

Global Weekly Flash

Not all uncertainties are lifted

Financial markets' strains remain at high levels ahead of the ratification of the Spanish Memorandum Of Understanding (MoU) by the Eurogroup partly due to an unexpected delay in the approval of the ESM in Germany.

- Today Eurozone finance ministers are expected to approve the EUR 100 bn bailout for the Spanish banking sector bailout. The Memorandum of Understanding (MoU) prepared by the Commission, together with the ECB, the IMF and EBA should provide for: 1) the conditions attached to the facility, including institution-specific details (such as burden sharing and segregation of impaired assets), the country-specific horizontal requests for the banking sector and the programme monitoring; 2) the terms of the facility (interest charged, maturity) and 3) the payment schedule. The approval of the MoU should contribute to clarify the doubts surrounding the conditionality and the own use of the amount of the financial assistance that emerged over the last week”.
- However, doubts regarding the entry into force of the ESM remain for at least two more months, as the Germany's Constitutional Court has announced that it will delay the first ruling on the matter until September 12. This decision could add more uncertainty to the markets.
- Against this backdrop, bond auctions in European markets continue to reflect the high risk in some peripherals, particularly in longer-dated notes, and to a lesser extent in short-term bills. Spain sold EUR2.98 bn of bonds, in line with its maximum target although at very high prices. In particular, Spanish's 5y borrowing cost rose to 6.459% vs 5.53% the auction held on the 5th of July. In contrast, Spain sold EUR3.56bn in 12-month and 18-month bills reaching its maximum selling target and the borrowing costs fell from June's auctions after the EU Summit held on June 28-29, although these prices are still very high. Spain's Treasury has sold 68.6% of the 86 billion euros of medium- and long-term debt it plans to issue this year. Amid the risk aversion observed in peripherals, flows to safe-haven assets continues. European core countries continue registering low record yields, as investors seek safer assets offering higher returns than those of German debt. France and the Netherlands sold T-bills at negative yields and Austria's bonds rose, with 2y yields falling below zero for the first time. In this context, the German 10y bond yield fell below 1.2%.
- This week commodities rallied, with oil prices rising more than 6% as tensions in Middle East are increasing. Moreover, other commodity prices have also increased as US drought worsens.
- The IMF has cut its forecast for global growth by 0.1 pp and 0.2pp for 2012 and 2013, and now expects World output to grow by 3.5% and 3.9% in 2012 and 2013 respectively. This revisions show how the latest round of turmoil in the Eurozone, combined with a slowdown in large emerging markets, is threatening the global economy. According to the institution, the most immediate risk to the global recovery is that delayed or insufficient policy action will reinforce the euro area crisis. In this context, the institution appeared to endorse further monetary easing by central banks if needed.

• **Central banks: no major news, wait- and- see stance, but ready to act**

- Fed Chairman Bernanke's semi-annual testimony to the Senate Banking Committee addressed a cautionary note on the economic outlook. Mr Bernanke did not provide additional clues of an immediate FED policy action, i.e. no additional insight on the probability of QE3, although he reiterated the Fed's commitment to take further action as appropriate in order to promote a stronger economic recovery. The Fed Chairman touched on the recent slowing in economic activity as well as the downside risks to growth, reiterating most of the details that were already highlighted in the latest FOMC meeting minutes. Regarding the labor market, he noted that the reduction in the unemployment rate will likely be “frustratingly slow”. Bernanke emphasized the significance of the European fiscal and banking crisis and the U.S. fiscal cliff as the two main sources of risk moving forward. He also stressed that “European developments that resulted in a significant disruption in global financial markets would inevitably pose significant challenges for our financial system and our economy.” Domestically, the impending fiscal cliff remains a significant risk to growth. As in previous statements, Bernanke once again underlined the importance of cooperation in Congress to address these fiscal challenges so as to avoid further deterioration in economic activity.

- BoE Minutes from the MPC monetary policy meeting held on 4 and 5 July showed that policy makers discarded cutting interest rates from 0.5%, although new lending and credit measures might alter their assessment in the coming months. Regarding the QE, seven MPC members voted in favor while two voted against.
- In Latin America, the minutes of Brazil's central bank July 10-11 meeting published yesterday refrained from signaling the end of the current easing cycle. The monetary authority insisted on its previous messages: "disinflationary" external environment, "parsimony", focus on the external sector, favourable balance of risks for inflation... This, therefore, reinforces our view that the SELIC rate will reach 7% in the last quarter of the year, following the two additional 50bps cuts we expect to be announced in August and October. In Mexico, Banxico will hold today its monetary policy meeting in a very uncertain external environment, which could lead the central bank to a more cautious assessment of the downward risks on economic activity. On the domestic side, recent figures of inflation and economic activity are still consistent with a monetary pause. We expect that the funding rate will remain unchanged at 4.5% during 2012. A rate cut remains possible as the persistence of risk factors could impair the global economy.

