BBVA Research

Global

Weekly Watch

Madrid, 18 June 2010

Economics Analysis

Financial Scenarios
Daniel Navia
daniel.navia@grupobbva.com
+34 91 537 83 51

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

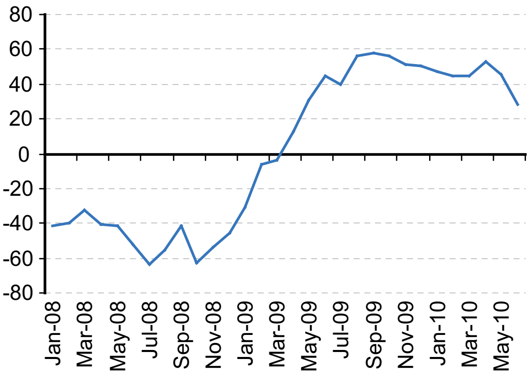
Europe's cycle remain the weakest link...

Europe is increasingly being perceived as the only major region in which financial risks and macro developments could cast a shadow to the global outlook. In spite of relatively good macro data, financial developments are already playing their effect into confidence as observed in Germany's ZEW this week. Fiscal plans will also play their part so the risks to the near-term outlook are clearly tilted downwards. Euro area's PMI flash data for June and business and consumer confidence releases in Germany, France and Italy will mark the path next week.

... while emerging economies and the US are still strong

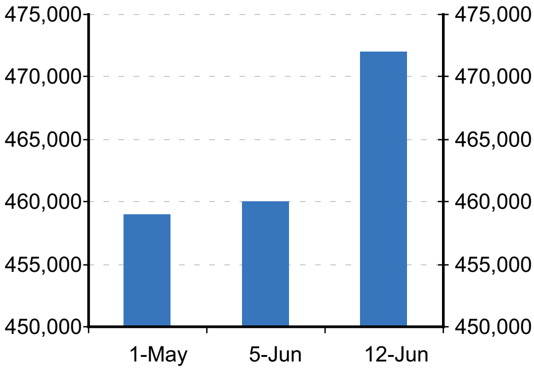
On the contrary, the economic data flow from medium and large emerging economies and to some extent from the US continues giving support to the global business cycle and to financial markets. Recent macro releases support this view, although risks are tilted downwards. In Asia, recent economic indicators have helped to alleviate market concerns of an abrupt slowdon, in particular strong exports, industrial production and GDP growth. In Latin America, real activity is also gaining momentum, leading some national Central Banks such as Brazil and Chile to speed up its tightening cycle. In the US, industrial production and manufacturing continue to steer the recovery while the labor market remain feeble as reflected in weekly jobless claims that persist stubbornly elevated. For this reason, next week's FOMC meeting is unlikely to modify the US monetary stance.

Chart 1
Germany: ZEW indicator of economic sentiment (net balance)



Source: BBVA Research

Chart 2
USA: Initial jobless claims (week ending)



Source: BBVA Research

Highlights

Europe: Fiscal plans on the spotlight

News on fiscal policy in Europe continue to arrive. The recent announcements highlight the lack of specific details and credible measures in some cases, while in others do not even involve any harder adjustment than the one outlined in their stability programs approved in early 2010.

USA: Fed conducted its first Term Deposit Auction

The Federal Reserve carried out its first auction of term deposits through its new Term Deposit Facility. The first competitive sale was a successful test to understand whether the system would work properly in the future, especially if we assume that the liability side of the Fed's balance sheet -versus the alternative of asset sales, which are unlikely in 2010- will initially bear the burden of its exit strategy.

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

The global risk premium eases

The easing of the global risk premium that has accompanied the continued fall in equity volatility from mid-May highs and the rise in stocks since the start of this week has not, however, had a significant impact on the Eurozone sovereign risk premium, which remains very much in place. Core-periphery spreads have therefore continued to widen, fundamentally in Spain, but also in other peripheral countries such as Greece and Portugal: the spread between the Bund and the 10Y Spanish bond reached 221bps, up from the 189bps of the end of last week. However, Spanish auctions returned to the region of 212bps. The auctions were well received, above all since the maximum possible amount was issued (3.5 billion euros).

