

## Summary

### Southern discomfort

With the spring came the first estimates of GDP growth at the start of the year from all over the world. Some aspects are not surprising, as the cooling Chinese economy, the great divergence between the US and the eurozone, and the persistence of even greater divergences within the eurozone. Some good surprises came with European data, though: the eurozone as a whole avoided recession

➤ Overview, page 2

### Economic indicators

➤ Page 4

### Market overview

➤ Page 5

Also in



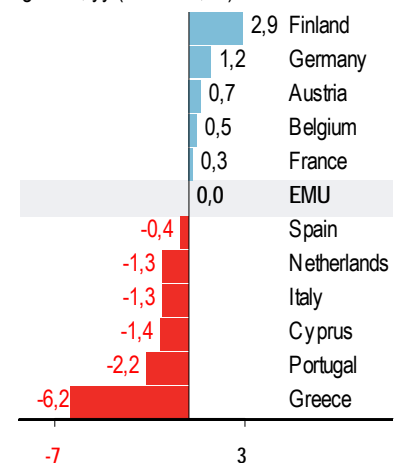
## Greece and Spain hit markets

■ German Bund yields fall to historical low (1.39% 10y) ■ The euro breaks the USD 1.30 threshold ■ Spanish debt come under pressure

Having failed to reach a ruling majority, the Greeks will return to the voting booths again on 17 June to decide on the country's future within the European Economic and Monetary Union (EMU). Fortunately, with a month to go before this crucial vote, German Chancellor Angela Merkel and French President Francois Hollande at their first meeting firmly defended the option of maintaining Greece within the eurozone. The international community, as well as private bondholders of Greek debt and, regardless of what some might say, the Greeks themselves have strived hard to avoid a divorce, too hard for an exit scenario to be considered inevitable. Despite €100bn in debt reduction, the biggest in history, the country still has considerable financial ties with the region. For example, France's official exposure to Greece amounts to roughly €50bn, including direct loans and those guaranteed by the EFSF, IMF and the ECB. And despite an "extremely severe" recession (see chart), Greece has managed to reduce its primary budget deficit to 9 points of GDP in four years, a record performance.

### WIDESPREAD PERFORMANCES

GDP growth, yy (2012 Q1, %)



Source : Eurostat

### THE WEEK ON THE MARKETS

Week 14-5 12 > 15-5-12

▼ CAC 40	3 130	▶ 3 039	-2.9 %
▼ S&P 500	1 353	▶ 1 331	-1.7 %
↗ Volatility (VIX)	19.9	▶ 22.0	+2.1 %
▼ Euribor 3M (%)	0.69	▶ 0.69	-0.3 %
▼ Libor \$ 3M (%)	0.47	▶ 0.47	-0.1 %
↗ OAT 10y (%)	2.81	▶ 2.89	+7.6 %
▼ Bund 10y (%)	1.43	▶ 1.39	-4.0 %
▼ US Tr. 10y (%)	1.81	▶ 1.78	-3.2 %
▼ Euro vs dollar	1.29	▶ 1.28	-1.3 %
▼ Gold (ounce, \$)	1 589	▶ 1 552	-2.3 %
▼ Oil (Brent, \$)	112.8	▶ 111.8	-0.9 %

## Overview

### Southern discomfort

With the spring came the first estimates of GDP growth at the start of the year from all over the world. Some aspects are not surprising, as the cooling Chinese economy, the great divergence between the US and the eurozone, and the persistence of even greater divergences within the eurozone. Some good surprises came with European data, though: the eurozone as a whole avoided recession, with a positive GDP growth in 2012 Q1, even if limited to +0.1% on a quarterly annualised basis.

#### Recession avoided

China is not (yet) the first economy of the world, but the first one to release its GDP estimates. In the first quarter, the slowdown in Chinese growth was slightly more marked than expected, remaining incredibly high on Western standards, though: +8.1% y/y, after +9.2% in 2011 and +10.4% in 2012.

