

Market Comment | Fed's hawkish tone raises yields and USD during the week

Global Financial Markets Unit
20 May 2016

- **US Existing house sales increased ahead of expectations in April** (5.45 million, consensus 5.40 million). Data from the previous month was revised upwards to 5.36 million.
- **The main driver in financial markets during the week was the tightening of the Fed's tone**, which influenced the performance of the main asset classes. The positive economic indicators in the US during the week (retail sales and inflation data) turned the market's previously dovish mood hawkish. During the week, some Fed members (Dudley, Lockhart and Williams) signalled a slight change of mood in the monetary authority and even hinted at the possibility of its carrying out two or three rate hikes in 2016 (whereas the market is still pricing in just one and at the end of the year). The release of the latest FOMC minutes, in which hawkish FOMC members argue that further delays could be confusing to the public in regards to their data-dependent strategy and may ultimately hurt their credibility, contributed to fuelling expectations of a sooner-than-previously-expected rate hike ([see](#)).
- The probability of a June hike increased to 32%, a September hike to 62% and a December one to 75%. Against this backdrop, **the US sovereign yield curve increased across all tenors**, but with greater intensity at shorter tranches (2Y:+14 bps, its highest since 15 March, 10Y: +16). Moreover, the implied volatility in the US treasury surged this week (by 10% to 70). The European curves were pulled up by the US rebound, while the in-line-with-expectations ECB Minutes ([see](#)) did not weigh on European yields. However, the increase in European yields were less intense than in US yields, and as a results the spread between the German and US yields widened (+13 bps in the 2Y yields and +10 bps in the 10Y yields).
- **The USD jumped, underpinned by the increasing probability of a rate hike in June**, appreciating against its main peers (JPY: -1.6%, EUR: -0.8%). The only exception was the GBP, which appreciated on the back of the decreasing probabilities of Brexit - according to the latest polls. EM currencies also depreciated on the back of the USD's strength and the performance of commodity prices (RUB: -2.1%, BRL: -0.2%, CLP: -0.3%, MXN: -1.3%, COP: -1.9%). Mexico 1Q GDP growth above expectations (+0.8% QoQ vs +0.7%QoQ). Nonetheless, the Finance Minister cut 2016 growth forecast to range of 2.2% - 3.2% from previous range (2.6%-3.6%). The EM credit default market also reflected the markets' repricing of higher interest rates in the US, with Latin American sovereign CDS increasing by 13 bps on average. Idiosyncratic factors further boosted Brazilian CDS (+27 bps)
- **Oil prices continued to show high volatility**, and after almost reaching the 50 USD/pb threshold at the beginning of the week, they dropped, affected by (i) the negative impact on emerging markets of a faster normalisation of US rates than had been expected by the market coupled with (ii) the strong USD - historical inverse correlation between USD and commodity prices as they are priced in US dollars - and (iii) larger-than-expected US oil inventories in the case of oil prices. In the end, the week on balance was positive for oil prices (Brent: +1.3%, WTx: +3.6 %).

- **Equity markets remained well supported despite the interest rate repricing.** European indices suffered high volatility but ended the week almost unchanged (EuroStoxx 50: +0.1%, IBEX: +0.5%, DAX: -0.5%, CAC:+0.7%). The banking sector (+3.1%) supported the main indices while the basic resources sector was the main dragger. In the same vein, US equity markets remained almost unchanged (S&P: +0.4% and Dow: +0.1%) despite the Fed's hawkish tone. The banking sector was also the main support in US equity indices (+4.2% during the week).

