BBVA Research

Global

Weekly Watch

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Economics Analysis

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Asian growth ever more important

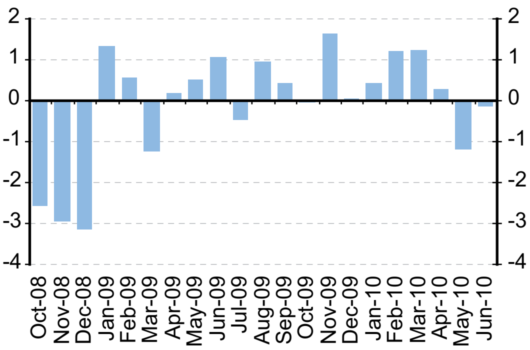
Increasing risks in developed countries...

Over the week, incoming data still suggested that US risks are tilted to the downside, as highlighted by IP and retail sales data and further in the FOMC minutes, which might lead to adjustments in monetary policy going forward. In Europe, macro data is obviously expected to be of secondary importance as the stress tests will be published, but the message remains that Europe is vulnerable in its internal demand and increasingly dependent on external purchases. That said, negative surprises in US housing data or Europe's PMI could still derail markets in anticipation of the CEBS results.

...put the focus on the resilience of Asian growth

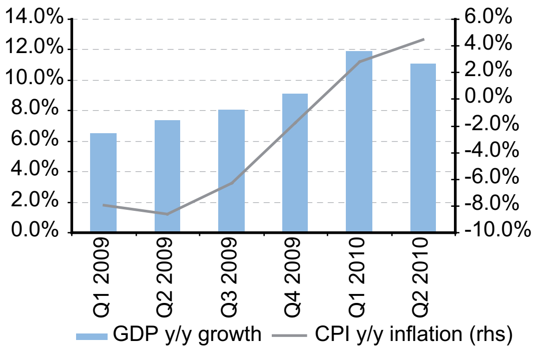
The latest macro releases in Asia point to further strong growth momentum, at a gradually slowing pace. China's much-anticipated GDP release for the second quarter, confirmed continued strong growth momentum in line with an expected soft-landing in the second half of the year, as the authorities recent tightening measures appear to be successfully damping domestic demand pressures. Other export-oriented economies in the region are still booming, such as Singapore which posted another quarter of rapid GDP growth, raising risks of overheating despite concerns about the global outlook.

Chart 1
USA: Retail sales excluding motor vehicles (m/m %; sa)



Source: Datastream and BBVA Research

Chart 2
China: GDP growth and inflation (in %)



Source: Bloomberg and BBVA Research

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USA: a more cautious Fed highlights

Fed members expressed new concerns to the outlook and revised slightly downwards its forecast for 2010. to top 3.5%. We expect low rates for a extended period of time.

Policy tightening is succeeding in emerging Asia

The Chinese economy is on track on a policy-driven soft landing as the 2Q10 GDP slowed to 10.3% y/y from 11.9% in 1Q10, in contrast overheating pressures continue to be present in the rest of Asia as it is reflected in the Singapore's growth (19.3% y/y in 2Q10).

Growth perspectives for the US and EMU in the second half of 2010

Recent data is showing a slowdown in growth in the 2H10 with respect to 1H10 in the two major regions of the world, deceleration that is consistent with our below-consensus forecasts.

Markets Analysis

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Markets

The market is starting to differentiate between peripheral countries while it waits for the results of the stress tests

Markets will be waiting for the results of the stress tests which will be published on Friday, following a reduction in the risk premium applied to Spain this week. The success of the 15-year bond issue was reflected in the maximum amount being placed (EUR3bn), a high bid-to-cover ratio (2.57 vs. 1.57), and the rally seen on the secondary market following the auction, allowing the Spanish 10-year spread to settle below 200bps. Meanwhile, Ireland and Portugal spreads rose, so the market's attention will be focused on the Irish issues of 6 and 10-year bonds next week. In Portugal, Moody's credit rating downgrade of the country by two notches had more of an impact than the fact that more debt was issued than expected, and the 6.1% increase in tax revenue in the first half of the year.

