

Market Comment | North Korea triggered risk-off mood in the ECB week

Global Financial Markets Unit
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- **Risk-off mood in financial markets due to a new North Korea nuclear test** [\(see\)](#). This action escalated the tension in the geopolitical field sending, a belligerent message and renewing fears of potential military action. By now the international community could support stronger sanctions [\(see\)](#).
- In this context, demand for **safe-haven assets increased sharply** on US Labor Day (US markets will remain closed): gold hovered around its highest level since 2014, while safe-haven currencies (JPY and CHF) appreciated against the USD. Consequently, equity indices dropped in the euro area following losses in Asia's equity indices, while EZ bond markets remained almost unchanged waiting for this **week's ECB meeting** (see the preview below).
- Although movements in the FX market showed the market's risk aversion, the **EUR remained strong against the USD**, despite geopolitical uncertainties [\(see\)](#) and ahead of the ECB policy meeting this week.
- Portugal's sovereign bond yields inched down, after **Moody's rating agency reviewed** [\(see\)](#) **the credit rating outlook to positive from stable**, citing improving resilience of economic growth and fiscal improvements.
- **Gasoline prices declined and oil prices inched down**, after refineries restarted once Hurricane Harvey started to fade, downgraded to a tropical storm [\(see\)](#). At the same time EM currencies showed a mixed performance, with little variation across the board.

ECB Preview: What to expect at the September meeting?

- **A revision of Staff forecasts is expected, especially of inflation given the recent euro appreciation, but the strength of growth continues.**
- **A higher euro forces the ECB to be very cautious, but it should start communicating its strategy as soon as possible in order to guide expectations.**
- At the July meeting the ECB President Mario Draghi stated that the Governing Council (GC) would take a decision on the roadmap for the monetary policy normalization process in the autumn. This was confirmed by the July meeting minutes: "the Governing Council would, in the autumn, consider the future course of its monetary policy and, in particular, its strategy for asset purchases beyond the currently communicated horizon."
- Since then the ECB has given no clues about the exit strategy, either on when to start it or on how to implement it. But in the meantime, the economic and financial outlook has continued to evolve in a way that poses some challenges for the monetary policy stance. On the one hand, the euro zone economy

continues to advance above its potential growth, at a solid pace (0.6% QoQ in 2Q17), boosted by the strength of domestic demand. Headline inflation increased to 1.5% YoY in August, but the energy base effect along with the recent appreciation of the euro could push it down by year end and the first quarter of 2018 to around 1% YoY. Core inflation has increased by 0.4 pp since January, to 1.3% YoY, while a very gradual increase is expected going forward, it is still failing to show a sustainable upward trend towards the ECB's target. On the other hand, the euro vis-à-vis the USD has accelerated its appreciation trend (by around 5% since July). Certainly, the strengthening of the euro reflects the stronger momentum in the euro zone economy and the expected normalization of monetary policy, but it also challenges the ECB's exit strategy. The euro is now around 8% more appreciated versus the USD than the assumption included in the June Staff's macroeconomic projections. According to their sensitivity analysis, ceteris paribus, the stronger euro could dampen GDP growth and inflation by around 0.3 pp and 0.6 pp respectively from next year onwards.

- Thus, at this meeting the update of macroeconomic projections and the assessment on the euro would be particularly relevant. Regarding GDP growth, we think that stronger domestic demand and the lagged effect of the stronger currency could lead to a slight upward revision of ECB growth forecasts this year (by around 0.1 pp or 0.2 pp from the 1.9% figure in June), while minor changes are expected over the forecast horizon (1.8% in 2018 and 1.7% in 2019). On inflation, the headline figure could be unchanged this year (1.5%) and revised down in 2018 and 2019 by around 0.2 pp from the June projections (1.3% and 1.6%, respectively), while more limited pass-through to core components could lead to slight downward revisions of underlying inflation (around 0.1 pp from 1.4% in 2018 and 1.7% in 2019). On the assessment of the euro, the ECB will probably signal that a (sharp) appreciation of the exchange rate requires a more prudent approach as long as it translates into a slower and more gradual convergence of inflation towards the target. Moreover, the ECB could be particularly cautious considering the lingering uncertainty in the US, which could result in a more dovish Fed carrying on the normalization of its monetary policy.
- All in all, while the euro is expected to weigh in the ECB's reactions going forward the improvement in the economic outlook in the euro zone is consistent with the ECB's gradual exit from QE. While it will maintain a very cautious stance, we expect it to remove the "explicit" downward bias regarding the asset purchase programme (APP), gaining (the desired) flexibility ahead of the announcement of a reduction of the APP in October. The ECB should not forget the importance of guiding expectations in advance.

