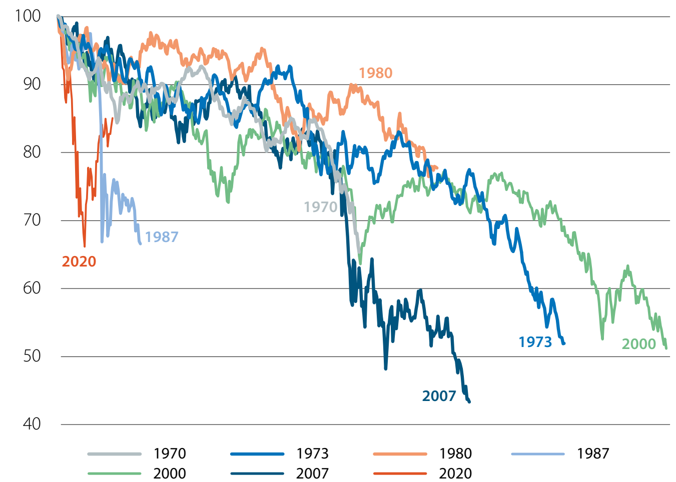
Financial markets' sentiment stabilises

The financial markets cling to economic support policies and de-escalation plans. After the collapse of February and March, which was not only severe but also of an unprecedented speed, in April investors enjoyed a respite, volatility decreased and financial security prices stabilised, even regaining some of the lost ground. Stock markets registered widespread gains (although they remain negative on a year-to-date basis), pressure on risk premiums eased (especially with regard to corporate debt, which had been more stressed in previous months), and in the currency market those of emerging economies showed greater stability. This better performance in the financial markets occurred as investors digested the rapid and significant response from economic policy and, in particular, the reduction of infections in key economies such as the euro area and the subsequent preparation of plans for the gradual lifting of restrictions on activity. However, despite the reduced stress in the markets, the financial environment remains highly demanding and prone to new spikes in volatility.

Oil dips into negative prices. The month proved more turbulent for the oil market, although in early April OPEC and other major oil-producing countries, such as Russia, put an end to a brief price war and signed a new agreement on production cuts. Specifically, in May and June 2020 there will be a reduction of 9.7 million barrels per day (mbd) compared to the levels of October 2018, while the cuts will be slightly less pronounced in the second half of 2020 (7.7 mbd) and throughout 2021 (5.8 mbd less from January 2021 until April 2022). However, the efforts of OPEC and its allies clashed with the freeze in demand caused by the COVID-19 crisis and the price of crude oil continued to fall, to the point where, in some indices, it even turned negative (in particular, in the case of WTI US crude oil contracts maturing in May). This anomaly was a reflection of the fact that, with the low oil prices, the accumulation of stocks is beginning to saturate US storage centres and forcing buyers to cope with higher storage costs. Thus, as the execution date of the May contracts approached, many US refineries were only willing to acquire new barrels of oil if they were compensated for the increase in costs, and on Monday 20 April the price of the WTI barrel came to be traded at –37.6 dollars, driving down the rest of the market. However, the price of Brent oil always remained in positive territory and, driven by an improvement in market sentiment, came to close the month of April with a slight recovery up to 25 dollars.

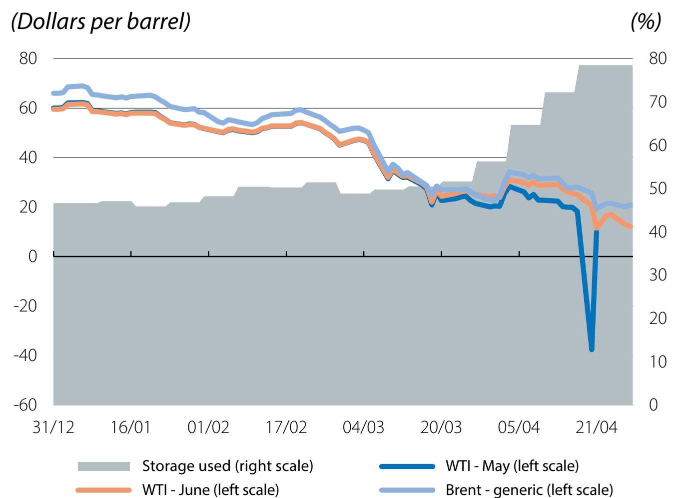
Stock markets recover some of the lost ground. Following the sharp declines suffered in March, in April the major stock market indices experienced gains of around 10%, both in advanced economies (although in the euro area there was greater disparity between the periphery and the core) and in

