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## Boon and bane

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The driving topics on the financial markets are the stabilisation of the oil price, mixed economic indicators globally vs. positive economic indicators for the Eurozone, the temporary decline in escalation risk, and the expansive central bank policies.

After the dramatic slump of the oil price of more than 50% from June 2014 to January 2015, the oil price stabilised at USD 60 per barrel (Brent). This supports those asset classes that had previously come under pressure (ruble, corporate bonds with low ratings in the USA).

Also, consumer purchase power has increased in many countries due to the decline in energy prices. The effect was so pronounced that many CPIs were even negative on a year-on-year basis in January. This has led global growth of retail sales to rise in the past months. In addition, it triggered an increase in the growth rate of industrial production. With the stabilising oil price, the impulse inflicted on inflation (falling) and retail sales (rising) has come to an end.

In spite of the effects supportive to the economy generated by the lower oil price, the downward revision of the estimate of the global economic growth rate in 2015 continues (according to Bloomberg, we are currently at 2.71%). In addition, the data surprises, globally speaking, were negative. This means that indicators such as employment, production, and exports many times fell short of the analyst consensus. At least the most recent leading indicators by the OECD and the purchasing managers indices are open to cautiously optimistic interpretation. However, the global economic growth close to potential growth, resulting from the falling growth rate of the employed population and low productivity, can be broken down into a vastly mixed set of developments. Brazil and Russia are "standing out" negatively.

The Eurozone, on the other hand, has broadly excelled. The weak euro, the – on aggregate – no longer restrictive fiscal policies of the governments, the improvement of the lending conditions of banks, the increase in demand for credit, the falling credit rates and bond yields, and the expansive policies of the European Central Bank have created an environment conducive to the increase of economic growth. Indeed, real economic growth in the Eurozone had already in Q4 2014 increased by a respectable 0.3% relative to the previous quarter. This does not sound like much, but it translates into an annualised +1.2%, which is close to potential growth. For the coming quarters we can see signs of a further improvement towards 0.5% q/q.

The preliminary agreement between Greece and the Eurogroup further strengthens the positive environment. In response, the spreads for the credit risk of government bonds have fallen. The biggest concession by the Eurogroup is the fact that the austerity targets will probably see some loosening. If the reform proposals by Greece were to suffice, the Eurogroup should accept a primary surplus (budget total prior to interest payments) lower than previously budgeted for this year. In all other respects, the Eurogroup has come out on top. The ECB, the European Commission, and the International Monetary Fund remain in charge of the monitoring of the reforms. The name "Troika" was changed to "Institutions" though. The bailout payments, previously rejected by Greece, will now be flowing after all from the IMF and the EFSF – but only if the reform proposals are deemed sufficient by the end of April. Also, there will be no reduction in debt. With respect to the financial sector, Greek banks can still not use Greek government bonds as collateral for liquidity from the ECB. Also, it seems that a third aid programme is already in the making. Either way, the political commitment to the integrity of the Eurozone remains strong.

In the past months 19 central banks have cut their key-lending rates. These steps were based on the fact that many inflation rates and inflation expectations had fallen to very low levels. Due to the bond purchasing programme, many currencies experience appreciation pressure (as a result of the downward pressure exerted on the euro),

as the ECB policy creates a shortage of government bonds in the Eurozone, and the central bank money supply is expanded drastically. As a result, the yields of bonds in the Eurozone remain very low (and sometimes negative) or indeed, continue to fall. The negative bond yields are also facilitated by the situation in some

countries/regions such as Denmark, Switzerland, Sweden, and the Eurozone itself, where the key-lending rate for surplus liquidity at the central bank is negative. Thus the investors are pushed into asset classes with higher promised yields (bonds with longer maturities, bonds with higher default risk, bonds with higher coupons in foreign currency, equities).

The measures by the central banks are showing the desired results. In addition to the asset price effect – caused by rising asset prices – the inflation expectations priced into the bond market have experienced an increase from low levels for some weeks across numerous countries. The US dollar and the British pound have appreciated vis-à-vis many other currencies. (Nominal) bond yields remain low, and real yields (i.e. nominal minus inflation) are falling.

A mixed economic environment presents both boon and bane. It is weak enough to trigger loosening measures from the central banks, and it is strong enough to keep the default risk low. At the same time it is subject to elevated risks; for example the risk of sustainable stagnation and of market distortions. As manifested by the decline in volatilities and spreads and by the increasing equity prices, market participants are currently betting on “boon”.

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