

Market Comment | Cyclical concerns and weak company profits drag on risk assets

Global Financial Markets Unit
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- **Worse than expected PMI data in China.** China manufacturing PMI data dropped in April against estimates of their remaining unchanged (by 0.1 points to 50.1; consensus: 50.3), while the Caixin China PMI manufacturing data released today showed a decline in April, deepening its contraction (to 49.4 from 49.7 points; consensus: 49.8).
- **According to Lockhart, two rate hikes are still possible this year.** Dennis Lockhart, Atlanta Fed president, considers that this year could see two rate hikes in the US, although global uncertainties such as Brexit are weighing on the FOMC decision. "Two rate hikes are certainly possible. We have enough (Fed policy) meetings remaining, but it depends entirely on how the economy evolves" he said.
- **European Commission revised downward its growth and inflation forecast.** Euro zone growth forecasts were cut by 0.1 percent in both 2016 and 2017, to 1.6 and 1.8 per cent respectively, although Pierre Moscovici said that "Growth in Europe is holding up despite a more difficult global environment." The inflation forecast was also revised downwards (to 0.2% from 0.5% in 2016, and to 1.4% from 1.5% in 2017).
- **Benoît Cœuré, an executive board member of the ECB, defended the low interest rates** saying that ECB "had proof that markets functioning below zero does not imply different logics and mechanisms. Or as I said elsewhere, there is life below zero." However, he pointed that the advantages of low interest rates could disappear if the ECB cut the deposit facility rate further. "We would not take it to absurdly low levels" he added as regards the deposit facility rate. On another front, **Yves Mersch warned about the impact of Brexit on economic confidence**, which could be sharper than quantifiable impact, "While the quantifiable impact [of Brexit] could be, I would say, digested in a pure macroeconomic modelling terms, there will be also confidence factors," he said.
- **Chinese confidence data hit markets.** Worse than expected confidence data in China triggered sharp movements in financial markets. The optimism shown during last month, supported among others by the recent green shoots in China, is fading on the back of fresh disappointing confidence data. The European Commission's downward revisions of growth and inflation in the euro zone may also have fuelled the early falls. Consequently, demand for safe-haven assets increased: gold prices recovered some ground after last month's poor performance, -reaching their highest level since January 2015 - while core economies' yields decreased, led by the US (US 10Y: -9 bps GER 10Y: -7 bps UK 10Y: -7 bps). Against this backdrop, risk assets registered an abrupt correction: equity indices dropped across the board (Euro Stoxx: -1.9% IBEX: -2.7% DAX: -1.9% CAC: -1.6% S&P: -1.2%) dragged down by the banking sector (Eurostoxx Banks: -3.5%) along with other cyclical sectors (Basic Resources: -3.2% Autos: -2.6%). The release of worse-than-expected profits at some major European banks (UBS and Commerzbank) and in the automobile company BMW, coupled with the cut in euro zone growth and inflation forecasts, weak economic data in China and the higher euro, have been the main drivers behind today's euro zone equity

falls. Moreover, this uncertain context set a negative feedback loop for the Italian banking sector, increasing doubts about the effectiveness of the Italian recapitalisation fund. Peripheral risk premia widened in Europe (ITA: +6 bps SPA: +6 bps POR: +7 bps). In the same line, commodity prices fell ahead of oil inventories data, which will be released today. On FX markets, the USD showed a mixed performance against its major peers, partly offsetting its first-half losses (EUR: -0.18% GBP: -0.9% JPY: +0.14%). The GBP was dragged down by the doubts about Brexit and by the disappointing macroeconomic data, while the euro reached 1.16 - its highest level since August 2015 - in the beginning of the session, helped by last week's disappointing 1Q16 US growth and the lack of explicit signals of further FOMC interest rate hikes, while the cut in the euro zone growth and inflation outlook had a dampening impact on the euro. EM currencies depreciated against the US dollar (RUB: -2.3% BRL: -1.8% CLP: -1.1% COP: -2.1% MXN: -1.9%) due to the plunge in commodity prices (Brent: -2.5% Wtx: -3.0% Copper: -2.3%) and weak manufacturing data in China.