S&P 500: the biggest falls
Index (100 = maximum prior to the fall)



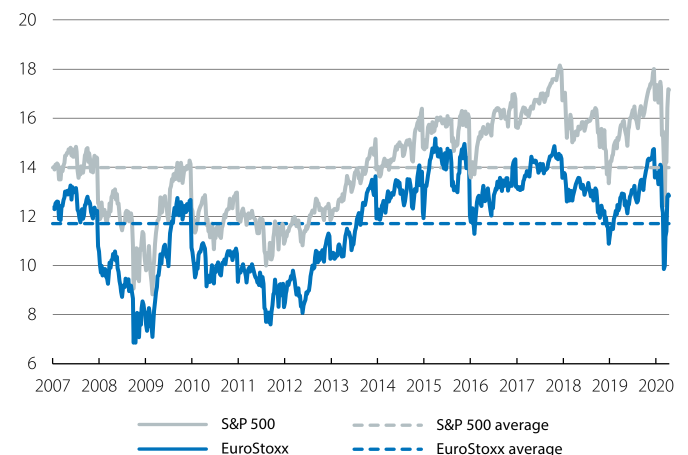
Source: *CaixaBank Research, based on data from Bloomberg.*

Oil: storage capacity in Cushing and price of a barrel of Brent and WTI
(Dollars per barrel) *(%)*



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

P/E ratio: evolution and average of recent years
(Forward 12-month ratio)



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

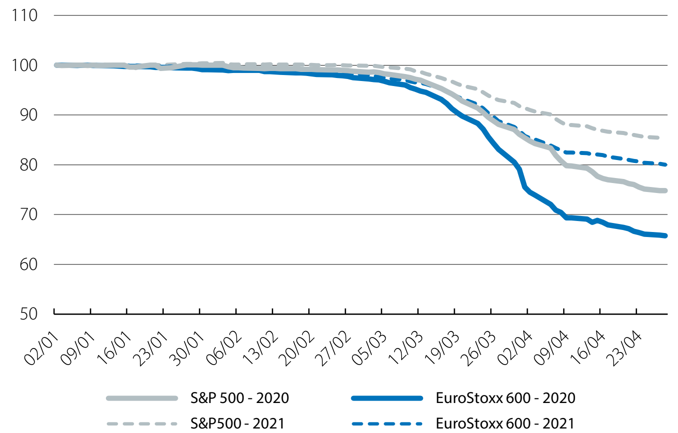
emerging economies. In addition to the improvement in sentiment, the publication throughout April of corporate earnings for Q1 2020 also gave the stock markets a boost. Despite reflecting a sharp deterioration in earnings in year-on-year terms due to the impact of the COVID-19 outbreak, in general the earnings published were somewhat better than expected by analysts, who in the preceding months had substantially lowered their forecasts. However, in the year as a whole the indices remain clearly negative and the volatility of the stock markets remains at historically high levels. Moreover, the recovery was not equal across all sectors and was especially concentrated in those less sensitive to the business cycle (such as health, non-cyclical consumption and telecommunications).

Tensions in credit markets take a respite. The surge in risk premiums on corporate debt that occurred in March tempered in April. The actions of the major central banks (the Fed and the ECB) through the special asset purchase programmes (involving the purchase of assets such as mortgage-backed bonds and corporate debt) provided support for investor confidence and favoured the easing of tensions in the credit markets, in both the investment-grade and the high-yield segments. Nevertheless, the credit environment continues to be highly demanding. One of the aspects arousing the most reticence among investors, and which lies behind the largest corporate risk premiums, is the capacity of the high-yield market to absorb all those companies that are losing their investment-grade rating (we analyse this phenomenon of «fallen angels» in the Focus «The vulnerabilities of corporate debt in the face of a historic shock» in this same *Monthly Report*).

