



OUTLOOK FOR FIXED INCOME MARKETS

BMCG - OCTOBER 2016

Market Developments

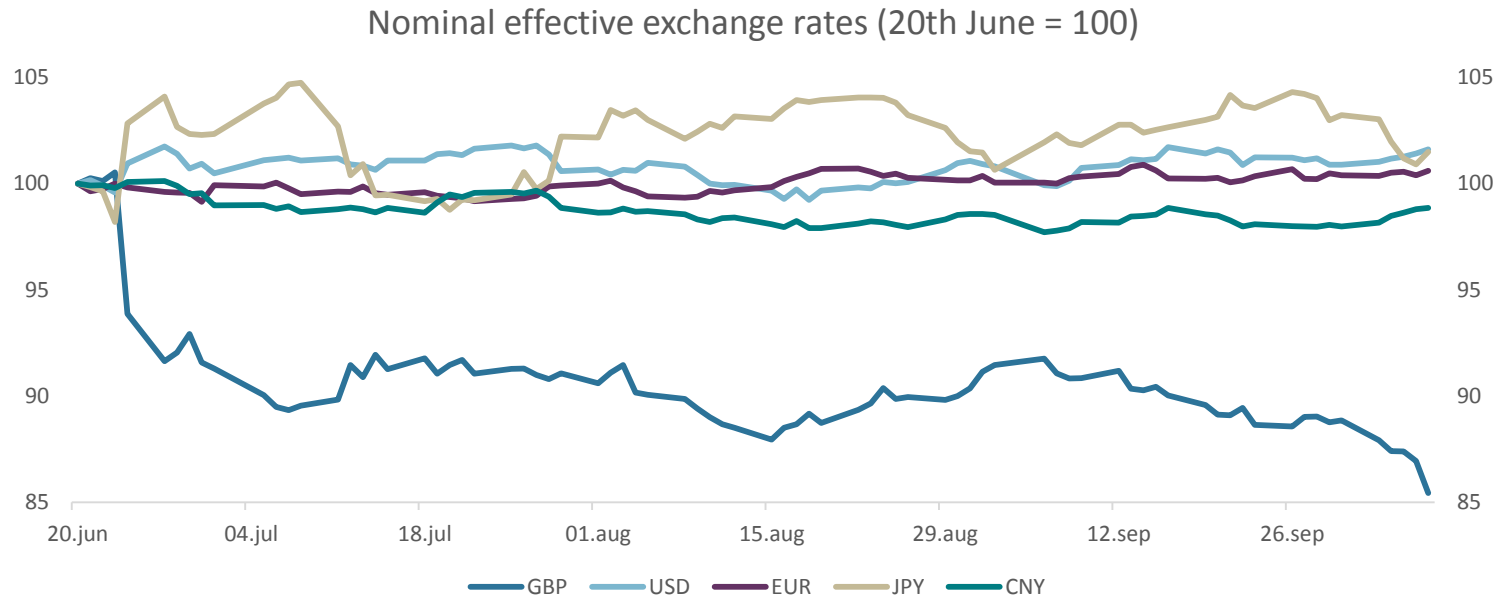
Key Themes driving markets this quarter

- Brexit - How to position for the impact ? (so far mostly GBP and gilts)
- Real yields driving FX instead of nominal – Monetary policy operating at limit
 - Bank of Japan making this most explicit ?
- Fed – Hiking in 2016 ? Implications for EM and capital flows
- Politics – Increasingly important for markets (eg MXN and Trump, European elections)



