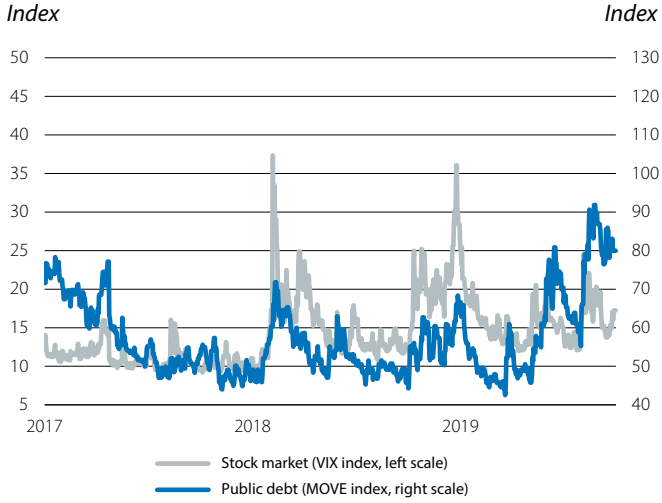
The central banks take the reins

The markets end a turbulent quarter on a calm note. After a summer of volatility marked by falling stock prices and declines in yields on sovereign bonds, September was characterised by a return to normality in the financial markets. The main catalysts for this improvement were the formal announcement of the resumption of trade negotiations between the US and China, and the accommodative measures taken by the major central banks (with a rate cut by the Fed and a new stimulus package from the ECB). Thus, risk aversion, which had prevailed during much of July and August, ceded its pressure on most types of assets and gave rise to a cautious recovery in the stock markets and in sovereign bond yields. Only at the end of the month did the concurrence of several geopolitical events (such as the drone attacks on the largest refinery in Saudi Arabia) and the publication of some rather disappointing economic indicators, mainly in the euro area, stoke the nervousness of the markets. As such, the markets have shown their continued susceptibility to political statements, messages from central banks and uncertainty over the slowdown of the global economy.

The Fed cuts interest rates in response to the sources of risk. At its September meeting, the US monetary institution cut interest rates by 25 bps (down to the 1.75%-2.00% range) and supported its decision based on contained inflationary pressures and the persistence of risks to the scenario (mainly uncertainty over the trade negotiations between the US and China and the moderation in global economic activity). Like at its July meeting, the decision was not unanimous, and the chairpersons of the regional Feds of Kansas and Boston voted to keep rates unchanged, while the chairman of the St. Louis Fed defended a cut of 50 bps. This division was also reflected in the path that interest rates are expected to follow over the coming quarters: in particular, the so-called dot plot shows that 7 of its members point towards a further cut before the end of the year, while the remaining 10 are split between keeping rates unchanged and raising them once again. As for the macroeconomic outlook, both the description of the economic scenario and the new economic activity projections for the next year remained favourable and without significant changes. That said, the members of the Fed stressed the perceived weakness in private investment and in the foreign sector. On the other hand, the New York Fed made several injections of liquidity into the interbank system for the first time in over 10 years, faced with the rise in interbank interest rates in the very short term. The gradual drain on reserves which domestic banks deposit in the Fed, as a result of the decrease in the size of its balance sheet over the past few months, put a strain on liquidity on the days on which firms had to meet their tax obligations.

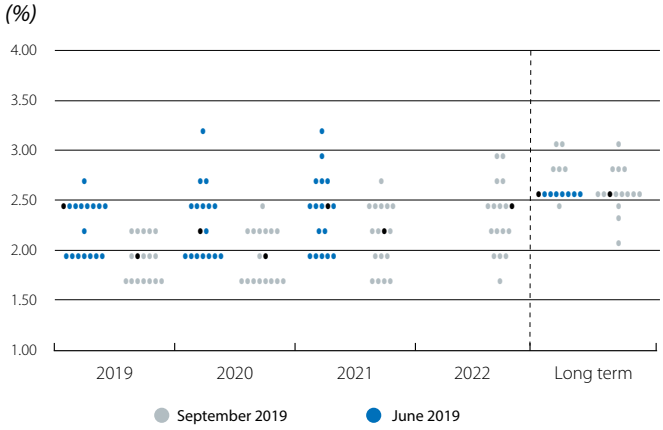
The ECB relaunched the monetary stimulus. In response to a somewhat weaker economic scenario in the euro area, at its latest meeting the ECB formalised the new monetary stimulus programme that it had announced at its July meeting.

Implicit volatility in the financial markets



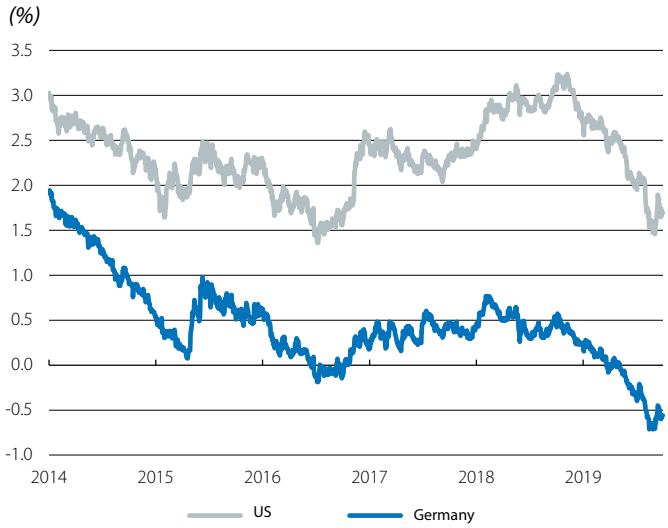
Source: *CaixaBank Research, based on data from Bloomberg.*

