol-dollar)	2,85	0,0	-0,1	-3,9
		Japan (Yen-Dollar)	91,72	1,0	-0,6	-6,6
		Korea (KRW-Dollar)	1218,95	0,0	5,6	-2,5
		Australia (AUD-Dollar)	0,827	-2,3	-7,5	3,1
Comm. (chg %)		Brent oil (\$/b)	73,7	-0,4	-7,7	7,9
		Gold (\$/ounce)	1204,0	-0,9	-0,4	26,0
		Base metals	474,2	-1,5	-4,6	18,7
Stock markets (changes in %)	Euro	Ibex 35	8889	-5,7	-5,0	-6,6
		EuroStoxx 50	2555	-2,3	-2,2	2,1
	America	USA (S&P 500)	1079	-0,9	-4,3	14,8
		Argentina (Merval)	2212	2,0	2,3	35,0
		Brazil (Bovespa)	62054	0,2	-2,1	16,3
		Colombia (IGBC)	12281	0,4	2,6	30,0
		Chile (IGPA)	18068	0,8	1,9	18,5
		Mexico (CPI)	31144	-1,3	-0,8	25,0
		Peru (General Lima)	14166	-2,3	-5,4	0,5
		Venezuela (IBC)	63268	2,5	3,2	47,9
	Asia	Nikkei225	9901	1,4	-7,4	1,4
		HSI	19780	0,1	-1,8	5,9
Credit (changes in bps)	Ind.	Itraxx Main	120	2	-3	17
		Itraxx Xover	560	3	11	-102
	Sovereign risk	CDS Germany	43	2	-14	8
		CDS Portugal	331	22	-119	258
		CDS Spain	253	37	-14	166
		CDS USA	39	2	-2	---
		CDS Emerging	272	-6	-13	-104
		CDS Argentina	1125	-80	83	-1297
		CDS Brazil	134	-2	-20	-40
		CDS Colombia	159	-4	-24	-46
		CDS Chile	100	-5	12	-30
		CDS Mexico	131	-5	-21	-72
		CDS Peru	133	-1	-20	-50

Sources: Bloomberg, Datastream and JP Morgan

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