

Market Comment | Search for yield strategies faded this week

Global Financial Markets Unit 29 Jul 2016

- US economy grew less than expected in the second quarter (1.2% SAAR, BBVA 2.5% SAAR, consensus 2.6% SAAR, previous 0.8% SAAR revised from 1.1% SAAR). Private investment dropped 3.2%, fixed investment subtracted 0.52 pp from growth and inventories took another 1.16 pp off, while consumption rose slightly less than expected (4.2%, consensus 4.4%).
- Very timid increase in easing measures by BoJ, which slightly disappointed financial markets.

 BoJ expanded its purchases of exchange-traded funds and doubled the size of a U.S. dollar lending programme. The central bank maintained its annual target for expanding the monetary base at ¥80 trillion. It also kept the minus 0.1 percent rate for commercial banks' extra reserves. The BoJ also updated its economic projections: inflation ex-fresh food has been revised to +0.1% (from 0.5%) for FY16 and left unchanged at +1.7% for FY17, while GDP growth estimates were cut to 1.0% YoY (from 1.2%) for FY16 and increased to 1.3% YoY for FY17 (from 0.1% YoY in April). (see official statement). According to market-based metrics the BoJ's additional monetary stimulus fell short of expectations.
- Central banks and oil prices drove the markets this week. The Central Banks meetings did not bring any significant news. The Fed used July's statement to re-prime the policy normalization pump. Improvements in domestic conditions moved the FOMC closer to resuming normalisation. However, the uncertainty and the U.S. elections will complicate the possibility of a rate increase in September (see). Moreover, the softer-than-expected 2Q16 GDP growth also led to a decline in the market implied probability of a rate hike in December's FOMC meeting (to 32% from 37%). On the other hand, the BoJ increased its easing measures, but slightly disappointed financial markets. The Japanese yen depreciated by -1.6% against US dollar, while the Japanese 10Y yield surged by 8 bps and Japanese equity markets showed only a shy increase +0.6%. Investors are now waiting for the ambitious anticipated fiscal package (more than 5% of GDP), which will be launched early next week.
- Nonetheless, the downward trend in oil prices (-7.5%) halted the search for yield strategies. In bond markets safe-haven bond yields ended the week down (-9 bps in US and -9 bps in Germany), while European peripheral bond prices also increased, sending their yields lower in the week (-7 bps Italy, -10 bps Spain and -7 bps Italy). Equity indices remained quite stable during the week amid the 2Q earnings report period (Euro Stoxx 50 +0.4%, S&P500 -0.1%, Nikkei -0.3%, Ibex35, -0.5%). However, the release of banking stress test results in the EZ could be a source of concern if their outcome disappoints.
- The US dollar depreciated in the week, reflecting the Fed's statement and the disappointing 2Q16 US GDP figures. The dollar index decreased (DXY 2.1%), with the dollar depreciating against its main peers (JPY 3.62% EUR 1.81% GBP 1.38%) in the week. The bearish sentiment in the oil market dragged down the main EM currencies, mostly those closely related with oil prices (CLP -0.4%, COP -4%, MXN -1.2%), while TRY +2.4% recovered from the sharp losses experienced last week.



Update 17.00 CET 29 July, 2016 Table 1



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

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