The US economy definitely performed well in 2012 Q1, growing by an annualised 2.2%. This represents a very limited slowdown from 2011 Q4 (+3.0%). The strength was mainly coming from a surprising resilience in households spending (3.4%), which was broad-based: all components of private consumption expenditure were solid (durable goods +6.2%, non-durable goods +2.1, services +1.2%) while residential investment recorded a double-digit growth for the second quarter in a row (+19.0% after +11.7%). The acceleration in final domestic demand was however limited (+1.6% after +1.5%). First, government expenditures kept on exerting downward pressure, contracting for the sixth quarter in a row. There were down 3% over the quarter, leaving them 4.2% below their peak of end-2010. As a percentage of GDP, there have been cut by almost two points in three years. Second, due to the expiration of the 100% bonus depreciation for new capital spending, business investment decreased, with a big contraction in spending on structures (-12%) and a slowdown in equipment and software expenditures (+1.7% vs +7.5%). Finally, while the inventory change added 0.5 pp to GDP growth, the contribution from net exports was limited to 0.02 pp.

The breakdown of GDP figures in the eurozone will not be available before the beginning of next month. We however assume that the biggest drag came from domestic demand, with austerity weighing down on private consumption and bleak prospects on business investment. What made the eurozone avoid recession (defined as two consecutive quarters of negative quarterly change) was thus either a positive development in exports (that would be good news) or a negative development in imports (that would be bad news, since resulting from a depressed domestic demand) or an increase in inventories (that would be bad news, the rebuilding of inventories likely being involuntary, thus reflecting a depressed domestic demand).

#### From one difference...

GDP growth, y/y, %

— China ; — US ; — Eurozone

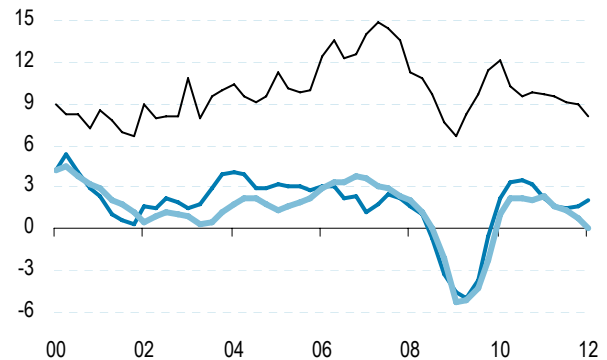


Chart 1

Sources : NBS, BEA, Eurostat

#### ... to the other

GDP growth, y/y, %

— Germany ; — South (weighted sum of Greece, Italy, Portugal and Spain) ;

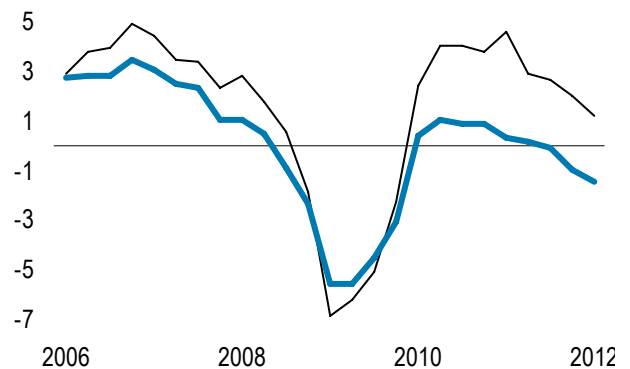


Chart 2

Source : Eurostat

The country details show that within the eurozone, divergences remained. As compared with the end of 2011, they however did not exacerbate in the extent that was feared. Germany rebounded markedly, recording a GDP growth of 0.5% q/q, way stronger than expected (we were forecasting +0.2%). Italian activity suffered a third consecutive decline (-0.8%), but Portugal and Spain managed to minimize the damage, with respective contractions of 0.1% and 0.3% in 2012 Q1. Greece once more recorded a sharp contraction of activity, even if slightly more limited than previously: -6.2% versus -7.5% y/y (note that the Greek statistic office no more publish seasonally adjusted numbers).

### So far, not so bad

When we last reviewed our global economic forecasts, we were assuming that the first quarter of 2012 would be the worst of the year. The resilience of growth over the period could thus be very good news. However, since then, we received both positive and negative signals. In China, March data were very positive and we then assumed that the economy was rebounding more quickly. But our enthusiasm was curbed with April figures. In the US, after strong job creations in January and February (534k positions added), March and April came as a great disappointment with monthly increase in non-farm payrolls cut by half. In the eurozone, purchasing manager indices were very weak. After a short-lived come-back above 50 in January, the composite PMI for the eurozone lost 3.8 points in three months. The levels are frighteningly low in Southern Europe (43.3 in Italy and 42.7 in Spain, in April) but the recent decline was more marked in major countries: the composite PMI lost 2.9 points in Germany (to 48.4 in April) and 3.7 points in France (46.0).