The Fed, ready to expand the safety net. After quickly launching a battery of substantial measures in March, the April meetings of the major central banks resulted in far fewer developments in terms of monetary policy. In contrast, the Fed and the ECB focused on analysing the change of economic scenario and reiterated that they are prepared to redouble their efforts if necessary. On the one hand, in the US, at the end of the Fed's last meeting, Jerome Powell described a gloomy economic outlook for the US economy in Q2, marked by a sudden drop in economic activity as well as the anticipation of a rise in the unemployment rate above 10% and weak inflation. Powell did not announce any new monetary policy measures, but remarked that the frictions in the domestic financial markets were moderating after the implementation of a full battery of measures (including unlimited purchases of treasuries and mortgage bonds). He also stressed that, in the face of the high degree of uncertainty surrounding the current economic outlook, the Fed could increase the stimuli to help the recovery to be as strong as possible.

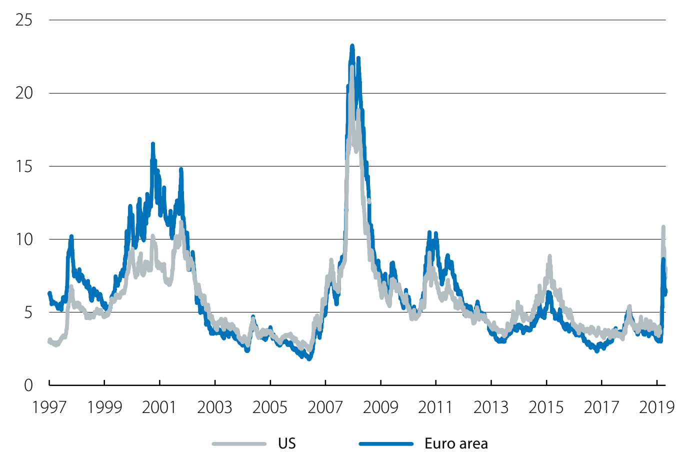
The ECB strengthens liquidity. Like the Fed, the ECB also presented an economic scenario involving a deep recession

Evolution of expectations of corporate earnings in 2020 and 2021
Index (100 = January 2020)



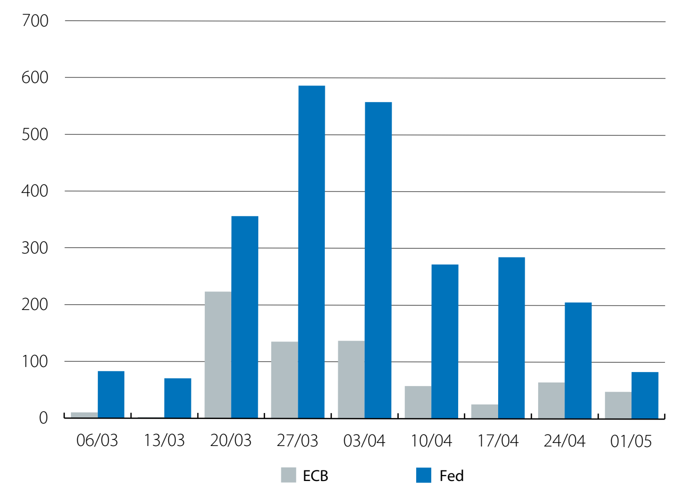
Note: *Evolution of the expectations of earnings per share in 2020 and 2021.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Speculative-grade corporate risk premiums
(pps)



Source: *CaixaBank Research, based on data from the Federal Reserve Bank of St. Louis.*

Central bank balance sheets: weekly increase
(EUR and USD billions)



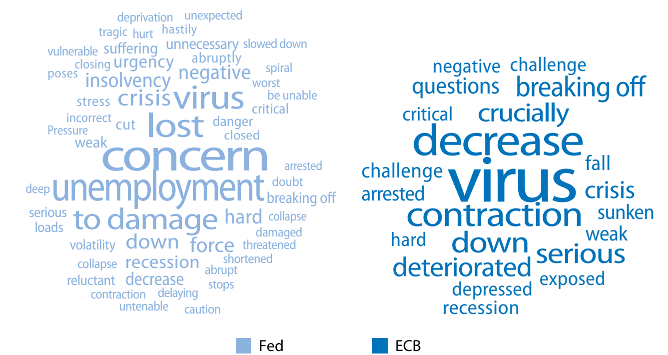
Source: *CaixaBank Research, based on data from Bloomberg.*

in the euro area for 2020. In this context, the Bank announced new stimuli, which come in addition to those already adopted in March, in order to bolster the abundance of liquidity and avoid credit tensions. The new measures included a reduction in the cost of financing through the TLRTO-III and the creation of a new programme of emergency liquidity injections to combat the impact of the pandemic (PELTRO). This programme will be launched starting in May 2020 and, with a maturity date in mid-2021, will satisfy all requests at an interest rate of –0.25%. Furthermore, the Bank made clear that it was prepared to increase the scale of its various tools to whatever extent necessary.

