

Market Comment | European financial markets rose ahead of the ECB meeting

Global Financial Markets Unit
07 Dec 2016

- Financial markets showed **less risk aversion**, as equity volatility decreased and the majority of stocks climbed (led by the banking sector), despite the **downward trend in oil prices** initiated yesterday. Nonetheless, sovereign **bond yields fell after yesterday's increase**. The major market-sensitive events were the following:
- Sovereign bond yields declined across the board and stock prices rose ahead of tomorrow's ECB policy meeting, as **markets expect the ECB to announce the extension of its QE programme beyond March 2017**.
- **Shares of major Italian banks soared**, pushing up European stock prices, on reports that the **Italian government may buy Monte dei Paschi junior bonds** held by retail investors (although it is still unclear how this measure would fit with the European Commission State aid normative and the resolution framework) ([see](#)). Although this event may fuel the negative feedback loop between sovereign debt and banks, Italy's sovereign risk premium narrowed ahead of the ECB monetary policy meeting. On the other hand, **Matteo Renzi announced that he will resign** from office late today after the Italian Senate approved the budget for 2017 ([see](#)).
- The British pound depreciated signally after **UK industrial production unexpectedly dropped**, explained by falls in manufacturing production and the standstill of some **oil rigs** ([see](#)). Moreover, uncertainty ahead of a parliamentary debate on Brexit also weighed on the British pound.

ECB Meeting, what we expect?

Projections and risks

- The **eurozone economy has performed in line with expectations** over the last three months, proving resilient to increased uncertainty since the summer. The GDP is growing at a broadly steady pace of about 0.4% QoQ by year end and inflation gradually increased from mid-year to 0.6% YoY in November, basically reflecting rising oil prices while core inflation remains flat (0.8% YoY).
- All in all, **we do not expect major changes in the ECB Staff projections**, with a moderate GDP growth, somewhat above 1.5%, over the forecast horizon. Regarding prices, inflation should continue to rise gradually next year, while a slight upward revision in the Staff figures could not be ruled out after increasing oil prices and the euro depreciation, but still remaining below the ECB's target in 2018. For the first time the ECB will present its inflation projections for 2019, which will likely be around target.
- Against this moderate environment of both growth and inflation, **risks continue tilted to the downside**, as the Eurozone has shown resilience to shocks but the **global outlook is more uncertain**.

- The ECB has incentives to continue with an accommodative monetary policy that ensure the materialization of this scenario. Moreover, given the recent increase in global bond yields dragged by the US curve, the ECB should be particularly alert to avoid any “unwarranted” tightening of financial conditions in the Eurozone. **We expect an extension of the Asset Purchase Programme** for six months at the current pace of purchases of 80 bn € per month combined with some tweaks in the technical parameters of sovereign bond purchases (increasing the issuer limits to non-CAC bonds). While there is a broad consensus about such extension, the ECB could take a more “flexible” approach, for instance extending QE based on the evolution of inflation instead of giving a calendar date. The ECB should be cautious since any sign of early tapering could trigger a very negative reaction in financial markets. No changes are expected on the policy rates.

