

Market Comment | Expectation of further QE stimulus from ECB drove European yields lower

Global Financial Markets Unit
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- **The eurozone's economic confidence has remained stable in November.** The index stood at 106.1, the same level as in October, which was upwardly revised from the 105.9 previously reported. (BBVA Research and consensus: 105.9). Moreover, the index level remained above its historical average (101.1). Nonetheless, the European Commission stated that the large majority of the survey results had been collected before the Paris terror attacks of Friday 13 November, so that we still have to wait until the December reading to assess any impact of these events. The stable outcome for euro area sentiment resulted from increases in confidence among consumers and in the services and construction sectors being offset by the deteriorating confidence in manufacturing industry and, to a lesser extent, retail trade. By countries, the economic confidence improved in Austria, the Netherlands and Spain, while it decreased in Italy, France and Portugal and inched down in Germany. Furthermore, Germany's GfK consumer confidence indicator has remained stable for December (9.3; BBVA Research: 9.0; consensus: 9.2, previous month: 9.4) as the expectation for unemployment increasing reined in the improvement in consumer confidence. Meanwhile, in France household consumption decreased in October (-0.7% MoM, BBVA Research and consensus: -0.1% MoM), below the 3Q15 average (+0.7% MoM). On the other hand, the flash indicator of the CPI confirms that the decline in headline prices continued to moderate in November. BBVA Research estimates suggest that energy continues to explain the fall in prices and core inflation is gradually improving ([see](#))
- **Expectation of further QE stimulus from ECB drove European yields lower.** The dovish tone of the ECB's vice-president, Vítor Constancio, increased the expectations of a further QE stimulus in next week's ECB meeting, driving German yields (both short- and medium-term) to new historically low levels. In contrast, US economic data released this week supported a Fed lift-off in December, but US markets were more focused on the Thanksgiving holiday and the Black Friday sales. Geopolitical tensions have escalated this week after a Russian jet fighter was shot down by Turkey, helping commodity prices to recover slightly this week. Concerns about China have not been dispelled. Today the Chinese equity market slumped by 5.5%, as three important Chinese securities firms are being investigated by China's Securities Regulatory Commission for suspected irregularities. Against this backdrop, on bond markets the European yields fell this week, especially in the periphery ahead of next week's ECB meeting (GER 10Y: -5bp, FRA 10Y: -5bp, ITA 10Y: -10bp, SPA 10Y: -12bp, POR 10Y: -19bp). As a result, peripheral risk premia narrowed, mainly in Portugal where the political uncertainty declined following the election of a new prime minister (ITA: -7bp, SPA: -8bp, POR: -16bp). Furthermore, the German 2Y yield (-0.42%) and 5Y yield (-0.2%) recorded new lows, while 18% of the current QE-eligible bonds are showing yields of -0.2%. On the other hand, the US curve flattened, with the 2Y yield remaining steady, while the 10Y yield decreased (-5bp). On FX markets, the USD appreciated against major currencies, mainly against the euro which fell to the lowest level since April during the week (EUR: -0.59%, GBP: -0.92%). EM

currencies depreciated against the dollar (RUB: -2.1%, BRL: -1.1%, COP: -1.1%, CLP: -0.2%, MXN: -0.1%), despite the slight improvement in commodity markets, as oil prices remained extremely volatile ahead of next week's OPEC meeting, where decisions will be made about production quotas. Furthermore, the escalation of geopolitical tension many also have contributed to today's increase in oil prices (Brent: +1.1%, WTI: +4.3%). In addition, the Turkish lira plunged (-3.2%), dragged by the attack on the Russian jet. Meanwhile, European equity markets rose across the board (Euro Stoxx: +1.1%, IBEX 35: +0.3%, CAC: +0.5%, DAX: +1.5%, MIB: +1.9%), as lower yields improve market valuations, while the lower euro improves revenues. On the other hand, US equity market remained flat during the week, waiting for the Black Friday sales. E-commerce sales are currently performing strongly, but it is too early to know how traditional sales are performing on Black Friday. Finally, Chinese equities fell sharply at the end of the week (-5.5%). The announcement that three Chinese securities firms are under investigation increased concerns ahead of next week, when IPO activity will return to the market.

