Market Comment | Sharp rally in global financial assets last week

Global Financial Markets Unit
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- **Better-than-expected non-farm payrolls in the US.** US nonfarm payrolls (seasonally adjusted) increased in February above expectations (by 242K; consensus: 190K; previous month: 172K), while manufacturing payrolls dropped more than expected (by -16K; consensus: -1K; previous month: 23K). Meanwhile, the unemployment rate remained unchanged at 4.9%, in line with estimations.

- **China: National People's Congress (NPC)** The annual plenary session of the NPC -one of the most important events on China's political calendar- starts tomorrow and will end on 16 March. Among other things, Premier Li Keqiang will announce the results of his "working report", which will include the key targets for 2016. The NPC will also serve as a platform for putting the finishing touches on China's upcoming 13th Five Year Plan (2015-2020). While we do not expect the full details to be disclosed until several weeks after the NPC, the tone of the meetings will give us an idea of how China's top leaders envision the economic landscape in the coming years. (see)

- **Sharp rally in global financial assets last week.** The increased confidence in financial markets during the past week was supported by multiple factors, including the ongoing rebound in oil prices. In addition, the better-than-expected economic data for the US, which reduced the probability of a tail-risk scenario in the US (e.g., recession) and the increasing expectation of action by the major central banks to support growth after the PBoC cut the minimum reserve requirement. All these factors encouraged improvement in emerging market assets and in the cyclical sector of the developed markets this week. Nonetheless, from now on, the volatility in oil prices should remain high until an agreement has been reached between the major exporters on freezing production. In addition, there are still additional negative drivers in the financial market that are increasing the vulnerability of the rebound, such as 1) the ongoing weakness in some relevant macroeconomic data, especially manufacturing confidence and EZ pricing, 2) the disappointing G20 meeting -where there was a recognition of global risks but no commitment to coordinated action- and 3) The erratic management of fx policy by Chinese authorities. Against this backdrop, European and US equity markets rose during the week (S&P: +2.8% Eurostoxx: +3.6% IBEX: +5.4% DAX: +3.2% CAC: +3.2%) with a sharp improvement in the banking sector (US: +6.3% EZ: +8.3%). In the same vein, the Asian indices increased (Nikkei: +5.1% Shanghai: +3.9%). On the bond markets, core yields inched up led by the US Treasury (US 10Y: +13 bps GER 10Y: +9 bps FRA 10Y: +8 bps), while European peripheral yields dropped slightly this week (ITA 10Y: -2 bps SPA 10Y: -2 bps POR 10Y: 0 bps) after suffering high volatility. As a result, peripheral risk premiums narrowed (ITA: -10 bps SPA: -10 bps POR: -9 bps). On the FX markets, the USD depreciated against other major currencies, especially against the GBP (EUR: +0.83% JPY: +0.17% GBP: +2.68%). EM currencies appreciated against the US dollar, mainly those most linked to commodity prices, especially oil (RUB: +5.7% BRL: +6.8% CLP: +1.7% COP: +5.5% MXN: +2.8%) due to the rebound during the week (Brent: +9.2% WTx: +8.7% Copper: +7.5%). Despite the positive performance of risk and cyclical assets, the strong rebound in gold prices (+4.2%) can be seen as a note of caution, suggesting that there are still many uncertainties to be dispelled.

ECB Thursday meeting (preview)

What we expect from the ECB

- At next week's monetary policy meeting, the ECB will ease its policy, announcing another package of measures, as it is very likely that it will significantly revise its inflation forecasts down. In particular, the central bank considers that the impact of external factors and heightened uncertainty are raising the possibility that the ECB's current measures might not be enough to achieve its objective for inflation rates. Against this background, the minutes of its 21 January meeting, comments from ECB governing council members and the recent financial market turmoil particularly affecting the banking system support further action at next week´s monetary policy meeting. In this context, dovish members, led by the ECB president, Mario Draghi, reasserted their readiness to expand the stimulus. In particular, he said that the ECB will not surrender to low inflation and he warned that "the risks of acting too late outweigh the risks of acting too early."

- This expectation of further easing has pushed down both the euro and the European curve, mainly the monetary rates. If the ECB disappoints at the March meeting, this market effect could be reversed. Therefore, we expect further easing by the ECB accompanied by a very dovish communication. Although the cyclical situation and the fragility of the recovery justify continuing a highly accommodating monetary policy, the fact is that the ECB has less and less margin for manoeuvre and effective action.

