

**Market Comment**

**Risk-off mood extends, fueling bond demand. Fed preview.**

- Increasing contagion fears from the outbreak of the coronavirus in China have remained the main market driver** at the start of the week. Investors are assessing the impact of the virus on financial variables. However, the Chinese authorities have taken rapid emergency action to contain the virus and the WHO has so far stopped short of declaring the current outbreak as a global emergency(see). China has also extended its New Year holiday until February 2 to contain the spread of the virus.
- Financial markets traded in with a risk-off mood.** Investors continued seeking shelter in bond markets, amid a surge in market-based risk measures, such as implied volatility in equity markets (**VIX above 18 vs 14 last Friday**).
- Economic data was unexpectedly weak.** German business climate slid back in January against expectations of an increase (95.9, consensus 97, previous 96.3), led by a drop in IFO expectations (92.9, consensus 94.8, previous 93.9). U.S. new home sales unexpectedly declined in December (694k, consensus 730k, previous 697k), while November data was downwardly revised.
- Crude oil has been one of the most penalized assets,** underpinned by the potential negative impact of the coronavirus not only on China's growth but also on the crude demand from airline companies as most flights to the region have been affected. The sharp fall in Brent prices (-3%, falling below 59\$/b), the attack on the U.S. embassy in Iraq on Sunday notwithstanding, led the OPEC and its allies to hold a meeting to study deeper oil supply cuts if the downward trend in oil prices extends further due to the coronavirus. Industry metal commodities also declined sharply, underpinned by concerns about the cyclical impact.
- Sovereign yields extended their decline across the board.** The U.S. 10Y yield tumbled (-8bps) sharply, hitting levels below 1.7%, breaking the sustained increase experienced after the U.S.-China trade agreement. Concerns about the impact of the coronavirus have led markets to increase the probability of a 25bps Fed interest rate cut this year to 78% from 67%. However, it is expected that the Fed will keep the monetary policy unchanged in this Wednesday's monetary policy meeting (see below). The declines in the 10Y German yield have been more contained (-5bps) than in the U.S. today, as the easing of political concerns in Italy has moderated the safe-haven flow towards the German bund. In Italy, the government coalition has been backed in a key regional election in Emilia-Romagna (see). The easing concerns about snap elections in Italy spurred flows toward Italian bond markets, resulting in narrow Italian risk premium (-15 bps to 142). Other peripherals were also boosted by easing political tensions in Italy, amid strong bond demand across the board.
- In FX markets, safe haven currencies attracted flows.** Nevertheless, G-10 currency traded in a narrow range. EM FX depreciated across the board, with the Chinese yuan extending its depreciation
- Equity markets extended declines.** European and Asia equity markets declined more than 2% led by Basic resources, airlines, luxury goods and other companies whose have production channels in China.

 **Central Bank Annex**

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**DEBT MARKETS (10Y, %, CHANGE IN BPS)**

Developed Markets	level	Daily	Week	Month	YoY
US (2-yr)	1.44	-5.2	-11.6	-19	-115
<b>US</b>	1.60	-7.9	-22	-29	-114
GER (2-yr)	-0.63	-1.6	-4.2	-1	-5
<b>Germany</b>	-0.39	-5.0	-16.7	-18	-59
France	-0.13	-5.4	-16.5	-19	-74
Spain	0.28	-6.9	-16.6	-16	-94
Italy	1.03	-20.0	-32.1	-40	-163
Portugal	0.31	-7.4	-18.5	-22	-134
Greece	1.18	-12.9	-23.5	-28	-288
Japan (2-yr)	-0.14	-1.1	-1.5	-2	3
<b>Japan</b>	-0.04	-2.4	-5.4	-3	-5
<b>Emerging Markets</b>	<b>level</b>	<b>Daily</b>	<b>Weekly</b>	<b>Monthly</b>	<b>YoY</b>
Brazil	6.72	0.0	-10.2	-16	-239
Chile	2.90	-0.8	2.2	6	-132
Colombia	5.95	-1.6	-11.1	-29	-111
Mexico	6.76	-5.9	-7.0	-14	-163
Peru	3.45	-0.7	-2.7	-6	-185
Poland	2.22	-3.4	-12.4	14	-59
Russia	6.35	9.0	9.7	-14	-206
Turkey	10.11	6.0	-66.0	-172	-470
India	6.56	-2.6	-8.8	-3	-78
Indonesia	6.71	8.7	-10.0	-40	-141