ECB Thursday meeting (pre-view)

- **At next week's monetary policy meeting, the ECB will ease its policy in some way, because its view is that downside risks have increased.** In particular, the central bank considers that the impact of external factors and heightened uncertainty raise the possibility that the ECB's current measures might not be enough to achieve its objective in terms of inflation rates. Moreover, the central bank cannot back out after hinting at further easing, as soon as in December, over the last month. Moreover, comments from ECB governing council members also support further action, despite the fact that there is an open debate on the need for further measures at this moment. On the one side, hawkish members such as Executive Board member Sabine Lautenschlaeger and Governing Council member Jens Weidmann showed caution and said that the central bank should not undertake any further measures for now, emphasising that the current stimulus needs time to work. On the other side, dovish members led by the ECB president, Mario Draghi, reasserted their readiness to expand the stimulus and warned on the needed "to raise inflation as quickly as possible". In this context, markets have already priced-in some action by the ECB. This expectation of further easing has pushed down both the euro and the European curve, mainly monetary rates. If the ECB disappoints at the December meeting, this market effect could be reversed. Therefore, we expect moderate action by the ECB accompanied by a very dovish communication.
- Against this background, we consider that an extension of the asset purchase programme (APP), until March 2017 at least, could be one of the preferred options (given the bank's implicit commitment to keep rates low for longer). We also expect changes in the technical parameters of the APP. Finally, it is also possible that the central bank might cut the interest rate on its deposit facility further into negative territory. In this regard, according to a leaked report from Reuters, the ECB is mulling the imposition of a two-tier deposit rate, in order to penalise asymmetrically banks with different levels of liquidity in the ECB. Yet there is a lack of detail about this measure, in order to address the effects on the euro or on the bank's own lending. Nonetheless, we consider that it would be premature to implement this measure as early as December.
- Our expectations of further action are based on our economic outlook. GDP growth in the eurozone slowed down by a tenth to 0.3% QoQ in Q3, compared to our forecast that it would remain unchanged at 0.4 % QoQ. However, growth is showing signs of relative steadiness since late last year, based on domestic factors, showing some resilience to the worsening of the global economy. Although the information for 4Q15 is limited to confidence data, improved PMIs so far this quarter suggest, according

to our models, that the pace of growth could accelerate and return to the 0.4% figure (even close to 0.5%) in 4Q15, in line with our scenario. Meanwhile, inflation will remain low and we have revised our forecast downwards for this year (to 0.1% on average), due to the recent slide in energy prices. Nonetheless, core inflation has not suffered from second-round effects and has risen slightly in the past few months (to 1.0% in October), broadly in line with our expectations. For 2016, inflation will remain clearly below the ECB's target and we expect it to record an annual average of 1.1%. Regarding the staff forecasts, we expect them to revise inflation projections downwards for 2016 and 2017 (from the current 1.1% and 1.7% respectively) by one or two decimal points, probably more for 2016 given the impact of lower energy prices. On economic growth, we expect minor downward revisions, as the ECB expects non-standard measures to support activity (mainly domestic demand, which could offset lower global demand). Nevertheless, downside risks will continue to be highlighted as in previous meetings, since the ECB will have to justify its measures.

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Table1

Current level and changes at daily, weekly, monthly and annual frequencies

Debt markets (changes in bp)

US 2y 0.84 (2.0) (21) (25)
 US 5y 1.64 (2.0) (17) (11)
 US 10y 2.21 (2.1) (16) (11) (9)
 Japan 10y 0.31 (1.1) (2) (12) (2)
 GB 5y 4.01 (0.1) (0) (22)
 GB 10y 4.2 (1.4) (4) (22)
 GB 15y 4.45 (1.1) (1) (14)

Emerging Markets

Brazil 10y 15.58 (4) (28) (2) (32)
 Chile 10y 8.9 (2) (1) (21) (26)
 Colombia 10y 6.6 (2) (1) (21) (26)
 Mexico 10y 6.22 (0) (1) (21) (26)
 Peru 10y 9.0 (1) (24) (1) (26)
 Poland 10y 2.62 (1.1) (1) (21) (26)
 Russia 10y 5.94 (1) (29) (1) (11) (26)
 Russia 10y 5.85 (1) (25) (1) (26) (26)
 Turkey 10y 9.95 (1) (31) (1) (31) (26)

