



## 1 MONTH IN 10 SNAPSHOTS

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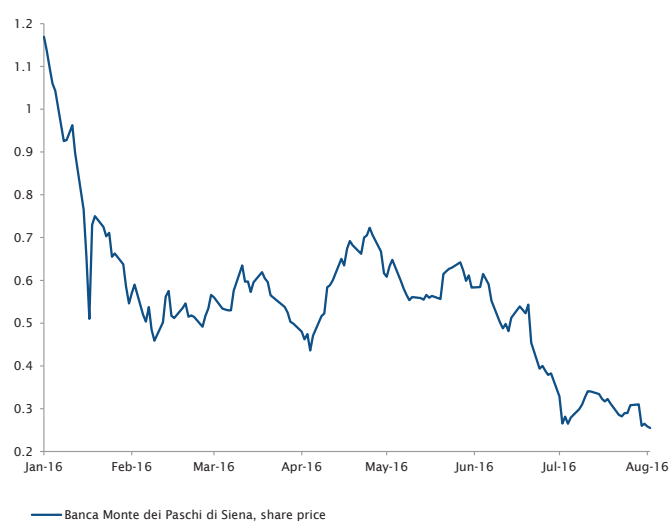
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### 1. Equities - Italian banking sector under stress

- Ahead of the EBA stress test, shares of the oldest Italian lender Banca Monte Paschi di Siena were under severe pressure. Even if the 2016 version of the stress test does not end up with a pass/fail result, investors anticipated that the bank would need a full recapitalization under the assumptions of the European Banking Authority. Results for Monte Paschi were no surprise as its CET1 ratio would fall to -2.4% under the EBA's adverse scenario.
- The problem faced by Monte dei Paschi is a good example of the overall general problem faced by the Italian banking sector, i.e. a large stock of bad loans sitting on bank's balance sheets. Italian authorities came up with a three-step solution for the troubled bank. Monte dei Paschi will transfer a portfolio of its non-performing loans to the Atlante private fund in order to increase its bad loan coverage ratio, and the final step will include a capital increase.
- The market remained sceptical as the solution applied to Monte dei Paschi cannot be applied to other Italian lenders. Indeed, the lack of capital in Atlante and a non-existent bad loan secondary market are leaving the sector in trouble and shareholders worried about the future.

#### *Race to the bottom*

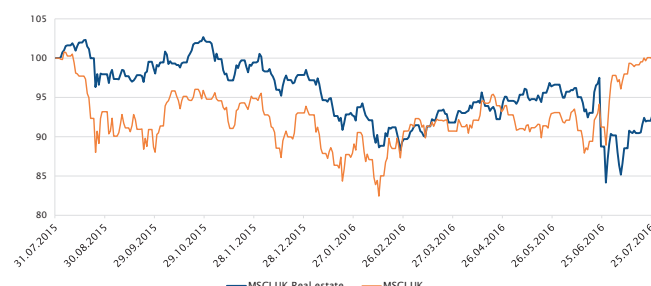


Source: Bloomberg

## 2. Equities - UK property market hit by Brexit

- Following the Brexit vote last month, uncertainty remains high in the United Kingdom because of fears surrounding the future negotiation process with Europe. The property market was under heavy pressure and a number of funds had to gate redemptions. UK commercial property funds worth more than GBP 9 billion have suspended redemptions showing the effect Brexit can have on markets.
- June 24th marked the end of the boom in UK real estate equities. On the other hand, in Europe, the real estate sector continued to outperform the broad market despite it being relatively expensive.
- Furthermore, in the UK, the construction PMI edged down to a seven year low at 46.0 in June from 57.8 at the beginning of the year. The second largest estate agency firm in the UK (LSL Property Services) recently issued a profit warning that annual profits are expected to be below expectations, undermined especially by the uncertainty created following the vote to leave the EU.
- Could the Brexit vote be the next catalyst to burst a bubble that has caused prices to rise sharply in London in the recent years?

*Performance of the MSCI UK Real estate vs. MSCI UK*



## 3. ECB - No changes in monetary policy

- The ECB press conference on 21st July brought no surprises to the market as the Bank left its three rates unchanged. The press conference was mostly focused on Brexit and the Italian banking issues as the European Banking Authority stress tests were due in less than 10 days. The ECB announced that rates will stay low for longer than QE and that asset purchases would continue until a sustained CPI adjustment is achieved.
- One of the likely reasons the ECB has not announced any further stimulus measure could probably be explained by the coming Bank of England meeting in early August. Since BoE officials have signaled a potential rate cut, this would give ECB officials approximately a month to assess the impact of any change in policy of the BoE and adjust their forecasts.
- The combined effect of asset purchases and low rates continue to push European credit spreads lower while it is hard to see a significant improvement in inflation for the Euro area.