**COUNTRY RISK (BP, CHANGE IN BPS)**

Developed Markets	level	Daily	Weekly	Monthly	YoY
<b>10-yr sovereign spread vs Germany</b>					
France	26	-0.4	0.2	-1	-15
Italy	142	-15.0	-15.4	-22	-104
Portugal	69	-2.4	-1.8	-4	-75
Spain *	66	-1.9	0.1	2	-35
<b>2-yr sovereign spread vs Germany</b>					
France	5	-1.8	0.3	3	-7
Italy	47	-8.4	-9.7	-14	-41
Portugal	19	-1.7	-4.3	8	-21
Spain	23	-0.3	0.5	0	-9
<b>Emerging Markets</b>	<b>level</b>	<b>Daily</b>	<b>Weekly</b>	<b>Monthly</b>	<b>YoY</b>
<b>5-yr sovereign CDS *</b>					
Brazil	102	2.8	4	-1	-68
Chile	51	2.3	5	7	2
Colombia	82	2.7	9	8	-46
Argentina	6390	702.6	1734	1003	5763
Mexico	85	2.6	6	4	-46
Peru	48	1.6	4	5	-29
Poland	50	-0.3	-1	-8	-15
Russia	64	-0.3	4	7	-67
Turkey	237	-3.0	-10	-43	-79
China	38	1.3	8	6	-20
India	63	0.0	2	-5	-44
Indonesia	63	-0.7	3	1	-53

**RISK INDICATORS**

Volatility indicators (change in pp)	level	Daily	Weekly	Monthly	YoY
<b>VIX</b>	18	3.0	5	5	-1
VSTOXX	17	4.5	6	6	1
EM EFT volatility Index	23	3.7	8	7	2
Dollar/euro volatility	4	0.2	0	0	-2
EM FX volatility index	6	0.0	0	0	-3
Credit spread (BAA) (change in bps)	208	7.9	8	10	-29
US bonds volatility index	60	4.6	10	4	9
<b>Inflation expectations (% , change in pp)</b>	<b>level</b>	<b>Daily</b>	<b>Weekly</b>	<b>Monthly</b>	<b>YoY</b>
US Inflation expectations (5Y5Y)	2.05	-	-4	-6	-12
EZ Inflation expectations (5Y5Y)	1.27	-	-6	-10	-24
<b>Banking 5y CDS (bps) *</b>	<b>level</b>	<b>Daily</b>	<b>Weekly</b>	<b>Monthly</b>	<b>YoY</b>
US	40	1.5	2	-1	-29
EZ	45	0.0	1	0	-43
UK	43	0.4	1	1	-34
Large Spanish	34	0.1	1	2	-36
Medium Spanish	67	-0.9	-2	-10	-46
<b>Corporate 5y CDS (bps) *</b>	<b>level</b>	<b>Daily</b>	<b>Weekly</b>	<b>Monthly</b>	<b>YoY</b>
US Non-financial	205	-5.1	-3	20	17
EZ Non-financial	66	-0.4	1	2	-20
UK Non-financial	97	-0.3	0	1	-13

**INTERBANK MARKETS (% , CHANGE IN BPS)**

	level	Daily	Weekly	Monthly	YoY
ESTR Index	-0.54	0	0	1	n.a.
Euribor 3m	-0.40	-1	-1	0	-9
<b>Euribor 12m</b>	-0.26	0	-2	-1	-15
Libor 3m	1.80	0	-2	-17	-96
Libor 12m	1.88	0	-3	-12	-115

**STOCK MARKETS (%)**

Main indices	level	Daily	Weekly	Monthly	YoY
<b>S&amp;P500</b>	3250	-1.4	-2.4	0.3	23
Dow Jones	28567	-1.5	-2.7	-0.2	16
Nikkei	23344	-2.0	-3.1	-2.4	13
FTSE 100	7412	-2.3	-3.1	-2.9	10
<b>EuroStoxx 50</b>	3678	-2.7	-3.2	-2.6	17
IBEX	9366	-2.0	-3.0	-3.1	3
DAX	13205	-2.7	-2.5	-0.7	18
CAC	5863	-2.7	-3.5	-2.8	20
MB	23416	-2.3	-2.4	-2.0	19
ASE Athens	936	-1.3	-0.4	2.6	48
<b>MSCI Latam *</b>	102145	-0.8	-0.9	1.3	9
Ibovespa (Brazil)	115152	-2.7	-3.1	-1.7	21
Mexbol (Mexico)	44175	-2.1	-3.8	-0.3	1
Merval (Argentina)	38898	-2.6	-9.7	-8.0	12
<b>MSCI EM Europe *</b>	6504	0.1	-1.4	2.4	15
Poland	2084	-3.3	-4.3	-2.7	-12
Micex 10 (Russia)	5371	-2.2	-4.8	0.6	21
Ise 100 (Turkey)	120150	-1.6	-2.0	5.7	19
<b>MSCI EM Asia *</b>	921	-0.2	-2.4	1.1	11
Shanghai Com (China)	2977	0.0	-3.9	-1.0	15
Jakarta (Indonesia)	6133	-1.9	-2.5	-2.7	-5
<b>Banking sector</b>	<b>level</b>	<b>Daily</b>	<b>Weekly</b>	<b>Monthly</b>	<b>YoY</b>
<b>US banks</b>	159.0	-1.9	-5.6	-3.0	20
JPM	132.0	-0.9	-4.5	-5.1	27
Citi	76.3	-2.7	-5.9	-4.4	19
BoA	32.9	-1.9	-5.2	-7.4	11
MS	53.0	-2.8	-7.8	3.7	24
GS	237.5	-1.8	-4.8	2.7	19
<b>EZ banks</b>	80.7	-1.7	-3.2	-5.5	9
BNP	48.9	-2.1	-3.2	-7.8	15
Crédit Agricole	12.3	-2.0	-3.8	-5.3	22
Deutsche Bank	7.7	-1.0	4.4	12.2	-4
ING	9.9	-2.7	-5.4	-8.1	-5
Intesa	2.3	-1.0	-2.7	-6.1	10
SG	29.8	-1.4	-2.6	-4.5	6
Unicredito	12.3	-0.9	-4.5	-7.5	15
<b>UK banks</b>	73.1	-2.4	-3.1	-7.9	-4
HSBC	559.1	-3.5	-5.6	-6.7	-11
RBS	218.1	-2.4	-2.1	-10.1	-9
Barclays	170.7	-1.6	-2.5	-5.2	7
Lloyds	57.1	-1.7	-1.4	-9.9	0
<b>Large Spanish banks</b>	54.1	-1.7	-4.6	-9.1	-17
Santander	3.5	-1.8	-4.3	-7.4	-20
<b>BBVA</b>	4.5	-1.6	-4.9	-10.5	-14
<b>Medium Spanish banks</b>	47.6	-1.3	-5.3	-9.8	-19
Caixabank	2.6	-1.7	-6.8	-7.6	-22
Sabadell	0.9	-1.8	-4.0	-9.7	-8
Bankinter	5.9	-0.8	-5.1	-10.6	-16
Bankia	1.7	-1.3	-6.0	-13.4	-35