Currency risk (changes in bp)

EUR vs domestic spreads (against Germany)
 Belgium 31 (1) (1) (2)
 France 32 (1) (2) (1)
 Greece 282 (3) (26) (26) (222)
 Ireland 30 (1) (2) (1) (2)
 Italy 35 (1) (2) (1) (2)
 Netherlands 16 (1) (1) (2) (1)
 Portugal 181 (2) (15) (7) (4) (182)
 Spain 107 (2) (1) (1) (2)

EUR vs domestic spreads (against Germany)

Belgium 13 (1) (1) (2) (1)
 France 13 (1) (1) (2) (1)
 Greece 162 (1) (1) (1) (1) (18)
 Ireland 21 (1) (1) (1) (1)
 Italy 24 (1) (1) (1) (1)
 Netherlands 1 (1) (1) (1) (1)
 Portugal 111 (1) (1) (1) (1)
 Spain 61 (1) (1) (1) (1)

EUR vs domestic spreads (against Germany)

Belgium 9 (1) (1) (1)
 France 9 (1) (1) (1)
 Greece 21 (1) (1) (1) (1)
 Ireland 11 (1) (1) (1)
 Italy 20 (1) (1) (1)
 Netherlands 1 (1) (1) (1)
 Portugal 81 (1) (1) (1) (1)
 Spain 28 (1) (1) (1)

EUR vs domestic spreads

EUR vs domestic spreads
 EUR vs Belgium 34 (1) (1) (1) (1)
 EUR vs France 28 (1) (1) (1) (1)
 EUR vs Germany 14 (1) (1) (1) (1)
 EUR vs Greece 102 (1) (1) (1) (1) (1)
 EUR vs Ireland 11 (1) (1) (1) (1)
 EUR vs Italy 97 (1) (1) (1) (1)
 EUR vs Netherlands 16 (1) (1) (1) (1)
 EUR vs Portugal 181 (1) (1) (1) (1) (1)
 EUR vs Spain 107 (1) (1) (1) (1) (1)
 EUR vs US 21 (1) (1) (1) (1)

EUR vs domestic spreads

EUR vs domestic spreads
 EUR vs Belgium 414 (1) (2) (2) (2)
 EUR vs France 221 (1) (2) (2) (2)
 EUR vs Germany 221 (1) (2) (2) (2)
 EUR vs Greece 193 (1) (2) (2) (2)
 EUR vs Ireland 181 (1) (2) (2) (2)
 EUR vs Italy 193 (1) (2) (2) (2)
 EUR vs Netherlands 148 (1) (2) (2) (2)
 EUR vs Portugal 148 (1) (2) (2) (2)
 EUR vs Spain 148 (1) (2) (2) (2)

Credit risk

10y credit spreads (changes in percentage points for AAA spreads, bp)
 UK 11 (1) (1) (1) (1) (1)
 US 12 (1) (1) (1) (1) (1)
 EU EFT equity index 27 (1) (1) (1) (1)
 Dailymov volatility 12 (1) (1) (1) (1) (1)
 EUR FX equity index 12 (1) (1) (1) (1)
 Credit spread (AAA) 322 (1) (1) (1) (1) (1)
 US term volatility index 7 (1) (1) (1) (1)

Bank risk (changes in bp)

Bank risk (changes in bp)
 UK banks CDS 76 (1) (1) (1) (1)
 EUR banks CDS 79 (1) (1) (1) (1)
 US banks CDS 74 (1) (1) (1) (1)
 Large Spanish banks CDS 120 (2) (1) (1) (1)
 Medium Spanish banks CDS 114 (4) (1) (1) (1)

Bank risk (changes in bp)

Bank risk (changes in bp)
 Greek banks CDS 189 (1) (1) (1) (1) (1)
 Russian banks CDS 371 (1) (1) (1) (1) (1)

Commodity risk (changes in bp)

