

Market Comment | Dovish Central banks drove markets during the week

Global Financial Markets Unit
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- **Last week's upturn in volatility was curbed during this week** by the outcome of the latest round of central bank meetings (VIX -22%, V2X -20%). There were some doubts about the supportive stance of the main central banks, but first the Bank of Japan and then the Federal Reserve showed their commitment to their goals: an increase in inflationary expectations and a very gradual interest rate normalisation respectively.
- **The Bank of Japan (BoJ) decided to tweak its monetary framework in its September meeting**, incorporating the **control of the yield curve as a new policy instrument**. Although the BoJ left the door open for additional easing, the introduction of a target for long-term yields could be its new approach to keeping them anchored at low levels, at the same time avoiding a bearish steepening of the Japanese Government Bond (JGB) curve. The main goals of the new implementation are: i) to limit the effect of negative interest rates on the profitability of the financial system (banks and insurance companies) and ii) to favour the recovery of inflationary expectations through the "forward looking mechanism".
- On another front, despite the increased number of dissenters, the FOMC remains on course for December and **kept interest rates unchanged in its September meeting**. Nonetheless, Yellen confirmed that short-run expectations are unifying around one increase this year. However, the committee's federal fund rate projections now imply a more gradual pace of normalisation (the range for GDP projection widened with a downward bias). As a result, a more pessimistic view of longer run potential and lower equilibrium interest rate projections increase the probability of a more gradual tightening cycle.
- Fears regarding a "disordered" rebound in bond yields, due to doubts about the degree of support from central banks, faded this week, after **the Fed showed patience in its hiking cycle**. The FOMC dots suggest a more gradual and moderate tightening cycle, reducing the expected interest rate by the end of 2017 in 2018 and estimating only a 2.6% interest rate by 2019. Consequently yields declined sharply across the board (10YUS -7bp, 10YGER -9bp, 10YFRA -9bp), trimming last week's losses in bond prices. Moreover, during the week sovereign yield curves flattened across the board. Meanwhile, European peripheral risk premiums inched down (ITA -4 bps, SPA -3 bps), with the exception of Portugal amid an upcoming crucial rating revision by DBRS agency.
- **Equity indices reacted during the week positively to the recent central bank measures**, Asia (Nikkei +1.4%, Hang Seng +1.5%) and Europe being the most benefited (Euro Stoxx50 +3.3%, Dax +3.4%). In Japan, the financial sector (banking and insurance companies) was especially favoured by the BoJ's strategy aimed at stopping the flattening of the yield curve. However, the European banking sector slightly underperformed (EMU Banks, +2.4%).
- The USD depreciated sharply (DXY 0.6%) after the FOMC's meeting, returning to 1.12 EURUSD against

the EUR. The **JPY also registered a high volatility** during the week. The announcement of the new package of measures by the BoJ caused depreciation, but as the session (and week) went by, this move turned to a sharp appreciation (+1.31% versus the USD). EM currencies (PLN +0.8%, CLP +2.2%, TRY +0.9%, COP +1.1%) also benefited from the Fed's stance and the rebound in oil prices.

- Oil markets also supported the positive mood in markets. The hints of willingness by the main oil producers at achieving an agreement in next week's OPEC meeting coupled with the decrease of US oil inventories contributed to the upward trend in oil prices (WTx +7.3%, Brent +4.2%).

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Table 1

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

Debt markets (changes in bps)

US 2 yr 0.77 (0.15) (126)
 US 5 yr 1.11 (0.33) (24) (48)
 US 10 yr 1.42 (0.17) (0) (46)

Japan 10 yr 0.81 (0.14) (1) (17)
 GSD 2 yr 0.67 (0.14) (4) (2)
 GER 5 yr 2.55 (1.54) (3) (42)
 GSD 10 yr 4.05 (2.9) (1) (17)

Belgium 10 yr 6.16 (0.19) (2) (42)
 France 10 yr 6.22 (0.18) (1) (37)
 Greece 10 yr 12.1 (0.21) (0) (17)
 Ireland 10 yr 6.1 (0.1) (2)
 Italy 10 yr 5.22 (0.13) (0) (34)
 Netherlands 10 yr 6.29 (0.15) (0) (17)
 Portugal 10 yr 7.28 (0.13) (0) (17)
 Spain 10 yr 6.37 (0.13) (0) (44)

Emerging Markets
 Brazil 10 yr 11.81 (0.40) (1) (74)
 China 10 yr 4.22 (0.21) (1) (17)
 Colombia 10 yr 7.81 (1.14) (0) (17)
 Mexico 10 yr 6.88 (0.13) (2) (1) (4)
 Peru 10 yr 8.7 (0.17) (2) (1) (50)