**CURRENCIES (% , RED FOR CURRENCY DEPRECIATION)**

Developed	level	Daily	Weekly	Monthly	YoY
<b>EURUSD</b>	1.102	0.0	-0.7	-0.7	-4
GBPUSD	1.306	-0.1	0.4	0.5	-1
USDJPY	108.950	0.3	1.1	0.6	0
DXY	97.951	0.1	0.4	0.4	2
<b>Emerging</b>	<b>level</b>	<b>Daily</b>	<b>Weekly</b>	<b>Monthly</b>	<b>YoY</b>
USDARS (Argentina)	60.16	-0.1	-0.3	-0.5	-38
USDBRL (Brazil)	4.23	-1.0	-0.9	-4.1	-11
USDCLP (Chile)	791.24	-1.7	-2.7	-5.7	-15
USDCOP (Colombia)	3397	-0.9	-1.9	-3.19	-7
USDMXN (Mexico)	18.95	-0.9	-1.5	-0.1	0
USDPEN (Peru)	3.34	-0.3	-0.5	-0.5	1
LACI	50.07	-0.9	-1.3	-2.4	-10
USDPLN (Poland)	3.88	-0.5	-1.5	-1.2	-3
USDRUB (Russia)	63.03	-1.4	-2.3	-1.2	5
USDTRY (Turkey)	5.95	-0.2	-0.6	-0.3	-10
USDCNY (China)	6.91	0.0	-0.6	1.2	-2
USDINR (India)	71.44	-0.2	-0.5	-0.2	0
USDIDR (Indonesia)	13615	-0.2	0.2	2.5	3
ADXNY	104.76	-0.5	-0.9	0.2	-1

**COMMODITIES (%)**

	level	Daily	Weekly	Monthly	YoY
<b>Brent</b>	58.9	-3.0	-9.7	-13	-2
WTx	53	-2.9	-10.1	-15	1
Copper	269	0.0	-5.8	-6	0
Gold	1583	0.7	1.4	5	21
S&P Spot commodity *	406	-1.8	-4.8	-8	1
S&P Brent Spot *	510	-2.3	-6.5	-10	0
S&P Metals Spot *	316	-1.0	-3.9	-3	-4
S&P Agricultural *	301	-1.3	-1.1	1	3

Source: Bloomberg, Datastream and Haver

\* With one day delay

\* Spain risk premium affected by the German bond rollover

**Central Bank Annex**

**Fed preview**

- We expect the Fed to leave interest rates unchanged at their upcoming meeting. Recent economic reports, including labor market indicators and consumer price indices were in line with our scenario of slowing economic momentum and moderate but stable inflation. Moreover, we expect the Fed will continue to hold interest rate for the foreseeable future unless there is a material change in their outlook. The Fed will also focus on guaranteeing the normal functioning of money markets by continuing its repo operations and outright treasury bond purchases. Ensuring ample liquidity will become increasingly important for the Fed as it tries to lend credibility to its shift to the "floor system". For the time being, our view is that the Fed considers that by increasing reserve balances, it will be able to gradually transition away from repo interventions