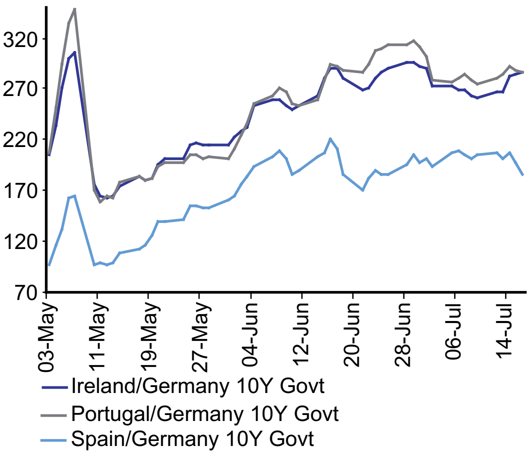
Corporate earnings support equity indexes

The focus of stock markets is shifting from European financial risk to US cyclical risk. Attention is therefore centred not only on macroeconomic data, and its downside risks, but also on US corporate earnings. In general, companies are following a positive trend, because the international exposure that many multinationals have is still acting as a driver, partially shielding them from a weak domestic market (this is also true for European and Spanish companies). Until now in the US, 14 companies have published 2Q10 results, and 12 of them have exceeded expectations. If this tone is maintained, we think this could cushion the negative impact of macroeconomic data, strongly supporting the market, despite occasional profit-taking following the rally of the last few days.

The dollar's recent depreciation appears to be coming to an end

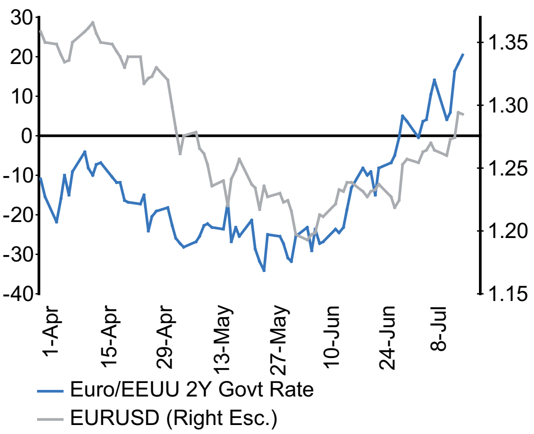
The dollar has continued to fall, in terms of both Effective Exchange Rate (now at April levels) and especially vs. the euro (now at 1.29). This profile continues to reflect high sensitivity on the market to US macro data, accompanied by (in the cross vs. the euro) the interest rate spread factor (the 2Y spread has continued to widen in favour of the euro). Meanwhile, the short end of euro curves have continued to rise, in line with Euribor rates, and US rates remain affected by a curve which has continued to flatten. In our opinion, there is limited room for these trends to continue and they should end up inverting: the "cyclical risk" in the US will not prevent the country from growing at a rate of around 3% this year (vs. 0.9% for the Eurozone). Furthermore, the rise in euro rates has a built-in limit in the form of ECB rates. Under these circumstances, the dollar should find room to move towards levels we would be more comfortable with (closer to 1.25 dollar/euro).

Chart 3
Core/Non Core 10Y Govt Spread



Source: Bloomberg and BBVA Research

Chart 4
Euro/EEUU 2Y Govt Rate vs EURUSD



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Highlights

USA: a more cautious Fed highlights

According to the minutes from the last FOMC meeting, Fed members expressed new concerns to the outlook and revised slightly downwards its forecast for 2010. GDP growth is now projected to top 3.5% in 2010, below the 3.7% that they estimated in April, mainly driven by emerging risks to global financial markets from European sovereign debt problems. Participants are concerned about persistent labor market weakness and they considered that the unemployment rate could remain well above its long-run sustainable level for several years, which partly guides policy decisions. This downward revision in economic prospects could lead the Fed to return to exceptional measures to support the economy, "the Committee would need to consider whether further policy stimulus might become appropriate if the outlook were to worsen appreciably". This context of moderate economic growth is in line with our projection that Fed will maintain rates low for an extended period of time, as markets now anticipate.

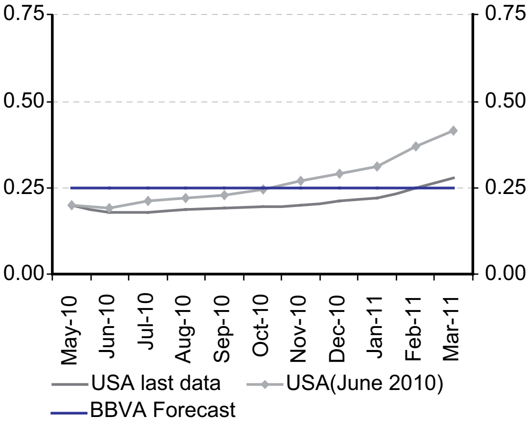
Policy tightening has resumed in emerging Asia