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Table 1

Debt markets (% 10Y, % changes in bp)					
Developed Markets	level	Daily	Weekly	Monthly	YTD
US (2-yr)	1.34	0.0	1.7	0	13
US	2.17	0.0	0.9	6	-27
GER (2-yr)	-0.73	-0.8	1.0	-5	4
Germany	0.37	-1.3	-1.0	-9	1
France	0.68	-0.5	-1.4	-4	-13
Spain	1.55	-5.0	-5.2	0	-2
Italy	2.04	-3.9	-4.4	5	17
Portugal	2.83	-0.8	-2.8	-3	-124
Greece	5.53	-0.5	-1.6	1	-136
Japan (2-yr)	-0.15	1.8	0.5	-3	4
Japan	-0.03	2.0	-3.8	-7	-7
Emerging Markets					
level	Daily	Weekly	Monthly	YTD	
Brazil	9.99	-1.1	-11.1	18	-142
Chile	4.35	-0.1	-4.1	5	2
Colombia	6.75	1.1	2.6	-15	-34
Mexico	6.85	-0.3	0.7	1	-79
Peru	5.21	3.3	3.6	5	-126
Poland	3.28	-3.2	-0.6	6	-44
Russia	7.70	-4.3	-18.3	-10	-75
Turkey	10.35	0.0	6.0	-1	65
India	6.50	1.3	-7.2	7	11
Indonesia	6.70	0.1	-8.3	22	-115
Country risk (bp, changes in bp)					
Developed Markets	level	Daily	Weekly	Monthly	YTD
10-yr sovereign spread vs Germany					
France	31	0.8	-0.4	5	-14
Italy	167	2.6	-3.4	14	15
Portugal	247	0.5	-3.6	6	-108
Spain	118	-3.7	-4.2	6	-9
2-yr sovereign spread vs Germany					
France	21	-0.5	-2.6	1	18
Italy	55	1.0	-4.3	10	-6
Portugal	72	-1.3	-6.9	-9	-74
Spain	38	1.7	-2.4	2	-10
Emerging Markets					
level	Daily	Weekly	Monthly	YTD	
5-yr sovereign CDS *					
Brazil	189	-4.5	-6	-11	-83
Chile	57	-0.3	-4	6	-25
Colombia	120	-3.1	-6	2	-43
Mexico	99	-1.6	-4	1	-57
Peru	73	-0.8	-4	-2	-35
Venezuela	6.457	-6.5	335	-49	2552
Poland	54	-1.5	-2	5	-22
Russia	139	-1.5	-7	-19	-38
Turkey	158	-2.1	-12	-19	-114
China	56	-1.0	-3	-7	-61
India	80	-0.9	-2	-6	-47
Indonesia	100	-0.6	-4	-10	-56
Risk indicators					
Volatility indicators (%)	level	Daily	Weekly	Monthly	YTD
VIX	10	0.0	-11	-3	-2
VST OXX	16	10.2	2	18	0
EM EFT volatility index	15	0.0	-8	1	-24
Dollar/euro volatility	8	4.1	6	5	-20
EM FX volatility index	7	0.3	4	-1	-33
Credit spread (BAA) (bps)	209	0.0	-4	3	-18
US bonds volatility index	49	-3.3	1	3	-35
Banking By CDS (bps) *					
level	Daily	Weekly	Monthly	YTD	
US	56	-0.6	1	4	-16
EZ	56	-1.4	-3	4	-52
UK	48	-0.3	-1	3	-42
Large Spanish	51	-1.1	-6	2	-66
Medium Spanish	88	-0.8	-5	-3	-64
Corporate By CDS (bps) *					
level	Daily	Weekly	Monthly	YTD	
US Non-financial	138	-0.6	-1	4	-16
EZ Non-financial	75	-1.4	-3	4	-52
UK Non-financial	106	-1.0	-3	-1	-19
Interbank markets (% changes in bp)					
level	Daily	Weekly	Monthly	YTD	
EONIA Index	-0.36	0.00	0.0	0.0	0.0
Euribor 3m	-0.33	0.00	0.0	0.0	0.0
Euribor 12m	-0.16	0.00	0.0	0.0	-0.1
Libor 3m	1.32	0.00	0.0	0.0	0.3
Libor 12m	1.71	0.00	0.0	0.0	0.0
Stock markets (%)					
Main indices	level	Daily	Weekly	Monthly	YTD
S&P500	2.477	0.0	1.3	0	9
Dow Jones	21.988	0.0	0.8	0	10
Nikkei	19.508	-0.9	0.3	-3	0
FTSE 100	7.411	-0.4	0.1	-1	3
EuroStoxx 50	3.431	-0.4	0.3	-1	3
BSE	10.243	-0.8	-0.4	-3	8