Federal Reserve: expected trend in interest rates



Note: *Each point represents a voter in the Federal Reserve's Federal Open Market Committee. The median voter is indicated in black.*
Source: *CaixaBank Research, based on data from the Federal Reserve.*

Yield on 10-year sovereign bonds



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

The new measures consisted of a 10-bp cut to the interest rate of the deposit facility (down to –0.50%) and the resumption of net purchases of assets (which had come to an end last December), starting in November at a monthly rate of 20 billion euros. In addition, in order to reduce the potential adverse effects of the prolonged environment of low rates on the financial system, the ECB has increased the appeal of its liquidity injections (TLTRO-III), extending the deadline and reducing the cost, as well as announcing a tiered system for reserve remuneration (only a portion of the excess liquidity deposited in the ECB will be subject to the deposit rate). Finally, the ECB did not provide any indicative date for the end of the programme (like it had done in the past) and suggested that the environment of low interest rates will persist until there are clear signs of recovery in inflation. However, some decisions (such as asset purchases) failed to receive the unanimous support of the Governing Council, and some information suggested a link between this and the resignation of Sabine Lautenschlager just days later.

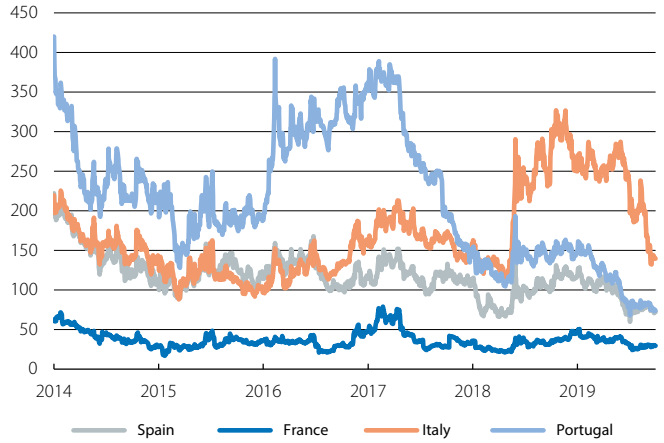
Sovereign yields increase. Despite the central banks adopting a more accommodative tone, financial security prices reflected investors' expectations of a bigger stimulus. Therefore, in response to the meetings of the Fed and the ECB, sovereign yields recovered some of the decline experienced during the summer, with increases of up to 17 bps being recorded in the US and 13 bps in Germany. Nevertheless, yields remain at their lowest levels in recent years, while the risk premiums of the euro area periphery experienced a widespread reduction. This recovery was also boosted by Standard & Poor's improving the credit ratings of Spain (from A– to A) and of Portugal (maintained at BBB, but with an improvement in the outlook), as well as by the positive response among investors to the new coalition government in Italy.

The stock markets recover following the summer. In addition to the decisions of the central banks, a more conciliatory tone was struck in the trade tensions between the US and China, in contrast with the escalation witnessed in August. These circumstances, in a month without major business news, facilitated a recovery of the appetite for risk and in the major stock markets of both developed and emerging economies closed the month with widespread gains (the US' S&P 500 closed up +1.7%, the Eurostoxx 50 +4.2% and the MSCI Emerging Markets +1.7%).

Geopolitical tensions drive up the oil price. The drone attack carried out on the largest refinery in Saudi Arabia, which damaged around 50% of the country's productive capacity, led to a significant, albeit short, surge in the price of oil in September. Specifically, fears of a possible fall in supply initially drove up the price of a barrel by 20%, placing it above 68 dollars. However, the statements by the Saudi government ensuring a quick recovery in its productive capacity and the extensive availability of crude oil reserves in the US and most advanced economies calmed the mood among investors and helped to bring prices down to around the 60-dollar mark.

Euro area: risk premiums of 10-year sovereign bonds

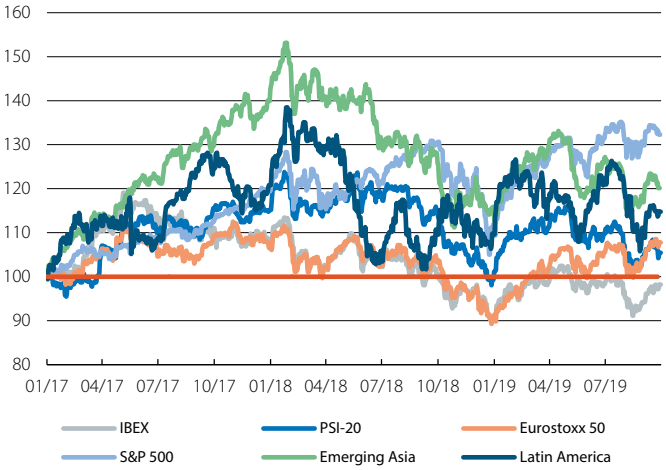
(bps)



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

Main international stock markets

Index (100 = January 2017)



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

Brent oil price

(Dollars per barrel)

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