All eyes are on the risk premiums of the periphery. The deployment of measures by the Fed and the ECB facilitated a stable environment with very low sovereign yields in the US and Germany. However, the month was less placid for sovereign yields in the periphery of the euro area. The growing funding needs of these countries in order to cope with the impact of the COVID-19 crisis continued to drive up their risk premiums (+35 bps in Italy, +16 bps in Spain and +6 bps in Portugal). In addition, in April, the ratings agency Fitch downgraded Italy's sovereign credit rating by one point (to BBB–). The ECB, meanwhile, maintained a high level of public debt purchases in its emergency programme to combat the effects of the pandemic (PEPP) and concentrated the purchases of its other programme (PSPP) in the peripheral countries (the geographical distribution of the purchases of the PEPP is not yet known).

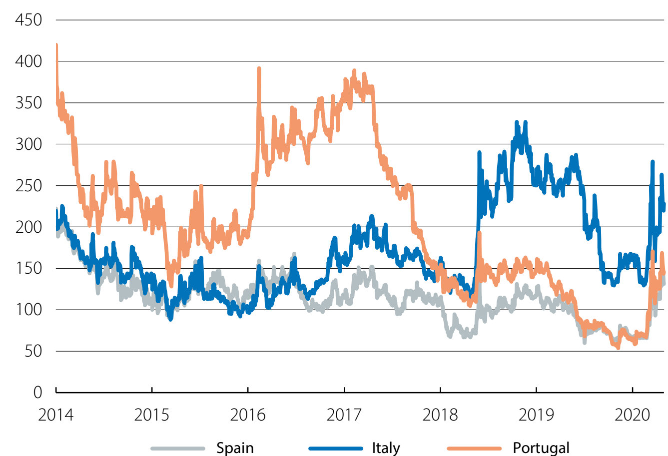
The emerging markets present high financing tensions. The surge in credit spreads observed in advanced economies in March had a greater impact on emerging economies. While the recovery of market sentiment in April and the implementation of injections of dollars by the Fed managed to reduce risk premiums on the debt of emerging economies, the collapse in oil prices exacerbated the situation for many oil-producing countries. In the currency market, meanwhile, emerging currencies were more stable, but they continue to be weak in the year as a whole (the JP Morgan aggregate index of emerging currencies has registered a cumulative decline of around 15% since the beginning of the year).

April meetings of the Fed and the ECB: main negative words



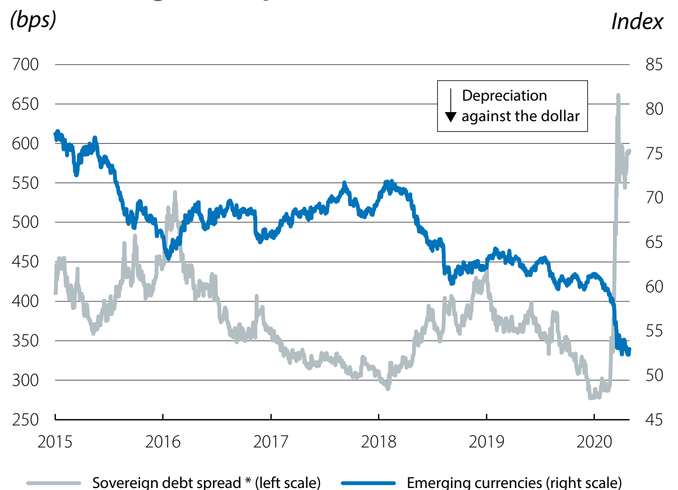
Source: *CaixaBank Research.*

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



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

Emerging economies: currencies against the US dollar and sovereign debt spread



Note: ** Spread between the emerging economy average and US treasuries.*
Source: *CaixaBank Research, based on data from Bloomberg.*