DAX	12.102	-0.3	-0.2	0	4
CAC	5.104	-0.4	0.5	-1	4
MIB	21.791	-0.3	0.3	0	11
ASE Athens	809	-1.2	-3.5	-2	23
MSCI Latam *	83.357	0.9	0.4	4	14
Ibovespa (Brazil)	71.902	0.0	1.2	8	17
Ibex35 (Spain)	50.923	-0.3	-0.7	-1	9
MSCI EM Europe *	5.191	-0.2	1.1	3	3
Poland	2.519	-0.3	-0.5	7	26
Moscú (Russia)	2.003	0.4	0.8	2	-12
Ise 100 (Turkey)	110.011	0.0	-0.3	3	44
MSCI EM Asia *	869	0.0	0.2	1	25
Shanghai Com (China)	3.380	0.4	0.5	3	7
Jakarta (Indonesia)	5.874	-0.9	-1.7	4	-10
Banking sector					
level	Daily	Weekly	Monthly	YTD	
US banks					
JPM	124.2	0.0	1.7	-1	4
Cit	91.7	0.0	0.1	-1	6
Ch	68.6	0.0	1.1	1	12
BoA	24.1	0.0	1.6	-1	5
MS	46.2	0.0	1.6	-2	6
GS	225.9	0.0	2.5	-7	-7
EZ banks					
BNP	111.3	-0.6	-0.7	4	6
BNP	63.9	-0.7	-0.1	-5	2
Crédit Agricole	14.8	-0.3	-0.7	0	21
Deutsche Bank	13.5	-0.5	-1.8	-12	-17
ING	14.9	-0.5	-0.5	5	7
Intesa	2.8	-0.2	-1.0	-2	12
SG	46.9	-1.1	0.2	-4	-3
Unicredit	17.2	0.4	-0.0	3	23
UK banks					
HSC	86.9	-0.8	-1.4	-4	-1
HSC	745.0	0.6	0.3	-2	11
Barclays	250.0	-1.1	-2.3	-2	7
Barclays	180.2	-1.0	-2.1	-9	-19
Lloyds	63.4	-0.5	-2.3	-5	-2
Large Spanish banks					
Santander	86.5	-0.8	-0.5	6	11
Santander	5.4	-0.7	0.1	6	8
BBVA	7.4	-0.8	-0.8	6	13
Medium Spanish banks					
Cajabank	79.5	-1.4	-1.0	-4	9
Cajabank	4.3	-1.3	-0.6	3	32
Sabadell	1.8	-2.8	-1.7	-4	32
Bankinter	7.9	-1.2	-0.7	5	5
Bankia	4.0	-0.3	-1.2	-7	-2
Commodities (% red for currency depreciation)					
Developed	level	Daily	Weekly	Monthly	Year
EURUSD					
EURUSD	1.19	0.5	-0.5	0.4	14
GBPUSD					
GBPUSD	1.29	-0.1	0.1	-1.5	5
USDJPY					
USDJPY	109.62	0.6	-0.3	-0.4	-7
DXY					
DXY	92.49	-0.4	0.3	0.4	10
Emerging					
level	Daily	Weekly	Monthly	Year	
USDARS (Argentina)					
USDARS	17.28	-0.3	-0.3	2.2	-7
USD BRL (Brazil)					
USD BRL	3.14	0.1	1.0	-0.7	3
USDCUP (Cuba)					
USDCUP	624.56	0.0	0.6	3.8	7
USDCOP (Colombia)					
USDCOP	2932	0.0	0.5	0.7	1
USDMXN (Mexico)					
USDMXN	17.87	-0.3	0.0	-0.1	17
USDPEN (Peru)					
USDPEN	3.24	0.0	0.0	0.0	4
LKR					
LKR	65.43	-0.2	0.7	0.4	8
USDPLN (Poland)					
USDPLN	3.56	0.8	-0.4	0.4	15
USD RUB (Russia)					
USD RUB	57.80	-0.5	1.1	4.2	4
USDTRY (Turkey)					
USDTRY	3.43	0.0	0.4	3.1	4
USDCNY (China)					
USDCNY	6.53	0.4	1.3	2.8	6
USDINR (India)					
USDINR	64.05	0.0	-0.2	-0.6	6
USDIDR (Indonesia)					
USDIDR	13.339	-0.2	0.0	-0.1	1
ADNY					
ADNY	108.3	0.0	0.4	1.2	5
Commodities (%)					
level	Daily	Weekly	Monthly	Year	
Brent					
Brent	52.4	-0.7	0.9	1	-7
WTI					
WTI	48	0.5	2.0	3	11
Copper					
Copper	313	1.1	2.2	9	23
Gold					
Gold	1334	0.7	2.0	5	15
S&P Spot commodity *					
S&P Spot commodity *	308	0.1	2.5	1	-2
S&P Brent Spot *					
S&P Brent Spot *	449	-0.2	2.6	1	-7
S&P Metals Spot *					
S&P Metals Spot *	372	0.8	3.0	10	22
S&P Agricultural *					
S&P Agricultural *	279	-0.3	0.8	-3	-7

