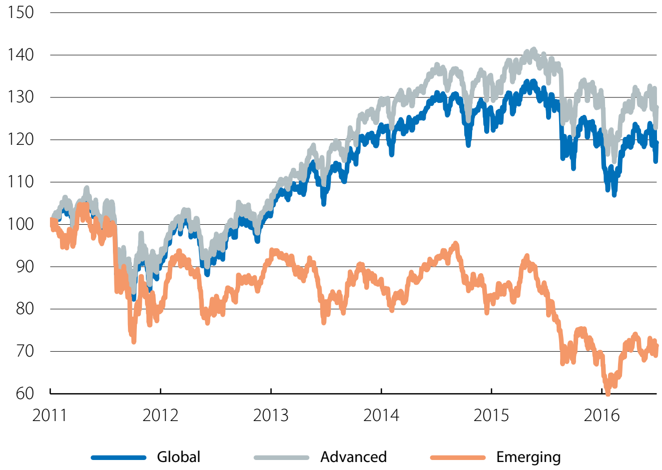
FINANCIAL OUTLOOK · **Brexit sends shockwaves through the markets, causing investors to seek safe havens**

The Brexit referendum cut short the trend in the markets in a month when they had been performing well. The first few days of June continued the rally of the previous month and, as doubts waned regarding the global environment, a renewed appetite for risk led to some recovery in the markets. However, this trend was interrupted mid-June by growing tensions regarding the Brexit referendum and four of the main central banks (Fed, Bank of Japan, Bank of England and Swiss National Bank) kept their monetary policy unchanged given the market situation. Finally, the option to leave the EU won the referendum by a slim margin, resulting in the pound sterling depreciating sharply and a widespread flight in global markets from riskier to safer assets. Most stock markets ended the month with losses and the MSCI World fell by 1.1% while Eurostoxx was hit harder, down by 5.8% in June. Emerging markets, however, recorded the best performance, posting gains of 4.1%. Global corporate bonds were also up, by 1.8% for investment grade and by 0.6% for high yield. On the other hand the price of crude oil continued its upward trend, going 33% higher than its price at the beginning of the year. Given this situation of instability and uncertainty, expectations have grown that the accommodative policies of the Fed and the ECB will be continued for longer than initially expected.

The Brexit «yes» vote surprises investors, resulting in a «Black Friday» that has left uncertainty in its wake. Markets had already been affected by the uncertainty caused by the referendum since the middle of June. European stock markets saw several sessions with losses of around 2% followed by gains of more than 3% depending on the polls being published. The pound sterling, which had depreciated by a cumulative 3.2% against the euro during the month, picked up again in the days prior to the referendum (with implied volatility at similar levels to the 2008 crisis). But on Friday, 24 June, the day after the vote, the pound fell by 8% against the dollar and by 7.5% against the euro. International markets were also hit hard, especially in Europe (FTSE: –4.2%, Eurostoxx 50: –8.9%, DAX: –7.1%, MIB Italy: –10.9%, Ibex 35: –12.5%) and particularly Europe's banking sector, which slumped by 18%. One of the expected consequences of this unstable environment has been a demand for safe assets which, together with the decisions taken by the central banks, has pushed yields on German debt to an all-time low. The IRR for the German 10-year bund had fallen into negative terrain for the first time in its history by the middle of the month and, after the referendum, descended by 20 bps to

International stock markets by geographical location

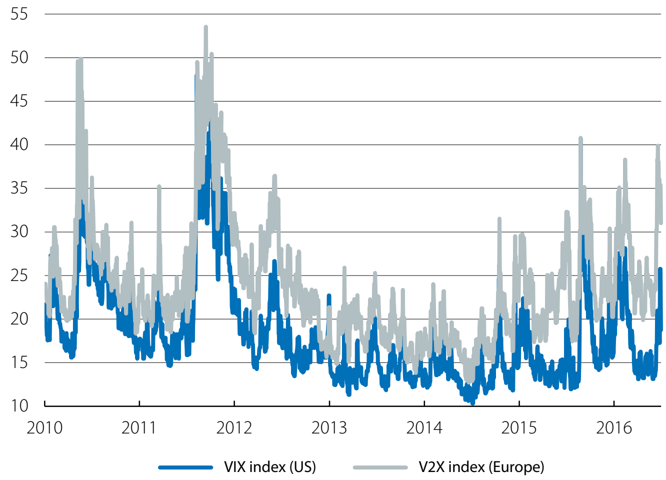
Index (100 = January 2011)



