BBVA Research

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

Global Financial Markets Unit
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- **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.

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Table 1

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

Debt markets *(changes in bp)*

Developed Markets

US 2-yr 0.7 (2) (9) (3) (-35)
US 5-yr 1.13 (4) (19) (6) (-63)
US 10-yr 1.57 (4) (22) (0) (-70)

Japan 10-yr -0.23 (3) (6) (-5) (-49)

GER 2-yr -0.65 (1) (4) (-6) (-31)
GER 5-yr -0.56 (1) (6) (-8) (-52)
GER 10-yr -0.014 (3) (18) (0) (-64)

Belgium 10-yr 0.24 (2) (9) (-21) (-73)
France 10-yr 0.21 (3) (11) (-19) (-78)
Greece 10-yr 7.85 (2) (-15) (-33) (-44)
Ireland 10-yr 0.48 (2) (5) (-35)
Italy 10-yr 1.24 (2) (4) (-26) (-36)
Netherlands 10-yr 0.1 (3) (10) (-14) (-69)
Portugal 10-yr 3.12 (1) (4) (-23) (61)
Spain 10-yr 1.2 (3) (5) (-36) (-57)

Emerging Markets

Brazil 10-yr 11.89 (-6) (-16) (-91) (-463)
Chile 10-yr 4.38 (0) (-1) (-16) (-28)
Colombia 10-yr 7.6 (0) (6) (-30) (-106)
Mexico 10-yr 5.94 (2) (10) (-15) (-33)
Peru 10-yr 5.73 (0) (-5) (-40) (-158)

Poland 10-yr 2.92 (0) (4) (-35) (-2)
Russia 5-yr 8.64 (0) (-3) (-23) (-124)
Russia 10-yr 8.4 (1) (3) (-27) (-115)
Turkey 10-yr 8.87 (3) (-8) (-64) (-160)

India 10-yr 7.27 (-1) (-11) (-25) (-49)
Indonesia 10-yr 7.16 (-1) (-22) (-49) (-159)

Country risk *(changes in bp)*

Developed Markets

10-yr sovereign spreads *(against Germany)*

Belgium 25 (0) (-9) (-20) (-9)
France 23 (0) (-7) (-19) (-13)
Greece 786 (0) (-32) (-33) (21)
Ireland 50 (0) (-13) (-34) (-3)
Italy 125 (-1) (-13) (-26) (28)
Netherlands 11 (0) (-7.5) (-14) (-5)
Portugal 314 (-2) (-13.1) (-22) (125)
Spain 122 (1) (-12) (-36) (7)

5-yr sovereign spreads *(against Germany)*

Belgium 12 (0) (-0.6) (-13) (4)
France 20 (1) (1) (-8) (8)
Greece 1659 (-1) (-6) (8) (52)
Ireland 57 (-1) (-6) (9) (31)
Italy 88 (0) (-4) (-10) (34)
Netherlands 14 (0) (1.4) (-8) (14)
Portugal 248 (2) (-3) (-18) (137)
Spain 83 (0) (-3) (-22) (11)

2-yr sovereign spreads *(against Germany)*

Belgium 10 (0) (-2) (1) (6)
France 12 (0) (3.1) (-3) (8)
Ireland 22 (-1) (-8) (0) (8)
Italy 61 (-1) (-3) (-7) (29)
Netherlands 5 (0) (-1) (-3) (8)
Portugal 137 (0) (-1) (-1) (92)
Spain 53 (-1) (-5) (-10) (18)

5-yr sovereign CDS

5-yr CDS Belgium 50 (0) (-5) (4) (18)
5-yr CDS France 37 (0) (-3) (1) (12)
5-yr CDS Germany 18 (0) (-1) (0) (6)
5-yr CDS Greece 934 (0) (-68) (27) (-124)
5-yr CDS Ireland 74 (0) (-8) (10) (34)
5-yr CDS Italy 135 (0) (-16) (-2) (40)
5-yr CDS Netherlands 28 (0) (-2) (1) (13)
5-yr CDS Portugal 294 (0) (-19) (4) (126)
5-yr CDS Spain 95 (0) (-7) (-9) (7)
5-yr CDS UK 39 (0) (-6) (4) (19)
5-yr CDS US 19 (0) (-1) (-1) (1)

Emerging Markets

5-yr sovereign CDS

5-yr CDS Argentina 393 (0) (-31) (-82) (-10903)
5-yr CDS Brazil 287 (0) (-29) (-63) (-205)
5-yr CDS Chile 79 (0) (-14) (-35) (-47)
5-yr CDS Colombia 179 (0) (-26) (-53) (-60)
5-yr CDS Mexico 135 (0) (-18) (-44) (-35)
5-yr CDS Peru 122 (0) (-13) (-37) (-64)
5-yr CDS Venezuela 4158 (0) (-159) (-1078) (-1886)