*European credit spread continue to tighten*

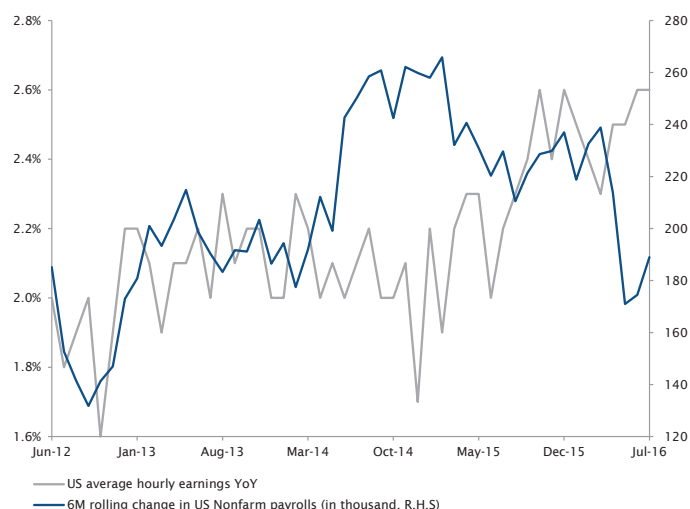


Source: Bloomberg

#### 4. US - Solid Job data

- The June 2016 job report released in early July topped analysts' and economists' predictions as the US created 287K jobs versus a median expectation of 175K. Following the shocker result of the Brexit vote in late June and a very weak job report in May, solid US job data for June was a relief for market participants as illustrated by the 3.5% increase in the S&P500 from the release date until the end of the month.
- The strengthening of the labour market is a clear sign that the Fed may be tempted to hike interest rates one more time this year. Wage inflation was however not as strong as expected with a 2.6% YOY growth compared with survey data of 2.7%. So far this year growth is being sustained by consumer consumption and some additional gains in wages would certainly help to support consumption.
- June data was collected before the Brexit vote, hence it is very likely that the market will watch very closely for July job reports to see any sign of worries or at least caution from US employers.

##### *Ongoing improvement in US employment*

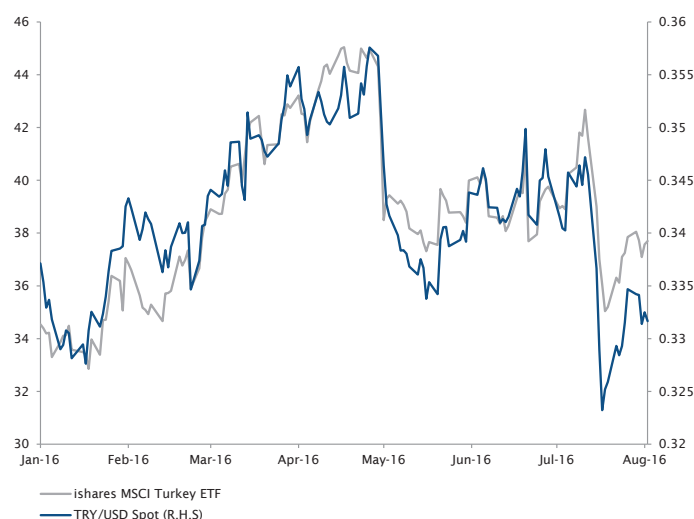


Source: Bloomberg/SYZ AM

#### 5. Turkey - Financial impact of the military coup

- Despite the fact that the failed coup attempt in Turkey should have limited impact abroad, it has put stress on the country's financial markets and its economy. The Turkish lira plunged by more than 6% against the dollar to a record low and the stock market faced a large sell-off (-18.6%) following the military coup. Although the government has quickly reestablished control, political instability remains and the downside risks to the country's economic growth have risen.
- According to a first estimation from government officials, the coup attempt has cost around USD 100 billion to the Turkish economy, but could be revised upwards. The revenue from the tourism sector, heavily hit this year (because of the tensions with Russia, terrorist attacks and now the military coup) is expected to drop by the equivalent of 1% of GDP. As a result, the country's gross domestic product growth is expected to fall to around 3.5% for 2016 (below the government target of 4.5%).
- The government remains nevertheless optimistic as it expects the impact of the failed coup to be likely "short-lived" and its economy to be sufficiently resilient. Except for a structural current account deficit, the country's other fundamentals are solid and the Turkish lira has already bounced back.