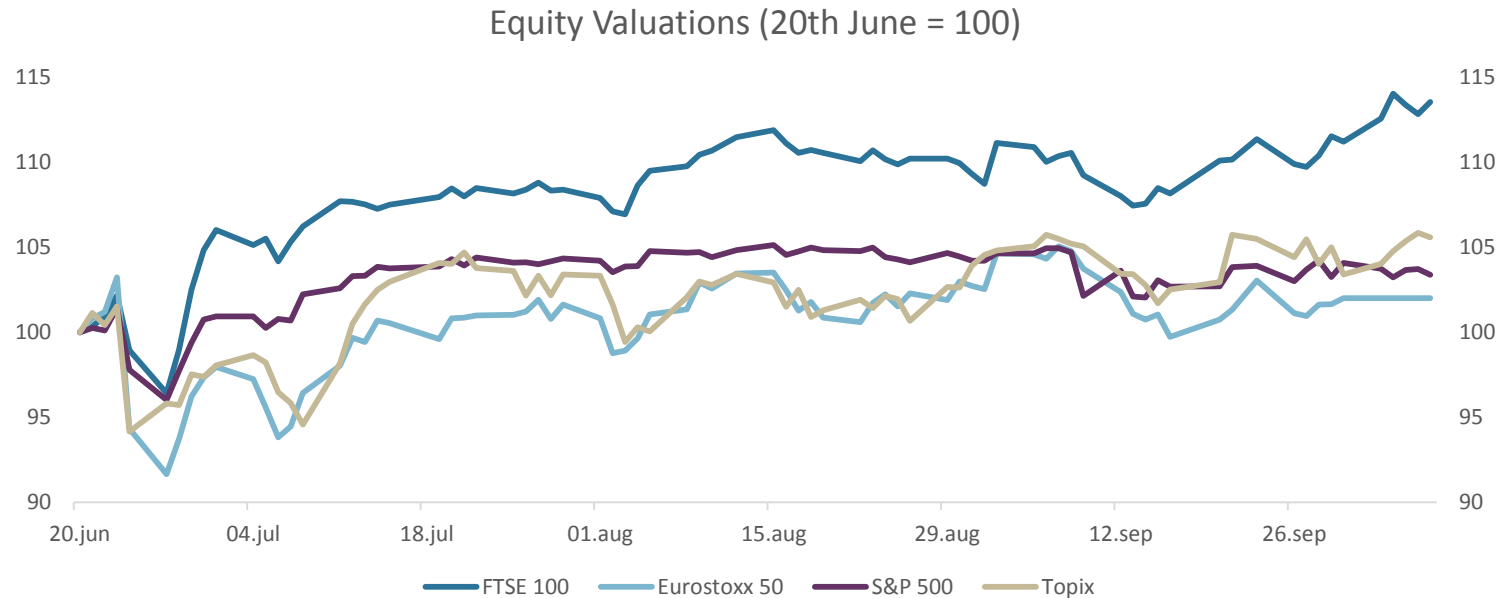
Market Developments

FX since 20-Jun – Broadly stable, sterling weaker on Brexit



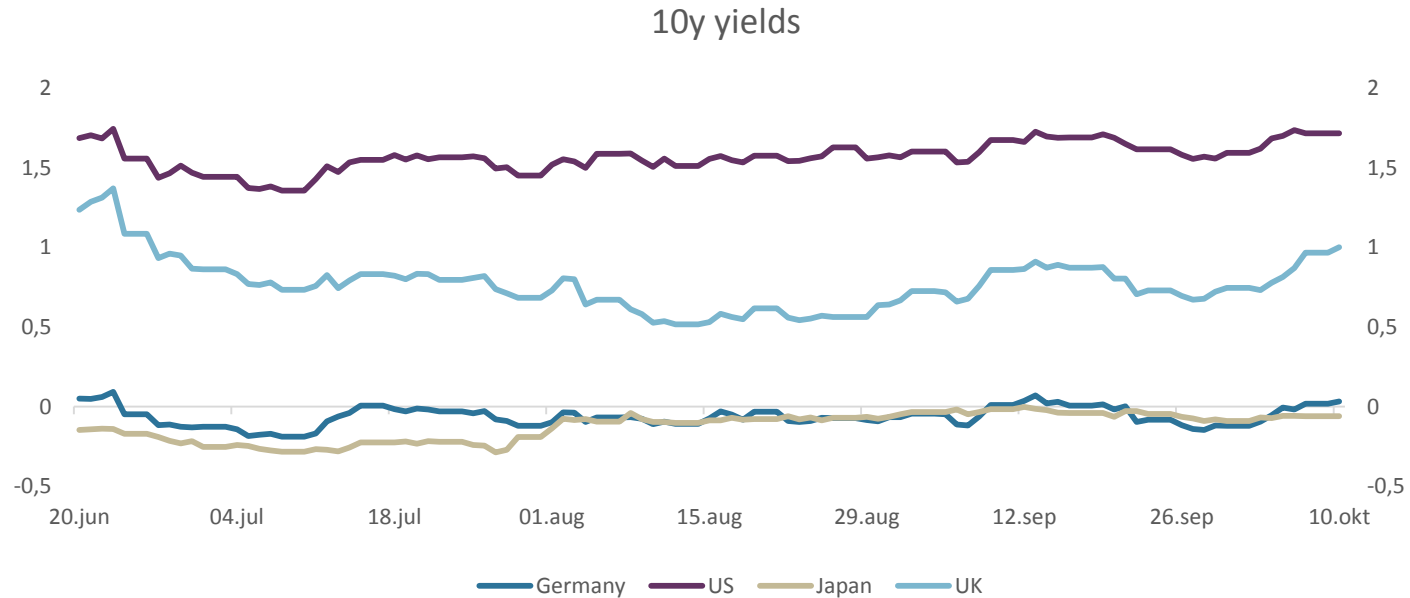
Market Developments

Equities since 20-Jun – Post Brexit rebound extends



