# Market Comment | Market recovery persisted ahead of Yellen's comments today

Global Financial Markets Unit 27 May 2016

BBVA Research

- **Upward revision of US GDP growth.** US 1Q16 GDP growth was revised upwards (by 0.8% QoQ) from the previous estimate of 0.5% QoQ. However, the revision was below analysts' expectations (+0.9% QoQ). This increase was due mainly to the contribution of the consumer sector.
- Fed's Powell thinks that a rate hike could come soon. Fed member Jerome Powell said that the FOMC could decide on a rate hike soon, supported by a solid US economy with positive macroeconomic data labour, inflation. "If incoming data support these expectations, I would see it as appropriate to continue to gradually raise the federal funds rate," he added. However, he considers that Brexit could bring uncertainty to the Fed's June meeting.
- **G7 meeting outcomes:** global growth to be an "urgent priority". "In light of this background, taking into account country-specific circumstances, we commit to strengthening our economic policy responses in a cooperative manner and to employing a more forceful and balanced policy mix, in order to swiftly achieve a strong, sustainable and balanced growth pattern. We stand ready to deploy robust policy responses to bolster short and longer-term growth as necessary". (see details in official statement).
- The rally in risk assets continued this week, favoured by the persistence of ongoing positive drivers. The increase in oil prices, which have been hovering around US\$50 pb this week, underpinned by lower US oil inventories, has been a relevant driver, which contributed to enhancing the performance of risk assets, amid some fading of latent risk (Greek and Brexit issues). The persistence of Fed officials' hawkishness was not enough to curb the good performance in equity indices across the board (S&P: +1.8%, EuroStoxx: +3.6%, IBEX: +3.6%, DAX: +3.7%, CAC: +3.3%) while it contributed to preserving last week's increase in US yields. In addition, in Europe, the banking sector outperformed for the second week in a row.
- The progress in the resolution of the Greek issue in the latest Eurogroup meeting eased peripheral risk premiums. Greece finally reached agreement with its European creditors, paving the way for the finalisation of the first review of the third macroeconomic programme and the disbursement of €10.3 billion of the loan in several tranches (see details). Against this backdrop, European yields declined, led by peripheral countries (GER 10Y: -3 bps FRA 10Y: -3 bps ITA 10Y: -11 bps, SPA 10Y: -7 bps, POR 10Y: -6 bps, GRE 10Y: -21 bps).
- Regarding the Brexit issue, the widening of the lead of the "remain" option over the "leave" option in the Brexit issue in the latest round of updated polls contributed to diminishing the risk of Brexit and favoured the GBP's appreciation. The USD showed varying responses against its major peers (EUR: -0.65%, JPY: +0.43%, GBP: +0.81%). EM currencies registered mixed performances against the US dollar (RUB: +1.2%, BRL: -2.8%, CLP: +0.4%, COP: -0.6%, MXN: -0.8%) despite the improvement in commodity prices (Brent: +0.1% Wtx: +2.1% Cooper: +2.6%). The Turkish lira appreciated after it was confirmed that

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(market-friendly) Mehmet Simsek would remain as deputy prime minister following the arrival of the new Turkish PM. On the other hand, the Central Bank of Turkey reduced the upper bound of its interest rate corridor (marginal funding rate) by a further 50 bps to 9.5% (see). The second issue did not change the positive trend in TRY, which improved following the low levels seen in the past several weeks (+0.8%).

