

Weekly Watch

Global

Madrid, 19 August 2011
Economic Analysis

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Poor data adds to recession fears

Most data surprised largely on the downside this week. EZ GDP growth slowed in Q2 while US data point to risks of further slowing in growth. The steep drop in the Philadelphia Fed index to -30.7 in August – a worrying level only seen around recessions – led to an intense risk-off mood. But not only mounting recession fears are contributing to safe-haven buying, concerns that the sovereign debt crisis in the EZ will continue to escalate along with rising fears about the funding of EZ banks have also contributed. Something is clearly wrong with EZ bank funding – banks are dependent on ECB liquidity provision and are hoarding funds rather than lending to each other – but signs of liquidity stress have been exacerbated by cycle-related market fears.

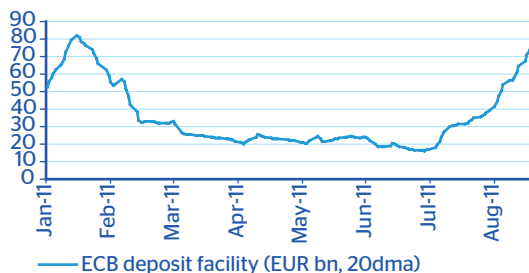
Highlights

Eurozone: Sharp slowdown, no firm decisions to solve sovereign debt crisis

EZ GDP slowed in Q2 somewhat more than expected. The surprise came mostly from France and Germany, which barely grew, increasing concerns about the outlook. Are these fears realistic? On the one hand, data in Germany and France suggest that private consumption slowed down even though investment could have increased further, a possible sign that domestic demand is not yet strong enough to take over from exports to lead the recovery and make it more sustainable. Still, drivers of private consumption in core countries continue to be positive, suggesting that the fall could have been due to a drop in consumer confidence. On the other hand, the recent slowdown in US growth also fed fears of a fading support of external demand, but emerging economies continue to grow robustly. Overall, the key for coming quarters is the sovereign debt crisis in the eurozone, which could continue weighing on confidence if it is not tackled satisfactorily. In the shorter term, available data for Q3 is still limited, but July's numbers suggest that weakness continues. Our MICA model now predicts that EZ GDP will grow around 0.1-0.2% q/q in Q3 and Q4, resulting in an annual growth of around 1.8% in 2011, similar to that of 2010.

Chart 1

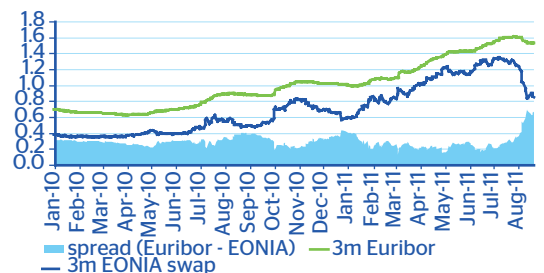
EZ banks are worried about lending to each other



Source: Bloomberg and BBVA Research

Chart 2

Signs of liquidity stress due to cycle-related fears



Source: Bloomberg and BBVA Research

Markets

More stimuli from central banks?

In Europe the market maintains its expectation of cuts to rates in coming months. In the US, we are seeing a decoupling between nominal and real interest rates. The latter have climbed 20bp in the 5Y and 10Y since last week's pledge by the Fed (no rate hikes until mid-2013), despite the sharp fall in nominal rates, prompting a major pullback in inflation expectations. This movement may be in part a response to the fact that the market expected a QE3 announcement and was somewhat disappointed that none was forthcoming. If this is the case, the movement should be limited until Bernanke's press conference in Jackson Hole (26 August), since the market may begin to price in an announcement of further monetary stimulus. In our view, this is unlikely, as Fed members appear divided on the issue. In equity markets, doubts over the recovery and the lack of concrete proposals to deal with the debt crisis, together with the burden of a mixed corporate earnings season in Europe point to high volatility in the short term. In forex, the absence of key messages in Europe might have the potential to keep a moderate offered-tone for EUR. Finally, in credit markets we maintain our cautious tone as we still do not foresee any major trigger for spread tightening in the near term.

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Economic Analysis

Calendar: Indicators

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Eurozone: Flash PMI composite (August, August 23rd)

Forecast: 50.1	Consensus: 50.3	Previous: 51.1
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Comment: we expect the composite PMI to decline again in August, though not as sharply as in the past three months, suggesting that the eurozone economy could be close to stagnation in the current quarter. In particular, the industrial PMI should indicate that this sector could be contracting slightly in Q3, while sentiment in the service sector is expected to continue pointing to a slight expansion. The recent increase in uncertainty linked to the sovereign debt crisis combined with concerns about more marked slowing of global growth is clearly weighing on confidence. This declining trend is expected to be observed across member states, but while PMI could still indicate modest growth rates in core countries, peripheral economies could have moved into contractionary territory. **Market Impact:** a sharp drop in PMIs in core countries could signal the return to recession in the eurozone.

Eurozone: Money Supply (July, August 26th)

Forecast: 2.2% y/y	Consensus: 2.3% y/y	Previous: 2.1% y/y
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Comment: Eurozone lending data for July are expected to reflect a still sluggish credit performance, although recent drops in economic sentiment could have negatively affected both supply and demand for credit and thus result in more negative figure. M3 growth is projected to have remained broadly stable in July, hovering around 2% as it has done since late 2010. Across its counterparts, loans to households are expected to have increased further, but at a more modest pace than in recent months, while loans to non-financial corporations are likely to continue at their subdued pace. **Market impact:** worse than expected outcomes could be received as further evidence about the fragility of the eurozone recovery, but they would also deprive the ECB of arguments to continue tightening.