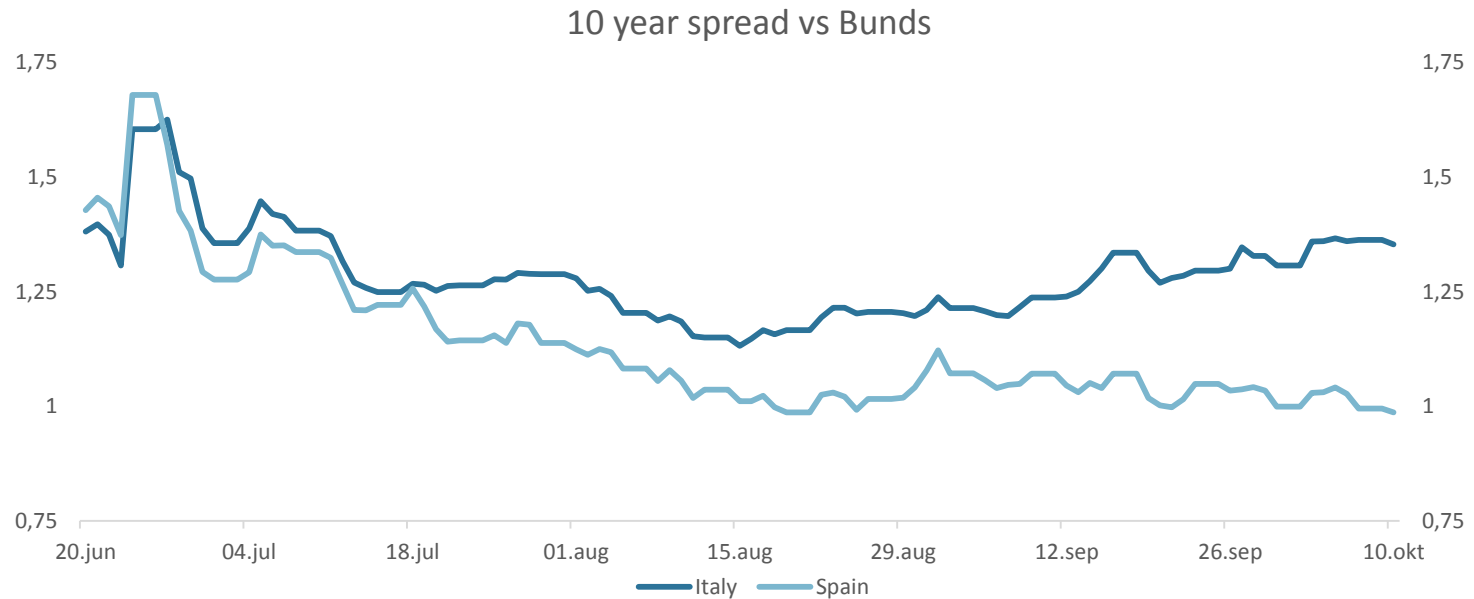
Bond Market Key Developments

Global yields lower



Bond Market Key Developments

Eurozone peripheral spreads



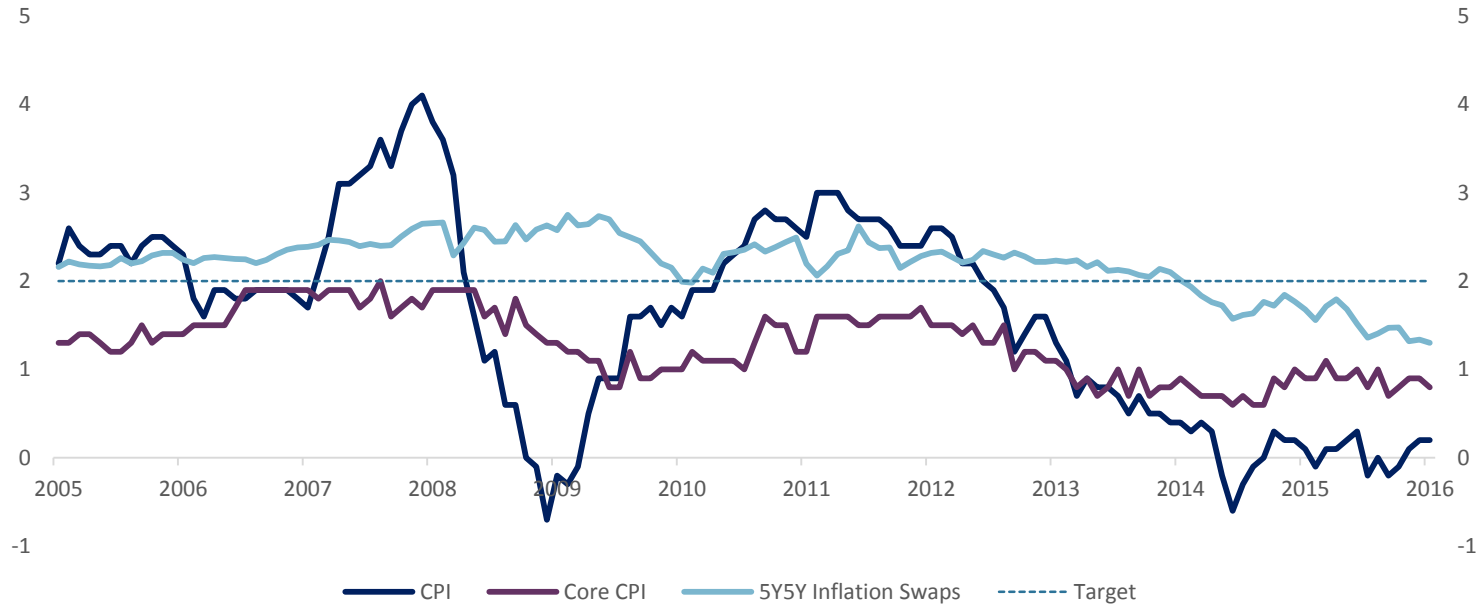
Eurozone swap rates

Per cent YoY



Eurozone Inflation Outlook