- **Macroeconomic data: Mixed economic data in the US, while German investor confidence surprised on the downside**

- In the US, retail sales fell 0.5% m/m in June for a second month in a row. The figure came below than expected (-0.1% m/m). Excluding Autos retail sales fell 0.4% m/m in June, below our forecast, 0.0% m/m. Additionally, inventories rose more than expected in May as sales declined for a second month, indicating companies may limit factory orders. Meanwhile, industrial production recovered from previous weakness, increasing 0.4% in June after falling 0.2% in May, with the index reaching its highest level of the recovery. Total output was led by the manufacturing sector, which gained 0.7% to offset the 0.7% decline in the previous month. Given the latest deterioration in other indicators on the sector, growth in manufacturing output is a positive surprise that should ease some worries on slowing activity. Also, manufacturing activity in the Philadelphia region rebounded only slightly in July, but the index remains in very negative territory.
- Some encouraging data came in the housing sector has been released. In particular, housing starts rose 6.9% in June from May to a seasonally adjusted annual rate of 760,000 the highest level in almost four years, indicating the residential real estate market may be recovering.
- In the eurozone, there were not many news this week. German investor confidence declined for a third month in July as the euro area debt crisis persists and cooling global demand affects the economic outlook. The ZEW index of investor and analyst expectations fell to -19.6 in July from -16.9 in June. On the external sector, the eurozone continued posting external trade surpluses in May (+€6.9bn), with exports rising by 0.3% and imports falling by 0.9% m/m. Germany continued leading with (€+59.3 bn in January-April 2012) while UK, France and Spain registered the highest deficits (-51.8bn -29.0bn, -15.3bn, respectively). Italy returned to trade surplus of 1bn in May, as a result of exports gaining 1.4% and imports up by 0.9% m/m.
- Regarding China, data on monthly housing prices showed a slight rebound in housing prices, by an average of 0.1% m/m according to our calculations (based on data covering 70 cities nationwide). The price increase follows 10 consecutive months of declines, which resulted in a cumulative fall of 1.8% since the peak in July 2011. The turnaround in the property sector follows recent policy easing measures, including interest rate cuts in June and July and a series of cuts in the RRR. Despite this support, authorities have vowed to maintain measures to curb property prices to prevent asset bubbles and maintain affordability. On the balance, a modest and sustained rise in housing prices would be positive in facilitating a pickup in overall economic growth momentum.

Next week: Busy week ahead for sovereign bond auctions. Spain, Germany, France, and Italy will sell bills, and Germany and Italy will also sell bonds. Investors will keep interest on the Eurozone PMI indexes and on the German IFO. In China, the focus will be on the release of the HSBC flash manufacturing PMI. Later in the week the focus will shift to the US with the release of the 2Q12 GDP (advance estimate) on Friday.

Calendar: Indicators

Eurozone: Flash PMI Composite (July, July 24th)

Forecast: 46.5

Consensus: 46.4

Previous: 46.5

We expect the composite PMI to have remained relatively stable in July, after the mild improvement registered in June. This forecast means that the indicator would have remained in contractionary territory, but with no signs that activity is getting worse at the beginning of Q3. Across components, we also expect both manufacturing and services PMIs to remain about stable, although slowing global demand and depressed investment of the private sector point to a gloomy outlook in both sectors for coming quarters. In addition, we expect divergence across countries to linger, as increasing concerns about financial needs in the periphery together with ongoing hard fiscal adjustments will persist.

Eurozone: M3 (June, July 26th)

Forecast: 3.1% y/y

Consensus: 2.9% y/y

Previous: 2.9% y/y

We expect M3 to have increased further in June, although at a more moderate pace than that observed in the previous month. Nonetheless, non-standard measures implemented by the ECB make the forecast of this series more uncertain. Across its counterparts, we estimate that loans to the private sector should have remained virtually flat in June, as observed in previous months. Loans to households could have increased slightly at steady rates up to June over Q1 (around 0.2%), while those to firms could have dropped slightly (around -0.1% q/q), after falling by -0.6% q/q in Q1. Overall, these figures show more evidence about the weakness of both private consumption and investment, while they raise doubts about the pace of the recovery in coming quarters.

US: Durable Goods Orders, Ex Transportation (June, July 26th)

Forecast: 0.2%, -0.3%

Consensus: 0.4%, -0.2%

Previous: 1.1%, 0.4%

The usual monthly volatility in durable goods orders has not subsided in recent months, with the indicator jumping in May following two consecutive months of declines. The main driver is often the aircraft orders component, which is likely to grow at a slower pace in June after increasing in the previous month. Slowing in manufacturing activity will likely weigh on the headline figure, with most surveys for June suggesting decelerating new orders. On the bright side, increasing demand for autos may help keep durable goods orders in positive growth territory.

