

Weekly Watch

Global

Madrid, 29 July 2011
Economic Analysis

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Uncertainties re-emerge

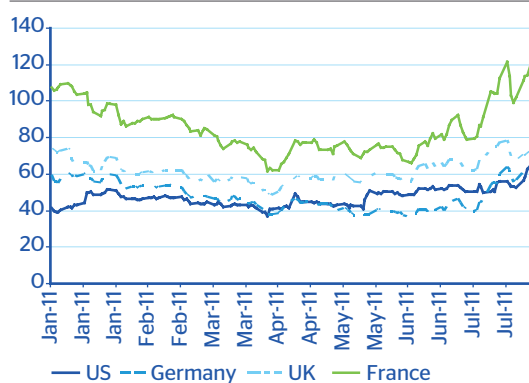
Doubts about the implementation of the EFSF flexibility have arisen as the German government rejects a 'carte blanche' for widespread purchases on the secondary market. Meanwhile, emerging economies at the IMF are reluctant to pump a large sum of money into another Greek bailout. Furthermore, as investors are mulling over the current PSI, S&P has warned of a second round of restructuring in Greece. All in all, more steps are needed to address the European problem. On the other hand, the US is still debating raising the debt ceiling. Remarks from S&P stating that it has not set a threshold for spending cuts to avoid a credit downgrade have at least delayed the risk of a downgrade of the US credit rating if the debt ceiling is increased. Meanwhile, BEA first estimate indicated a frustrating 1.3% q-o-q GDP growth in 2Q (1.7% of our forecast and 1.8% consensus). Next week, the US ISM index, the US employment survey and the Chinese PMI for July will be key figures for gauging the expected rebound in economic activity at the start of 3Q.

Highlights

Quiet meeting but ECB sticking to a pre-emptive approach

The hawkish tone will be maintained but not hinting at another hike in the following meeting. The statement will repeat that upside inflation risks will continue to be monitored "very closely" while the monetary policy stance will be labelled again as "accommodative", showing that the ECB still does not feel comfortable with the level of rates - even taking into account the latest 25bp hike which brought the policy rate to 1.50% - and suggesting that more hikes are likely. We expect another 25bp hike in 4Q and one more in 1Q12.

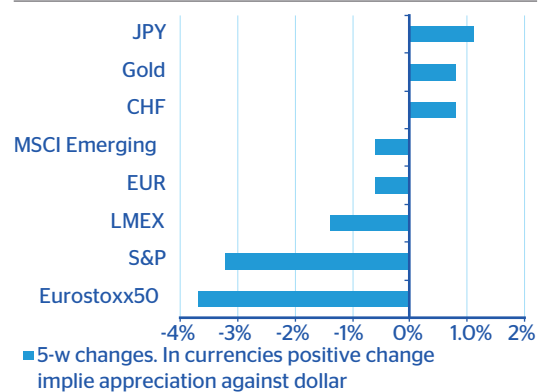
Chart 1
5Y CDS



Source: BBVA Research

Chart 2

Flows searching for safe-haven



Source: BBVA Research

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Markets

The potentially positive impact of the recently announced Eurogroup measures seems to have been eclipsed in the short term by doubts over their implementation. The defensive bias looks set to continue in the short term, especially after Moody's decision to put Spain's rating under review. Additional news flow is not very reassuring. The markets therefore remain defensive, which may continue to drive instability in core non-core spreads and cap any attempts at rises in yields in both core bonds and swap curves. 2Q11 earnings are proving positive in the US, although the surprises are increasingly small in number and less significant, while in Europe the surprises have been on the downside in investment banking and energy.

Economic Analysis

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Calendar: Indicators

Eurozone: Germany: Industrial production (June, August 5th)

Forecast: 0.1% m/m	Consensus: 0.1% m/m	Previous: 1.2% m/m
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Comment: after the surge registered in May we expect industrial production to have moderated in June. The overall performance for Q2 suggests that the industrial recovery slowed down in line with business surveys that are showing signs of temperance. Looking forward, we think that the industrial sector recovery remains on track, but at a more moderate pace, after the strong but unsustainable growth recorded last year. Export dynamism should continue to support the industrial sector in coming quarters, especially from emerging economies. However, on a positive note, the pattern of growth in Germany seems to be shifting towards domestic demand. **Market impact:** a very negative surprise could be interpreted by markets as a faster moderation in economic growth than anticipated.

US: ISM Manufacturing Index (July, August 1st)

Forecast: 54.0	Consensus: 55.4	Previous: 55.3
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Comment: preliminary data for the month of July suggests that the ISM index will decline but remain indicative of overall growth. Moderating price pressures should act to offset the downside risk to demand expectations. Furthermore, conflicting Federal Reserve regional manufacturing reports suggest the national manufacturing sector is slowing but does not signal recessionary activity. In addition, job creation momentum appeared to slow in July possibly impacting this month's employment index. **Market Impact:** manufacturing has remained relatively stable throughout the current soft patch soothing market apprehension. However, a substantial pull-back this month would increase market anxiety, which has reached its apex in anticipation of a debt ceiling agreement.