- Against this background, we expect that the central bank will cut the interest rate on its deposit facility further into negative territory, to -0.4%. In this regard, while trying to mitigate the immediate direct impact on banks, the ECB would likely implement a tiered deposit rate. In particular, Benoît Coeuré and vice president Vitor Constancio expressed concern at the impact of negative rates on the banking sector, stressing that the central bank would aim to protect banks if the ECB decides to ease its monetary policy even further. We also consider that an extension of the asset purchase programme (APP) until at least September 2017 could be one of the preferred options (given the bank's implicit commitment to keeping rates low for longer). We also expect changes in the technical parameters of the APP to coincide with the semiannual revision of the APP. Finally, the central bank could also ease conditions on TLTROs. However, we do not dismiss more aggressive action on the part of the central bank, i.e., a 20 bps deposit rate cut, further TLTROs or significantly increasing the pace of asset purchases.

Macroeconomic environment

- The economic indicators for the eurozone over the last month and a half were disappointing, and therefore suggest that the global slowdown and increasing uncertainty are weighing on the economy, compensating for the tailwinds - lower oil prices and more supportive political measures.

- GDP growth remained unchanged at 0.3% QoQ in 4Q15, with domestic demand as the main driver of growth, but with only a slight improvement in investment, while net exports were weak. Confidence declined in January and February, especially in manufacturing, with gloomy signs broadly spread across the region. More encouraging data came from January's retail sales, along with the resilience of services. All these indicators suggest that GDP growth remains weak or may even be slowing somewhat in the first half of the year, as financial tensions and political strains in some countries in the area are more persistent than expected. With information for 1Q16 still limited, our MICA-BBVA model now projects a quarterly GDP growth of around 0.2% QoQ in 1Q16, against our previous forecast of 0.4% QoQ.

- Regarding prices, February's inflation figures increased concerns for potential second-round effects, especially in the non-energy industrial goods component, while confidence surveys suggest that companies are passing on the falls in raw materials prices to customers. The evolution of oil prices will continue to shape inflation in the coming months. We now expect the drop in inflation to intensify again in March (after -0.2% YoY in February) and to continue throughout the second quarter (when we expect oil prices to reach the minimum), and to only pick up marginally after the summer to slightly positive rates later this year.

- Against this background, the ECB will update its projections, which will be crucial for next week's monetary policy decision. In regard to activity, the worsening incoming data (especially weaker foreign demand) along with higher global and idiosyncratic financial uncertainty might lead to a downward revision of GDP growth of around 0.3pp this year, from the 1.7% projected last December. But we do not expect any significant changes for the 2017 projection of 1.9%, and probably an unchanged figure for 2018.

- More importantly, we think inflation forecasts will be revised down significantly, mainly driven by the sharp fall in oil prices since last December. Taking into account the fact that the expected oil prices on the futures' markets at the end of February up to the end of the projection horizon (USD40.7 per barrel in December, USD44.7 by end 2017, and USD47 by end 2018, which is the variable used in its assumptions by the ECB) are around 40% and 30% and lower for 2016 and 2017, respectively, than those included in the December Staff forecasts, we see a significant downward revision by a bit less than 1pp for 2016 (from the 1% previously projected) and 0.2pp for 2017 (from 1.6% previously), while meeting the inflation target should be delayed until 2018 (according to our forecasts). We expect core inflation to be revised down by around 0.2pp in 2016 and 2017 to 1% and 1.4%. We also expect the ECB to express more concerns about eventual second-round effects on oil prices after a protracted period of very low inflation and a further fall in market-based inflation expectations by around 0.2pp to just below 1.5% since the beginning of the year.

Update 17.30 CET 04 March, 2015
Table1

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

Debt markets *(changes in bp)*

Developed Markets
US 2-yr 0,87 (3) (8) (15) (-17)
US 5-yr 1,39 (4) (15) (11) (-37)
US 10-yr 1,89 (6) (13) (0) (-38)

Japan 10-yr -0,04 (-3) (2) (-11) (-31)

GER 2-yr -0,54 (4) (1) (-4) (-20)
GER 5-yr -0,34 (6) (3) (-8) (-30)
GER 10-yr 0,23 (7) (9) (-4) (-40)

Belgium 10-yr 0,7 (5) (7) (-4) (-27)
France 10-yr 0,58 (4) (8) (-3) (-41)
Greece 10-yr 9,76 (6) (-55) (44) (148)
Ireland 10-yr 0,95 (4) (3) (0)
Italy 10-yr 1,46 (3) (-2) (2) (-14)
Netherlands 10-yr 0,38 (6) (9) (-3) (-42)
Portugal 10-yr 3,08 (9) (0) (15) (57)
Spain 10-yr 1,56 (2) (-2) (1) (-22)