Chinese data shows that the economy is on track for a policy-driven soft landing as 2Q10 GDP slowed to 10.3% y/y from 11.9% in 1Q10, below our (10.8%) and consensus (10.4%) expectations. These figures remain broadly consistent with our 9.8% y/y growth projection for 2010 which builds in a further slowdown in 2H10. Price data also shows that the government is succeeding in its objective of preventing "overheating" as June's CPI inflation declined to 2.9% from 3.1% in May well below expectations (BBVA: 3.7%, Consensus 3.3%). Overheating pressures continue to be present in the rest of Asia as it is reflected in the impressive Singapore's growth (19.3% y/y in 2Q10). Also this week the Bank of Japan revised its growth forecast to 2.6% for fiscal 2010 (BBVA 2.3%) raising from the 1.8% it predicted in April arguing, "Japan's economy shows further signs of a moderate recovery, induced by improvement in overseas economic conditions".

Growth perspectives for the US and EMU in the second half of 2010

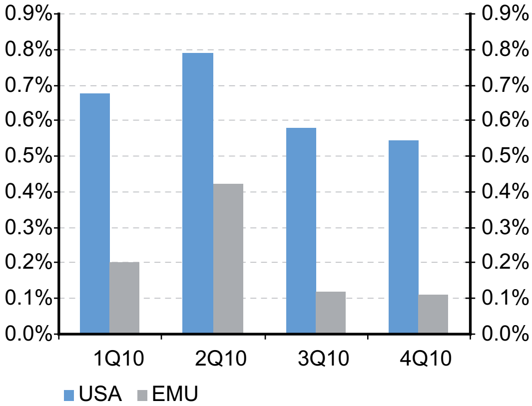
Recent data is showing a slowdown in the pace of growth in the two major regions of the world, deceleration that is consistent with our below-consensus forecasts, as we repeatedly commented in past issues of the global weekly. In the second half of the year we continue to expect a further easiness in US growth momentum with respect to the 1H10, as fiscal policy will continue its easing and private demand will fail to fully replace public stimulus. In particular, we expect US GDP growth to slow from +0.8% q/q in 2Q10 to +0.6% q/q in 3Q10 and to 0.5% q/q in 4Q10. As a result, GDP in 2H10 in the US will be 1.3% higher than in 1H10. In the EMU GDP growth will be more anemic in 2Q10 and 3Q10 than in the US and is also expected to decelerate on quarterly basis in 3Q10 and 4Q10, resulting in a 2H10 only 0.4% higher than 1H10.

Chart 5
United States:
implicit official rate in Fed Funds futures



Source: Bloomberg and BBVA Research

Chart 6
US and EMU:
GDP growth in 2010 (q/q, in %)



Source: Bloomberg and BBVA Research

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Calendar: Indicators

USA: Housing Starts (June, July 20th)

Forecast: 582K	**Consensus:** 585K	**Previous:** 593K

Comment: Builders' confidence cooled in June as indicated by the NAHB Index, which dropped five points. Builders have seen a sharp decline in demand following the expiration of the home buyers' tax credit and are uncertain about the future. As a result, ground breaking on new homes will drop in June. **Market Impact:** A greater than expected decline would indicate serious weakness in the residential construction sector, which would lead to further job losses and worries about the pace of recovery.

USA: Existing Home Sales (June, July 22nd)

Forecast: 5.39M	**Consensus:** 5.22M	**Previous:** 5.66M

Comment: Existing home sales are expected to drop in June, but they are still benefiting from the home buyers' tax credit, which requires all sales to be completed by June 30th. The largest downward adjustment for this series will take place in July. **Market Impact:** A negative surprise would indicate significant weakness in housing demand. As a result, builders' confidence and residential investment would drop even further.

Eurozone: PMI Composite (July, July 22nd)

Forecast: 55.3	**Consensus:** 55.2	**Previous:** 56.0

Comment: As both the debt crisis and the strong fiscal retrenchment in European countries continue to erode economic agents' confidence, we expect the PMI composite to decline further in July for the third month in a row, although the fall should not be too strong, in line with recent positive economic data, especially manufacturing sentiment. **Market Impact:** A large negative surprise could have a significant market impact as it would be interpreted as a sign that there could be a significant slowdown in 2H10.

