

Market Comment | Safe-haven yields set new record lows amid doubts on the economic outlook

Global Financial Markets Unit 05 Jul 2016

- BoE cuts banks' capital requirements to ensure the flow of credit. The BoE has reduced the UK countercyclical capital buffer rate from 0.5% to 0% for UK banks at least until June 2017, with immediate effect. The decision is expected to raise the lending capacity of UK banks by up to £150 billion. The decision is aimed at mitigating the effects of Brexit on the banking sector and boosting the economy, to ensure that there will not be a problem of availability of credit.
- The post-Brexit rally in financial markets started to fade as global economic uncertainties increased. The partial recovery of risk assets after the Brexit referendum came to a halt and volatility increased across the board (VIX: +9%) amid uncertainty about global growth. Market-based metrics showed the market's pessimistic view regarding the future economic outlook and inflationary expectations continued their downward trend: EZ 5Y5Y inflationary expectations fell to 1.27% while US 5Y5Y expectations stood at 1.85%. Moreover the consequences of Brexit continue to determine the UK performance: the likely action in upcoming Bank of England meetings (extension of easing measures) hampered the GBP (-1.9% against the USD) again while increasing demand for UK gilts (at historical low levels: 0.77%)
- Consequently, markets registered a risk-off movement in that demand for safe-haven assets increased sharply while prices of risky assets fell. Gold prices rose (+1%) while the main safe-haven bonds broke their all-time low yield levels (US 10Y at 1.37% after falling 7 bps and GER 10Y at -0.18%, UK10Y at 0.77%). Meanwhile peripheral yields inched down, so peripheral risk premiums widened today (ITA: +5 bps, SPA: +7 bps).
- Equity indices also suffered from the current increase in risk aversion and the main indices dropped across the board, led by European indices (Euro Stoxx 50 -1.8%; DAX -1.9%; S&P -0.6%; Nikkei -0.7%). Regarding the Italian banking sector, Monte dei Paschi continued its downward trend (-19%) while the remaining Italian banks' stock prices registered moderate increases. No major changes in the UK banking sector after the BoE relaxed banks' capital requirements.



Against this backdrop, oil prices were down (Brent: -4.4% Wtx: -4.5%) due to worsening global oil demand expectations and in response to the improvement in the supply side: supply disruptions seem to be fading as a partial recovery in Nigeria contributed to a rise in OPEC output last month, while new rigs are in operation in US, showing a potential recovery in US oil supply in upcoming months. Today's downward trend in oil prices coupled with increasing risk aversion hit the value of EM currencies (MXN -1.9%, CLP -0.6%, TRY -0.8%, COP -1.2%). Developed country currencies also registered the current risk aversion in financial markets and the USD appreciated against the EUR (-0.58%) and depreciated against the JPY (0.88%)

Update 17.45 CET 5 July, 2016 Table 1



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(Current level and changes at daily, weekly, monthly and annual frequencies)
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USDMXN (Mexico) 10,77 (-1,9) (0,4) (-1) (0,1) USDPEN (Pen) 329 (0,1) (0,5) (1,4) (0,7) LACI 64,64 (-1) (0,4) (1,5) (0,2)
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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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