#### ECB Thursday's meeting: What we expect from the ECB

- At its 2 June meeting, we expect no change to the ECB's monetary policy stance after actions taken in March. The uncertainty and volatility in the financial markets remain contained, which paves the way to maintaining a steady monetary policy on course. Certainly, the central bank will retain its dovish communication and reiterate its focus on implementation measures announced in March. Its commitment to do more, if needed, will also remain on the table.
- Since the last monetary policy meeting, the uncertainty and volatility in the financial markets has improved on the back of the rebound in oil prices coupled with the hawkish tone of the latest FOMC minutes (and stronger USD). Now markets price in a 32% probability of a rate hike in June, which has led to USD appreciation. Moreover, another risk that has receded over the last month is the possibility of the UK's leaving the European Union, as the latest polls suggest the "Bremain" option is building a considerable lead. Nonetheless, in a context where main uncertainties on the global outlook still persist, the ECB will keep its easing bias.
- Regarding communication, central bank communication has been focused on the implementation of the measures announced in the March package, stressing that patience is needed. In particular, Vice President, Vitor Constâncio said "We have to allow some time for the package of measures adopted in March to produce its effects;" while Peter Praet said that "We shouldn't be talking of new instruments. We must focus on the implementation of our recent decisions." Regarding rate cuts, recent ECB communication has been very clear, signalling that the central bank would only send interest rates further into negative territory should the inflation outlook worsen significantly. Benoit Coeure said "It is in principle possible to cut deposit rate further, but there is currently no plan to do so."
- GDP growth in the euro zone accelerated by 0.2 pp to 0.5% QoQ in 1Q16, somewhat more than expected, showing its resilience to the sharp increase in uncertainty at the beginning of the year. Growth was most probably based on domestic demand, especially private consumption and a gradual recovery in investment, while net exports ended up weighing on activity again. Nonetheless, this acceleration was partly due to transitory factors such as early Easter this year and the rebound of consumption in France after the terrorist attacks of November. For 2Q16, the indicators of activity for March (falling retail and exports sales) are less encouraging, and confidence surveys until May point to a slower pace of growth. Our MICA-BBVA model suggests GDP growth of around 0.3% QoQ. We continue to be cautious due to still weak global environment and less favourable tailwinds, but these data reinforce our forecast for 2016 (BBVA Research: 1.6%, slightly more optimistic than the ECB's 1.4%).
- Regarding inflation, moderating services and falling energy prices resulted in a negative headline rate again in April (-0.2% YoY). Beyond the volatility over the last few months, we still see low and relatively stable core inflation (slightly below 1% over the year), while oil prices will keep headline inflation in negative figures until the summer, rebounding to slightly positive rates from then onwards. Despite the high uncertainty around oil markets, the Brent oil price at \$50 per barrel beats our projections and market expectations; today's futures of Brent are around 30% higher than three months ago for 2016 and 2017,



which could make the ECB Staff revise slightly upwards its inflation forecast for both years (by around 0.1-0.2 pp), but with little impact on 2018 figures. In addition, this effect could also be partly offset by a somewhat stronger euro. Overall, these slight revisions do not change the underlying picture, with inflation at very low rates and below the ECB's target over the forecast horizon, but relieve pressures on monetary policy regarding inflationary expectations and potential second round effects.

Updat 17.0 CET 27 May, 2016 Table 1

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Selection (a) (1) (1) (1) (3) (3) (3) Russian bants 172 (4) (1) (4) (5) (4) (5) (12) Soutiant 12 (5) (4) (6) (6) (5) (12) Soutiant 12 (5) (4) (6) (6) (5) (1) (5) (6) (4) (4) (4) (4) (4) (4) (4) (4) (4) (4	
Currencies (in percentage, positive for dollar depreciation)	
2000 2000 2000 2000 2000 2000 2000 200	
Emerging Marketts USGARS (Argentina) 14,02 (-0,1) (0,5 (1,2) (-0,4) USGARL (Brazil) 342 (-1,1) (-2,4) (-2,7) (0,6) USGCLP (Chine) 663,58 (-0,1) (-0,4) (-2,3) (-2,4) USGCLP (Chine) 663,58 (-0,1) (-0,4) (-2,3) (-2,4) USGCLP (Chine) 663,58 (-0,1) (-0,4) (-2,3) (-2,4)	
USDM 301 (#texico) 18.4 (+2) (+2) (+2) (+3) (+5) (-2) (-2) (-2) (+2) (+2) (+2) (+2) (+2) (+2) (+2) (+	
USDPLNI Poland 3,344 (4,1) (4,1) (4,7) (-6,4) USDRUB Runnin (66,55 (42) (7,2) (-6,4) (6,5) USDRV (Tuchny) 2,36 (46,0) (6,0) (4,7) (-2)	
USDCNY' (Zhina) 6.56 (4), 1) (4.2) (-1) (4.1) USDIRR (noda) 67 A (4.2); (9), (-4.9) (-1.3) USDIRR (nodese) 1357 (9) (3.2) (-2.5) (1.5) ADXY' 106,56 (4,1) (0,1) (-4.9) (9)	
CommonRel (data) packetskej (data) (data) packetskej (data) (data) (data) (data) (data) (data) (data) (data) (data) (data) (data	
Geld 1216, 76 (4.2) (4.2, 14.4) (4.5) Bette Day Index, 691 (9) (4.3) (4.5) (4.5) B&P GSCI Sout commonly index, 371.6 (4.2) (1.3) (5.7) (50.2) B&P GSCI Sout commonly index, 371.6 (4.2) (1.3) (5.7) (50.2) B&P GSCI Better Spot. 426, 976 (4.3) (1.7) (10.1) (56.1)	
S&P OSCI Intellin Spot 250,25 (0,5) (5,9) (5,9) (5,5) S&P OSCI Agroutives Spot. 317,777 (1,2) (5) (2,7) (5,5) Source Biomberg, Desenses and Hever	



#### \*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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