

Macro Rate Markets Outlook

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and of European Economics

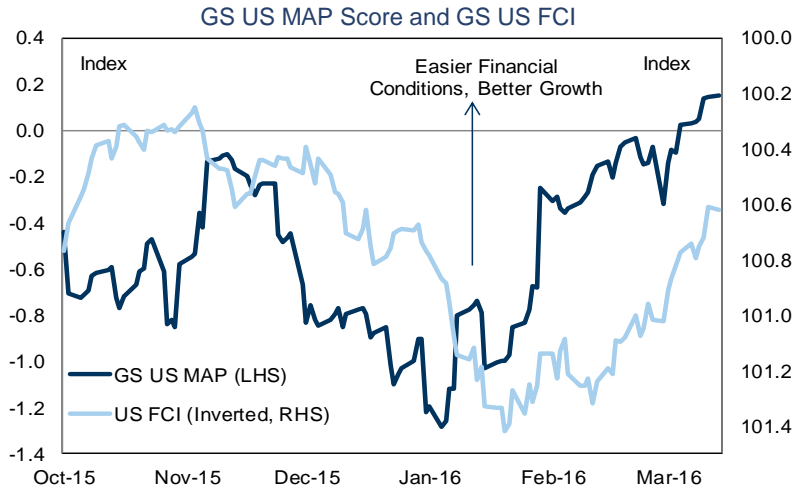
Goldman Sachs International

Frankfurt, 7th April 2016

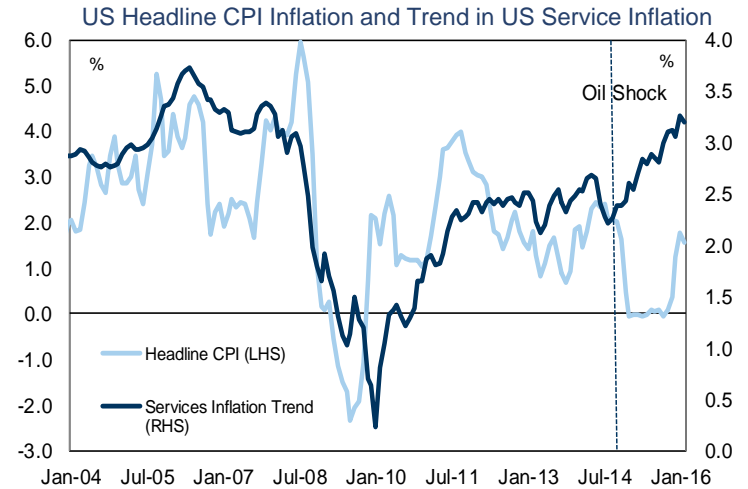
United States

Resilient Growth and a More Dovish Fed

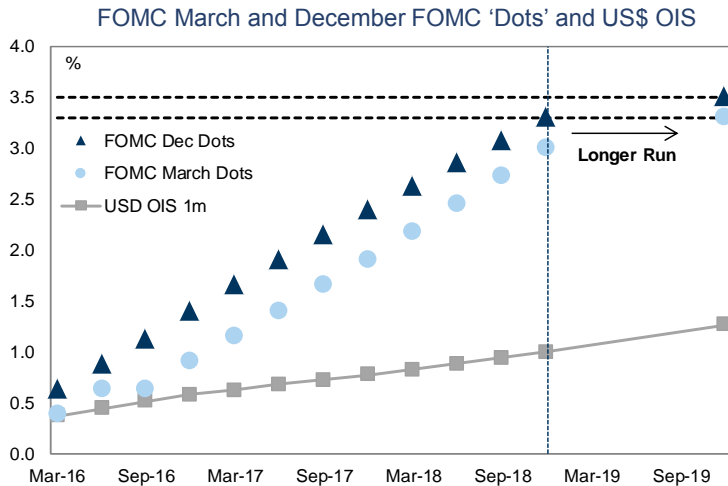
US Data Surprising Positively as FCI Eases