5-yr CDS Poland92 (0) (-7) (-2) (20)
5-yr CDS Russia 222 (0) (-12) (-43) (-79)
5-yr CDS Turkey 221 (0) (-13) (-46) (-52)

5-yr CDS China 113 (0) (-9) (-18) (5)
5-yr CDS India 157 (0) (-22) (-13) (9)
5-yr CDS Indonesia 162 (0) (-23) (-39) (-65)

Credit risk

Risk indicators *(changes in percentage except for BAA spreads, bp)*

VIX 12.6 (-1.7) (-4.5) (-37.4) (-6)
VSTOXX 21.65 (-0.8) (-12.1) (-42.6) (-1)
EM EFT volatility Index 21 (0) (-2) (-23) (-8)
Dollar/euro volatility 8 (-0.2) (-10.6) (-33.1) (-17)
EM FX volatility index 10 (0) (-3) (-11) (-15)
Credit spread (BAA) 259.7 (-3.8) (-19.5) (-29.4) (-63)
US bonds volatility index 74 (0) (2) (-6) (8)

Bank risk *(changes in bp)*

US banks CDS 74 (-1) (-11) (-21) (-1)
EMU banks CDS 117 (-6) (-28) (-17) (33)
UK banks CDS 110 (-6) (-34) (-20) (33)

Large Spanish banks CDS 0 (0) (-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) (-50)

Corporate risk *(changes in bps)*

EMU Non-financial CDS 109 (0) (-11) (-249) (-64)
UK Non-financial CDS 159 (0) (-12) (-19) (-33)

Interbank markets *(changes in bp)*

UEM OIS spread 3m 6 (0) (-1) (-3) (-5)
UEM OIS spread 12m 36 (0) (-3) (-3) (2)
UEM TED spread 3m 46 (0) (3.2) (9) (5)

US OIS spread 3m 28 (-1) (-1) (0) (5)
US OIS spread 12m 81 (-2) (-3) (-1) (25)
US TED spread 3m 37 (1) (-2) (-3) (-8)

Spain Ted Spread 3m 2 (1) (1.7) (16) (-3)

EONIA Index -0.33 (0) (-1.1) (0) (-21)
Euribor 3m -0.29 (0) (0) (-3) (-16)
Euribor 12m -0.06 (0) (0) (-4) (-12)

Libor 3m 0.68 (0) (1) (2) (7)
Libor 12m 1.29 (0) (4) (3) (12)

Stock markets *(Changes in percentage)*

Developed Markets

Main equity indices

S&P500 2163.8 (0) (1.6) (4.5) (6)
Dow Jones 18506.4 (0) (2) (4.9) (6)
Nikkei 16497.9 (0.7) (9.2) (3.6) (-13)
FTSE 100 6642.7 (-0.2) (0.8) (11.3) (6)
EuroStoxx 50 2953.8 (-0.3) (4.1) (4.4) (-10)
IBEX8531.1 (-0.2) (4.2) (3.4) (-11)
DAX 10046 (-0.2) (4.3) (4.6) (-6)
CAC4364.2 (-0.5) (4.1) (4.6) (-6)
MIB 16738.5 (-0.4) (4.2) (1.4) (-22)
ASE Athens 551.9 (-2) (2.7) (-4.1) (-13)

Bank stocks

JPM 64.1 (0) (3.7) (3.5) (-3)
Citi 44.5 (0) (5.9) (5.8) (-14)
BoA 13.7 (0) (3.6) (2.3) (-19)
MS 28 (0) (6.2) (13.3) (-12)
GS 162.5 (0) (8.1) (11.2) (-10)

HSBC 477.4 (0.1) (1.4) (12.1) (-11)
RBS 185 (1.5) (9.6) (-14.7) (-39)
Barclays 149.7 (1.1) (7.5) (-7) (-32)
Lloyds 56.4 (0.4) (7.3) (-10.4) (-23)

EMU banks 73.1 (0.1) (8.7) (-0.7) (-32)
BNP 43.1 (0.5) (8.2) (1.6) (-17)
Crédit Agricole 7.9 (-1.4) (4.4) (0.8) (-28)
Deutsche Bank 13.1 (0.9) (11.8) (-1.1) (-42)
ING 9.8 (0.4) (7.9) (0.9) (-21)
Intesa 1.9 (-0.7) (9.2) (-2.3) (-38)
SG 30.5 (0.6) (8.9) (-2.6) (-28)
Unicredito 2.2 (1.2) (14.4) (-3.3) (-58)

Large Spanish banks 61.4 (0.1) (7.7) (4.2) (-19)
Santander 3.8 (0.2) (8.8) (4) (-16)
BBVA 5.3 (-0.1) (6.9) (4.3) (-21)