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Spain	1.55	-5.0	-5.2	0	-2
Italy	2.04	-3.9	-4.4	5	17
Portugal	2.63	-0.8	-2.8	-3	-134
Greece	5.53	-0.5	-1.6	1	-136
Japan (2-yr)	0.15	1.8	0.5	-3	4
Japan	0.01	-2.0	-7.8	-7	-7
Emerging Markets					
level	Daily	Weekly	Monthly	YTD	
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Colombia	120	-3.1	-6	-2	-43
Mexico	99	-1.6	-4	1	-57
Peru	73	-0.8	-4	-2	-35
Venezuela	6,457	-6.5	335	-49	2,552
Poland	94	-1.5	-2	-5	-22
Russia	139	-1.5	-7	-19	-38
Turkey	158	-2.1	-12	-19	-114
China	56	-1.0	-3	-7	-61
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Volatility indicators (%)					
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Eurbor 3m	-0.33	0.00	0.0	0.0	0.0
Eurbor 12m	-0.16	0.00	0.0	0.0	-0.1
Libor 3m	1.32	0.00	0.0	0.0	0.3
Libor 12m	1.71	0.00	0.0	0.0	0.0
Stock markets (%)					
level	Daily	Weekly	Monthly	YTD	
Main indices					
S&P500	2,477	0.0	1.3	0	9
Dow Jones	21,988	0.0	0.8	0	10
Nikkei	19,508	-0.9	0.3	-3	0
FTSE 100	7,411	-0.4	0.1	-1	3
EuroStoxx 50	3,411	-0.4	0.3	-1	3
IBEX	10,243	-0.8	-0.4	-3	8
DAX	12,102	-0.3	-0.2	0	4
CAC	5,104	-0.4	0.5	-1	4
MBI	21,291	-0.3	0.3	0	11
ASE Athens	809	-1.2	-3.5	-2	23
MSCI Latam *	83,357	0.9	0.4	4	14
Ibovespa (Brazil)	21,992	0.8	1.2	8	17
Mibex (Russia)	59,923	-0.9	-0.7	-1	9
MSCI EM Europe *	5,191	-0.2	1.1	3	3
Poland	2,519	-0.3	-0.5	7	26
Micex (Russia)	2,803	-0.4	0.8	-2	-12
Isx 100 (Turkey)	110,011	0.0	-0.3	3	44
MSCI EM Asia *	869	0.0	0.2	1	25
Shanghai Com (China)	3,380	0.4	0.5	3	7
Jakarta (Indonesia)	5,814	-0.9	-1.7	0	10
Banking sector					
level	Daily	Weekly	Monthly	YTD	
US banks					
JPM	124.2	0.0	1.7	-1	4
CB	91.7	0.0	0.1	-1	6
BoA	68.6	0.0	1.1	1	12
MS	24.1	0.0	1.6	-1	5
GS	46.2	0.0	1.6	-2	6
Wells	225.9	0.0	2.5	1	7
EZ banks	111.5	-0.6	-0.7	-4	6
BNP	63.9	-0.7	-0.1	-5	2
Credit Agricole	14.8	-0.3	-0.7	0	21
Deutsche Bank	13.5	-0.5	-1.8	-17	-17
ING	14.9	-0.5	-0.5	-5	7