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Table 1

[Current level and changes at daily, weekly, monthly and annual frequencies]

Debt markets (changes in bp)

Government bonds

US 2yr 0.74 (0.12) (2) (2)

US 5yr 1.24 (0.18) (2) (2)

US 10yr 1.78 (0.14) (1) (4)

Japan 10yr 0.7 (0) (2) (2) (2)

GER 2yr 0.5 (2) (1) (2) (1)

GER 5yr 2.33 (3) (0) (2)

GER 10yr 3.2 (1) (0) (0) (4)

Belgium 10yr 0.6 (4) (0) (0) (3)

France 10yr 0.56 (4) (0) (0) (4)

Canada 10yr 0.7 (0) (0) (0) (1)

India 10yr 6.47 (1) (0) (2) (1)

Netherlands 10yr 0.4 (0) (0) (0) (0)

Portugal 10yr 3.1 (0) (1) (2) (0)

Spain 10yr 1.5 (1) (0) (0) (2)

Emerging Markets

Brazil 10yr 12.40 (1) (2) (1) (4)

China 10yr 3.1 (0) (0) (0) (0)

Colombia 10yr 6.1 (0) (1) (1) (1)

Vietnam 10yr 5.88 (1) (1) (1) (1)

Iran 10yr 5.35 (0) (0) (0) (0)

Poland 10yr 3.1 (0) (1) (2) (0)

Russia 10yr 8.5 (0) (1) (1) (2)

Turkey 10yr 9.23 (2) (0) (2) (0)

India 10yr 6.47 (1) (0) (2) (1)

Indonesia 10yr 7.68 (1) (0) (1) (1)

C country risk (changes in bp)

10yr sovereign spreads (against Germany)

Belgium 40 (2) (1) (0) (0)

France 36 (1) (2) (0) (0)

Germany 30 (0) (2) (0) (0)

Italy 60 (2) (0) (1) (1)

Spain 57 (0) (0) (0) (0)

Netherlands 24 (1) (1) (0) (0)

Portugal 28 (1) (2) (1) (2)

Spain 57 (0) (0) (0) (0)

5yr sovereign spreads (against Germany)

Belgium 4 (0) (1) (0) (2)

France 18 (0) (1) (2) (0)

Germany 10 (0) (0) (2) (0)

Italy 20 (0) (0) (0) (0)

Netherlands 2 (0) (0) (1) (1)

Portugal 24 (0) (0) (0) (0)

Spain 35 (0) (1) (1) (1)

3yr sovereign spreads (against Germany)

Belgium 4 (0) (1) (0) (2)

France 18 (0) (1) (2) (0)

Germany 10 (0) (0) (2) (0)

Italy 20 (0) (0) (0) (0)

Netherlands 2 (0) (0) (1) (1)

Portugal 24 (0) (0) (0) (0)

Spain 35 (0) (1) (1) (1)

1yr sovereign spreads

Belgium 4 (0) (1) (0) (2)

France 18 (0) (1) (2) (0)

Germany 10 (0) (0) (2) (0)

Italy 20 (0) (0) (0) (0)

Netherlands 2 (0) (0) (1) (1)

Portugal 24 (0) (0) (0) (0)

Spain 35 (0) (1) (1) (1)

10yr CDS

US 10yr CDS 120 (2) (1) (2) (1)

US 5yr CDS 65 (0) (0) (0) (0)

US 3yr CDS 45 (0) (0) (0) (0)

US 1yr CDS 35 (0) (0) (0) (0)

US 6m CDS 30 (0) (0) (0) (0)

US 3m CDS 25 (0) (0) (0) (0)

US 15yr CDS 180 (3) (2) (1) (1)

US 10yr CDS 120 (2) (1) (2) (1)

US 5yr CDS 65 (0) (0) (0) (0)

US 3yr CDS 45 (0) (0) (0) (0)

US 1yr CDS 35 (0) (0) (0) (0)

US 6m CDS 30 (0) (0) (0) (0)

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US 6m CDS 30 (0) (0) (0) (0)

*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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