Core Inflation Trending Higher

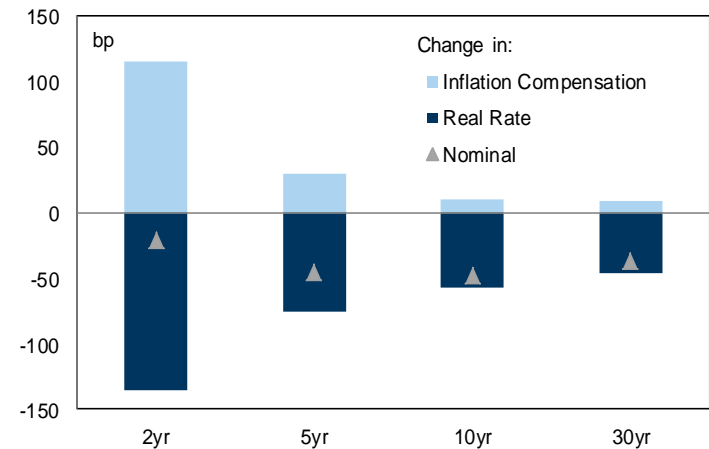


FOMC Converging to Market Expectations



Real Rates Driving the Rally in Nominals

Decomposition of Change in US Treasury Yields Since Dec FOMC

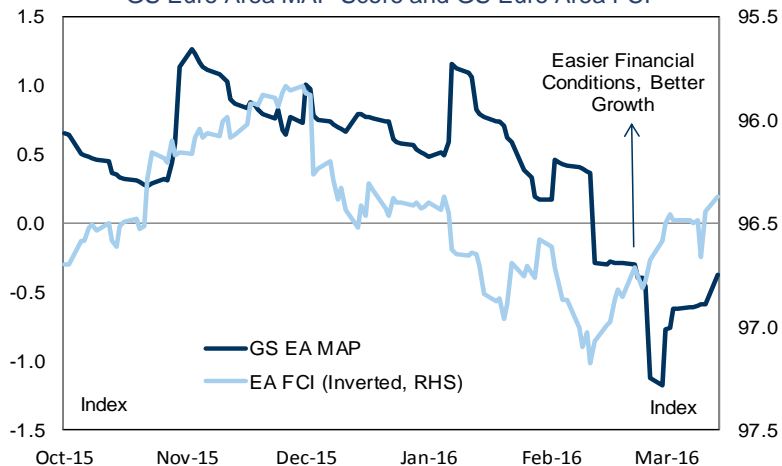


Euro Area

ECB Still the Marginal Price Setter for Euro Rates

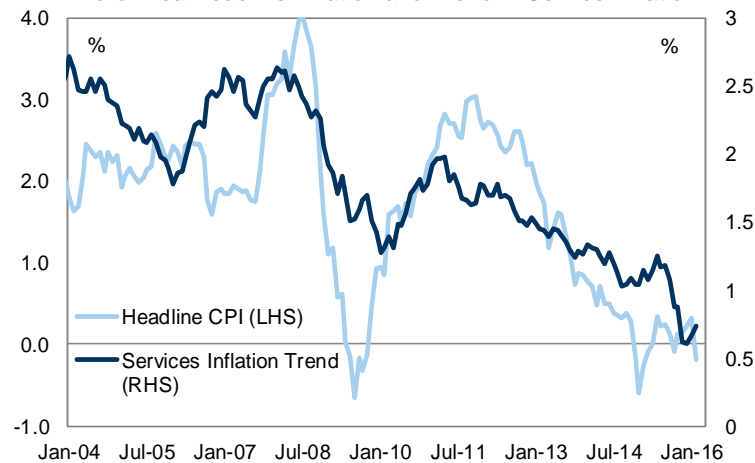
Activity Data Improving from Lows

GS Euro Area MAP Score and GS Euro Area FCI