##### *The Turkish lira and equity market dropped following the coup attempt*

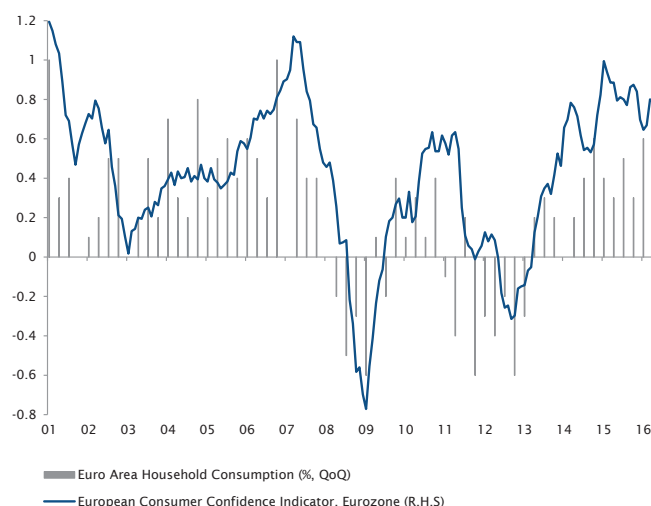


Source: Bloomberg

## 6. Europe - European consumer indifferent to Brexit (for now?)

- After the Brexit vote there was a general worry that the vote would jeopardize the fragile recovery in the Euro area and more particularly consumers would start to spend less. The first surveys released in July have shown otherwise, reassuring investors and economists of the resilience of the ongoing recovery.
- The European Commission's Consumer Confidence and the Euro Area Household Consumption indicators for the monetary union have shown that the economy has been able to maintain its uptrend into the third quarter, which is a very encouraging sign. First, it probably means that Brexit was more about the uncertainty it created before the vote rather than the result itself. Second, one could interpret the number by saying that the accommodative monetary policy of the ECB is continuing to feed into the real economy. However, investors should not completely dismiss the impact of Brexit, but it is more likely that any negative effect on growth would be spread over the coming years and not the coming months due to the complexity of the exit process.
- The strong reading of the Euro Area Household Consumption indicator at 0.6% QoQ for the first quarter suggests the euro-area households will maintain their activity going into the rest of the year.

**Solid European consumption**

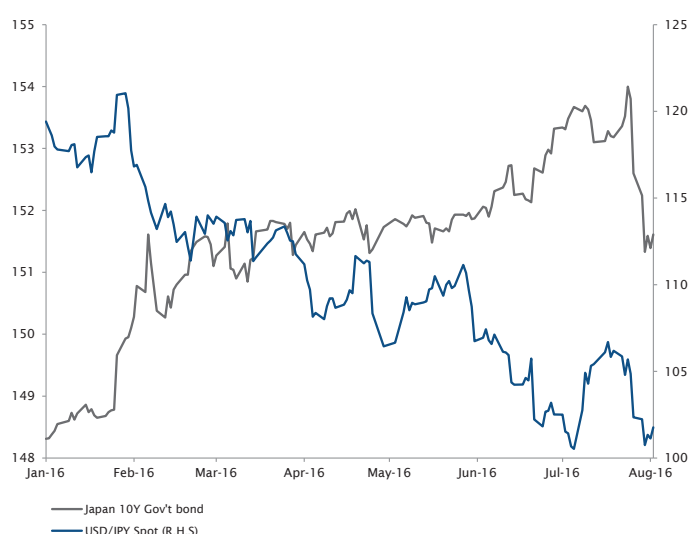


Source: Bloomberg

## 7. Japan - Hopes of helicopter money disappointed

- July was volatile for currency traders and more particularly the ones trading the yen. The month started with a build-up in expectations around the Bank of Japan announcing a set of significant easing measures designed to fight falling inflation, including so-called "helicopter money". In a helicopter money policy, the Central Bank would have pledged to increase the money supply indefinitely by funding the government by buying perpetual bonds that would have never been repaid. Expectations of such a policy might have been amplified by the Brexit vote, which added stress to the world's macro outlook. The yen fell from 101 to 107 against the Dollar on those expectations.
- Governor Kuroda finally fell short of expectations by announcing that there was no need and no possibility for helicopter money to take place at present in Japan. The yen reversed its down trend and strengthened back to 101 against the US dollar in the few days following the announcement by the Bank of Japan. Although the Bank does not plan to weaken the size and pace of its stimulus package, it left investors confused by leaving the door open for further measures by September.

