

## Market Comment | Positive week for risk assets as global concerns eased

Global Financial Markets Unit 15 Jul 2016

- China's growth stabilising in Q2. China's 2016 Q2 GDP came out today at 6.7% YoY, slightly better than expected (BBVA MICA model forecasting: 6.6% YoY) and unchanged from Q1. Although both industrial production and retail sales improved from the previous month, FAI remained sluggish, in particular for investment by private firms. Meanwhile, credit supply surged significantly in June (see).
- Positive mood in financial markets persisted during the week. Risk assets recovered almost all the ground lost after the Brexit outcome due to the increasing appetite for risk brought about by, among other things, positive economic indicators and the expected support from monetary policy ahead of next week's ECB meeting. On the global policy front there was fresh news regarding BoJ and BoE. Bank of Japan showed its willingness to continue implementing measures to ease monetary conditions while also exploring fiscal measures to improve growth momentum. Meanwhile, the Bank of England surprised the market by keeping its interest rates on hold. A sizeable part of the market had been expecting easing measures, but the monetary authority finally did not meet expectations. Nonetheless, it warned about a likely easing in upcoming meetings once economic activity data are available. UK assets reacted sharply and the GBP recovered some ground against its main peers, while the sovereign curve rebounded.
- Against this backdrop, bonds halted their downward path in yields (which dad driven yields to all-time lows) and prices of bonds started to fade across the board, (GER 10Y +18 bps, US 10Y +22 bps, UK10Y +8 bps in the week) reflecting the positive mood in financial markets. Peripheral premiums decreased quite substantially in line with the reduction in risk premium (SPA, -12 bps; POR, -13 bps; ITA, -13 bps).
- The release of Chinese 2Q GDP figures contributed to maintaining the **upward trend in equity indices**, and most of them are hovering around pre-Brexit levels, led by the US and EM, which stand at higher levels. European indices increased sharply in the week (Euro Stoxx50, +4.1%; Dax, +4.3%; Ibex35, +4.2%). Financials (Euro Stoxx banks: +8.7%) behaved especially bullishly, favoured by the upturn in yields. In the same line, US indices again rose to all-time highs, supported, among other things, by better-than-expected 2Q16 quarterly earnings (S&P: +1.6% in the week, to 2,163 points).
- The Dollar index (-0.1%) remained unchanged during the week, while the GBP recovered some of the ground lost against the USD (+2.54%) after the sharp fall seen immediately after the Brexit outcome, while the EUR experienced a lesser appreciation against the USD (+0.23%). The Japanese yen halted its upward trend this week and depreciated strongly against the USD (-5.34%), after Shinzo Abe's sweeping win in the elections lent support to his government's new fiscal and monetary stimulus measures which are underway.
- High volatility in oil prices during the week, given the important flow of new information for the oil market published during the week: oil stockpiles data (lowering less than expected) and the OPEC



monthly report (forecasting higher demand in the next few years). The positive mood in financial markets was partially offset by bigger-than-expected US oil stockpiles, which reduced the strength of the upward trend in oil prices, recovering this week (+2.2%) from the great fall seen last week (around 8%). Consequently, EM currencies appreciated slightly across the board against the USD (COP +0.4%, MXN +0.2%, CLP +1.6%, PLN +0.1%, TRY +0.1%).