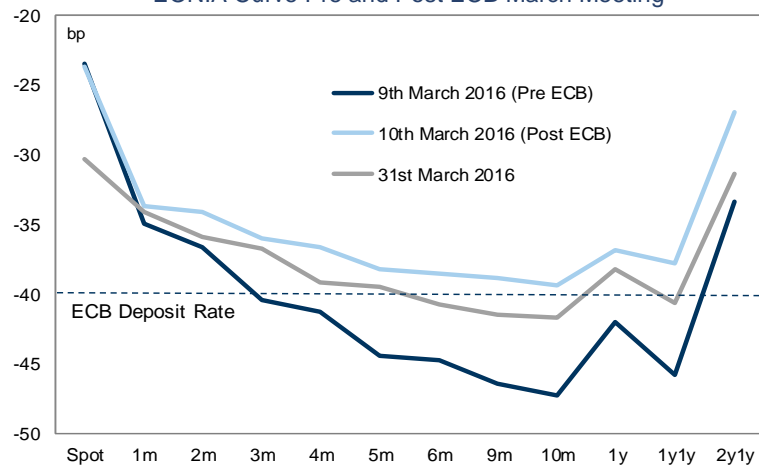
Inflation Dynamics Remain Subdued

Euro Area Headline Inflation and Trend in Service Inflation



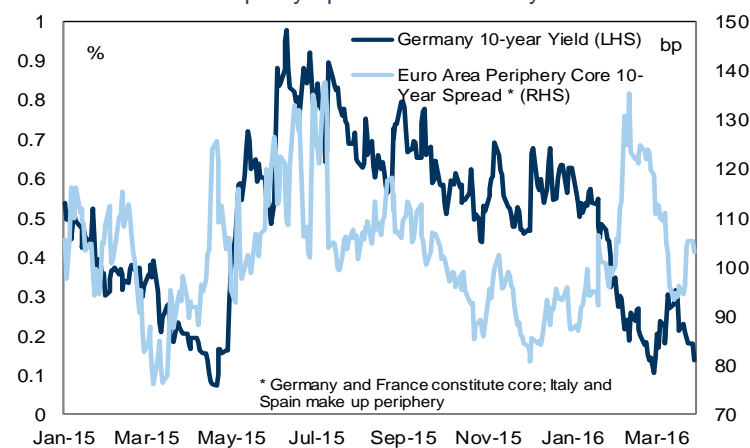
Market is No Longer Expecting Further Rate Cuts

EONIA Curve Pre and Post ECB March Meeting



Step Term Structure of Periphery Spreads

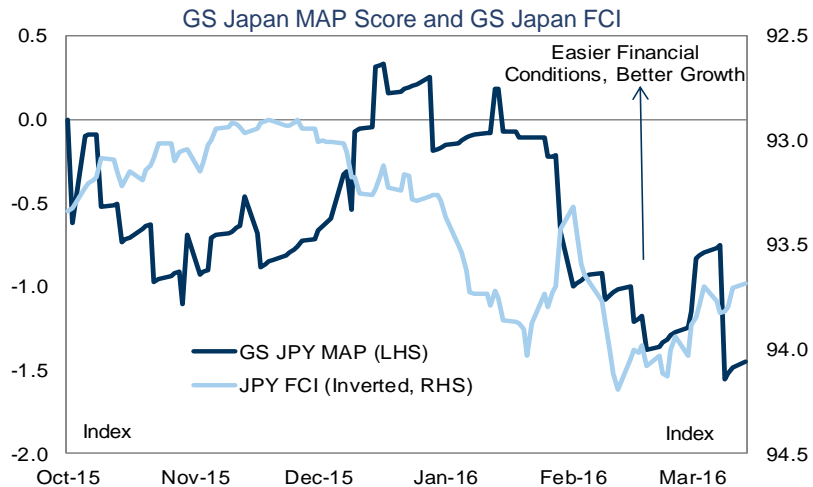
Euro Area Core Periphery Spread and Germany 10 Year Yield