It is almost impossible to be optimistic about Southern Europe prospects. Austerity bites hard on their economies and it will keep on doing so for a prolonged period of time. Thanks to a mix of declining benefits and rising taxes on top of cuts in wages, household disposable income is under great pressure. To keep on consuming, they do not have a choice but to tap their savings. This leads to shrinking banks deposits that in turn limit the ability of the banking sector to increase credit. The two waves of LTRO (Long-Term Refinancing Operation) from the ECB provided some fresh air, but the effect on the real economy has been limited so far (see *"Were the 3-year LTROs a success?"*, Clemente De Lucia, EcoWeek #12-19).

A rebound in activity in Southern Europe is unlikely in the short-term, which will put great pressure on the ability of governments to meet fiscal targets. As long as meeting those targets is top priority for European leaders, this will lead to additional deficit cutting measures, weighing on down heavier on activity.

### The lack of growth and the damage done

Some European leaders and, more strikingly, Mario Draghi called for a growth pact. One of the caveats is that, even if using the same terminology, they certainly do not mean the same thing. Mr Draghi calls for what Southern Europe countries are currently trying to implement: growth enhancing structural reforms, through liberalisation of the labour market but also goods and services markets. Politicians probably mean relaxed fiscal rules (if you are inclined to cynicism) or greater use of funds from the European Investment Bank.

Another element that would definitely help Europe overcoming the crisis is growth abroad. For sure, Germany would be first in line to

### Southern gloom

Economic Sentiment Indicator

— Germany; — South

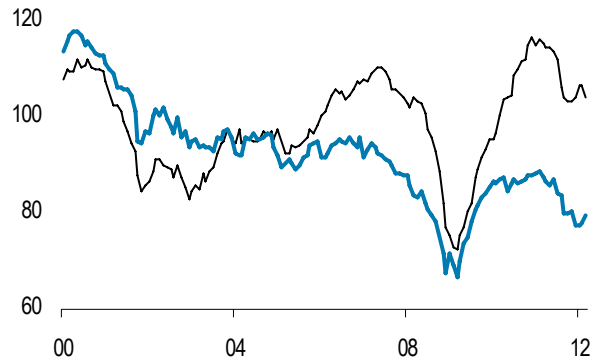


Chart 3

Source : European Commission

benefit, but eventually, this boost would translate into stronger domestic demand in turn benefiting countries that do export to Germany. China may be cooling down but the smaller rates of growth apply to a bigger economy. Additionally, the slowdown comes with a rebalancing of growth engines towards a more dynamic domestic demand. Both elements lead us to expect China to add more to global activity than it used to do in the past.

China is not the only place where demand does not stand still. Asia is currently accelerating, mainly thanks to increasing domestic demand. And there is the US. Remember the good old days, when the whole world was waiting for US consumers to come to the rescue? Their potential contribution is way more limited than it used to be, but they still can help. US data released so far this week came on a bright tone. In April, retail sales were expected to suffer from a perfect storm: lower oil prices, disappointing car sales, and early summer-clothes shopping due to warm weather that pushed up sales in March with adverse impact on April data. At the same time, inflation moderated to 2.3% y/y, down from 2.6% in March and a high 3.9% in September 2011. The final piece of good news came from the manufacturing sector, with the New York Fed survey pointing to strengthening activity. The PMI Index (which is not published but that we calculate using the ISM method) jumped to 55.1 in May, from 52.9 in March, reaching its highest level in a whole year.

Next week will bring additional data of importance, with the release, on Thursday, of Flash PMIs. For the first time ever, the US will be part of the release. We will have additional data to measure the growth gaps that exist between China and the developed world, between the US and the eurozone, and within the eurozone.

## To watch from 21 May to 25 May 2012

### Tuesday 22 May 2012

#### UNITED KINGDOM: Inflation ( March)



In March, inflation increased somewhat from 3.4% in February to 3.5%. It should be back on its downward trend in April.