Source: *CaixaBank Research, based on Bloomberg data.*

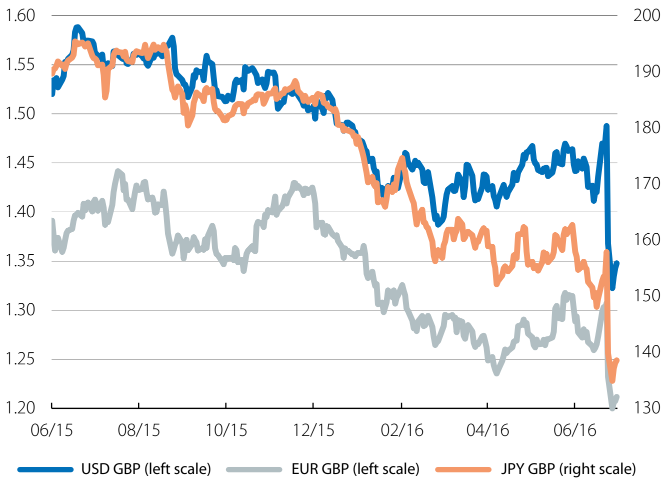
Implied volatility of US and Europe stock markets

(%)



Source: *CaixaBank Research, based on Bloomberg data.*

Exchange rate for the pound sterling against the euro, dollar and yen



Source: *CaixaBank Research, based on Bloomberg data.*

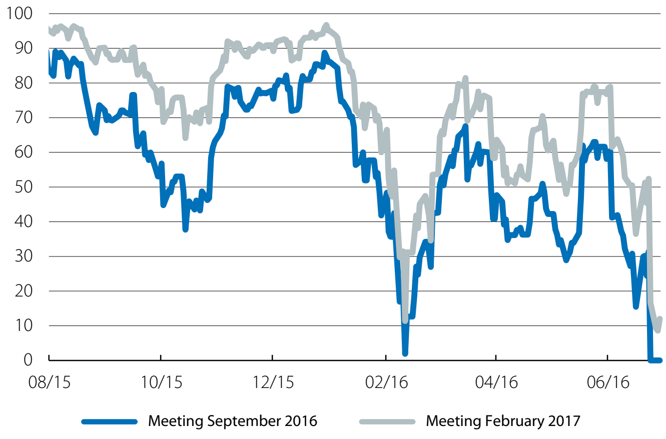
–0.11%. This brought about an increase in peripheral risk premia which, by the end of the month, stood at around 130 bps in Spain, 140 bps in Italy and close to 310 bps in Portugal. Monetary market rates also recorded drops while gold was up by 8.8%, already accumulating a 25% rise this year so far. In the coming weeks this high volatility and risk aversion in financial markets is likely to continue, awaiting clear guidelines to be defined regarding the future relationship between the UK and the EU.

Given this turbulent situation, the Fed is likely to postpone its next interest rate hike for a few months. At the meeting of the Federal Open Market Committee (FOMC) on 15 June, the Fed decided to keep the fed funds rate at 0.25%-0.50%, as had been predicted. In the days prior to the meeting, and given the market volatility, future contracts on interest rates had already eliminated any expectation of an interest rate hike in June. The press release by the FOMC noted that, in spite of higher growth in economic activity, some economic indicators are still not conclusively in favour of raising interest rates. The forecasts published by the Fed after this meeting suggest that the Fed funds rate will end 2016 at 0.75%-1.0%, which implies two hikes this year, each of a quarter of a point. After the Brexit, however, future contracts assigned a 12.5% probability to a hike before March 2017. In any case, the Fed reduced its own forecasts for interest rates in 2017 and 2018 (from 1.9% to 1.6% and from 3.0% to 2.4%, respectively), as well as the long-term rate (from 3.3% to 3.0%). Regarding the macroeconomic forecasts, we should also note the slight downward revision in the trend rate of growth in GDP, which now stands at 2% from this year on. Initially yield on US public debt fell slightly, both for short and long maturities, ending the month at 0.6% and 1.47% respectively, also affected by the British vote (dropping by 25 bps and 30 bps on 24 June).