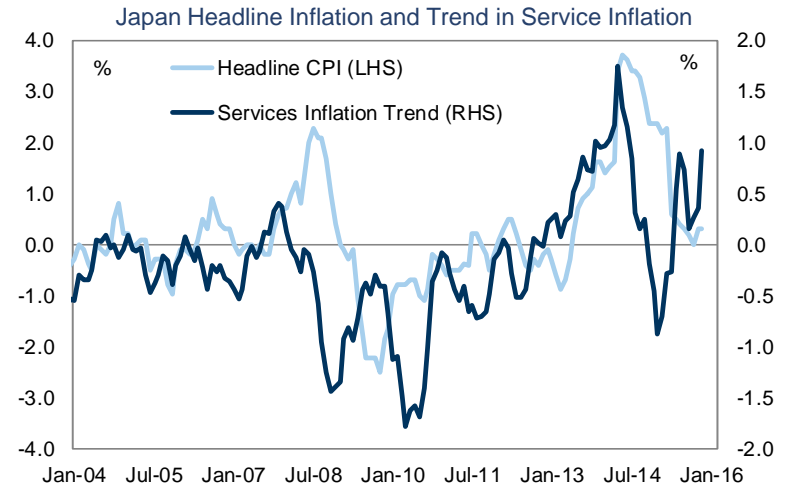
Japan

Negative Rates Result in Tighter Financial Conditions

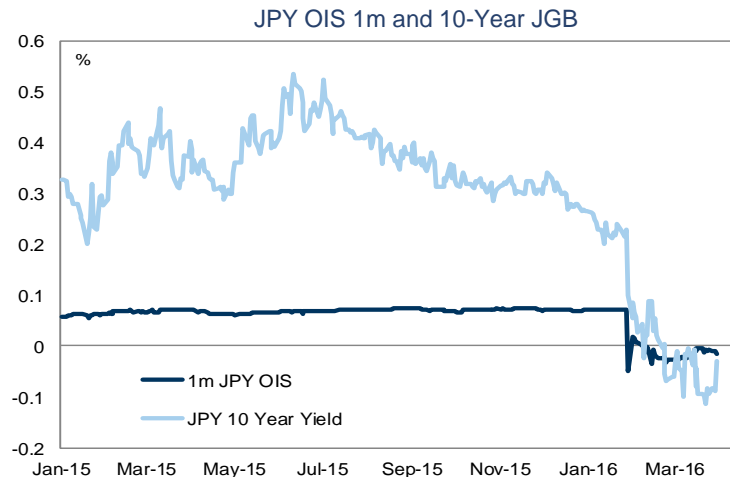
Activity Data Still Weak



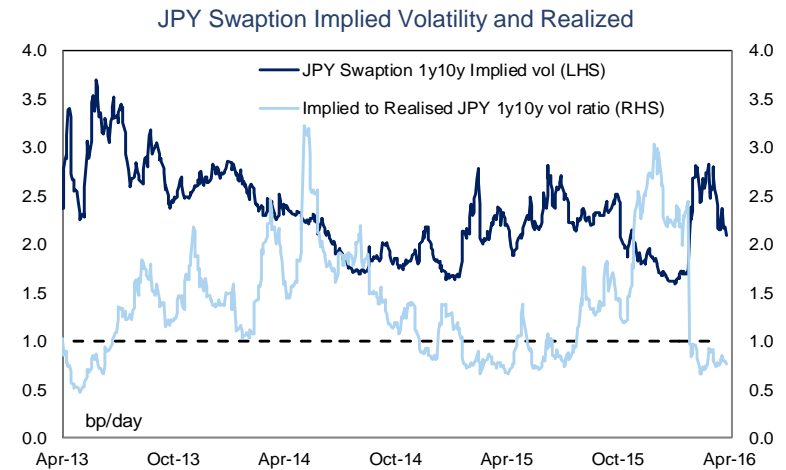
Core Inflation Is Stabilizing



NIRP has Dragged JGBs Lower..