**Volatility around BoJ meeting**



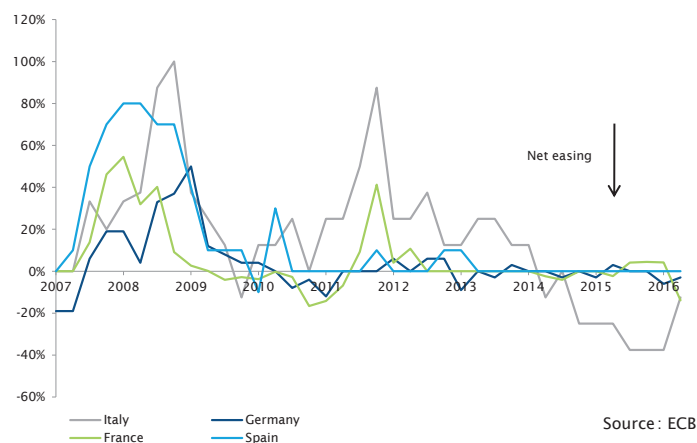
Source: Bloomberg



## 8. Credit - Easing of European bank lending standards

- Credit activity in the euro area continued to improve according to the quarterly bank lending survey issued by the ECB. The report showed that European banks further eased their credit standards on loans to enterprises in the second quarter, mainly due to the narrowing of margin on loans in a competitive environment and lower risk perceptions. From a general standpoint, credit standards on loans to enterprises fell by -7% in Q2 (versus -6% in Q1), slightly better than what banks had expected in the previous survey.
- This is an encouraging sign for credit activity in the Euro area and a positive signal for the ECB as its ultra-easy monetary policy seems to finally be feeding into the real economy through bank lending. Among the largest EU countries, bank credit standards eased the most in France (-14% vs. +4% in Q1), while Italy continues to be the leader, although experiencing recent tightening (from -13% vs -38% in Q1).
- Looking ahead to Q3 2016, euro area banks expect broadly unchanged credit standards on loans to enterprises. On the household front, credit standards on consumer credit and other lending also continue to ease (-5% vs -3% in Q1).

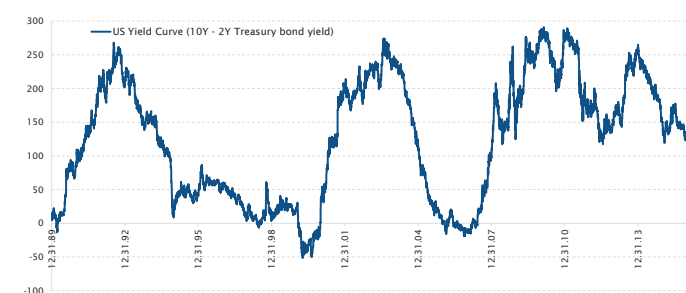
**Net percentage of banks reporting tightening in the quarterly Bank Lending Survey**



## 9. Fixed Income - Flattening of the US yield curve

- The spread between the 10Y and 2Y has been narrowing since 2014 from 264bps to 79bps. This is not giving an easy task to the US Federal Reserve which is in the process of normalizing its monetary policy. Whatever the Fed is trying to communicate and whether it adopts a hawkish or a dovish tone, the yield curve is flattening.
- Normally, the yield curve tends to predict the outlook for economic growth but since 2014 it has only been heading south.
- A positive signal would arise when long-term rates gradually rise compared to the short end of the curve, implying a better outlook for growth and inflation.
- In this context, the collapse in government bond yields is such that until 10Y maturity, Switzerland (CHF), Germany (EUR) and Japan (JPY) government bonds are returning negative yield to investors. This indicates that investors are so desperate to hold "safe haven" assets that they are willing to pay governments to lend them some money. Hence, in comparison, higher yields prevailing in the United States turn out to be more attractive; some value can still be found for example with the US 10Y Treasury even though it touched an all-time low of 1.36% at the beginning of the month.

**US Yield Curve (10Y - 2Y Treasury bond yield)**





## 10. Crude Oil - Oversupply concerns back again

- After the strong recovery from February lows, oil prices have been under downward pressure in July. The price of West Texas Intermediate dropped by -13.9% to \$41.6 while Brent crude fell by -14.5% to \$42.46, the lowest levels since April. The resurgence in supply concerns, as well as worries about a potential global economic slowdown amplified by the UK Brexit vote, explain the correction.
- The output disruptions (Canada, Nigeria, Libya), that took hundreds of thousands of barrels out of the oil market during the springtime, have helped to compensate excess inventories. Now, with the supply disruptions being resolved in Canada and Libya back in the markets, concerns about the production glut are under the spotlight again. Indeed, with the increase of supply from OPEC, (which could even rise further), and signs that drilling activity in the US is picking up, the market oversupply is continuing to put downward pressure on oil prices.
- The rebalancing of the oil market that was expected in the second half of the year now seems more likely to occur next year.

### *Oil prices correction underway*