Eurozone: Industrial new orders (May, July 22nd)

Forecast: -0.1% m/m	**Consensus:** -0.2% m/m	**Previous:** 0.6% m/m

Comment: Industrial new orders in the eurozone are expected to stagnate in May, after the strong upward trend observed since mid-2009 and linked in part to the strong and temporary inventory rebuilding process. This goes in line with the assessments of order books levels from the EC confidence survey. **Market Impact:** A negative surprise would rise concerns about the sustainability of industrial sector recovery and thus about the fragility of the economic recovery.

Taiwan: Export Orders (July 20th)

Forecast: 22.1%	**Consensus:** 21.8%	**Previous:** 34.0%

Comment: Taiwan is well-integrated into the global supply chain and its export orders—a 1-3 months leading indicator of actual exports—is a good gauge of global demand. We expect export orders to ease in June weighed down by weaker global demand. **Market Impact:** A significantly weaker reading could jolt markets by intensifying concerns about a global slowdown.

Mexico: CPI, 1st half of July (%, July 22nd)

Forecast: 0.3% over 2nd half of June	**Consensus:** n.a.	**Previous:** 0.0%

Comment: July could be the first period with CPI increase after three consecutive monthly. The middle of the year should show the 2010 bottom on annual inflation. **Market Impact:** inflation downward surprise has been one of the main factors behind curve flattening. Considering the impact on markets from volatile non-core component of CPI, the reaction to possible upwards surprises has to be monitored.

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				Close	Weekly change	Monthly change	Annual change
Interest Rates	(changes in bps)	US	3-month Libor rate	0.52	-1	-2	2
			2-yr yield	0.58	-4	-12	-40
			10-yr yield	2.94	-11	-25	-71
		EMU	3-month Euribor rate	0.86	4	13	-9
			2-yr yield	0.77	0	25	-49
			10-yr yield	2.62	-1	-4	-78
Exchange Rates	(changes in %)	Europe	Dollar-Euro	1.294	2.3	4.8	-8.4
			Pound-Euro	0.84	0.5	1.1	-2.5
			Swiss Franc-Euro	1.35	1.1	-1.7	-11.0
		America	Argentina (peso-dollar)	3.93	0.0	0.2	3.4
			Brazil (real-dollar)	1.78	1.2	-0.2	-7.7
			Colombia (peso-dollar)	1881	0.3	-0.9	-6.3
			Chile (peso-dollar)	530	-1.7	-0.2	-0.5
			Mexico (peso-dollar)	12.87	0.7	2.1	-3.6
			Peru (Nuevo sol-dollar)	2.82	-0.1	-0.4	-6.2
		Asia	Japan (Yen-Dollar)	86.32	-2.5	-4.9	-8.2
			Korea (KRW-Dollar)	1213.15	1.2	0.1	-3.7
			Australia (AUD-Dollar)	0.871	-0.5	0.8	8.6
Comm.	(chg %)		Brent oil ($/b)	75.0	-0.6	-4.7	14.7
			Gold ($/ounce)	1187.5	-2.0	-4.6	26.7
			Base metals	471.3	-0.4	-1.2	13.7
Stock Markets	(changes in %)	Euro	Ibex 35	10022	-1.0	2.7	-0.2
			EuroStoxx 50	2663	-0.7	-2.4	7.8
		America	USA (S&P 500)	1075	-0.2	-3.6	14.4
			Argentina (Merval)	2307	0.8	-0.3	42.2
			Brazil (Bovespa)	62780	-1.1	-2.7	20.6
			Colombia (IGBC)	12958	3.3	4.4	31.0
			Chile (IGPA)	19553	1.1	3.5	28.4
			Mexico (CPI)	32293	0.9	-1.5	25.4
			Peru (General Lima)	14078	0.7	-1.9	7.7
			Venezuela (IBC)	64893	-1.0	0.3	41.4
		Asia	Nikkei225	9408	-1.8	-5.9	0.1
			HSI	20250	-0.6	0.6	7.7
Credit	(changes in bps)	Ind.	Itraxx Main	115	1	-6	8
			Itraxx Xover	527	-2	-14	-181
		Sovereign risk	CDS Germany	41	-1	0	7
			CDS Portugal	293	15	-7	227
			CDS Spain	225	11	-18	147
			CDS USA	36	0	0	---
			CDS Emerging	242	-5	-19	-150
			CDS Argentina	908	2	-133	-1214
			CDS Brazil	124	-5	-8	-47
			CDS Colombia	133	-7	-19	-74
			CDS Chile	92	-3	0	-16
			CDS Mexico	124	-4	-4	-90
			CDS Peru	118	-7	-10	-65

Sources: Bloomberg, Datastream and JP Morgan

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