

# Market Comment | Sharp rally in global financial assets last week

Global Financial Markets Unit  
04 Mar 2016

- **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**

**Index markets (changes in bp)**

**US**  
 US 2yr 0.87 (2) (0) (15) (17)  
 US 5yr 1.38 (4) (15) (13) (27)  
 US 10yr 1.88 (8) (17) (3) (36)

**Japan**  
 Japan 10yr 0.24 (0) (2) (11) (21)

**UK**  
 UK 2yr 0.54 (4) (1) (4) (26)  
 UK 5yr 0.74 (6) (3) (4) (30)  
 UK 10yr 1.07 (9) (1) (4) (49)

**Region**  
 Region 10yr 0.75 (7) (4) (27)  
 France 10yr 0.50 (0) (5) (2) (44)  
 Germany 10yr 0.30 (0) (4) (4) (46)  
 Health 10yr 0.80 (2) (0)  
 Italy 10yr 0.48 (2) (2) (1) (44)  
 Netherlands 10yr 0.30 (0) (1) (1) (42)  
 Portugal 10yr 0.38 (0) (0) (1) (37)  
 Spain 10yr 0.50 (2) (1) (1) (42)

**Emerging Markets**  
 Brazil 10yr 6.50 (6) (1) (27) (129) (180)  
 China 10yr 4.75 (5) (2) (2) (2) (14)  
 Colombia 10yr 6.75 (7) (2) (2) (2) (14)  
 Mexico 10yr 4.14 (2) (2) (2) (16) (12)  
 Peru 10yr 10.14 (11) (12) (2) (2)

**Russia**  
 Russia 10yr 2.09 (4) (2) (1) (0) (4)  
 Russia 5yr 2.20 (4) (1) (1) (0) (4)  
 Russia 10yr 1.98 (4) (2) (1) (1) (2) (2)  
 Turkey 10yr 10.15 (10) (2) (2) (2) (2) (2)

**India**  
 India 10yr 10.14 (10) (2) (2) (2) (2)  
 Indonesia 10yr 7.82 (7) (3) (3) (3) (3) (3)

**Country risk (changes in bp)**

**3yr sovereign spreads (against Germany)**  
 Belgium 46.2 (1) (1) (2)  
 France 35 (2) (1) (1) (1)  
 Germany 0 (0) (0) (0) (0) (0)  
 Ireland 71 (2) (1) (1) (1)  
 Italy 22 (1) (1) (1) (1)  
 Netherlands 14 (0) (1) (1) (1)  
 Portugal 235 (2) (1) (1) (1) (1)  
 Spain 122 (0) (1) (1) (1)

**5yr sovereign spreads (against Germany)**  
 Belgium 10 (1) (1) (1) (1)  
 France 17 (1) (1) (1) (1)  
 Germany 0 (0) (0) (0) (0)  
 Ireland 27 (1) (1) (1) (1)  
 Italy 17 (1) (1) (1) (1)  
 Netherlands 1 (0) (1) (1) (1)  
 Portugal 225 (2) (1) (1) (1) (1)  
 Spain 79 (4) (1) (1) (1)

**3yr sovereign spreads (against Germany)**  
 Belgium 8 (1) (1) (1) (1)  
 France 11 (2) (1) (1) (1)  
 Germany 0 (0) (0) (0) (0)  
 Ireland 24 (1) (1) (1) (1)  
 Italy 14 (1) (1) (1) (1)  
 Netherlands 1 (1) (1) (1) (1)  
 Portugal 193 (1) (1) (1) (1) (1)  
 Spain 54 (2) (1) (1) (1)

**5yr sovereign CDS**  
 Eur CDS Belgium 49 (1) (1) (1) (1) (1)  
 Eur CDS France 21 (2) (1) (1) (1)  
 Eur CDS Germany 21 (2) (1) (1) (1)  
 Eur CDS Ireland 146 (1) (1) (1) (1) (1)  
 Eur CDS Italy 87 (1) (1) (1) (1) (1)  
 Eur CDS Spain 123 (1) (1) (1) (1) (1)  
 Eur CDS Netherlands 26 (1) (1) (1) (1) (1)  
 Eur CDS Portugal 202 (1) (1) (1) (1) (1)  
 Eur CDS Spain 101 (0) (1) (1) (1) (1)  
 Eur CDS UK 37 (1) (1) (1) (1) (1)  
 Eur CDS US 19 (1) (1) (1) (1) (1)

**5yr sovereign CDS**  
 Eur CDS China 414 (2) (1) (1) (1) (1)  
 Eur CDS China 105 (1) (1) (1) (1) (1)  
 Eur CDS Colombia 240 (1) (1) (1) (1) (1)  
 Eur CDS Mexico 178 (1) (1) (1) (1) (1)  
 Eur CDS Peru 109 (1) (1) (1) (1) (1)  
 Eur CDS Venezuela 887 (1) (1) (1) (1) (1)

**5yr CDS spreads (in basis points)**  
 Eur CDS Russia 26 (1) (1) (1) (1) (1)  
 Eur CDS Russia 26 (1) (1) (1) (1) (1)  
 Eur CDS Turkey 27 (1) (1) (1) (1) (1)

**5yr CDS China 128 (4) (1) (1) (1) (1)  
 Eur CDS India 102 (1) (1) (1) (1) (1)  
 Eur CDS Indonesia 211 (1) (1) (1) (1) (1) (1)**

