Market Comment | Chinese sell-off causes a widespread risk-off mood in markets

Global Financial Markets Unit 04 Jan 2016

BBVA Research

- China's manufacturing PMI fell again. China's manufacturing PMI continued to show a contraction in the manufacturing activity, and dropped slightly unexpectedly in December (by 0.4 points to 48.2; consensus: 48.9).
- US manufacturing activity contracts in December, reaching the lowest level for six years. US ISM manufacturing declined in December, surprising expectations (by 0.9 points to 48.2; consensus: 49.0). This is the second month in a raw that the manufacturing index has fallen into contraction territory (below the 50 level). The ISM prices paid sub-index also dropped unexpectedly (by 2 points to 33.5; consensus: 35.5).
- Slight upward revision on final prints of Eurozone Markit manufacturing PMI in December (53.2 points; BBVAe, consensus and flash estimate: 53.1, previously: 52.8). By country, Germany's manufacturing PMI rose slightly against the flash estimate (by 0.2 points to 53.2; BBVAe and consensus: 53.0), while the French index suffered a downward revision of 0.2 points to 51.4 points (BBVAe and consensus: 51.6, previously: 50.6). In Spain, it remained almost unchanged at 53.0 points (previously: 53.1, consensus: 51.7) and the Italian PMI rose more than estimated (by 0.7 points to 55.6; previously: 54.9; BBVAe: 54.7; consensus: 54.9). On another front, German CPI increased less than expected in December. The harmonised inflation rate decreased by 10bp to 0.2% (BBVAe and consensus: 0.4%, previously: 0.3%) while German harmonised CPI stood broadly unchanged in December against estimates of a slight increase.
- · Chinese sell-off causes a widespread risk-off mood in markets during the first trading session of the new year. The Shanghai composite index plunged 7% after an early close due to the high volatility (see). The authorities implemented new regulations - approved late last year - to prevent a violent sell-off. At first they temporarily suspended trading activity - when the major equity indices were around 5% down - and then, as the falls continued, the indices were closed before the usual closing time. Doubts on the Chinese economic outlook (confidence prints worse than expected) and some regulatory changes (related to IPOs and the ban on selling by big stakeholders, that expire next week) could explain the high volatility and the investors' uncertainty about China. These events also have a relevant effect on the exchange rate. The official exchange rate was established above USDRMB 6.50 - the weakest RMB rate against the USD for four years - and then it experienced further depreciation until reaching USDRMB 6.53, continuing the ongoing depreciation path of last year. Against this backdrop, the volatility rose today across the board (VIX: +5bp to 22.88%) and equity indices dropped abruptly (Nikkei: -3.1%, S&P 500:-2.4%, Euro Stoxx: -3.4%, DAX: -4.4%, IBEX-35: -2.7%), while developed countries' government yields fell, including peripheral yields, in a move towards safe-havens (USA 10 Y: -6bp, GER 10Y: -6bp, ITA 10Y: -5bp, SPA 10Y: -5bp). Commodity prices also tracked the uncertainty surrounding China, and cooper fell by 2.5% while gold (+1.5%) was a beneficiary of the risk-off mood in global markets. On another front, oil prices rebounded on the back of the increase in geopolitical risk between major oil



producers (Saudi Arabia and Iran), but it remains at very low levels (Brent: +0.9% to USD37.63/bbl). Emerging markets also reacted to the increased financial instability in China that the market is pricing today, and EM currencies depreciated against USD (BRL: -2.0%, RUB: -1.0%, CLP: -1.3%, MXN: -0.7%, COP: -1.6%). The depreciation of the TRY (-1.9%), one of the most punished EM currencies today, was fuelled by the December inflation prints (+8.8%), which were in line with the BBVA forecast but above market estimates. Among developed currencies, JPY (+1.05 against USD) was the largest beneficiary, as the market identifies it as a safe haven, while the EUR depreciated slightly (-0.5%) in a session of high volatility.

Update 17.15 CET 04 January, 2016 Table1

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(Current level and changes at daily, weekly, monthly and annual frequencies)
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Canadi Banda & 4.4 (3, 0, 13) (3, 0, 16) Marka Banda (3, 13) (3, 10) (16) (6) Pinwa Banda (3, 10) (16) (16) (16) Evolution (2 and Banda (3, 13) (16) (16) (16) Evolution (2 and Banda (3, 13) (16) (16) (16) (16) (16) (16) (16) (16
Company Biotechine Biotechinininin
lae 100 (Turkey) 70518 (4, 7) (45) (45,5) (47,7) MSC/E M Asia 660 (5,01) (40) (4,7) (47,9) Shangha Composite (Thins) 2364 (46) (47) (43, 15) Jakarta Composite Indonesia) 4526 (4,5) (4,7) (4,3) (-13)
Bank docks Markon Banks 72 (-1.8) (-6.7) (-6. %) (-27.8) Albank 17.4.5.7 (-7.6) (-7.5) (-6.9) (-6.9) Mannel 17.2 (-7.6) (-6.6) (-6.5) Turkye In Banksas 5 (-1.5) (-4.2) (-6) (-52.8)
Russian basis 147 (32) (47) (45) (46) Schemat 56 (32) (27) (58 (163) VTB Bask 0.1 (5.1) (1.6) (7.7) (52) <u>Currencies</u> (in percentage, positive for dollar depreciation)
EURUSD 1.68 (4,51) (-1.52) (-1.3) (-9.8) GBPUSD 1.47 (-4.40) (-1.35) (-31) (-6.8) GBDUFY (1132: 4) (-58) (782)(27) (74.4) DDOT 98:09 (-3.1) (-1.1) (-1.4) (-9.7)
$\label{eq:constraint} \begin{array}{c} 1000000000000000000000000000000000000$
USDFULN (Poland) 338 (4.8) (4.2) (4.2) (4.4) (4.2.3) USGRUB (Russia) 73.22 (4) (4.4) (4.5) (26.7) USGRUY (Russia) 73.28 (4) (4.4) (4.3) (26.7)
UBCOVY Chemiol 63 (4 (4 / 17 (2)) (42) UBDR (House) (46) (3 / 146) (6) (4) UBDR (House) (46) (3 / 146) (6) (4) UBDR (House) (4) (4) (4) (2) (4) (4) Commodities (Anayei in percentinge) Perc 278 (6) (45) (445) (44) (4)
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*CDS, EMBI & MSCI indices with one day delay **Credit spread (BAA) with two days delay

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