

Market Comment | Increasingly divergent monetary policies drove markets this week

Global Financial Markets Unit
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- **Very positive payroll data in the US.** US non-farm payrolls rose in October, beating expectations (by 134K to 271K; consensus: 180K), while private non-farm payrolls also increased more than expected (by 119K to 268K; consensus: 165K). In addition, the unemployment rate dropped slightly, against estimations of remaining unchanged, by 0.1% to 5.0% (consensus: 5.1%).
- **Disappointing industrial production data in Germany.** German industrial production dropped unexpectedly in September (by -1.1% MoM; BBVAe: +0.7%; consensus: +0.5%), while in annual terms it rose less than estimated (by 0.2% YoY; consensus: 1.3%). Finally, industrial production fell slightly in 3Q15 (-0.2% QoQ) after the increase in the 2Q15 (by +0.2% QoQ).
- **Greece approved a new package of measures ahead of next week's Eurogroup meeting.** It covers the calculations of pensions, energy efficiency rules and port regulations, among other topics. Passing the reforms was vital to unlock a sub-tranche (EUR2bn) of the EUR26bn tranche - needed to strengthen the Greece banking sector - within the total EUR86bn of the new bail-out. The VAT tax on private education is now a source of dissent but, as the finance minister said, the decision will be announced today.
- **Increasingly divergent monetary policies drove markets this week.** Monetary policy continued to drive market sentiment. The rising probability of further divergence among the main central banks weighed on markets this week. On the one hand, the ECB continued to strike a dovish tone -- reinforced by some of the Governing Council's members warning about the downside risk in inflation. On the other hand, the Fed evinced a growingly hawkish tone - led by Janet Yellen's evidence to Congress. Furthermore, the better-than-expected US labour readings released today reinforced markets' expectations of divergence. During the week, the implied probability of a Fed lift-off in December rose from around 50% to 70%. On another front, the Bank of England made no changes to its policy stance, keeping its interest rate and purchase program unchanged, maintaining its dovish message and stating that borrowing costs would probably stay lower for longer. As a result, US treasury yields surged during the week (2Y: +17bp, 10Y: +18bp), underpinned by the sharp increase in the probability of a rate hike before the year-end. The fall in US bond prices dragged down European ones, with European yields rising across the board this week (GER 10Y: +17bp, FRA 10Y: +15bp, ITA 10Y: +21bp, SPA 10Y: +24bp, POR 10Y: +18bp). That said, the German 2Y yield remained anchored to the ECB's loosening monetary policy, and barely rose at all in the week (+2 bp), while peripheral risk premia increased only slightly over the week (ITA: +4bp, SPA: +7bp, POR: +1.3bp). On the FX markets, the US dollar appreciated sharply against other major currencies, (EUR: -2.35%, GBP: -2.26%, JPY: -1.77%), helped by today's positive labour data in the US. EM currencies depreciated against the USD (RUB: -1.0%, CLP: -1.0%, MXN: -2.0%, IND: -1.2%, TRY: -0.1%), dragged down by expectations of a Fed lift-off and falls in commodity prices (Brent: -3.4%, WTI: -3.8%, copper: -2.7%). On equity markets, US equity indices ended the week showing a slight increase, although they have fallen sharply today, as the surge in bond yields weighed

on equity valuations (S&P 500: +0.5%, Dow: +0.7%). European equity markets also rose during the week, finding some support from the euro depreciation, which improves the prospects of European exporters and multinationals (Euro Stoxx: +1.2%, IBEX-35: +0.5%, CAC: +1.7%, DAX: +1.1%). Asian markets had a positive performance this week (Shanghai: +6.1%, Shenzhen: +6.8%, Nikkei: +1.0%) helped by China's release of a new five-year plan that was well received by markets. The main topics in the plan were the establishment of a 6.5% growth target, the abandoning of the "one child policy" and price liberalisation in competitive sectors such as water, oil, gas, electricity etc.

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Table1

*CDS, EMBI & MSCI indices with one day delay

**Credit spread (BAA) with two days delay

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