Update 18 CET 07 December, 2016

Table 1

Debt markets (10Y, % changes in bp)					
Developed Markets	level	Daily	Weekly	Monthly	YTD
US (2-yr)	1.10	-1.2	-1.1	28	5
US	2.35	-4.0	-3.2	92	8
GER (2-yr)	-0.67	1.9	5.3	-4	-33
Germany	0.35	-2.8	7.0	18	-28
France	0.76	-5.1	0.3	29	-23
Spain	1.41	-7.8	-13.7	17	-36
Italy	1.88	-6.5	-11.0	17	28
Portugal	3.51	13.1	-20.5	27	99
Greece	6.67	-6.7	9.6	-75	-161
Japan (2-yr)	-0.19	0.1	-3.3	6	-18
Japan	0.03	0.7	7.8	-23	-23
Emerging Markets	level	Daily	Weekly	Monthly	YTD
Brazil	11.95	-22.8	11.3	59	-457
Chile	4.44	0.0	15.7	92	-24
Colombia	7.30	-6.4	0.6	-7	-136
Mexico	7.22	-4.4	-3.1	100	86
Peru	6.30	-3.0	-2.2	60	118
Poland	3.54	-8.6	-10.8	48	60
Russia	8.63	-4.7	-23.1	16	-92
Turkey	10.77	12.0	-7.0	55	30
India	6.41	20.5	16.1	-43	-135
Indonesia	7.71	30.7	-43.1	37	-104
Country risk (bp/Change in bp)	level	Daily	Weekly	Monthly	YTD
Developed Markets	level	Daily	Weekly	Monthly	YTD
10-yr sovereign spread vs Germany					
France	41	-2.3	-6.7	10	5
Italy	153	-3.7	-18.0	2	57
Portugal	316	-10.3	-27.5	8	127
Spain	107	-5.0	-20.7	-2	-7
2-yr sovereign spread vs Germany					
France	11	-0.5	0.8	8	8
Italy	66	-3.0	-12.2	5	34
Portugal	87	-1.4	-19.0	-8	42
Spain	48	-0.6	-12.6	8	13
Emerging Markets	level	Daily	Weekly	Monthly	YTD
5-yr sovereign CDS *					
Brazil	295	-4	1	15	-197
Chile	79	-2	-11	-16	-46
Colombia	175	-9	-19	-11	-63
Mexico	168	-6	-16	6	-3
Peru	111	-4	-9	3	-75
Venezuela	3,912	-286	-516	91	-2,131
Poland	83	1	0	5	11
Russia	208	5	-18	-25	94
Turkey	284	-8	-2	15	11
China	114	-1	-4	3	5
India	131	-1	-1	-3	-17
Indonesia	105	-5	-6	5	-62
Risk indicators	level	Daily	Weekly	Monthly	YTD
Volatility indicators (%)					
VIX	11	-2.7	-14	-39	-7
VSTOXX	17	-2.8	-20	-30	-5
EM ETT volatility index	20	-2.4	-9	-26	-15
Dolar/euro volatility	9	-3.2	-20	11	-3
EM FX volatility index	11	0.4	1	7	-5
Credit spread (BAA) (bps)	248	-8.0	4	-22	-75
US bonds volatility index	77	-4.1	-5	6	13
Banking 5y CDS (bps) *					
US	77	0.3	1	-3	2
EZ	130	-2.7	-4	7	46
UK	101	-2.0	-1	8	24
Large Spanish	138	-4.3	-4	7	1
Medium Spanish	165	-1.5	-7	2	8
Corporate 5y CDS (bps)					
US Non-financial	184	-0.3	0	-2	2
EZ Non-financial	105	-2.7	-4	7	46
UK Non-financial	126	-1.2	-5	-11	-66
Interbank markets (% change in bp)	level	Daily	Weekly	Monthly	YTD
EONIA Index	-0.35	0.00	0.0	0.0	-0.2
Euribor 3m	-0.32	0.00	0.0	0.0	-0.2
Earlibor 12m	-0.08	0.00	0.0	0.0	-0.1
Libor 3m	0.95	0.00	0.0	0.1	0.3
Libor 12m	1.65	0.00	0.0	0.1	0.5
EZ TED spread 3m	60.9	0.40	10.9	5.9	20.1
Stock markets (%)	level	Daily	Weekly	Monthly	YTD
Main Indices					
S&P500	2,216	0.2	0.8	4	8
Dow Jones	19,312	0.2	1.0	6	11
Nikkei	18,497	0.7	1.0	8	-3
FTSE 100	6,902	1.8	1.7	1	11
EuroStoxx 50	3,142	1.3	3.0	4	4
BEX	8,960	0.8	3.1	0	6
DAX	10,987	2.0	3.3	5	2
CAC	4,695	1.4	2.5	5	1
MIB	18,131	2.1	7.1	8	-15
ASE Athens	640	2.8	1.8	10	1
MSCI Latam *	72,436	1.2	0.2	-2	22
Ibovespa (Brazil)	61,336	0.4	-0.9	-4	41
Mexbol	45,382	0.6	0.1	-6	6
MSCI EM Europe *	4,785	0.4	4.0	9	13
Poland	1,890	0.7	5.1	7	2
Mircex (Russia)	2,161	0.4	2.6	11	23
Ise 100 (Turkey)	76,031	0.8	2.8	0	6
MSCI EM Asia *	696	0.7	-0.1	-1	5
Shanghai Com (China)	3,222	0.7	-0.9	3	9
Jakarta (Indonesia)	5,265	-0.1	2.5	-2	15
Banking sector					
US banks	115.0	0.0	4.1	25	22
JPM	83.0	-0.8	3.5	19	26
Cit	58.4	0.8	3.5	17	13
BoA	22.1	-0.4	4.5	30	31
MS	42.3	-0.4	2.4	25	33
GS	231.6	0.1	5.6	28	29
EZ banks	98.7	2.6	9.9	16	9
BNP	59.5	2.3	8.5	13	14
Credit Agricole	11.4	0.9	6.9	17	5
Deutsche Bank	17.4	5.4	17.0	35	23
ING	13.5	0.0	4.9	10	8
Intesa	2.3	1.7	10.6	9	25
SG	44.9	3.7	10.5	22	5
Unicredit	2.5	9.4	22.9	12	-52
UK banks	86.3	4.0	8.4	15	-2
HSC	679.6	3.9	7.0	9	27
RIS	217.2	3.9	11.8	16	-28
Barclays	234.9	3.6	8.8	27	7
Lloyds	62.3	4.7	7.6	11	-15
Large Spanish banks	72.9	1.8	7.4	1	-3
Santander	4.7	2.5	8.6	7	3
BBVA	6.2	1.3	6.4	3	-8
Medium Spanish banks	69.4	0.8	9.2	9	-16
Caixabank	3.1	2.0	13.7	13	-3
Popublr	1.0	4.0	19.8	6	-64
Sabadell	1.3	0.2	10.4	6	-20
Banqueparibas	7.3	1.8	2.9	4	12
Banika	0.9	3.2	10.2	16	-14
Commodities (%)					
Currencies (% red for currency depreciation)					
Developed					
EURUSD	1.08	0.4	1.6	-2.6	-1
GBPUSD	1.26	0.6	0.8	1.7	-14
USDJPY	113.47	0.5	0.9	8.6	-6
DXY	100.23	-0.2	-1.3	-2.5	-2
Emerging					
USDARS (Argentina)	15.98	-0.4	-0.7	-6.2	-24
USDBRL (Brazil)	3.40	0.4	-0.3	-6.0	14
USDCLP (Chile)	656.57	0.6	2.6	-0.5	7
USDCOP (Colombia)	2894	0.3	2.6	-1.5	6
USDMXN (Mexico)	20.33	0.3	1.2	-9.4	-18
USDPEN (Peru)	3.41	0.2	0.2	-1.0	0
LACI	61.86	0.3	0.7	-5.2	-1
USDPOLN (Poland)	4.13	0.8	1.9	-5.3	-5
USDRUB (Russia)	63.74	0.2	0.6	-0.1	12
USDTRY (Turkey)	3.39	1.6	1.4	-7.9	-16
USDCNY (China)	6.88	0.1	0.2	-1.5	6
USDINR (India)	67.64	0.4	1.1	-1.3	-2
USDIDR (Indonesia)	13,333	0.3	1.6	-1.9	3
ADXY	104.2	0.1	0.6	-1.5	-2
Commodities (%)					
Brent	53.4	-1.0	5.8	16	43
WTI	50.2	-1.8	1.5	12	35
Copper	262	-1.8	0.1	14	23
Gold	1,178	0.7	0.4	-8	11
S&P Spot commodity *	387	-0.8	2.6	10	24
S&P Brent Spot *	459	-1.8	4.0	16	43
S&P Metals Spot *	320	-0.7	0.5	9	26
S&P Agricultural *	296	0.4	0.7	-2	4