Per cent yoy

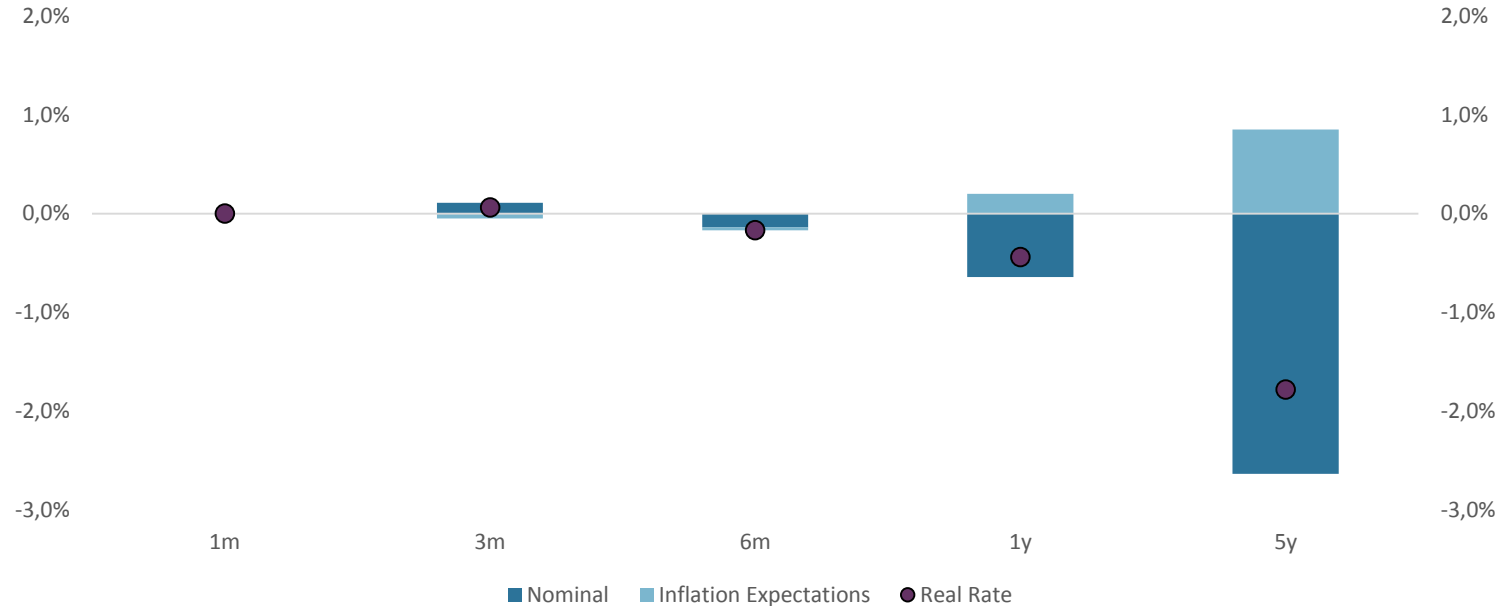


Source : Eurostat, Bloomberg.



Decomposing yields

France 10y real rate using nominal yields and inflation swaps

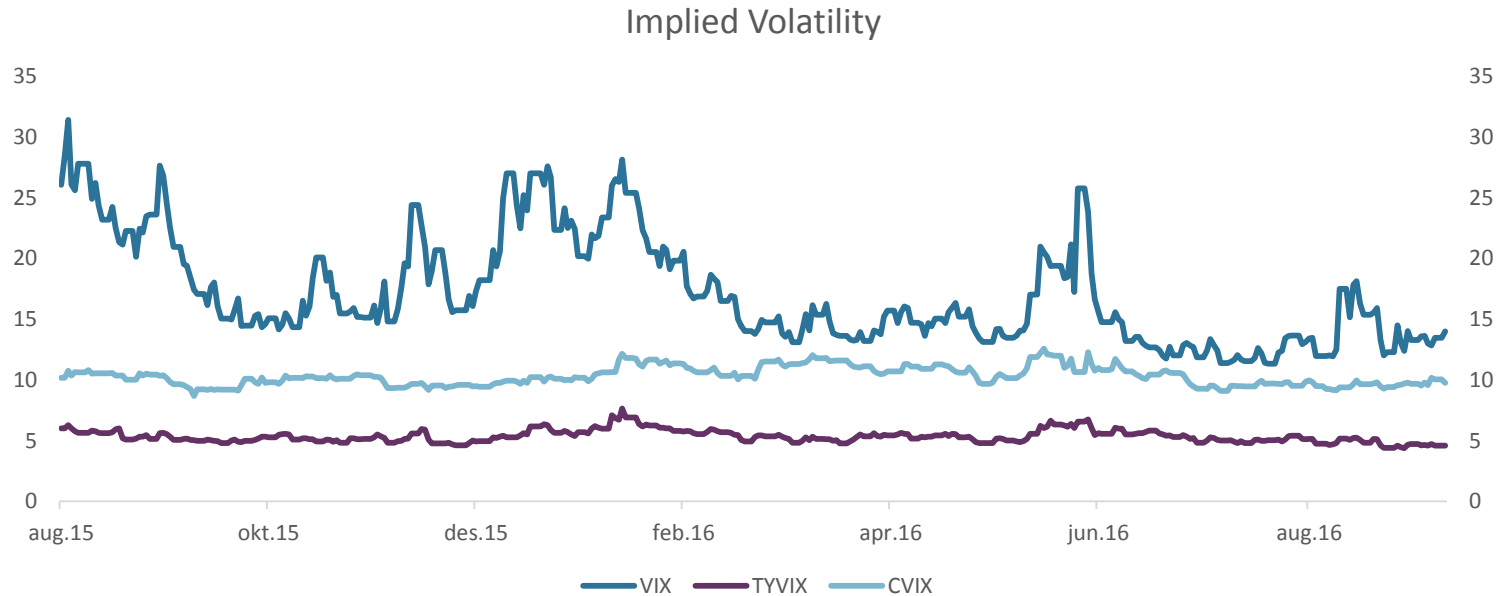


Source : Bloomberg as of 10th Oct 2016.