## ECB Thursday's meeting: What is expected?

- · At its 21 July meeting, we expect no change in the ECB's monetary policy stance.
- The sharp increase in volatility in the financial markets after the Brexit outcome has eased, which makes it easier to maintain a steady monetary policy on course this month. Certainly, at its July meeting the central bank will retain its dovish communication. However, uncertainty around the impact of Brexit on the euro zone, not only on the economic front but, most importantly, on the political front, increases downside risks to both growth and inflation in the euro zone. In particular, market-based inflation expectations have further deteriorated since the last monetary policy meeting. Moreover, European assets, particularly the banking sector have been particularly affected by Brexit. So far, the depreciation of the euro against the USD has been moderate, as markets are expecting a more dovish Fed path going forward.
- Thus, the pressure for the ECB to reassess its monetary stance has increased and we expect the ECB to pave the way for fresh announcements by September. However it is a matter of fact that the ECB has less and less margin for manoeuvre and effective action.
- Against this background, we consider that the extension of the asset purchase programme (APP) until at least September 2017, combined with some changes in the QE is the most likely scenario to cope with increasing risks for the EZ recovery. In particular, we expect changes in the technical parameters of the APP to cope with the scarcity of German bonds and coinciding with the semi-annual revision of the APP. In this regard, we consider fine tuning of the APP more likely before any change in capital key (political decision). In this context, as a first option, we are very likely to see an increase in issuer limits from 33% to 50%/70% for bonds without Collective Action Clauses (CAC). On depo rates, while the ECB has repeated that they are part of the toolkit, we consider that current conditions do not warrant such action at all.
- Euro zone GDP growth is expected to return in 2Q16 to the moderate pace of the recovery of the last two years, after the strong rebound in the first quarter (0.6% QoQ). Industrial production and retail sales up to May anticipate a moderate growth rate of domestic demand, mainly in private consumption and especially in France and Germany. In contrast, exports are showing more optimistic signals after weak performance in previous months and, along with a smaller increase in imports, suggest that net exports could contribute to growth in 2Q16. In addition, confidence remained stable over the second quarter, but we do not yet have data to assess the impact of Brexit.
- The MICA-BBVA model estimates growth of around 0.4% QoQ in 2Q16. We expect this growth rate to
  continue in coming quarters, but downward biases have increased until the uncertainty over the process
  of the UK's leaving the EU is cleared up. Our GDP growth forecast for 2016 is kept at 1.6%, but we
  revise it down to 1.5% in 2017, as we estimate that Brexit could drain between 0.4pp and 0.6pp from
  GDP growth in 2016-18.



• Regarding prices, core inflation remained stable at around 0.8% YoY in June, and headline inflation is still very low at 0.1% YoY. Higher oil prices could drive inflation up by year-end and early 2017, but remaining well below the ECB's target.