Intesa	2.8	-0.2	-1.0	-2	12
SG	46.9	-1.1	0.2	-4	-3
UniCredit	17.2	-0.4	-3.0	-3	23
UK banks	86.9	-0.8	-1.4	-4	-1
HSBC	745.0	-0.6	0.3	-2	11
RBS	250.0	-1.1	-2.3	-2	7
Barclays	190.2	-1.0	-2.1	-9	-19
Lloyds	63.4	-0.5	-2.3	-5	-2
Large Spanish banks					
Santander	86.5	-0.8	0.5	-6	11
Banco Sabadell	5.4	-0.7	-0.1	-6	8
BBVA	7.4	-0.8	-0.8	-6	13
Medium Spanish banks					
Cajabank	79.5	-1.4	-1.0	-4	9
Caja de Pensiones	4.3	-1.3	-0.6	-3	32
Sabadell	1.8	-0.8	-1.7	-4	32
Bankinter	7.9	-1.2	-0.7	-5	5
Banco Popular	4.0	-0.3	-1.2	-7	2
Currencies (% , red for currency depreciation)					
Developed	level	Daily	Weekly	Monthly	Year
EURUSD					
EURUSD	1.19	0.5	-0.5	0.4	14
GBPUSD	1.29	-0.1	0.1	-1.5	5
USD JPY	109.62	0.6	-0.3	-0.4	-7
DXY	92.49	-0.4	0.5	-0.4	10
Emerging					
level	Daily	Weekly	Monthly	Year	
USDARS (Argentina)					
USDARS	17.28	-0.3	-0.3	2.2	-7
USD BRL (Brazil)					
USD BRL	3.14	0.1	1.0	-0.7	3
USD COP (Colombia)					
USD COP	624.56	0.0	0.6	3.8	7
USD COP (Colombia)					
USD COP	2932	0.0	0.5	0.7	1
USD MXN (Mexico)					
USD MXN	17.87	-0.3	0.0	-0.1	17
USD PEN (Peru)					
USD PEN	3.24	0.0	0.0	0.0	4
LACI	66.43	-0.2	0.7	0.4	8
USD PLN (Poland)					
USD PLN	3.56	0.8	-0.4	0.4	15
USD RUB (Russia)					
USD RUB	57.80	-0.5	1.1	4.2	4
USD TRY (Turkey)					
USD TRY	3.43	0.0	0.4	3.1	4
USD CNY (China)					
USD CNY	6.53	0.4	1.3	2.8	6
USD INR (India)					
USD INR	64.05	0.0	-0.2	-0.6	6
USD IDR (Indonesia)					
USD IDR	13,339	-0.2	0.0	-0.1	1
ADXY	100.7	0.0	0.4	1.2	5
Commodities (%)					
level	Daily	Weekly	Monthly	Year	
Brent					
Brent	52.4	-0.7	0.5	-1	-9
WTI	48	0.5	2.0	3	11
Copper	313	1.1	2.2	9	23
Gold	1334	0.7	2.0	5	15
S&P Spot commodity *	386	0.1	2.5	1	-2
S&P Brent Spot *	449	-0.2	2.6	1	-7
S&P Metals Spot *	372	0.8	3.0	10	22
S&P Agricultural *	279	-0.3	0.8	-3	-7

Source: Bloomberg, Datastream and Haver

* With one day delay

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