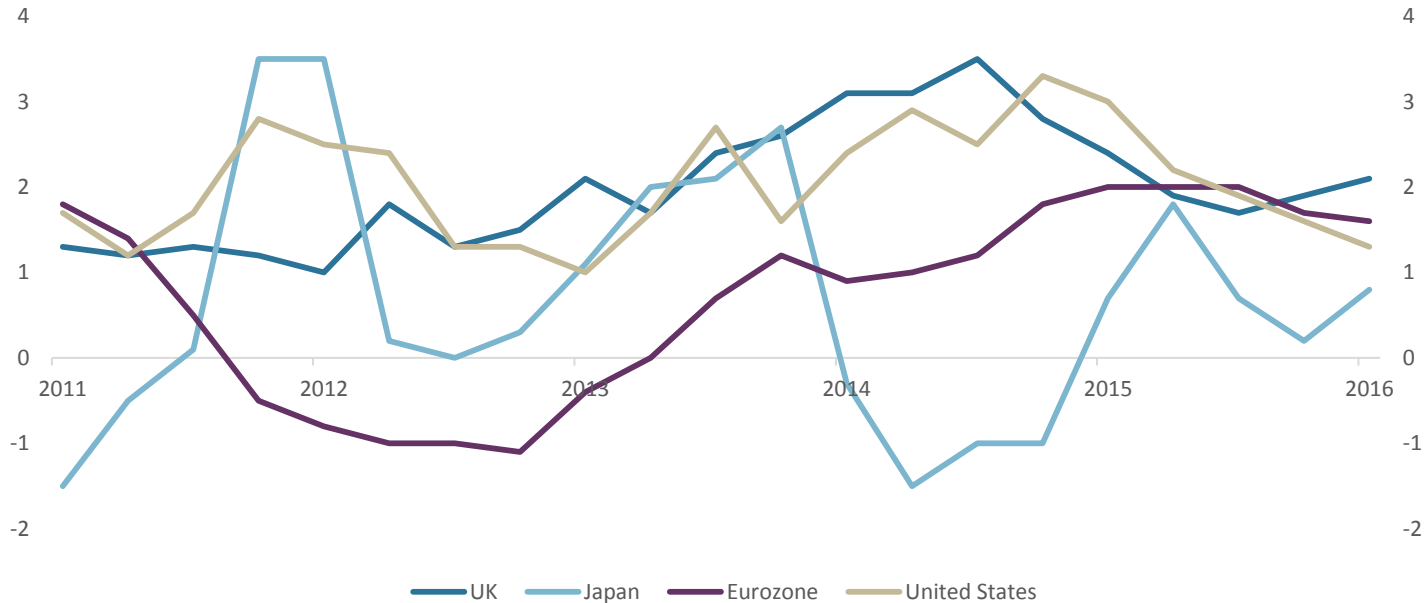
Volatility

Implied Volatility across asset classes



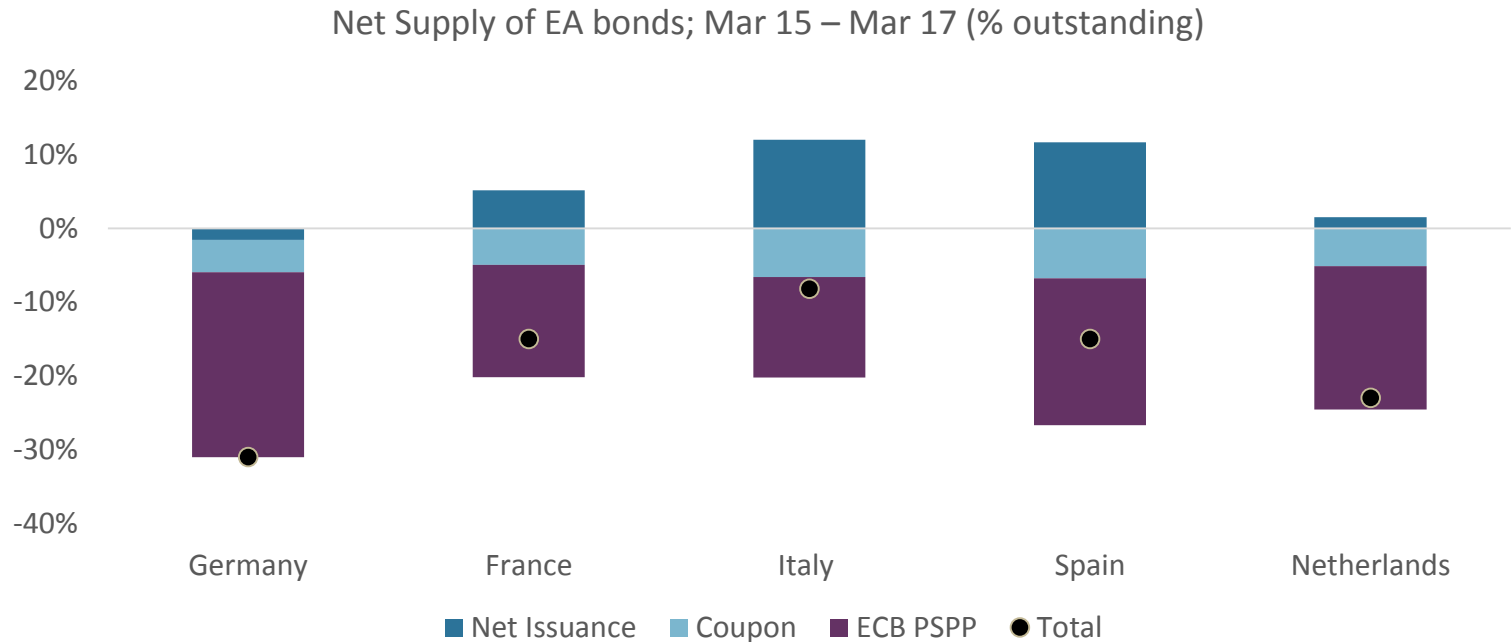
Growth slowing into Q3 2016

Real GDP growth; per cent yoy



ECB PSPP

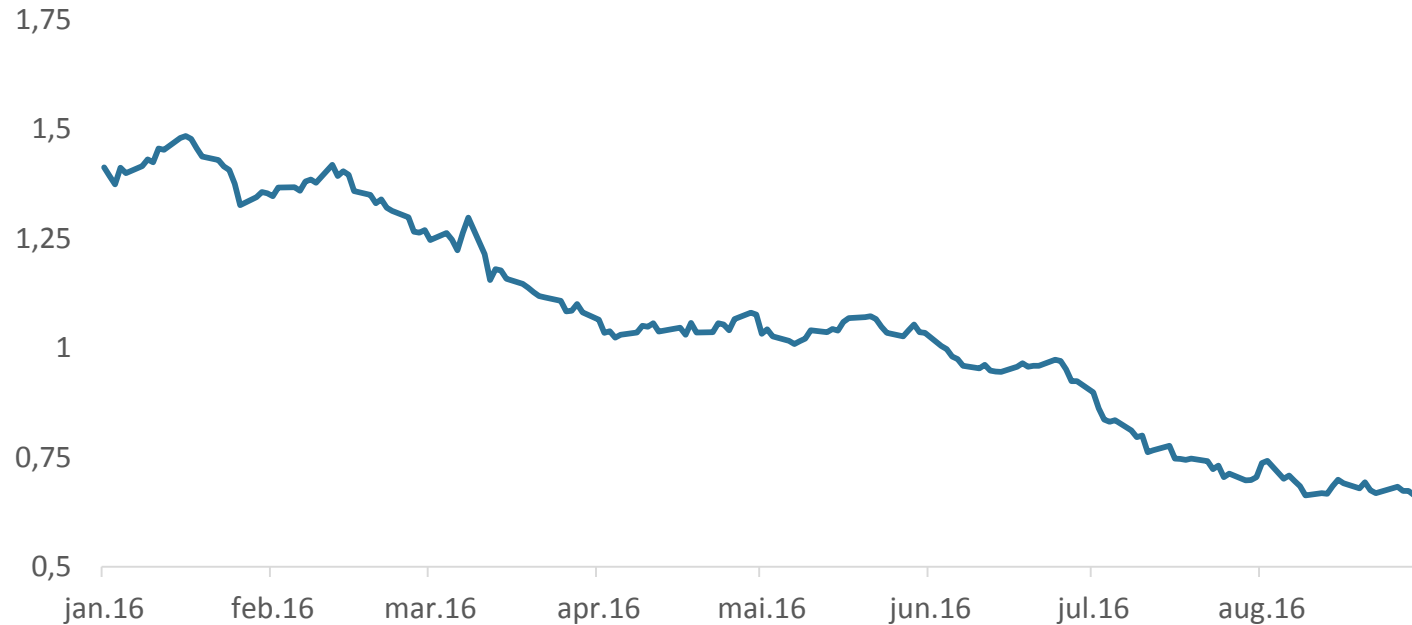
Change in supply of public debt (% of outstanding) by Mar 17



ECB CSPP

Yields still grinding lower; ECB driving issuance

BoA ML Eurozone Corporate Investment Grade YTM (per cent)



OUTLOOK



Key Issues

- Monetary Policy exhausted ?
 - Will EUR move stronger if the market senses lethargy from fiscal side ?
 - Impact of low rates unclear
- Impact of Brexit, what is it ?
 - Trade agreements needed sorting. British imports vital for Eurozone growth
 - Real investor sentiment dampened across Europe and not just UK ?
- Politics the key factor looking ahead
 - Italy, France, Germany elections; Euro scepticism rife and growing
- Structural questions surrounding Eurozone setup unresolved
 - Strong core with fiscal unity or widening core – periphery disparity ?