Poland 10 yr 7.4 (0.12) (1) (15)
 Russia 5 yr 3.38 (0.17) (0) (17) (15)
 Russia 10 yr 4.7 (0.12) (0) (17)
 Turkey 10 yr 9.23 (0.18) (2) (26) (15)
 India 10 yr 8.4 (0.14) (2) (18)
 Indonesia 10 yr 6.37 (0.15) (0) (15) (2) (18)

Country risk (changes in bps)

10 yr sovereign spreads (against Germany)
 Belgium 31 (0.1) (1)
 France 36 (0.1) (1) (4)
 Greece 167 (4.1) (0) (20) (42)
 Ireland 47 (0.1) (0) (1)
 Italy 75 (0.1) (0) (0) (2)
 Netherlands 12 (0.1) (0) (1)
 Portugal 54 (0.1) (0) (0) (1)
 Spain 18 (0.1) (0) (1) (0)

5 yr sovereign spreads (against Germany)
 Belgium 19 (0.1) (0) (1)
 France 15 (0.1) (0) (1)
 Greece 107 (3.1) (0) (18)
 Ireland 35 (0.1) (0) (0)
 Italy 61 (0.1) (0) (0)
 Netherlands 10 (0.1) (0) (1) (0)
 Portugal 42 (0.1) (0) (0) (1) (0)
 Spain 14 (0.1) (0) (0) (1) (0)

2 yr sovereign spreads (against Germany)
 Belgium 16 (0.1) (0) (0)
 France 12 (0.1) (0) (0)
 Greece 93 (2.4) (0) (2)
 Ireland 31 (0.1) (0) (1)
 Italy 55 (0.1) (0) (0) (2)
 Netherlands 9 (0.1) (0) (1) (0)
 Portugal 39 (0.1) (0) (0) (1) (0)
 Spain 11 (0.1) (0) (1) (1)

5 yr sovereign CDS
 5 yr CDS Belgium 32 (0.0) (0) (4) (1)
 5 yr CDS France 38 (0.1) (0) (2) (3)
 5 yr CDS Germany 48 (0.2) (0) (2) (3)
 5 yr CDS Greece 148 (4.0) (4) (8) (15) (0)
 5 yr CDS Ireland 19 (0.1) (0) (1) (0)
 5 yr CDS Italy 17 (0.1) (0) (1) (0)
 5 yr CDS Netherlands 25 (0.1) (0) (1) (1) (0)
 5 yr CDS Portugal 30 (0.0) (0) (1) (0) (1)
 5 yr CDS Spain 18 (0.0) (0) (1) (1)
 5 yr CDS UK 14 (0.0) (0) (1) (0)
 5 yr CDS US 20 (0.0) (0) (1) (2) (1)

Emerging Markets

5 yr sovereign CDS
 5 yr CDS Argentina 391 (8.9) (4) (10) (1) (10) (10)
 5 yr CDS Brazil 264 (4.3) (7) (1) (20)
 5 yr CDS China 71 (1.3) (1) (7) (4) (8)
 5 yr CDS Colombia 146 (2.6) (6) (0) (2) (0)
 5 yr CDS Mexico 107 (4.0) (2) (1) (3)
 5 yr CDS Peru 102 (4.0) (1) (4) (4)
 5 yr CDS Venezuela 208 (2.0) (6) (6) (4) (2) (2) (4) (0)

5 yr CDS Russia 211 (4.0) (0) (1)
 5 yr CDS Russia 245 (2.7) (1) (2) (1) (8)
 5 yr CDS Turkey 242 (5.0) (1) (1) (3)
 5 yr CDS China 102 (2.0) (0) (4) (4)
 5 yr CDS India 137 (0.0) (0) (1) (1)
 5 yr CDS Indonesia 143 (1.1) (1) (1) (0)

Credit risk

Bank solvency (percentage of nonperforming except for BAA assets, %)
 VIX 12.52 (0.2) (2) (4) (0) (4) (0)
 EUR EPT volatility index 20 (1.1) (1) (1) (1) (1)
 Turkish volatility 6.1 (0.1) (0) (1) (0) (1) (0)
 EM FI volatility index 41 (0.1) (0) (1) (1) (1)
 Credit spread (BAA) 288 (3.1) (0) (0) (1) (0) (1) (0)
 US bonds volatility index 61 (0.1) (1) (0) (1) (0)

Bank risk (changes in bps)

US banks CDS 71 (0.2) (0) (1)
 EMU banks CDS 118 (4.0) (0) (0)
 UK banks CDS 96 (1.0) (0) (1) (0)
 Large Spanish banks CDS 156 (4.7) (0) (1) (1)
 Medium Spanish banks CDS 152 (1.6) (0) (0) (2)
 Greek banks CDS 842 (4.1) (4) (4) (3) (4) (0)
 Russian banks CDS 321 (1.0) (0) (1) (4) (1)

Interbank markets (changes in bps)