US: Non-farm Payroll, Unemployment (July, August 5th)

Forecast: 70k, 9.2%	Consensus: 100k, 9.2%	Previous: 18k, 9.2%
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Comment: non-farm payrolls are expected to improve in July after last month's disappointing employment report, though the outlook is conservative. Moderate employment creation is expected to continue in the services, manufacturing, and construction sectors, and a decreasing trend in jobless claims may indicate stronger labor market growth. However, sustained government job cuts are likely to weigh down overall non-farm payrolls in July. The general consensus is that the employment situation is still weak, and we see no indication that the unemployment rate will change. **Market impact:** markets are hoping for better employment news in July, and after last month's surprisingly negative report, small positive changes should slightly ease investor concerns.

Brazil: Inflation (July, August 5th)

Forecast: 0.20% m/m	Consensus: 0.13% m/m	Previous: 0.15% m/m
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Comment: after averaging 0.80% in the first five months of the year, the inflation is expected to be in the 0.1% m/m-0.2% m/m range for the second month in a row in July. This moderation is being driven by seasonal factors and a gradual slowdown of the economy. In yearly terms, however, July's inflation will increase to around 6.9% y/y, the highest value in six years. **Market Impact:** we see more room for the figure surprising to the downside (i.e. lower than expected inflation). If inflation surprises to the upside the impact on future interest rates should be significant and the CB would have practically no room for keeping the SELIC rate unchanged at its next meeting in the end of August.

China: PMI for July (August 1st)

Forecast: 50.2	Consensus: 50.1	Previous: 50.9
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Comment: the Purchasing Managers' Index (PMI) for July will be closely watched against the backdrop of lingering worries of a hard landing. A strong Q2 GDP outturn (9.5% y/y) allayed such concerns, but they could re-emerge as signs of further growth moderation appear and as the PMI flirts with the important benchmark level of 50 (reflecting expansion/contraction). We expect the PMI to decline for a fourth consecutive month to 50.2, due in part to seasonal effects (despite NBS efforts to seasonally adjust the series). We expect a rebound in August, in line with seasonal trends and our soft landing scenario. **Market impact:** a lower-than-expected reading, especially below 50, could dent market sentiment by exacerbating fears of a hard landing.

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Markets Data

			Close	Weekly change	Monthly change	Annual change
Interest Rates (changes in bps)	US	3-month Libor rate	0.26	0	1	-20
		2-yr yield	0.38	-1	-9	-17
		10-yr yield	2.87	-10	-25	-4
	EMU	3-month Euribor rate	1.61	0	7	71
		2-yr yield	1.17	-22	-39	38
		10-yr yield	2.55	-28	-44	-12
Exchange Rates (changes in %)	Europe	Dollar-Euro	1.437	0.1	-0.3	10.2
		Pound-Euro	0.88	-0.6	-2.5	5.3
		Swiss Franc-Euro	1.13	-3.5	-6.1	-16.6
	America	Argentina (peso-dollar)	4.14	0.1	0.9	5.2
		Brazil (real-dollar)	1.56	0.5	-0.7	-11.4
		Colombia (peso-dollar)	1777	1.0	-0.2	-3.5
		Chile (peso-dollar)	457	-1.0	-2.9	-12.3
		Mexico (peso-dollar)	11.76	1.1	-0.2	-7.1
		Peru (Nuevo sol-dollar)	2.74	0.1	-0.5	-2.9
		Japan (Yen-Dollar)	77.05	-1.8	-4.7	-10.9
	Asia	Korea (KRW-Dollar)	1054.43	0.3	-1.8	-10.8
		Australia (AUD-Dollar)	1.095	0.9	2.7	21.1
Comm. (chg %)	Brent oil (\$/b)	116.2	-2.1	3.4	48.6	
	Gold (\$/ounce)	1629.1	1.7	7.7	37.9	
	Base metals	596.6	0.4	-0.4	22.5	
Stock Markets (changes in %)	Euro	Ibex 35	9538	-5.2	-6.0	-9.2
		EuroStoxx 50	2634	-5.0	-6.0	-3.9
		USA (S&P 500)	1289	-4.2	-1.4	17.0
	America	Argentina (Merval)	3271	-2.5	-2.5	36.6
		Brazil (Bovespa)	58318	-3.2	-6.4	-13.6
		Colombia (IGBC)	14069	1.8	-1.0	5.9
		Chile (IGPA)	21090	-4.2	-6.4	3.9
		Mexico (CPI)	35731	-0.1	-2.3	10.6
		Peru (General Lima)	21963	-0.4	17.3	53.9
		Venezuela (IBC)	89251	2.3	11.0	39.3
	Asia	Nikkei225	9833	-3.0	0.4	3.1
		HSI	22440	0.0	1.7	6.7
Credit (changes in bps)	Ind.	Itraxx Main	114	3	4	9
		Itraxx Xover	430	17	21	-50
	Sovereign risk	CDS Germany	63	5	19	25
		CDS Portugal	913	-3	146	688
		CDS Spain	346	37	65	170
		CDS USA	65	11	14	--
		CDS Emerging	212	0	-6	-2
		CDS Argentina	596	-7	-25	-198
		CDS Brazil	114	2	-1	-3
		CDS Colombia	111	1	-1	-13
		CDS Chile	70	-4	-7	-8
		CDS Mexico	111	1	-1	-6
		CDS Peru	123	2	-19	13

Source: Bloomberg and Datastream

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