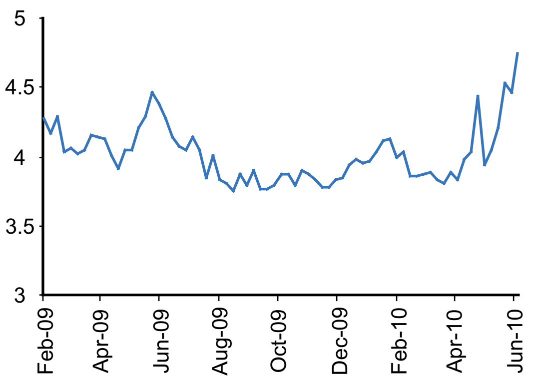
While we wait for the next bond auctions, we see scarce upside in the 10-year Spanish bond's yield

In our view the levels reached this week by the 10Y Spanish bond (up to 4.99%) have been accentuated by the market's anticipation of the auction. We think that any break above the key 4.80% level (2007 highs), and in a second stage 5% (2008 highs) would be very significant from a technical standpoint. There may therefore be little upside left in the 10Y Spanish bond. This improvement, even though it is limited, may slow rises in absolute levels and spreads. Auctions will remain the centre of attention, in particular the 3 and 6-month Spanish T-bills planned for the 22 June and the 5-year Portuguese bonds on 23 June. The maximum amount for the latter is 800 million euros, and the placement will be under a great deal of scrutiny following Portugal's decision to postpone a 3 billion euro syndicated bond issue due to market conditions, instead choosing to increase the amount of existing bond issues.

Euro appreciation is limited in our view

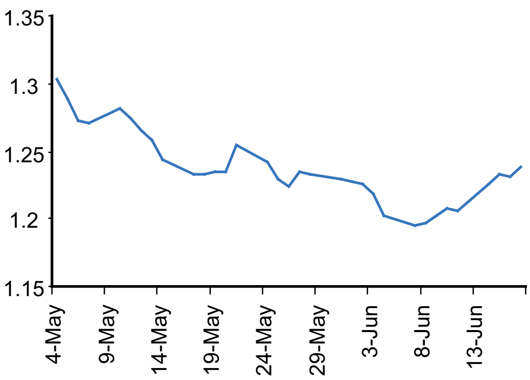
The improvement in the global risk premiums is also reflected in the appreciation of commodity-linked and emerging currencies. We think the euro's upside is limited to the 1.24-1.25 zone, by the risk elements affecting the Eurozone and movements in flows. Portfolio inflows of long-term assets in the US in April were a clear sign of a recovery in confidence in the dollar among international investors.

Chart 3
Spain 10Y Govt



Source: Bloomberg

Chart 4
EURUSD



Source: BBVA Research

Economics Analysis

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

Agustín García Serrador
agustin.garcia@grupobbva.com
+34 91 374 79 38

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

Financial Scenarios
Daniel Navia
daniel.navia@grupobbva.com
+34 91 537 83 51

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

US
Nathaniel Karp
nathaniel.karp@bbvacompass.com
+1 713 881 0663

Hakan Danis
hakan.danis@bbvacompass.com
+1 713 843 5382

Highlights

Europe: Fiscal plans on the spotlight

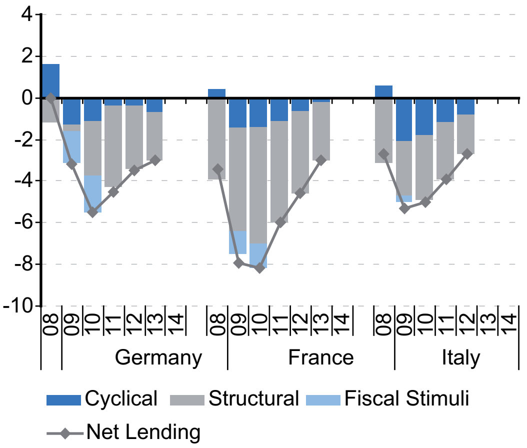
News on fiscal policy in Europe continue to arrive. The recent announcement by the German government of an 80 bn package was sold as an example of fiscal rectitude but was much lower in practice, as that figure incurs in double counting by adding all the cumulated savings until 2014. There is no adjustment in 2010 (indeed there is still a positive stimulus), while cuts will grow progressively from a relatively modest adjustment of 11bn in 2011 to larger one of 34 bn in 2014. Measures have been defined for 2011 (cuts in welfare spending and the public wage bill) but are less defined for later years. This fiscal package does not involve any harder adjustment than the one outlined in the stability programme approved in early 2010, it only fills it with concrete measures. The same story can be told about Italy, as its 24 bn package provides details on the relatively small adjustment needed –and the details do not sound well, since about one third is supposed to come from fight against tax evasion, and much of the rest from spending restraint by local governments.