US: Gross Domestic Product, 2nd estimate (2Q11p, August 26th)

Forecast: 1.1%	Consensus: 1.1%	Previous: 1.3%
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Comment: the combination of lower-than-expected exports and greater-than-anticipated imports suggests that the 2Q11 preliminary release will be revised down. The advanced forecasts released by the BEA anticipated a jump in exports with slowed import growth, however recent releases are pointing to both increased imports and decreased exports. The negative trade headwinds could be offset by increased inventories, although evidence from the Census Bureau suggests that inventories could be less than initially forecasted. As for consumption, weak labor markets and slowed retail sales coincide with low consumer expenditure and therefore the probability of an upward revision to consumption is low. **Market Impact:** after last month's significant revision to 1Q11 GDP, markets will be watching the more validated second release. Current volatility swings suggest any significant downward revision will likely result in the similar flight to risk-free assets.

US: Consumer Sentiment (August, August 26th)

Forecast: 55.5	Consensus: 56.0	Previous: 54.9
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Comment: preliminary estimates for consumer sentiment in August surpassed historical lows, suggesting a discouraging outlook for the final report. Growing uncertainties regarding future earnings have weakened consumer activity and increased expectations for a continued slowdown. The string of debt ceiling negotiations followed by the U.S. credit downgrade in early August triggered a growing lack of confidence in the political system and likely had a lasting impact on consumers. Although the employment situation has improved slightly, as suggested by declines in initial jobless claims, we expect consumer sentiment in August to remain low. **Market Impact:** continued declines in consumer confidence will lead to negative reactions in an already volatile market.

Singapore: CPI inflation for July (August 23rd)

Forecast: 5.1% y/y	Consensus: 5.0% y/y	Previous: 5.2% y/y
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Comment: after rising at its fastest pace since January, inflation is expected to remain elevated in July on rising transportation and housing costs. Recent indicators show that domestic demand is holding up, and that inflationary pressures from the demand side are still evident. However, given its small size and export-dependence, Singapore's economy is especially vulnerable to a possible weakening of global demand. **Market impact:** given downside risks to the global economy and the recent decline in exports (-2.8% yoy in July), markets do not expect an increase in the pace of appreciation at the Monetary Authority of Singapore's next policy meeting in October; however, a higher-than expected inflation outturn could change these expectations and set the stage for further regional currency appreciation.

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Markets Data

			Close	Weekly change	Monthly change	Annual change
Interest Rates (changes in bps)	US	3-month Libor rate	0.30	1	5	-3
		2-yr yield	0.20	1	-18	-29
		10-yr yield	2.11	-14	-81	-50
	EMU	3-month Euribor rate	1.53	0	-7	64
		2-yr yield	0.67	-2	-63	6
		10-yr yield	2.13	-20	-64	-14
Exchange Rates (changes in %)	Europe	Dollar-Euro	1.444	1.5	1.7	13.7
		Pound-Euro	0.87	-0.6	-1.1	6.3
		Swiss Franc-Euro	1.13	3.1	-2.8	-14.0
	America	Argentina (peso-dollar)	4.18	0.4	1.0	6.1
		Brazil (real-dollar)	1.59	-1.4	1.8	-9.5
		Colombia (peso-dollar)	1777	-0.4	1.1	-2.3
		Chile (peso-dollar)	468	-0.5	1.2	-7.3
		Mexico (peso-dollar)	12.21	-0.6	4.8	-4.3
		Peru (Nuevo sol-dollar)	2.74	-0.2	-0.1	-2.2
		Japan (Yen-Dollar)	76.20	-0.9	-3.3	-11.1
	Asia	Korea (KRW-Dollar)	1087.28	0.7	3.1	-8.2
		Australia (AUD-Dollar)	1.047	1.3	-2.5	17.6
Comm. (chg %)	Brent oil (\$/b)	107.8	-0.2	-8.8	45.1	
	Gold (\$/ounce)	1844.8	5.6	15.3	50.2	
	Base metals	567.9	0.0	-4.5	13.5	
Stock Markets (changes in %)	Euro	Ibex 35	8219	-5.0	-15.6	-18.6
		EuroStoxx 50	2182	-5.4	-19.4	-17.5
		USA (S&P 500)	1146	-2.7	-13.5	7.0
	America	Argentina (Merval)	2870	-3.3	-13.9	17.7
		Brazil (Bovespa)	53462	0.0	-9.6	-19.8
		Colombia (IGBC)	13049	-2.7	-4.0	-3.0
		Chile (IGPA)	19904	-1.9	-9.2	-5.8
		Mexico (CPI)	33060	-0.9	-6.5	2.4
		Peru (General Lima)	19560	-1.9	-11.8	31.5
		Venezuela (IBC)	99260	-0.3	14.0	53.1
	Asia	Nikkei225	8719	-2.7	-12.9	-5.0
		HSI	19400	-1.1	-11.8	-7.5
Credit (changes in bps)	Ind.	Itraxx Main	153	3	35	39
		Itraxx Xover	646	18	207	139
	Sovereign risk	CDS Germany	80	0	22	37
		CDS Portugal	878	34	-215	599
		CDS Spain	362	7	21	135
		CDS USA	48	-2	-5	---
		CDS Emerging	284	8	64	50
		CDS Argentina	783	26	160	-41
		CDS Brazil	146	-5	29	24
		CDS Colombia	142	-9	27	19
		CDS Chile	97	-5	22	22
		CDS Mexico	145	-8	31	25
		CDS Peru	152	-11	23	52

Source: Bloomberg and Datastream

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