### Wednesday 23 May 2012

#### JAPAN: Trade (April)



Exports, mainly driven by the gradual pickup in world trade, could have increased by 1% in April. The seasonally adjusted trade deficit could have narrowed to around JPY500 billion.

#### UNITED KINGDOM: Retail sales (April)



Retail sales jumped in March. They were up by 1.8% m/m, more than offsetting February's fall. They probably corrected somewhat downwards in April.

### Thursday 24 May 2012

#### UNITED STATES: Durable goods (April)



After a 4% m/m decline in durable goods new orders in March, we are looking for a correction. It should however be limited to 1%.

#### UNITED KINGDOM: Q1 GDP (2nd estimate)



Q1 GDP contracted by 0.2% q/q following -0.3% in Q4 2011. The United Kingdom has thus been in technical recession since the end of last year. GDP second estimate will detail the demand factors which contributed the most to this contraction.

#### EUROZONE: PMI surveys (May flash estimates)



In April, the composite PMI for activity, a good leading indicator of GDP growth, dropped to 47, down for the third month in a row. Survey details suggest that this trend could continue in May.

#### GERMANY: Details of GDP (Q1 2012)



The German economy renewed with growth in Q1 2012 (+ 0.5% q/q, after -0.2% q/q in Q4 2011). Capital formation fell, but the contribution from foreign trade and domestic consumption to GDP growth was positive.

#### GERMANY: The IFO survey (May)



The IFO business climate index rose by only 0.1 point (to 109.9) in April. The expectations index may decline in May.

#### FRANCE: INSEE business confidence surveys (May)



After a series of mixed figures for April, a widespread deterioration of May business confidence surveys is likely because of new tensions on the sovereign crisis front and despite the reduced political uncertainty in France and the resilience of growth.

### Friday 25 May 2012

#### JAPAN: Consumer Prices (April, Tokyo: May)



Inflation is expected to remain at around 0.5% in April. Excluding food and energy, prices are projected to stay 0.5% below last year's level, which confirms that the economy is still in deflation.

#### FRANCE: Consumer confidence (May)



As is the case after each presidential election, consumer confidence should improve in May, though modestly. The stability of GDP and employment in Q1 and less expensive gasoline are supportive but the high unemployment and fiscal austerity are a cause of concern.

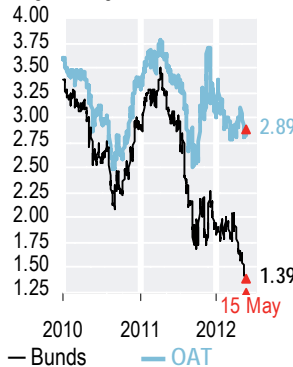
## Markets overview

### The essentials

Week 14-5 12 > 15-5-12

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10y bond yield, OAT vs Bund



Euro-dollar



CAC 40

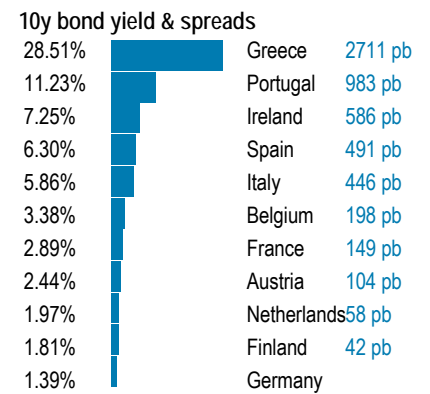


### Money & Bond Markets

Interest Rates	highest 12	lowest 12	Yield (%)	highest 12	lowest 12
€ ECB	1.00	1.00 le 02/01	€ AVG 5-7y	2.87	3.67 09/01
Eonia	0.34	0.40 le 03/01	Bund 2y	0.07	0.33 20/03
Euribor 3M	0.69	1.34 le 02/01	Bund 10y	1.39	2.04 20/03
Euribor 12M	1.27	1.94 le 02/01	OAT 10y	2.89	3.37 06/01
\$ FED	0.25	0.25 le 02/01	Corp. BBB	4.62	6.25 02/01
Libor 3M	0.47	0.58 le 03/01	\$ Treas. 2y	0.28	0.39 20/03
Libor 12M	1.06	1.13 le 04/01	Treas. 10y	1.78	2.38 19/03
£ BoA	0.50	0.50 le 02/01	Corp. BBB	3.77	4.30 03/01
Libor 3M	1.01	1.09 le 12/01	£ Treas. 2y	0.41	0.54 14/03
Libor 12M	1.86	1.90 le 25/01	Treas. 10y	1.80	2.36 16/03