Impact of low rates

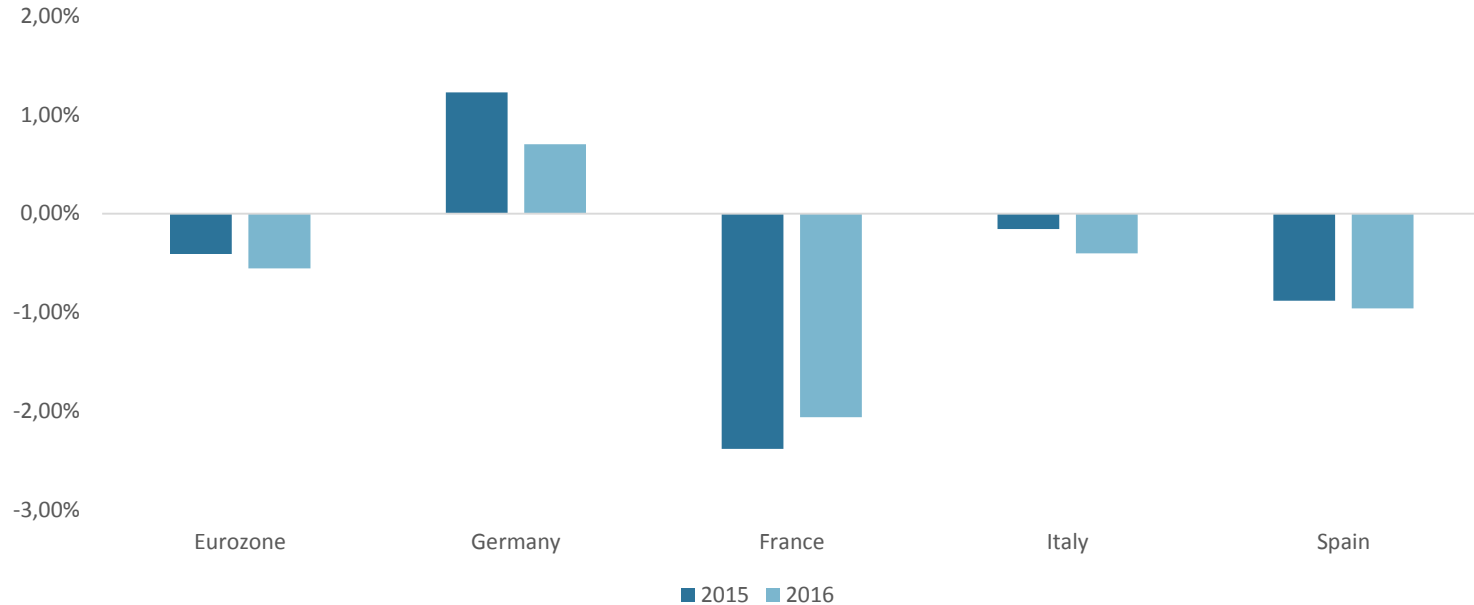
- Pension systems under stress. Companies diverting profits to fund deficits instead of investment ?
- Banks - credit creation under jeopardy as margins squeezed ?
- Absence of animal spirits means lower rates encourage **more** saving ?
- Frothy asset markets setting the stage for the next bubble ?

Deutsche Bank share price (€)



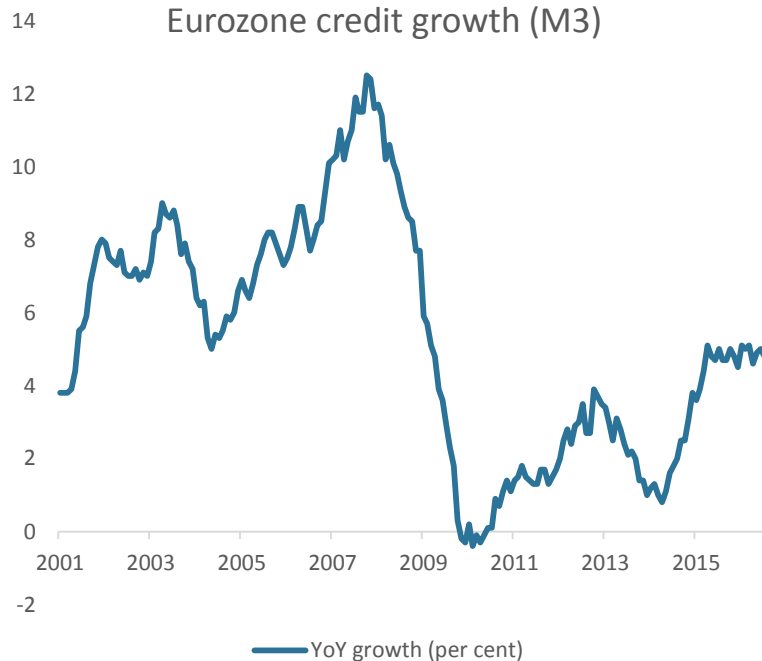
Fiscal trajectory finally aligned with ECB