This week the French government outlined its proposal of pension reform, the day after it was criticised by the European Commission for being too optimistic on its growth projections incorporated in its fiscal plans and not having approved any measures of fiscal restraint yet. The pension reform will have a small impact on the budget in the short run (0.5% of GDP in 2013), but it will be larger in the long term (1.9% by 2020) and important because it provides a sign of willingness to tackling deep structural problems. The plan raises the official retirement age from 60 to 62, but also eliminates exemptions to payroll taxes, introduces a new top income tax rate of 41% and raises contributions for public sector workers (to make them equal to those in the private sector).

USA: Fed conducted its first Term Deposit Auction

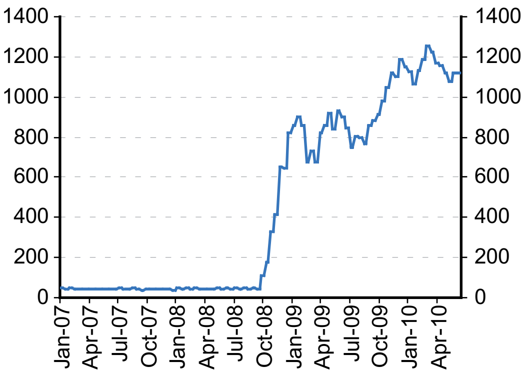
The Federal Reserve carried out its first auction of 14-day term deposits for $1bn through its new Term Deposit Facility (TDF) on June 14th. Although the auction was relatively small, it represents an important step forward for the Fed in its ongoing exit strategy. Term deposits will be used like certificates of deposits to drain excess reserves as funds to pay for them will be removed from the accounts of participating institutions for the life of the term deposit. Nonetheless, the Fed is not expected to drain excess reserves in large amounts in next auctions. All in all, the first competitive sale was a successful test to understand whether the system would work properly in the future, especially if we assume that the liability side of the Fed's balance sheet -versus the alternative of asset sales, which are unlikely in 2010- will initially bear the burden of its exit strategy. Excess bank reserves are now more than $1 trillion and represent 52% of its monetary base.

Chart 5
EMU: Fiscal deficits projected paths



Source: National Sources, European Commission and BBVA Research

Chart 6
USA:
Federal Reserve Excess Reserves ($ bn)



Source: Federal Reserve and BBVA Research

Economics Analysis

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

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

Latin America
Myriam Montañez
miriam.montanez@grupobbva.com
(+34) 91 374 5536

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

Ricard Torne
ricard.torne@bbva.com.hk
+852 2582 3198

Calendar: Indicators

USA: Durable Goods Orders, excl. Transportation (May, June 24th)

Forecast: -1.0%, 0.6% **Consensus: -1.5%** **Previous: 2.8%, -1.1%**

Commentary: The transportation component is expected to pull down the overall figure due to a downward adjustment following April's large order of non-defense aircraft and parts. Apart from this, orders are expected to post a widespread increase, which would point to strengthening private demand. **Market impact:** A negative surprise in this component would raise concerns about the sustainability of private demand growth.

USA: FOMC Statement (June 23th)

Forecasts: 0%-0.25% **Consensus: 0%-0.25%** **Previous: 0%-0.25%**

Commentary: The FOMC is expected to hold interest rates at 0%-0.25% and maintain the "extended period of time" language. Recent Fed speeches have indicated that economic conditions are improving in line with Fed expectations, but growth will only be moderate and inflationary pressures will remain at bay. **Market impact:** A surprise in the statement would be the removal of the "extended period of time" language, which would indicate that rates will rise sooner than expected.

Eurozone: PMI Composite (June, June 23rd)

Forecasts: 55.8 **Consensus: 55.6** **Previous: 56.4**

Commentary: Economic agents' sentiment in the eurozone is likely to decline further in June, mainly hit by the sovereign crisis. In particular, the PMI composite is expected to fall slightly to 55.8 points from 56.4 printed in May, resulting from lower confidence in the manufacturing sector, while confidence in the service sector should remain stable. **Market impact:** A negative surprise could have a relevant market impact as financial risks remain formidable.