Updat 16.30 CET 20 May, 2016

Table 1

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

Index markets (changes in bp)

US Dow 3,58 (114) (9) 146
 US S&P 1,35 (17) (7) 240
 US 10yr 1,86 (1) (1) 141

Japan Nikkei 2,11 (8) (8) (2) 180
 CSI 2,5r 2,51 (6) (1) (8) 145
 CSI 5r 2,5 (3) (3) (2) 230
 CSI 10r 1,18 (1) (1) 145

Region 10yr 2,56 (1) (8) (2) 141
 France 10yr 2,52 (1) (5) (2) 141
 Germany 10yr 2,56 (1) (8) (2) 140
 Health 10r 2,56 (1) (8) (2) 140
 Italy 10r 2,56 (1) (8) (2) 141
 Netherlands 10r 2,56 (1) (8) (2) 141
 Portugal 10r 2,56 (1) (8) (2) 141
 Spain 10r 2,56 (1) (8) (2) 141

Emerging Markets

China 10yr 2,52 (1) (5) (2) 141
 India 10yr 2,56 (1) (8) (2) 141
 Korea 10r 2,56 (1) (8) (2) 141
 Mexico 10r 2,56 (1) (8) (2) 141
 Peru 10r 2,56 (1) (8) (2) 141

Russia 10r 2,56 (1) (8) (2) 141
 Russia Eup 5,08 (2) (14) (14) 138
 Russia 10r 2,56 (1) (8) (2) 141
 Turkey 10r 2,56 (1) (8) (2) 141

India 10yr 2,56 (1) (8) (2) 141
 Indonesia 10r 2,56 (1) (8) (2) 141

Country risk (changes in bp)

10yr sovereign spreads (against Germany)

Belgium 20 (2) (1) (1) 141
 France 34 (1) (1) (1) 141
 Germany 73 (1) (1) (1) 141
 Ireland 80 (1) (1) (1) 141
 Italy 21 (1) (1) (1) 141
 Netherlands 7 (1) (1) (1) 141
 Portugal 25 (1) (1) (1) 141
 Spain 14 (1) (1) (1) 141

10yr sovereign spreads (against Germany)

Belgium 4 (1) (1) (1) 141
 France 5 (1) (1) (1) 141
 Germany 10 (1) (1) (1) 141
 Ireland 1 (1) (1) (1) 141
 Netherlands 2 (1) (1) (1) 141
 Portugal 1 (1) (1) (1) 141
 Spain 1 (1) (1) (1) 141

10yr sovereign spreads (against Germany)

Belgium 4 (1) (1) (1) 141
 France 5 (1) (1) (1) 141
 Germany 10 (1) (1) (1) 141
 Ireland 1 (1) (1) (1) 141
 Netherlands 2 (1) (1) (1) 141
 Portugal 1 (1) (1) (1) 141
 Spain 1 (1) (1) (1) 141

10yr sovereign spreads (against Germany)

Belgium 4 (1) (1) (1) 141
 France 5 (1) (1) (1) 141
 Germany 10 (1) (1) (1) 141
 Ireland 1 (1) (1) (1) 141
 Netherlands 2 (1) (1) (1) 141
 Portugal 1 (1) (1) (1) 141
 Spain 1 (1) (1) (1) 141

Index risk

VIX 15,64 (2,2) (1,7) (2) 141
 WTI 67,00 (1,2) (1,2) (1) 141
 EUR FX volatility index 24 (1,2) (1,2) 141
 Goldman volatility 9 (1,2) (1,2) (1) 141
 EIA FT volatility index 11 (1,2) (1,2) 141
 CME wheat (WHE) 207 (1,4) (1,4) (1,4) 141
 US bonds volatility index 71 (1,4) (1,4) 141

Bank & deposits (bp)

US banks CCS 98 (8) (8) (8) 141
 EU banks CCS 117 (1) (1) (1) 141
 UK banks CCS 118 (8) (8) (8) 141

Large Spanish banks CCS 142 (2) (2) (2) 141
 Italian Spanish banks CCS 152 (2) (2) (2) 141

Czech banks CCS 132 (1) (1) (1) 141
 Russian banks CCS 263 (1) (1) (1) 141

Commodity (bp)

US Non-Renewable CCS 24 (8) (8) (8) 141
 EU Non-Renewable CCS 24 (8) (8) (8) 141
 UK Non-Renewable CCS 24 (8) (8) (8) 141

Interest rate spreads (changes in bp)

EUR CCS spread 3m 8 (8) (8) (8) 141
 EUR CCS spread 6m 38 (8) (8) (8) 141
 EUR CCS spread 12m 32 (8) (8) (8) 141