Cyclically adjusted primary balance



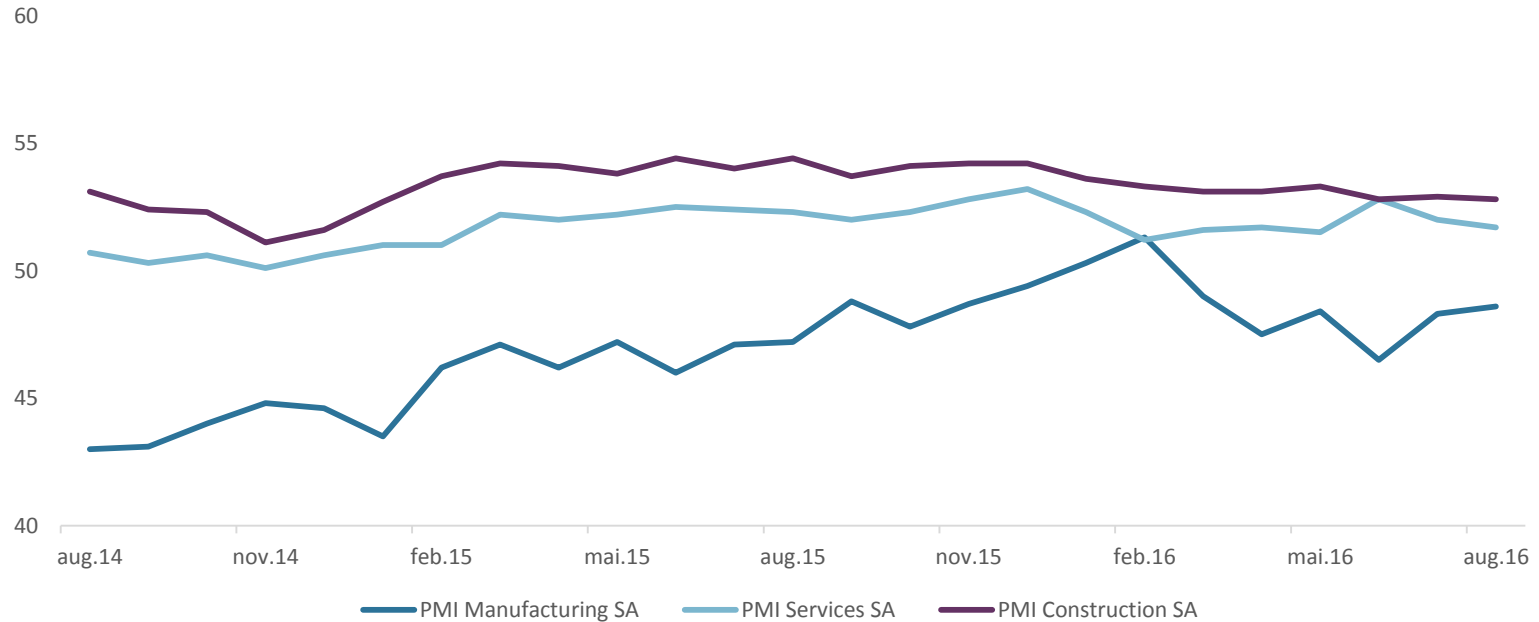
Credit more abundant and cheaper

Growth firm, interest rates declining



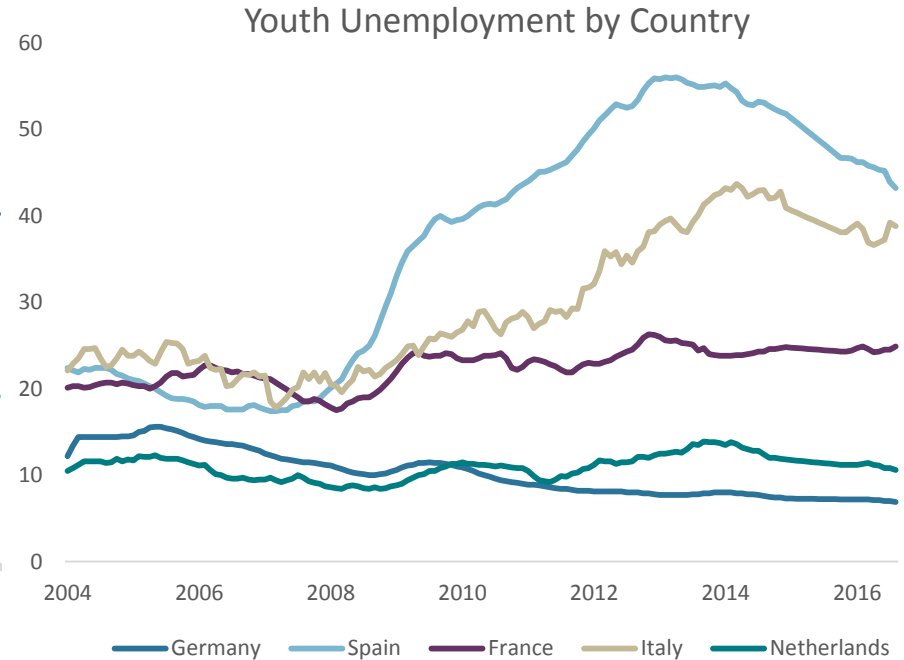
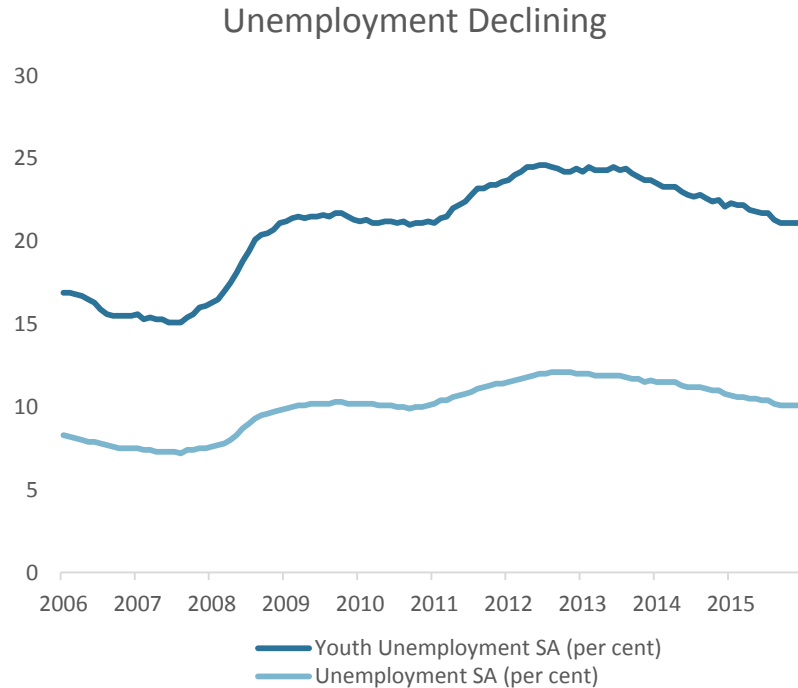
PMI surveys however mixed

Eurozone Manufacturing, Services and Construction PMI



Unemployment

Declining, but structural questions persist



Discussion Points

- Likelihood of additional fractures in the European project – economic and political
- Is unconventional policy the new convention ? What next ?
- Willingness and ability for fiscal authorities to act
- Impact of low yields. Would higher rates help ?
- A de-globalizing world, implications for markets.

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