**Credit risk**

**1m volatility - divergence in percentage except for IAA spreads, bp**  
 UK 16.26 (2) (6) (7) (6) (24) (6) (2)  
 IT 17 (2) (1) (1) (1) (1) (1) (1)  
 EU FT volatility index 21 (4) (2) (2) (2) (1)  
 CDS volatility index 11 (2) (1) (1) (1) (1) (1)  
 EIA FT volatility index 11 (2) (1) (1) (1) (1) (1)  
 CDS volatility index 241 (1) (1) (1) (1) (1) (1) (1)  
 US bonds volatility index 82 (1) (1) (1) (1) (1) (1)

**Bank CDS spreads (in bp)**

US banks CDS 96 (1) (1) (1) (1) (1)  
 EU banks CDS 123 (2) (1) (1) (1) (1)  
 UK banks CDS 132 (1) (1) (1) (1) (1)

**Large European banks CDS 148 (2) (1) (1) (1) (1)  
 Medium European banks CDS 209 (1) (1) (1) (1) (1) (1)**

**Other banks CDS 170 (2) (1) (1) (1) (1) (1)  
 Russian banks CDS 414 (1) (1) (1) (1) (1) (1) (1)**

**Country risk - changes in bp**

US Non-sovereign CDS 49 (1) (1) (1) (1) (1) (1)  
 EU Non-sovereign CDS 49 (1) (1) (1) (1) (1) (1) (1)  
 UK Non-sovereign CDS 79 (1) (1) (1) (1) (1) (1) (1)

**Interest rate markets (changes in bp)**

**EUR CDS spread 3m 14 (1) (1) (1) (1) (1)  
 EUR CDS spread 6m 44 (1) (1) (1) (1) (1)  
 EUR CDS spread 12m 38 (0) (1) (1) (1) (1)**

**US CDS spread 3m 23 (0) (0) (0) (0) (0)  
 US CDS spread 6m 59 (1) (1) (1) (1) (1) (1)  
 US CDS spread 12m 36 (0) (1) (1) (1) (1)**

**Swiss Tied Spread 3m 11 (1) (1) (1) (1) (1) (1)**

**EDB index 2.24 (2) (1) (1) (1) (1)  
 EDB index 2.22 (1) (1) (1) (1) (1) (1)  
 EDB index 2.22 (1) (1) (1) (1) (1) (1)**

**Libor 3m 0.64 (0) (0) (0) (0) (0)  
 Libor 12m 1.2 (0) (1) (1) (1) (1)**

**Stock markets (changes in percentage)**

**Spain - weekly returns**  
 S&P500 2012.05.25 (2) (1) (1) (1) (1)  
 Dow Jones 1707 (1) (1) (1) (1) (1) (1)  
 Nikkei 1074.8 (2) (1) (1) (1) (1) (1)  
 FTSE 100 1400 (1) (1) (1) (1) (1) (1)  
 Eurostoxx 42 300.4 (2) (1) (1) (1) (1) (1)  
 MSCI EAFE 14 (1) (1) (1) (1) (1) (1)  
 DAX MSCI 6.9 (1) (1) (1) (1) (1) (1)  
 CAC40 6.2 (1) (1) (1) (1) (1) (1)  
 NYB 1020 (1) (1) (1) (1) (1) (1)  
 AEX 1022 (1) (1) (1) (1) (1) (1)

**Bank stocks**  
 US banks 15.4 (1) (1) (1) (1) (1) (1)  
 JPM 16.3 (1) (1) (1) (1) (1) (1)  
 Cit 14.1 (0) (1) (1) (1) (1) (1)  
 BofA 17.1 (1) (1) (1) (1) (1) (1)  
 WFC 16.3 (1) (1) (1) (1) (1) (1)  
 GS 17.1 (1) (1) (1) (1) (1) (1)

**UK banks**  
 HSBC 4.4 (0) (1) (1) (1) (1) (1)  
 RBS 2.0 (0) (1) (1) (1) (1) (1)  
 Barclays 1.4 (0) (1) (1) (1) (1) (1)  
 Lloyds 1.1 (0) (1) (1) (1) (1) (1)

**EU banks**  
 EBR 0.1 (0) (1) (1) (1) (1) (1)  
 BNP 0.1 (0) (1) (1) (1) (1) (1)  
 CDB 0.1 (0) (1) (1) (1) (1) (1)  
 ING 1.4 (0) (1) (1) (1) (1) (1)  
 Intesa 1.2 (0) (1) (1) (1) (1) (1)  
 UniCredit 1.4 (0) (1) (1) (1) (1) (1)

**Large European banks 0.1 (0) (1) (1) (1) (1) (1)  
 Medium European banks 0.1 (0) (1) (1) (1) (1) (1)  
 Other banks 0.1 (0) (1) (1) (1) (1) (1)**

**Russian banks 1.5 (1) (1) (1) (1) (1) (1)  
 Sberbank 1.5 (1) (1) (1) (1) (1) (1) (1)  
 Russian banks 1.5 (1) (1) (1) (1) (1) (1) (1)**

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

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\*CDS, EMBI & MSCI indices with one day delay

\*\*Credit spread (BAA) with two days delay

\*\*\*S&P GSCI with one day delay

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