LEER US spread 3m 18 (0.0) (0) (1) (1)
 LEER US spread 12m 33 (0.0) (1) (1) (1)
 LEER US spread 3m 49 (0.0) (1) (1) (1) (1)
 USDS spread 3m 43 (0.0) (0) (1) (0) (1)
 USDS spread 12m 46 (0.0) (0) (1) (0) (1) (0)
 US TED spread 3m 18 (0.0) (1) (0) (1) (0) (1)
 Spain Ted Spread 3m 18 (0.0) (1) (0) (1) (0) (1)

Stock markets (Changes in percentage)

Major equity indices
 S&P 500 17.74 (1.2) (1) (1) (4) (1) (0)
 Dow Jones 1624.9 (1.0) (1) (1) (1) (0) (0)
 Nikkei 16254.3 (1.0) (1) (1) (1) (1) (0)
 FTSE 100 9877.8 (1.2) (1) (1) (1) (1)
 Euro Stoxx 50 3024.4 (1.0) (1) (1) (1) (1) (0)
 MSCI EAFE 14.1 (1.0) (1) (1) (1) (1) (0)
 DAX 16624.4 (1.0) (1) (1) (1) (1) (0)
 CAC 40 16424.1 (1.0) (1) (1) (1) (1) (0)
 ASI 16424.1 (1.0) (1) (1) (1) (1) (0)
 ASI All Asia 19.1 (1.0) (1) (1) (1) (1) (0)

Bank assets

JPM 47.7 (0.4) (0) (2) (4) (2)
 Cit 47.2 (0.3) (0) (1) (0) (1)
 BAC 35.6 (0.7) (1) (1) (1) (1) (1)
 MS 23 (0.8) (1) (1) (1) (1) (1)
 GS 16.7 (0.8) (0) (1) (2) (1) (1)

EMU banks

HSH 513 (4.7) (1) (2) (0) (7)
 HSH 162 (1.5) (1) (1) (1) (1) (4)
 Bawag 191 (1.2) (1) (1) (1) (1) (2)
 Uniqa 45 (1.6) (0) (1) (1) (1) (2)

Large Spanish banks

Santander 41 (3.0) (2) (0) (1)
 BBVA 41 (4.0) (2) (0) (1) (1)
 Caixa 41 (3.0) (2) (0) (1) (1)
 Bankia 41 (3.0) (2) (0) (1) (1)

Medium Spanish banks

Castellana 2.1 (0.1) (0) (1) (0) (1)
 Popular 1.1 (0.1) (0) (1) (0) (1)
 Sabadell 1.1 (0.1) (0) (1) (0) (1)
 Bankia 1.1 (0.1) (0) (1) (0) (1)

Greek banks

Alpha Bank 1.1 (0.1) (0) (1)
 Piraeus Bank 1.1 (0.1) (0) (1)
 National Bank 1.1 (0.1) (0) (1)
 Eurobank Ergasias 1.1 (0.1) (0) (1)

Emerging Markets

MSCI Latin 2286 (1.2) (0) (1) (0) (2) (1)
 Russian Stocks 2500 (1.2) (1) (1) (1) (1) (0)
 Mexico 1976 (1.0) (0) (1) (1) (1)
 MSCI EAFE Europe 1616 (1.1) (0) (1) (1) (1) (0)
 Poland FWD 162 (0.1) (1) (1) (1) (1) (0)
 Mexico (Bolsa) 2504 (1.0) (0) (1) (1) (1) (0)
 Iva 100 (Turkey) 7974 (0.0) (0) (1) (0) (1) (0)

Bank assets

HSH 513 (4.7) (1) (2) (0) (7)
 HSH 162 (1.5) (1) (1) (1) (1) (4)
 Bawag 191 (1.2) (1) (1) (1) (1) (2)
 Uniqa 45 (1.6) (0) (1) (1) (1) (2)

Currencies (in percentage, positive for dollar depreciation)

EURUSD 1.13 (0.16) (0.54) (0.3) (0) (4)
 USDGBP 1.3 (0.0) (0) (0) (0) (0)
 USDJPY 109.95 (0.15) (1) (1) (0) (1) (0)
 DXY 95.4 (0.1) (0) (1) (0) (1) (0)

Commodities (change in percentage)

Brent 47.72 (0.16) (0.1) (7) (2)
 WTI 42.1 (0.1) (0.1) (0) (1) (0) (1)
 Copper 3.0 (0.1) (0) (1) (0) (1)
 Gold 1209.74 (0.2) (0) (1) (0) (2) (0) (2)
 Bank Dry Index 307 (0.1) (0) (1) (0) (1)
 S&P 500 Spot commodity index 104.881 (1.1) (1) (1) (1) (1) (1) (1)
 S&P 500 Brent Spot 412.266 (1.1) (1) (1) (1) (1) (1)
 S&P 500 Alaska Spot 279.21 (1) (1) (1) (1) (1) (1)
 S&P 500 Agricultural Spot 207.88 (1.1) (1) (1) (1) (1) (1)

Source: Bloomberg, Dealogic and others

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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