The ECB starts its corporate sector purchase programme (CSPP) with some of the predicted effects already having occurred. On 8 June the ECB launched its corporate sector purchase programme which covers investment grade corporate bonds issued in euros. The impact since this opening salvo is difficult to measure as it coincided with the start of tension caused by the British referendum but its effects actually started to be felt as from its announcement last March. Since then the average IRR for the Investment Grade European Corporate Bond index (published by Bloomberg) has fallen by more than 35 bps and the volume of issuances keeps on rising. In spite of the fall in corporate yields, the spread compared with German public debt has remained relatively flat due to the considerable drop in the bund's yield. On the other hand, although debt classed as speculative (high yield) is not included in the ECB's purchase programme, this has also benefitted from the CSPP indirectly (via the restructuring of investment portfolios) and has also followed the same downward trend as investment grade bonds.

US: probability associated with an increase in the federal funds rate *

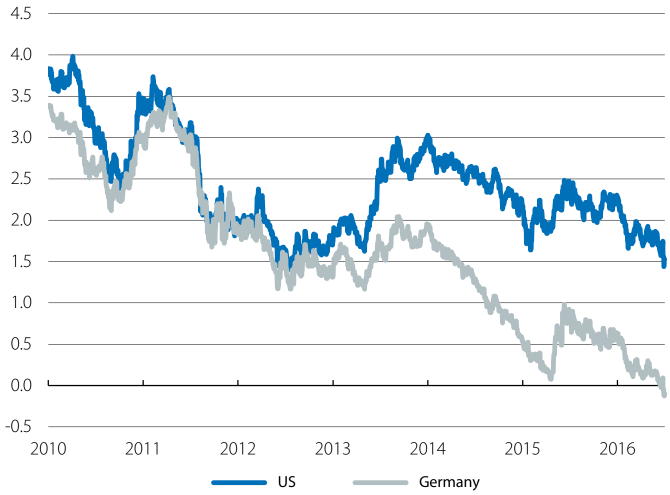
(%)



Note: ** Obtained from fed funds futures.*
Source: *CaixaBank Research, based on Bloomberg data.*

Yields on 10-year public debt

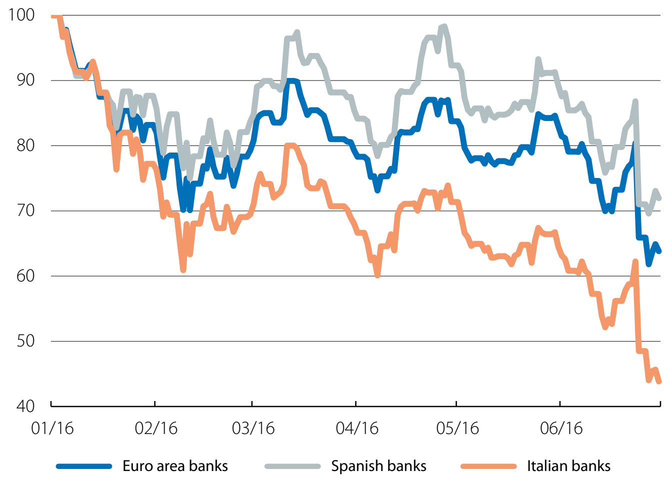
(%)



Source: *CaixaBank Research, based on Bloomberg data.*

Euro area stock market: banking sector

Index (100 = January 2016)