Commodity risk (changes in bp)
 US benchmark CDS 5 (1) (1) (1) (1)
 EU benchmark CDS 5 (1) (1) (1) (1)
 US benchmark CDS 5 (1) (1) (1) (1)

Interest rate markets (changes in bp)

Interest rate markets (changes in bp)
 EUR 3m swap 17 (1) (1) (1) (1)
 EUR 6m swap 20 (1) (1) (1) (1)
 EUR 12m swap 21 (1) (1) (1) (1)
 US 3m swap 12 (1) (1) (1) (1)
 US 6m swap 12 (1) (1) (1) (1)
 US 12m swap 12 (1) (1) (1) (1)
 UK 3m swap 12 (1) (1) (1) (1)
 UK 6m swap 12 (1) (1) (1) (1)
 UK 12m swap 12 (1) (1) (1) (1)

Stock markets (changes in percentage)

Stock markets (changes in percentage)
 US S&P 500 1.16 (1) (1) (1) (1)
 Dow Jones 1727 (1) (1) (1) (1) (1)
 Nikkei 1881 (1) (1) (1) (1) (1)
 FTSE 100 627 (1) (1) (1) (1) (1)
 Euro Stoxx 50 3463 (1) (1) (1) (1) (1)
 CSI 300 4118 (1) (1) (1) (1) (1)
 DAX 1294 (1) (1) (1) (1) (1)
 CAC40 1294 (1) (1) (1) (1) (1)
 IBEX 3500 (1) (1) (1) (1) (1)
 ASE Athens 649 (1) (1) (1) (1) (1) (1) (1) (1)

Bank stocks

Bank stocks
 US banks 97 (1) (1) (1) (1) (1)
 UK banks 97 (1) (1) (1) (1) (1)
 US 5y 10y 14 (1) (1) (1) (1)
 US 10y 14 (1) (1) (1) (1) (1)
 US 10y 14 (1) (1) (1) (1) (1)
 US 10y 14 (1) (1) (1) (1) (1)
 US 10y 14 (1) (1) (1) (1) (1)

Bank stocks

Bank stocks
 UK banks 88 (1) (1) (1) (1) (1)
 HSBC 194 (1) (1) (1) (1) (1)
 RBS 185 (1) (1) (1) (1) (1)
 NatWest 194 (1) (1) (1) (1) (1)
 Lloyds 71 (1) (1) (1) (1) (1) (1) (1) (1)

Bank stocks

Bank stocks
 EUR banks 114 (1) (1) (1) (1) (1)
 BNP 161 (1) (1) (1) (1) (1)
 Credit Agricole 114 (1) (1) (1) (1) (1)
 NatWest 194 (1) (1) (1) (1) (1)
 HSBC 194 (1) (1) (1) (1) (1)
 Lloyds 71 (1) (1) (1) (1) (1) (1) (1) (1)

Bank stocks

Bank stocks
 US banks 10 (1) (1) (1) (1) (1)
 JP Morgan 10 (1) (1) (1) (1) (1)
 Citigroup 10 (1) (1) (1) (1) (1)
 Wells Fargo 10 (1) (1) (1) (1) (1)
 Bank of America 10 (1) (1) (1) (1) (1)
 Sun Life 10 (1) (1) (1) (1) (1)

Commodity risk (percentage points positive for dollar depreciation)

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 US 10y 100 (1) (1) (1) (1) (1)
 US 10y 100 (1) (1) (1) (1) (1)
 US 10y 100 (1) (1) (1) (1) (1)
 US 10y 100 (1) (1) (1) (1) (1)
 US 10y 100 (1) (1) (1) (1) (1)
 US 10y 100 (1) (1) (1) (1) (1)

Commodity risk (percentage points positive for dollar depreciation)

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 US 10y 100 (1) (1) (1) (1) (1)
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 US 10y 100 (1) (1) (1) (1) (1)
 US 10y 100 (1) (1) (1) (1) (1)
 US 10y 100 (1) (1) (1) (1) (1)
 US 10y 100 (1) (1) (1) (1) (1)
 US 10y 100 (1) (1) (1) (1) (1)
 US 10y 100 (1) (1) (1) (1) (1)

*CDS, EMBI & MSCI indices with one day delay

**Credit spread (BAA) with two days delay

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