Emerging Markets
Brazil 10-yr 14,71 (-53) (-137) (-125) (-180)
Chile 10-yr 4,44 (0) (-1) (-3) (-22)
Colombia 10-yr 8,79 (2) (-19) (-23) (14)
Mexico 10-yr 6,14 (-2) (3) (16) (-12)
Peru 10-yr 7,41 (0) (-11) (-22) (10)

Poland 10-yr 2,99 (-4) (3) (-18) (4)
Russia 5-yr 9,28 (-9) (-41) (-116) (-60)
Russia 10-yr 9,19 (-8) (-39) (-112) (-37)
Turkey 10-yr 10,15 (-3) (-25) (-28) (-32)

India 10-yr 7,64 (-2) (-14) (-21) (-12)
Indonesia 10-yr 7,92 (-13) (-34) (-24) (-82)

Country risk *(changes in bp)*

Developed Markets
10-yr sovereign spreads *(against Germany)*
Belgium 46 (-2) (-1) (0) (12)
France 35 (-2) (-1) (1) (-1)
Greece 953 (0) (-63) (48) (187)
Ireland 71 (-2) (-5) (4) (19)
Italy 122 (-3) (-10) (6) (26)
Netherlands 14 (0) (-0,1) (1) (-2)
Portugal 285 (3) (-8,6) (19) (96)
Spain 132 (-5) (-10) (5) (18)

5-yr sovereign spreads *(against Germany)*
Belgium 10 (-1) (1,3) (4) (3)
France 17 (-1) (0) (6) (4)
Greece 1636 (-6) (-3) (8) (30)
Ireland 37 (-2) (-6) (8) (12)
Italy 73 (-3) (-11) (4) (18)
Netherlands 1 (0) (0,5) (4) (1)
Portugal 223 (5) (-19) (35) (112)
Spain 79 (-4) (-12) (8) (8)

2-yr sovereign spreads *(against Germany)*
Belgium 8 (-1) (0) (2) (4)
France 11 (-2) (-0,8) (3) (8)
Ireland 24 (0) (-5) (8) (10)
Italy 49 (-3) (-8) (1) (17)
Netherlands 5 (-2) (-2) (0) (8)
Portugal 118 (-1) (-14) (32) (73)
Spain 54 (-2) (-8) (7) (19)

5-yr sovereign CDS
5-yr CDS Belgium 51 (0) (-1) (13) (19)
5-yr CDS France 33 (-2) (-3) (9) (7)
5-yr CDS Germany 21 (-1) (-2) (8) (8)
5-yr CDS Greece 1346 (27) (-45) (116) (288)
5-yr CDS Ireland 67 (-1) (-2) (23) (27)
5-yr CDS Italy 135 (-1) (-12) (23) (39)
5-yr CDS Netherlands 26 (-1) (-1) (10) (11)
5-yr CDS Portugal 262 (-2) (-60) (82) (94)
5-yr CDS Spain 105 (0) (-12) (22) (16)
5-yr CDS UK 37 (-1) (0) (9) (17)
5-yr CDS US 19 (-1) (0) (-2) (1)

Emerging Markets
5-yr sovereign CDS
5-yr CDS Brazil 414 (-20) (-27) (-66) (-78)
5-yr CDS Chile 105 (-5) (-12) (-33) (-21)
5-yr CDS Colombia 248 (-8) (-18) (-49) (10)
5-yr CDS Mexico 176 (-6) (-18) (-29) (6)
5-yr CDS Peru 169 (-5) (-24) (-49) (-16)
5-yr CDS Venezuela 5597 (-52) (-633) (-3012) (-446)

5-yr CDS Poland92 (1) (-3) (-1) (20)
5-yr CDS Russia 305 (1) (-30) (-40) (3)
5-yr CDS Turkey 275 (-6) (-25) (-11) (2)

5-yr CDS China 128 (-4) (-6) (-7) (20)
5-yr CDS India 162 (-6) (-12) (-13) (13)
5-yr CDS Indonesia 210 (-5) (-24) (-37) (-17)

Credit risk

Risk indicators *(changes in percentage except for BAA spreads, bp)*
VIX 16,26 (-2,6) (-17,9) (-24,9) (-2)
VSTOXX 24,51 (-7,6) (-16,3) (-20,3) (2)
EM EFT volatility Index 23 (-6) (-22) (-26) (1)
Dollar/euro volatility 11,2 (-0,4) (-1,1) (17,2) (16)
EM FX volatility index 11 (0) (-6) (-10) (0)
Credit spread (BAA) 341 (-5,6) (-14,8) (-4,8) (18)
US bonds volatility index 82 (0) (-1) (3) (20)