Update 17.00 CET 15 July, 2016 Table 1



## (Current level and changes at daily, weekly, monthly and annual frequencies). Deet mark ets: (Photypes in Dp) 19 2 or 2 (2 0) (3) (3) (3) 19 2 or 3 (2 0) (3) (4) (4) 20 5 or 1 (3) (4) (4) (4) 20 or 1 (4) (4) (4) (4) GER (Oyr - 0.01 - 0.01 (10) (144) Belgium 10-yr - 0.24 (2) (6) (-21) (-23) Faston 15-yr - 0.21 (5) (11) (-16) (-26) Grecon 15-yr - 7.85 (2) (-16) (-32) (-144) related 10-yr - 0.62 (2) (15) (-33) tally 10-yr 1.24 (2) (1) (-20) (-30) Notherisands 10-yr - 2.1 (2) (14) (-24) (-20) Portigal 16-yr - 1.2 (1) (4) (-23) (-35) Spain 10-yr 1.2 (2) (5) (-36) (-47) Emerging Markets Brazil 10-yr 11.89 (-6) (-16) (-91) (-463) Chile 16-yr 4.38 (8) (-1) (-16) (-26) Colembia 10-yr 7.8 (3) (6) (-20) (-106) Mexico 10-yr 5.94 (2) (15) (-15) (-33) Peru 10-yr 5.73 (6) (-6) (-40) (-156) india 10-yr 7.27 (-1) (-11) (-25) (-49) indonesia 10-yr 7.16 (-1) (-22) (-49) (-159) Country risk (changes in bp) Country this primings are style Developed that primings and departed Germany! Segue 22 (9) (4) (2) (4) Fasca 23 (9) (7) (19) (11) General 28 (9) (42) (23) (21) setant 68 (9) (43) (43) (3) 48 yr 125 (1) (3) (48) (38) Sectorology 11 (6) (43) (43) Foreign 31 (4) (2) (13) (42) (23) Spain 122 (1) (42) (43) (7) Foreign 31 (4) (42) (43) (7) Spain 122 (1) (-12) (-50) (7) 5-ye aveve iga spena da jagahat Germanyi Balgium (2 (0) (-2 6) (-13) (4) Franca 20 (1) (1) (-4) (6) (1) (2) reland 57 (-1) (-4) (6) (6) (1) (2) reland 57 (-1) (-4) (6) (6) (1) hyi § 80 (1) (-4) (-6) (34) hetherionds 14 ((6) (-4) (-3) (34) Fortugal 248 (2 (-3) (-48) (137) Spain 53 (0) (-5) (-22) (11) Spain SS (9) (2/20) (11) 2-yr soversign spreads (spaint) Germany) Solgian 18 (9) (-2) (1) (8) Solgian 18 (1) (-2) (-2) 5-yr CDS Poland92 (0) (-7) (-2) (20) 5-yr CDS Russin 222 (0) (-12) (-43) (-75) 5-yr CDS Turkey 221 (0) (-13) (-46) (-62) 5-yr CDS China 113 (8) (4) (-18) (5) 5-yr CDS India 157 (8) (-22) (-13) (9) 5-yr CDS Indonesia 162 (8) (-23) (-39) (-45) Expr (CD Foreness 182 (0) (2) (0) (4) (6) (6) (TOTAL ITAL) (TOTAL ITAL Large Spanish banks CDS 0 (3) (-169) (-165) (-137) Medium Spanish banks CDS 0 (0) (-194) (-196) (-157) Greek banks CDS 979 (-37) (-179) (-344) (-673) Russian banks CDS 332 (-1) (-19) (-33) (-69) Corporate risk (changes in 8ps) EMU Non-Standal CDS 189 (0) (-11) (-249) (-84) UK Nes-Standal CDS 159 (0) (-12) (-15) (-53) Interbank markets (changes in bp) IEM DIS spread 3m 6 (0) (-1) (-3) (-5) IEM DIS spread 12m 36 (0) (-3) (-5) (2) IEM TED spread 3m 46 (0) (-3) (-2) (5) Liber 3m 0.68 (0) (1) (2) (7) Liber 12m 1.29 (0) (4) (3) (12) Stock markets (Changes in percent \$500k marries (./mitigg62) processors ### 600 process # 858C-477-4(0.1)(1.4)(2.1)(-1) 885-180 (1.3)(2.6)(-4.7)(-0.3) Budyla 542 (-6.1)(-7.6)(-7.2) Budyla 542 (-6.1)(-7.6)(-7.2) Budyla 543 (-6.1)(-7.6)(-7.2) Budyla 544 (-6.1)(-7.6)(-7.2) Budylas 544 (-6.1)(-7.6)(-7.2) Budylas 544 (-6.1)(-7.6)(-7.2) Budylas 74 (-6.1)(-7.2)(-7.2) Geld Japone 74 (-6.1)(-7.2)(-7.2)(-7.2) Geld Japone 74 (-6.1)(-7.2)(-7.2) Large Spanish banks: 61.4 (6.1) (7.7) (4.2) (-19) Santander: 3.8 (6.2) (8.8) (4) (-16) SBVA: 5.3 (4.1) (6.9) (4.3) (-21) BBVA 5.5 (4.1) (8.9) (4.3) (41) Medium Spanish banks 56.3 (4.1) (7.5) (2.6) (20) Carinabank 2.2 (4.5) (7.9) (47) (42) Popular 1.3 (8.2) (8.4) (7.1) (43) Saladedii 1.3 (0.4) (113) (7.5) (21) Bankinder (4.0) (8.7) (6) (46) Bankinder (4.0) (7.4) (4.4) (38) Free part Markets Market Parkets Market Parkets Market Parkets Market Parkets Markets MSCIEM Asia 682 (0.45) (3.1) (4.9) (3.2) Shanghai Composite (China) 3954 (0.01) (2.2) (5.8) (-13.7) Jakarta Composite (Indonesia) 5110 (0.5) (2.8) (6.1) (11) Back stocks Takish banks 59 (0.7) (7.5) (12.4) (00.2) Albank 1.4.5. 9 (0.7) (7.5) (12.4) (00.2) Albank 1.4.5. 9 (0.7) (7) (13.4) (02.8) Garand 1.6.9 (0.7) (7.1) (14.6) Takish is Bankasi 5 (1) (0) (11.7) (0.3) Russian banks 1.56 (1) (0) (11.7) (0.3) VIB Sank 0.1 (4.8) (4.1) (2.9) (-14.6) Vita Saw 0.1 (4.0) (4.1) (4.2) (-1.4) (2.5) (-1.4) (Currencies (in percentage, positive for dollar depreciation) 0.000 (0.000 (0.0000 Emerging Markets WSDARS (Argentina) 14.76 (-0.2) (-0.3) (7.4) (-14.1) WSDARS (Argentina) 14.76 (-0.2) (-0.3) (7.4) (-14.1) WSDDAR (Market) 236 (-0.3) (1.6) (6.1) (7.6) WSDDAR (Charles) 236 (-0.4) (1.6) (6.4) (1.6) (-0.4) (1.6) (-0.4) (1.6) (-0.4)

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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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