

Market Comment | Safe-haven yields set new record lows amid doubts on the economic outlook

Global Financial Markets Unit
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- **BoE cuts banks' capital requirements to ensure the flow of credit.** The BoE has reduced the UK countercyclical capital buffer rate from 0.5% to 0% for UK banks at least until June 2017, with immediate effect. The decision is expected to raise the lending capacity of UK banks by up to £150 billion. The decision is aimed at mitigating the effects of Brexit on the banking sector and boosting the economy, to ensure that there will not be a problem of availability of credit.
- **The post-Brexit rally in financial markets started to fade as global economic uncertainties increased.** The partial recovery of risk assets after the Brexit referendum came to a halt and volatility increased across the board (VIX: +9%) amid uncertainty about global growth. Market-based metrics showed the market's pessimistic view regarding the future economic outlook and inflationary expectations continued their downward trend: EZ 5Y5Y inflationary expectations fell to 1.27% while US 5Y5Y expectations stood at 1.85%. Moreover the consequences of Brexit continue to determine the UK performance: the likely action in upcoming Bank of England meetings (extension of easing measures) hampered the GBP (-1.9% against the USD) again while increasing demand for UK gilts (at historical low levels: 0.77%)
- Consequently, **markets registered a risk-off movement in that demand for safe-haven assets increased sharply while prices of risky assets fell.** Gold prices rose (+1%) while the main safe-haven bonds broke their all-time low yield levels (US 10Y at 1.37% after falling 7 bps and GER 10Y at -0.18%, UK10Y at 0.77%). Meanwhile peripheral yields inched down, so peripheral risk premiums widened today (ITA: +5 bps, SPA: +7 bps).
- **Equity indices also suffered from the current increase in risk aversion** and the main indices dropped across the board, led by European indices (Euro Stoxx 50 -1.8%; DAX -1.9%; S&P -0.6%; Nikkei -0.7%). Regarding the Italian banking sector, Monte dei Paschi continued its downward trend (-19%) while the remaining Italian banks' stock prices registered moderate increases. No major changes in the UK banking sector after the BoE relaxed banks' capital requirements.

- Against this backdrop, **oil prices were down** (Brent: -4.4% Wtx: -4.5%) due to worsening global oil demand expectations and in response to the improvement in the supply side: supply disruptions seem to be fading as a partial recovery in Nigeria contributed to a rise in OPEC output last month, while new rigs are in operation in US, showing a potential recovery in US oil supply in upcoming months. Today's downward trend in oil prices coupled with increasing risk aversion hit the value of EM currencies (MXN -1.9%, CLP -0.6%, TRY -0.8%, COP -1.2%). Developed country currencies also registered the current risk aversion in financial markets and the USD appreciated against the EUR (-0.58%) and depreciated against the JPY (0.88%)

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Table 1

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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