Bank risk *(changes in bp)*
US banks CDS 96 (1) (-10) (3) (21)
EMU banks CDS 129 (2) (-23) (8) (45)
UK banks CDS 132 (3) (-16) (23) (55)

Large Spanish banks CDS 146 (0) (-26) (-16) (9)
Medium Spanish banks CDS 209 (-12) (-24) (-1) (52)

Greek banks CDS 1702 (6) (57) (247) (51)
Russian banks CDS 414 (8) (-7) (-19) (32)

Corporate risk *(changes in bps)*
US Non-financial CDS 469 (-45) (-209) (-44) (88)
EMU Non-financial CDS 258 (-13) (3) (65) (85)
UK Non-financial CDS 199 (1) (-14) (-29) (7)

Interbank markets *(changes in bp)*

UEM OIS spread 3m 14 (-1) (-1) (0) (3)
UEM OIS spread 12m 40 (-3) (-2) (-2) (6)
UEM TED spread 3m 38 (0) (-0,9) (10) (-2)

US OIS spread 3m 23 (0) (0) (0) (0)
US OIS spread 12m 68 (-2) (0) (-1) (12)
US TED spread 3m 36 (0) (4) (7) (-9)

Spain Ted Spread 3m 11 (1) (10,4) (-4) (6)

EONIA Index -0,24 (0) (0,5) (1) (-11)
Euribor 3m -0,22 (0) (-1,3) (-5) (-8)
Euribor 12m -0,03 (0) (-1) (-4) (-9)

Libor 3m 0,64 (0) (0) (2) (2)
Libor 12m 1,2 (0) (4) (7) (2)

Stock markets *(Changes in percentage)*

Developed Markets
Main equity indices
S&P500 2002,5 (0,5) (2,8) (4,7) (-2)
Dow Jones 17007,7 (0,4) (2,2) (4,1) (-2)
Nikkei 17014,8 (0,3) (5,1) (-1) (-11)
FTSE 100 6192 (1) (1,6) (6,1) (-1)
EuroStoxx 50 3035,4 (0,7) (3,6) (4,8) (-7)
IBEX8797,4 (0,3) (5,4) (5,8) (-8)
DAX 9821,5 (0,7) (3,2) (4,1) (-9)
CAC4454,2 (0,9) (3,2) (5,4) (-4)
MIB 18280 (-0,4) (4,6) (5) (-15)
ASE Athens 552,8 (0,3) (9) (4,4) (-12)

Bank stocks
US banks 80,4 (1,1) (6,3) (5,7) (-14)
JPM 60,3 (0,5) (4,7) (5) (-9)
Citi 43,4 (1,3) (9,9) (7,5) (-16)
BoA 13,7 (1,6) (8) (5,3) (-18)
MS 26,3 (0,7) (4,6) (8,2) (-17)
GS 157,4 (1,3) (4,8) (3,1) (-13)

UK banks 75,2 (1,6) (0,7) (7,1) (-14)
HSBC 454 (0,8) (-2,9) (1) (-15)
RBS 230,9 (0,8) (1,9) (-0,8) (-24)
Barclays 174,1 (4,7) (3) (5,1) (-20)
Lloyds 73 (0,5) (1,2) (20,2) (0)

EMU banks 91,1 (0,3) (8,3) (15,3) (-16)
BNP 46,3 (1,3) (9,1) (17,1) (-11)
Crédit Agricole 10,1 (1,1) (7) (20,7) (-7)
Deutsche Bank 18 (1,8) (12,9) (21,9) (-20)
ING 11,4 (0,4) (5,9) (18,3) (-8)
Intesa 2,5 (-2,3) (7,7) (7,4) (-18)
SG 35,1 (1,9) (9,7) (11,2) (-17)
Unicredito 3,6 (-2,4) (7,5) (13,5) (-29)

Large Spanish banks 69,1 (0,8) (9,5) (15,9) (-8)
Santander 4,1 (1,7) (11,6) (18,8) (-10)
BBVA 6,2 (0,1) (8) (13,8) (-8)

Medium Spanish banks 70,7 (-1) (6,5) (3,9) (-14)
Caixabank 2,7 (-0,9) (5,6) (10,7) (-16)
Popular 2,3 (-2) (7,6) (7,8) (-24)
Sabadell 1,6 (-1,6) (7,6) (1,9) (-5)
Bankinter 6,2 (-0,7) (3,8) (3,7) (-5)
Bankia 0,8 (-0,1) (9,3) (-2,3) (-24)