US: GDP, Advance Estimate (2Q12, July 27th)

Forecast: 1.9%

Consensus: 1.5%

Previous: 1.9%

Economic activity has been mixed throughout the second quarter compared to the recovery strength seen earlier in 2012, yet we expect that GDP growth will continue at similar QoQ annualized pace. In regards to the underlying GDP components, improvements in trade and production data will likely offset some of the slowing in inventory and real PCE growth. On average, the trade balance in 2Q12 was slightly better compared to 1Q12 given the improvement in May and the rebound in export growth. Furthermore, industrial production has fared slightly better in the second quarter in terms of average monthly growth. On the downside, inventory growth has been slower compared to the first quarter. Also, real PCE has increased only 0.1% per month on average in 2Q12 thus far compared to more than 0.2% in 1Q12. Still, we expect that the pace of overall GDP growth will not change significantly from the previous quarter.

Korea: 2Q GDP (July 26)

Forecast: 2.6% y/y

Consensus: 2.4% y/y

Previous: 2.8% y/y

Being heavily export-dependent, Korea's economy is highly exposed to weakening external demand. With the economy slowing and inflation (2.2% y/y in June) remaining well within the official 2-4% target range, the Bank of Korea cut interest rates on July 12th by 25bp cut, the first easing move since 2009. The move came against weakening external demand, a half percentage point lowering of the BoK's full year forecast to 3.0% y/y (BBVA: 2.9% y/y). We expect a further slowdown in Korea's second quarter GDP. Given recent fiscal stimulus measures and the likelihood of another rate cut during the year, we expect Q2 to reflect a bottoming out of growth momentum, although there are downside risks from the weak external environment.

Markets Data

			Close	Weekly change	Monthly change	Annual change	
Interest rates (changes in bps)	US	3-month Libor rate	0.45	0	-2	20	
		2-yr yield	0.21	-3	-10	-18	
		10-yr yield	1.48	-1	-18	-148	
	EMU	3-month Euribor rate	0.45	-4	-21	-116	
		2-yr yield	-0.06	-2	-21	-145	
		10-yr yield	1.18	-8	-44	-165	
Exchange rates (changes in %)	Europe	Dollar-Euro	1.223	-0.1	-3.7	-14.8	
		Pound-Euro	0.78	-0.9	-3.6	-11.5	
		Swiss Franc-Euro	1.20	0.0	0.0	2.1	
	America	Argentina (peso-dollar)	4.56	0.2	1.2	10.1	
		Brazil (real-dollar)	2.01	-1.2	-0.7	29.7	
		Colombia (peso-dollar)	1780	0.2	0.5	1.3	
		Chile (peso-dollar)	485	-1.1	-2.0	5.2	
		Mexico (peso-dollar)	13.25	-0.3	-3.4	13.8	
		Peru (Nuevo sol-dollar)	2.62	-0.1	-1.0	-4.2	
	Asia	Japan (Yen-Dollar)	78.55	-0.8	-1.2	0.0	
		Korea (KRW-Dollar)	1141.20	-0.8	-0.9	8.5	
		Australia (AUD-Dollar)	1.041	1.8	2.1	-4.1	
Comm. (chg %)		Brent oil (\$/b)	106.7	4.2	15.1	-10.1	
		Gold (\$/ounce)	1582.8	-0.4	-1.5	-1.2	
		Base metals	502.6	0.4	-2.3	-15.4	
Stock markets (changes in %)	Euro	Ibex 35	6475	-2.8	-4.7	-35.6	
		EuroStoxx 50	2277	0.8	3.2	-17.9	
	America	USA (S&P 500)	1377	1.5	1.5	2.3	
		Argentina (Merval)	2503	5.1	6.4	-25.4	
		Brazil (Bovespa)	55347	1.9	-3.2	-8.2	
		Colombia (IGBC)	13723	0.4	-1.7	-0.7	
		Chile (IGPA)	21066	0.4	0.1	-4.3	
		Mexico (CPI)	40753	0.6	4.6	14.0	
		Peru (General Lima)	20116	0.0	-2.9	-8.8	
	Asia	Venezuela (IBC)	245602	-1.5	-2.9	181.6	
		Nikkei225	8670	-0.6	-0.9	-14.4	
		HSI	19641	2.9	0.6	-12.5	
Credit (changes in bps)	Sovereign risk	Ind.	Itraxx Main	161	-5	-8	50
		Itraxx Xover	642	-23	-19	229	
		CDS Germany	74	-9	-26	17	
		CDS Portugal	829	-5	-102	-86	
		CDS Spain	580	25	8	271	
		CDS USA	47	-2	-2	---	
		CDS Emerging	251	-7	-28	39	
		CDS Argentina	1135	-5	-96	532	
		CDS Brazil	140	-3	-5	28	
		CDS Colombia	123	-4	-11	13	
		CDS Chile	107	-1	-4	34	
		CDS Mexico	121	-2	-14	11	
		CDS Peru	138	-7	-13	17	