Mexico: CPI (H1 June, June 24th)

Forecast: 0.3% **Consensus: -0.2%** **Previous: -0.6%**

Commentary: We expect the first rise in consumer prices since April, mainly due to seasonal upward pressures in agricultural prices and also in the services sector. **Market impact:** A negative surprise will strongly support our view that Banxico will delay its first rate hike.

Colombia: GDP (Q110, June 24th)

Forecast: 2.5% **Consensus: 3.9%** **Previous: 2.5%**

Commentary: We expect Q1 GDP growth to hold steady in yearly terms and below market consensus. Nonetheless, recent macro releases suggest an upward bias to our outlook. **Market impact:** We should no discard a negative surprise as market consensus remain well above our forecast.

Japan: Consumer price index (May, June 25th)

Forecast: -0.9% **Consensus: -1.1%** **Previous: -1.2%**

Commentary: We expect the pace of Japan's deflation to ease slightly in May. Recent indicators point in this direcction. Exports are robust (especially to the rest of Asia), and domestic business spending is picking up. Nevertheless, uncertainty to the global outlook and Japan's high public debt burden will present headwinds, with deflation likely to persist into next year. **Market impact:** Lower than expected deflation would improve sentiment and help support the recovery by encouraging consumer and business spending.

Table 1
Market data

			Close	Weekly change	Monthly change	Annual change
Interest rates (changes in bps)	US	3-month Libor rate	0.54	0	5	-7
		2-yr yield	0.71	-2	0	-49
		10-yr yield	3.20	-3	-1	-58
	EMU	3-month Euribor rate	0.73	1	4	-49
		2-yr yield	0.57	11	9	-88
		10-yr yield	2.72	16	4	-78
Exchange rates (changes in %)	Europe	Dollar-Euro	1.236	2.5	0.1	-11.5
		Pound-Euro	0.83	0.5	-3.1	-1.5
		Swiss Franc-Euro	1.37	-1.2	-3.5	-8.9
	America	Argentina (peso-dollar)	3.93	0.1	0.5	4.0
		Brazil (real-dollar)	1.78	-1.5	-6.0	-9.3
		Colombia (peso-dollar)	1901	-1.2	-5.6	-10.1
		Chile (peso-dollar)	533	-0.9	-2.4	-0.4
		Mexico (peso-dollar)	12.56	-1.1	-4.7	-6.1
		Peru (Nuevo sol-dollar)	2.83	-0.4	-0.6	-5.0
	Asia	Japan (Yen-Dollar)	90.71	-1.0	1.5	-5.7
		Korea (KRW-Dollar)	1195.50	-4.2	-2.7	-5.9
		Australia (AUD-Dollar)	0.868	2.4	6.4	7.7
Comm. (chg %)		Brent oil ($/b)	77.7	4.5	8.1	12.3
		Gold ($/ounce)	1255.9	2.4	6.2	34.5
		Base metals	478.1	0.5	-0.7	19.9
Stock markets (changes in %)	Euro	Ibex 35	9875	3.3	6.5	3.1
		EuroStoxx 50	2729	3.4	6.2	12.1
	America	USA (S&P 500)	1115	2.1	4.0	21.0
		Argentina (Merval)	2315	1.5	10.8	48.4
		Brazil (Bovespa)	64513	1.4	10.9	25.6
		Colombia (IGBC)	12407	0.8	4.7	27.3
		Chile (IGPA)	18931	2.6	6.9	26.3
		Mexico (CPI)	32694	1.8	7.7	34.7
		Peru (General Lima)	14367	1.0	1.1	9.4
		Venezuela (IBC)	64715	1.6	4.0	49.6
	Asia	Nikkei225	9995	3.0	-0.4	2.1
		HSI	20287	2.1	3.8	13.2
Credit (changes in bps)	Ind.	Itraxx Main	121	-9	-5	2
		Itraxx Xover	541	-55	-63	-199
	Sovereign risk	CDS Germany	40	1	-3	2
		CDS Portugal	301	12	-28	220
		CDS Spain	243	37	36	145
		CDS USA	36	-1	-2	---
		CDS Emerging	261	-25	-53	-150
		CDS Argentina	1041	-69	-221	-1171
		CDS Brazil	131	-10	-22	-62
		CDS Colombia	152	-11	-33	-73
		CDS Chile	92	-13	-18	-38
		CDS Mexico	128	-13	-25	-106
		CDS Peru	129	-12	-25	-68

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".