Medium Spanish banks 58.3 (-0.1) (7.5) (-2.6) (-29)
Caixabank 2.2 (-0.5) (7.8) (4.7) (-32)
Popular 1.3 (0.2) (8.4) (-7.1) (-53)
Sabadell 1.3 (0.4) (11.3) (-7.5) (-21)
Bankinter 6 (-0.3) (4.7) (0) (-8)
Bankia 0.7 (-0.1) (7.4) (-4) (-38)

Greek banks 2.9 (-4) (9.5) (-11.4) (-35)
Alpha Bank1.8 (-3.8) (8) (-6.4) (-30)
Pireus Bank0.2 (-4.2) (8.2) (-20.2) (-43)
National Central Bank0.2 (-3) (4.8) (-13.3) (-43)
Eurobank Ergasias0.6 (-4.6) (14.5) (-20.4) (-42)

Emerging Markets

Main equity indices

MSCI Latam 70036 (1.16) (4.7) (9.6) (18.1)
Ibovespa (Brazil) 55481 (0) (4.4) (13.4) (28)
Mexbol 46499 (0) (1.6) (3.3) (8.2)

MSCI EM Europe 4491 (0.76) (4.2) (3.6) (5.7)
Poland 1761 (0.9) (3.3) (-0.7) (-5.3)
Micex (Russia) 1943 (0) (2.6) (2.8) (10.3)
Ise 100 (Turkey) 82505 (-0.1) (5.7) (8.2) (15)

MSCI EM Asia 682 (0.45) (3.1) (4.9) (3.2)
Shanghai Composite (China) 3054 (0.01) (2.2) (5.8) (-13.7)
Jakarta Composite (Indonesia) 5110 (0.5) (2.8) (6.1) (11)

Bank stocks

Turkish banks 89 (0.7) (7.5) (12.4) (20.2)
Akbank T.A.S. 9 (0.7) (7) (13.4) (32.8)
Garanti 8 (0.6) (7.5) (11.8) (18.1)
Turkiye Is Bankasi 5 (1) (8) (11.7) (8.3)

Russian banks 178 (-0.5) (2.5) (4.1) (17.1)
Sberbank 139 (-0.5) (3.6) (7.3) (37.6)
VTB Bank 0.1 (-0.6) (-0.1) (-2.9) (-14.6)

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

Developed Markets

EURUSD 1.108 (-0.4) (0.23) (-1.6) (2)
GBPUSD 1.33 (-0.45) (2.54) (-6.5) (-9.9)
USDJPY 105.91 (-0.53) (-5.34) (0.1) (11.9)
DXY 96.44 (-0.4) (-0.1) (-1.9) (2.2)

Emerging Markets

USDARS (Argentina) 14.76 (-0.2) (-0.3) (-7.4) (-14.1)
USDBRL (Brazil) 3.26 (-0.3) (1.1) (6.1) (17.6)
USDCLP (Chile) 649.05 (0.3) (1.6) (5.4) (8.4)
USDCOP (Colombia) 2922.54 (-0.2) (0.4) (1.8) (7.9)
USDMXN (Mexico) 18.46 (-0.6) (0.2) (2.4) (-7.3)
USDPEN (Peru) 3.28 (0) (0.1) (0.9) (4)
LACI 65.56 (-0.4) (1.1) (3) (4.7)

USDPLN (Poland) 3.99 (-0.5) (0.1) (-1.4) (-1.6)
USDRUB (Russia) 63.46 (-0.9) (0.6) (3.2) (12.5)
USDTRY (Turkey) 2.89 (-0.4) (0.1) (1.2) (0.9)

USDCNY (China) 6.69 (-0.1) (0) (-1.6) (-3)
USDINR (India) 67.07 (-0.2) (0.4) (0.1) (-1.4)
USDIDR (Indonesia) 13096 (-0.2) (0.6) (1.9) (5)
ADXY 106.94 (-0.1) (0.3) (0) (0.4)

Commodities *(change in percentage)*

Brent 47.77 (0.8) (2.2) (-2.5) (28.1)
WTx 46.02 (0.7) (1.3) (-4.1) (24.2)
Copper 225.15 (0.5) (6.3) (7.5) (5.9)
Gold 1327.82 (-0.5) (-2.8) (2.8) (25.1)
Baltic Dry Index 738 (0) (5) (22.2) (54.4)
S&P GSCI Spot commodity index 362.253 (1.2) (2) (-4.5) (17.2)
S&P GSCI Brent Spot 407.915 (2.6) (3.3) (-4.8) (30)
S&P GSCI Metals Spot 280.53 (0.4) (4.5) (8.3) (10.1)
S&P GSCI Agricultural Spot 305.759 (-0.8) (4) (-8) (7.8)

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

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