Source: Bloomberg and Datastream

Weekly Publications

Country	Date	Description
EMU	07/17/2012	➤ Europe Economic Watch: "Eurozone: Growth prospects worsen in Q2" Incoming data for the Eurozone in Q2 suggests negative growth at -0.2% q/q, with downside risks, after a stagnated economy in Q1
	07/16/2012	➤ Europe Flash: "Both headline and core inflation remained stable in June" Inflation remained stable in June at 2.4% y/y, interrupting the downward trend observed in the previous months
España	07/18/2012	➤ Flash España: "España: Balanza comercial de mayo 2012" El déficit de la balanza comercial en el acumulado a 12 meses de mayo se reduce sustancialmente hasta alcanzar un registro de -42,1 mil millones de euros.
	07/16/2012	➤ Presentación de "Situación Galicia. Primer semestre 2012" Galicia: recesión algo más suave que en España, por menos desequilibrios
	07/16/2012	➤ Situación Galicia. Primer semestre 2012 Galicia: recesión algo más suave que en España, por menos desequilibrios
US	07/17/2012	➤ U.S. Economic Flash. Bernanke Emphasizes Risks, June's Inflation and Production Data Unlikely to Influence Immediate Fed Policy Fed Chairman Addresses Cautions on Economic Outlook. Upward Pressure on Core Inflation Continues. Industrial Production Rebounds in June
Latin America	07/16/2012	➤ U.S. Weekly Flash. FOMC Minutes Suggest Continued Divide Among Committee Members The minutes of the FOMC meeting from three weeks ago coincided with an expansion of the maturity extension program and a downgrade of the Fed's forecast for US growth (Spanish Version)
Brazil	07/19/2012	➤ Brazil Flash: "CB to continue cutting the SELIC at a 50bps pace in the months ahead" By leaving the monetary policy minutes practically unchanged, the CB signalled that it is not currently planning to change its recent monetary easing strategy.
Peru	07/16/2012	➤ PIB soprendió al alza En mayo, la actividad económica se expandió 6,5% a/a, por encima de lo previsto (BBVA: 5,4%, Consenso: 5,3%) debido, principalmente, al mejor desempeño de la manufactura.
Mexico	07/18/2012	➤ Mexico Banxico Flash. No change in monetary policy rate. Special attention to the assessment of the balance of risks of economic activity The uncertainty of the external environment could lead Banxico to a more cautious assessment of the downward risks on economic activity (Spanish Version)
	07/18/2012	➤ Mexico Migration Outlook July 2012 The economic crisis and the "Arizona Effect" are the main factors that have held back the flow of Mexican immigrants to the U.S. (Spanish Version)
	07/18/2012	➤ Presentación Situación Migración México Julio 2012 Con la recuperación económica de EEUU las remesas han empezado a aumentar, los flujos migratorios paulatinamente también podrían hacerlo

Asia

- 07/19/2012 ➤ **Asia Daily Flash | 19 July 2012: Indonesia unveils bank ownership rules; China announces new loans to Africa**
Bank Indonesia yesterday revealed its long-anticipated new rules on domestic bank ownership, which were largely in line with expectations. The new ownership limit is reduced to 40%.
- 07/18/2012 ➤ **Asia Daily Flash | 18 July 2012: China's property market rebounds; Malaysia's inflation shows further moderation**
China's property market rebounds in June, reflecting a turning point following 10 consecutive months of declines.
- 07/17/2012 ➤ **Asia Daily Flash | 17 July 2012: Singapore's non-oil exports show resilience; China's outbound FDI expands rapidly**
Asian markets trended higher today in anticipation that Fed Chairman Bernanke's scheduled testimony before the US Congress on Tuesday might raise prospects of further QE
- 07/17/2012 ➤ **China Watch: As RMB internationalization advances, new headwinds call for policy steps**
In Q2 2012, cross-border trade transactions settled in RMB amounted to 10.9% of China's trade, up from almost zero when the program began.
- 07/16/2012 ➤ **Asia Daily Flash | 16 July 2012: India's inflation softens; More policy easing expected in China**
India's wholesale price inflation softened in June; meanwhile more policy easing is expected in China, with the mid-year economic meeting being held on Wednesday
- 07/16/2012 ➤ **India Flash: June WPI inflation softens, but elevated food prices may keep the RBI cautious on imminent rate cuts**
India's wholesale price inflation softened in June to 7.25% y/y from 7.55% in May as a let up in fuel and non food articles offset elevated food inflation.

Publications on July 20, 2012 to 11:00, Madrid time

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