Greek banks 3 (-4,9) (20,9) (1,6) (-34)
Alpha Bank1,7 (-4) (12) (1,8) (-33)
Pireus Bank0,2 (0) (27) (11,5) (-37)
National Central Bank0,2 (-6,3) (21,3) (-1,3) (-35)
Eurobank Ergasias0,7 (-6,6) (43,3) (1,7) (-36)

Emerging Markets
Main equity indices
MSCI Latam 63273 (2,59) (7,4) (12,2) (6,7)
Ibovespa (Brazil) 49086 (4) (18) (24) (13,2)
Mexbol 45185 (1) (3,9) (4,5) (5,1)

MSCI EM Europe 4348 (1,71) (4,2) (6,1) (2,4)
Poland 1874 (-0,2) (1,6) (7,7) (0,8)
Micex (Russia) 1878 (1,1) (3,4) (7,6) (6,6)
Ise 100 (Turkey) 77191 (0,5) (3) (5,4) (7,6)

MSCI EM Asia 640 (0,57) (4,3) (4) (-3,1)
Shanghai Composite (China) 2874 (0,5) (3,9) (4,9) (-18,8)
Jakarta Composite (Indonesia) 4851 (0,1) (2,5) (5,5) (6)

Bank stocks
Turkish banks 79 (0,4) (2,6) (3,5) (6,7)
Akbank T.A.S. 8 (0,3) (0,9) (3,9) (12,2)
Garanti 7 (0,1) (1,9) (2,2) (5,1)
Turkiye Is Bankasi 5 (0,9) (5,6) (4,4) (2,2)

Russian banks 155 (1,8) (2,9) (12,2) (2,1)
Sberbank 109 (1,9) (2,6) (15,3) (7,6)
VTB Bank 0,1 (1,6) (3,5) (7,2) (-6,5)

Currencies *(in percentage, positive for dollar depreciation)*

Developed Markets
EURUSD 1,103 (0,62) (0,83) (-0,7) (1,5)
GBPUSD 1,42 (0,46) (2,68) (-2,5) (-3,3)
USDJPY 113,81 (-0,11) (0,17) (3,5) (5,3)
DXY 97,21 (0,4) (1) (0,1) (1,4)

Emerging Markets
USDARS (Argentina) 15,19 (0,1) (1,8) (-7,3) (-17,5)
USDBRL (Brazil) 3,73 (1,9) (6,8) (4,4) (5,9)
USDCLP (Chile) 680,17 (1) (1,7) (3,8) (4)
USDCOP (Colombia) 3157,61 (1,1) (5,5) (6,4) (0,5)
USDMXN (Mexico) 17,76 (0,9) (2,8) (2,3) (-3,2)
USDPEN (Peru) 3,45 (0,4) (2,1) (1,2) (-1,1)
LACI 62,51 (1,2) (4,3) (2,5) (-0,2)

USDPLN (Poland) 3,93 (0,9) (1,9) (1,5) (-0,1)
USDRUB (Russia) 71,93 (1,6) (5,7) (6,3) (0,8)
USDTRY (Turkey) 2,9 (0,1) (3) (0,4) (0,4)

USDCNY (China) 6,51 (0,4) (0,5) (1) (-0,2)
USDINR (India) 67,1 (0,4) (2,2) (1,4) (-1,4)
USDIDR (Indonesia) 13132 (0,8) (1,9) (4,6) (4,8)
ADXY 107,08 (0,8) (1,7) (1,3) (0,5)

Commodities *(change in percentage)*

Brent 38,33 (3,4) (9,2) (9,4) (2,8)
WTx 35,62 (3) (8,7) (10,3) (-3,8)
Copper 227,65 (3,3) (7,5) (8,8) (7,1)
Gold 1273,57 (0,7) (4,2) (11,5) (20)
Baltic Dry Index 342 (0) (4,6) (12,9) (-28,5)
S&P GSCI Spot commodity index 307,158 (0,3) (2,1) (7,6) (-0,6)
S&P GSCI Brent Spot 315,49 (0,4) (3,8) (13,3) (0,5)
S&P GSCI Metals Spot 264,73 (0,8) (4,5) (6,5) (3,9)
S&P GSCI Agricultural Spot 276,517 (0,9) (0,4) (-1,6) (-2,5)

Source: Bloomberg, Datastream and Haver

*CDS, EMBI & MSCI indices with one day delay
**Credit spread (BAA) with two days delay
***S&P GSCI with one day delay

Spain with number 0182.