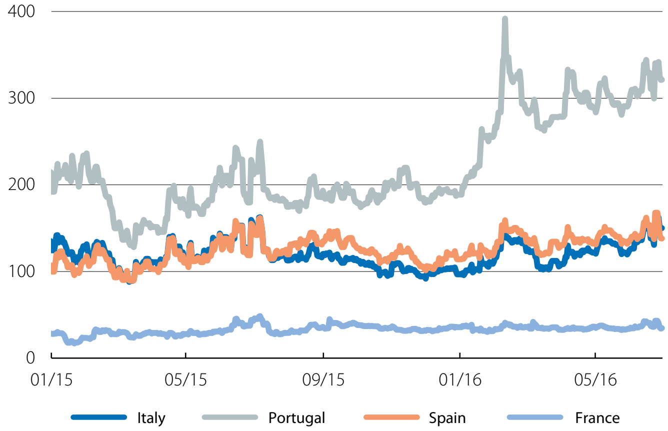


Source: *CaixaBank Research, based on Bloomberg data.*

International equity suffers from the uncertainty produced by the Brexit, recording losses over the month. British risk assets seemed, *a priori*, to be the most vulnerable to the tense trading in the days prior to the Brexit referendum (falling by 5% in 3 days) but it was actually the European index that came under most pressure in these sessions and recorded the most losses (Eurostoxx: –6.3%). The same message could be seen in the implied volatility of European indices, posting a maximum upswing in June of almost 70% (V2X Index for Europe and VFTSE Index for the United Kingdom) while implied volatility in the US stock market rose by 49% (VIX Index). Regarding the overall figure for the month, and with an upswing in the last few days after Brexit doubts had waned, the main US indices ended flat (S&P 500: +0.25%) while the European indices were down by 6%. This brings the cumulative figure for the year to losses ranging from 2% for the Nasdaq to 5% for the Stoxx 600 Europe and 19.5% for the Nikkei. This trend has reduced even further the European stock market's performance compared with the US stock market: the cyclically adjusted price-to-earnings ratio (CAPE) is over 16 in Europe and over 25 in the US, while the Price to Book ratio in Europe is 1.38 compared with 2.80 in the US.

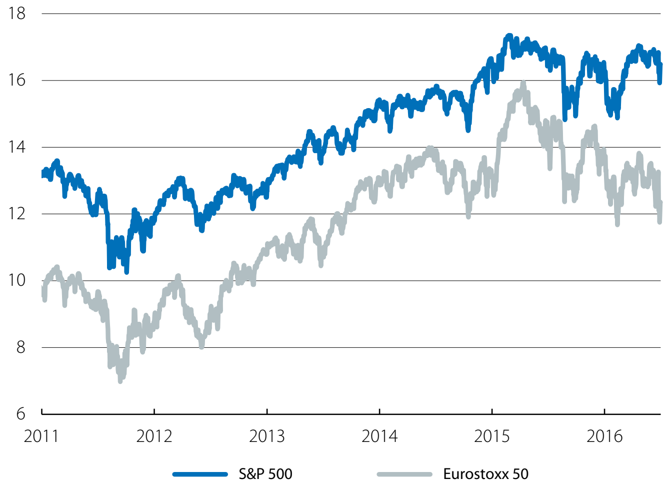
Emerging markets and commodities manage to weather the storm in the midst of an unstable outlook. In spite of these losses for 2016 as a whole, the emerging markets have proved to be the exception, posting gains in excess of 6.5% (MSCI Emerging Market Index) in June although also suffering big losses during the last few days of the month. This performance is due to the improvements in the macroeconomic framework observed at the beginning of the month. In the absence of bad news from China, we should also add the support provided by commodities for this positive trend. So far oil prices have increased by a total of 33% in 2016 while copper and iron ore also picked up at the end of the month, with a cumulative rise of 2% and 23% this year, respectively. Moreover, the flash PMI of the G3 for June (US, the euro area and Japan) was showing signs of improvement. In any case, in the medium term attention will still be focused on the Chinese banking sector (mainly due to problems of asset quality as a result of high debt levels) and on the rise in defaults in its corporate bond market, half of which are from state enterprises. In the short term the trend in emerging assets will be influenced by the effects of the Brexit on risk aversion and on the outlook or doubts regarding world growth. Volatility is very likely to reign supreme in the markets until such uncertainty wanes.

Euro area: risk premia of 10-year public debt
(bps)



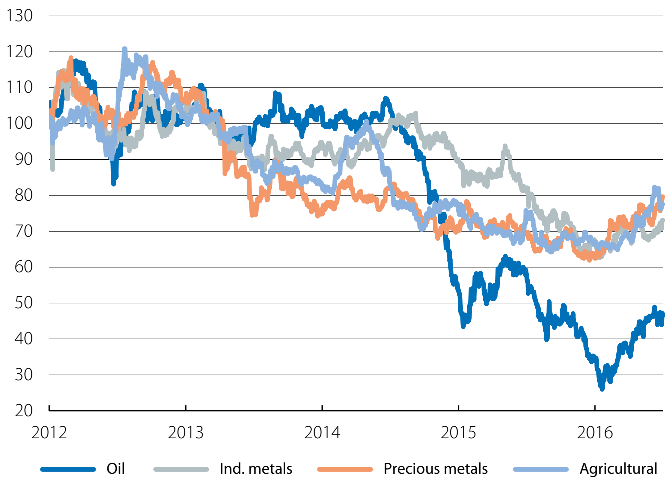
Source: *CaixaBank Research, based on Bloomberg data.*

Developed stock markets: price/earnings ratios (P/E ratio)
(Ratio)



Source: *CaixaBank Research, based on Bloomberg data.*

Trends in commodities
Index (100 = January 2012)



Source: *CaixaBank Research, based on Bloomberg data.*