At 15-5-12

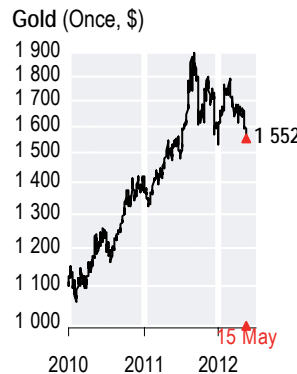
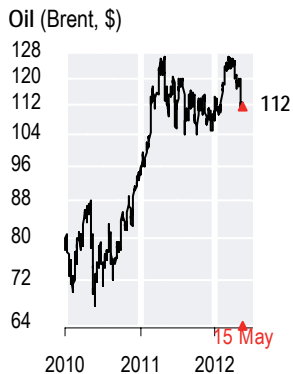
10y bond yield & spreads	highest 12	lowest 12
28.51%	09/01	2.65 13/03
11.23%	20/03	0.07 14/05
7.25%	20/03	1.37 14/05
6.30%	06/01	2.79 01/03
5.86%	02/01	4.47 02/04
3.38%	20/03	0.21 26/01
2.89%	19/03	1.76 14/05
2.44%	03/01	3.75 08/05
1.97%	14/03	0.35 31/01
1.81%	16/03	1.79 14/05
1.39%		



### Commodities

Spot price in dollars	lowest 12	2012(€)	Variations
Oil, Brent	112	108 le 02/01	+4.9%
Gold (ounce)	1 552	1 552 le 15/05	+0.2%
Metals, LME	3 339	3 297 le 05/01	+2.6%
Copper (ton)	7 798	7 488 le 09/01	+4.4%
CRB Foods	421	417 le 11/05	-1.8%
wheat (ton)	231	223 le 18/01	+0.8%
Corn (ton)	245	231 le 18/01	-2.0%

At 15-5-12



### Exchange Rates

1€ =	highest 12	lowest 12	Variations
USD	1.28	1.35 le 24/02	1.27 le 13/01 -1.6%
GBP	0.80	0.85 le 24/02	0.80 le 15/05 -4.7%
CHF	1.20	1.22 le 04/01	1.20 le 15/05 -1.1%
JPY	102.34	110.76 le 27/03	97.21 le 16/01 +2.5%
AUD	1.28	1.29 le 09/05	1.22 le 16/02 +1.1%
CNY	8.07	8.48 le 24/02	7.99 le 13/01 -1.2%
BRL	2.55	2.55 le 14/05	2.24 le 06/02 +5.3%
RUB	39.12	41.70 le 02/01	38.40 le 15/03 -6.2%
INR	68.74	70.29 le 03/05	63.89 le 03/02 -0.3%

At 15-5-12

### Equity indices

Index	High 12	Low 12	2012	2012(€)
CAC 40	3 039	3 595 le 16/03	3 039 le 15/05	-3.8% -3.8%
S&P500	1 331	1 419 le 02/04	1 258 le 02/01	+5.8% +7.5%
DAX	6 401	7 158 le 16/03	6 017 le 09/01	+8.5% +8.5%
Nikkei	8 901	10 255 le 27/03	8 378 le 16/01	+5.3% +2.7%
China*	56	62 le 29/02	53 le 02/01	+5.4% +7.1%
India*	366	454 le 21/02	348 le 02/01	+6.8% +7.1%
Brazil*	2 596	3 487 le 02/03	2 596 le 15/05	-1.7% -6.7%
Russia*	736	940 le 16/03	736 le 15/05	-4.1% +1.5%

At 15-5-12

Variations

(1) Informations: Tarik Rharrab (2) 95.56 ; Veary Bou (2) 05.27 ; Patrick Capeillere (2) 95.57

\* MSCI Indices



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