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Medium Spanish	165	-1.5	7	2	8
Deposits by CDS (bps) *					
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Euribor 12m	-0.08	0.00	0.0	0.0	-0.1
Libor 3m	0.95	0.00	0.0	0.1	0.3
Libor 12m	1.65	0.00	0.0	0.1	0.5
EZ TED spread 3m	60.9	0.40	10.9	5.9	20.1
Stock markets (%)					
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IBEX	8,960	0.8	3.1	0	-6
DAX	10,987	2.0	3.3	5	2
CAC	4,695	1.4	2.5	5	1
MBI	18,131	2.1	7.1	8	-15
ASE Athens	640	2.8	1.8	10	1
MSCI Latam *	72,436	1.2	0.2	-2	22
Bovespa (Brazil)	61,336	0.4	-0.8	-4	-41
Moodi	45,382	0.6	0.1	-6	6
MSCI EM Europe *	4,785	0.4	4.0	9	13
Poland	1,890	0.7	5.1	7	2
Mircz (Russia)	2,161	0.4	2.6	11	23
Ise 100 (Turkey)	76,031	0.8	2.8	0	6
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Shanghai Com (China)	3,222	0.7	-0.9	3	-9
Jakarta (Indonesia)	5,265	-0.1	2.5	-2	15
Banking sector	level	Daily	Weekly	Monthly	YTD
US banks	115.0	0.0	4.1	25	22
JPM	83.0	-0.8	3.5	19	26
CB	98.4	0.8	3.5	17	13
BoA	22.1	-0.4	4.5	30	31
MS	42.3	-0.4	2.4	25	33
GS	231.6	0.1	5.6	28	29
EZ banks	98.7	2.6	9.9	16	9
BNP	59.5	2.3	8.5	13	14
Credit Agricole	11.4	0.9	6.9	17	5
Deutsche Bank	17.4	5.4	17.0	35	23
ING	13.5	0.0	4.9	10	8
Intesa	2.3	1.7	10.6	9	25
SG	44.9	3.7	10.5	22	5
Unicredit	2.5	9.4	22.9	12	-52
UK banks	86.3	4.0	8.4	15	-2
HSBC	679.6	3.9	7.0	9	27
RBS	217.2	3.9	11.0	16	-28
Barclays	234.9	3.6	8.8	27	7
Lloyds	62.3	4.7	7.6	11	-15
Large Spanish banks					
BBVA	72.9	1.8	7.4	11	-3
Santander	4.7	2.5	8.6	7	3
Caixa	6.2	1.3	6.4	-3	-8
Medium Spanish banks					
CaixaBank	69.4	0.8	9.2	9	-16
Popubir	3.1	2.0	13.7	13	-3
Bankia	1.0	4.0	19.8	6	-64
Sabadell	1.3	0.2	10.4	6	-20
Banqueparibas	7.3	-1.8	2.9	4	12
Bankia	0.9	3.2	10.2	16	-14
Commodities (%)					
level	Daily	Weekly	Monthly	YTD	
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Gold	1,178	0.7	0.4	-8	11
S&P Spot commodity *	387	-0.8	2.6	10	24
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Source: Bloomberg, Datastream and Haver

* With one day delay

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