US CCS spread 3m 19 (8) (8) (8) 141
 US CCS spread 6m 19 (8) (8) (8) 141
 US CCS spread 12m 33 (8) (8) (8) 141

Spain Ted Spread 3m 14 (8) (8) (8) 141

EU bank CCS 3m 14 (8) (8) (8) 141
 EU bank CCS 6m 14 (8) (8) (8) 141
 EU bank CCS 12m 14 (8) (8) (8) 141

Stock markets (changes in percentage)

Spain 10yr 2,56 (1) (8) (2) 141
 S&P 500 1,35 (17) (7) 240
 Nikkei 2,11 (8) (8) (2) 180
 CSI 2,5r 2,51 (6) (1) (8) 145
 CSI 5r 2,5 (3) (3) (2) 230
 CSI 10r 1,18 (1) (1) 145

Region 10yr 2,56 (1) (8) (2) 141
 France 10yr 2,52 (1) (5) (2) 141
 Germany 10yr 2,56 (1) (8) (2) 140
 Health 10r 2,56 (1) (8) (2) 140
 Italy 10r 2,56 (1) (8) (2) 141
 Netherlands 10r 2,56 (1) (8) (2) 141
 Portugal 10r 2,56 (1) (8) (2) 141
 Spain 10r 2,56 (1) (8) (2) 141

Bank assets

US banks 25,8 (1) (1) (1) 141
 JPM 24,1 (1) (1) (1) 141
 Citi 24,1 (1) (1) (1) 141
 Bank 14 (1) (1) (1) 141
 HSBC 14 (1) (1) (1) 141

Bank liabilities

US banks 25,8 (1) (1) (1) 141
 JPM 24,1 (1) (1) (1) 141
 Citi 24,1 (1) (1) (1) 141
 Bank 14 (1) (1) (1) 141
 HSBC 14 (1) (1) (1) 141

Bank capital

US banks 25,8 (1) (1) (1) 141
 JPM 24,1 (1) (1) (1) 141
 Citi 24,1 (1) (1) (1) 141
 Bank 14 (1) (1) (1) 141
 HSBC 14 (1) (1) (1) 141

Commodity (change in percentage)

WTI 67,00 (1,2) (1,2) (1) 141
 EUR FX volatility index 24 (1,2) (1,2) 141
 Goldman volatility 9 (1,2) (1,2) (1) 141
 EIA FT volatility index 11 (1,2) (1,2) 141
 CME wheat (WHE) 207 (1,4) (1,4) (1,4) 141
 US bonds volatility index 71 (1,4) (1,4) 141

Commodity (change in percentage)

WTI 67,00 (1,2) (1,2) (1) 141
 EUR FX volatility index 24 (1,2) (1,2) 141
 Goldman volatility 9 (1,2) (1,2) (1) 141
 EIA FT volatility index 11 (1,2) (1,2) 141
 CME wheat (WHE) 207 (1,4) (1,4) (1,4) 141
 US bonds volatility index 71 (1,4) (1,4) 141

Commodity (change in percentage)

WTI 67,00 (1,2) (1,2) (1) 141
 EUR FX volatility index 24 (1,2) (1,2) 141
 Goldman volatility 9 (1,2) (1,2) (1) 141
 EIA FT volatility index 11 (1,2) (1,2) 141
 CME wheat (WHE) 207 (1,4) (1,4) (1,4) 141
 US bonds volatility index 71 (1,4) (1,4) 141

Commodity (change in percentage)

WTI 67,00 (1,2) (1,2) (1) 141
 EUR FX volatility index 24 (1,2) (1,2) 141
 Goldman volatility 9 (1,2) (1,2) (1) 141
 EIA FT volatility index 11 (1,2) (1,2) 141
 CME wheat (WHE) 207 (1,4) (1,4) (1,4) 141
 US bonds volatility index 71 (1,4) (1,4) 141

*CDS, EMBI & MSCI indices with one day delay

**Credit spread (BAA) with two days delay

***S&P GSCI with one day delay

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of investment and, in such circumstances; investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".

BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of

Spain with number 0182.