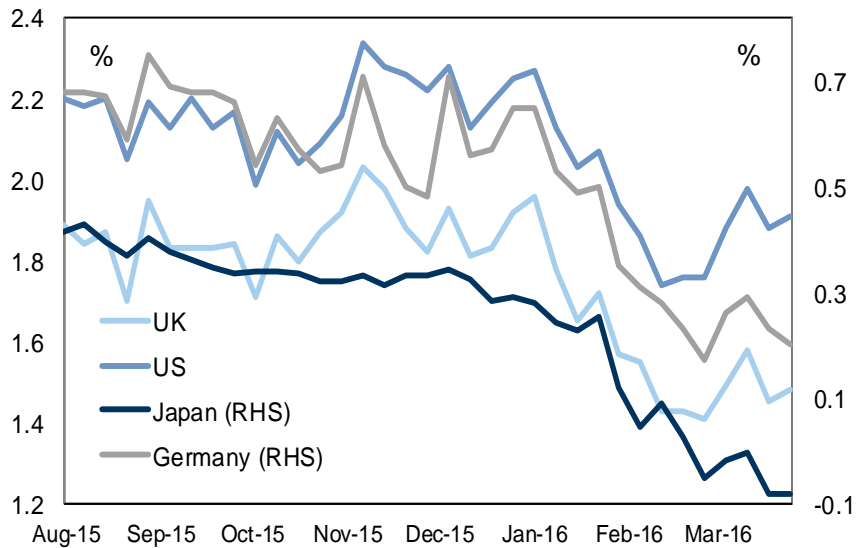
...And Led to an Increase in Market Volatility



Japan in the 'Driving Seat' of Global Rate Rally

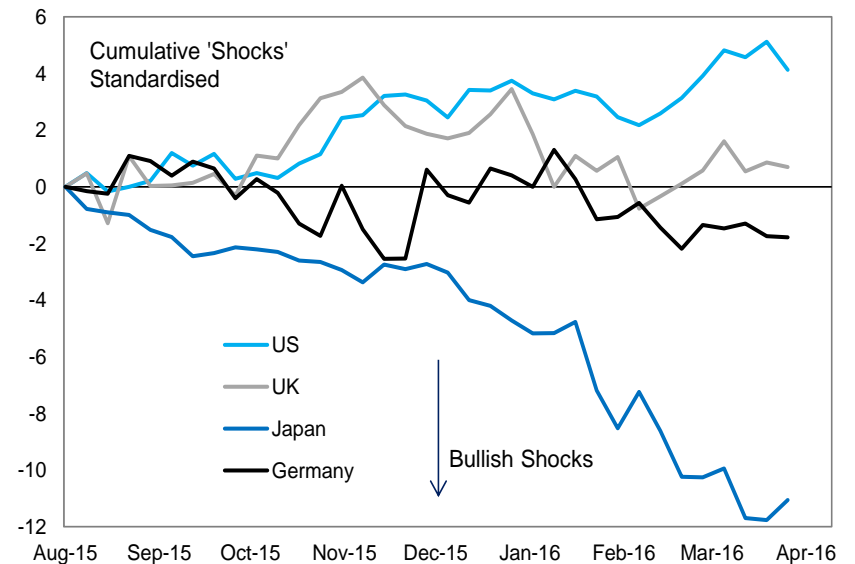
Yields in G-4 Have Co-Moved Since the Start of Year

10-yr nominal bond yields in G-4 countries



JGBs have Been in the Driving Seat Since Last November

Idiosyncratic 'shocks' originating in each market, estimated through a methodology based on Rigobon (2003)

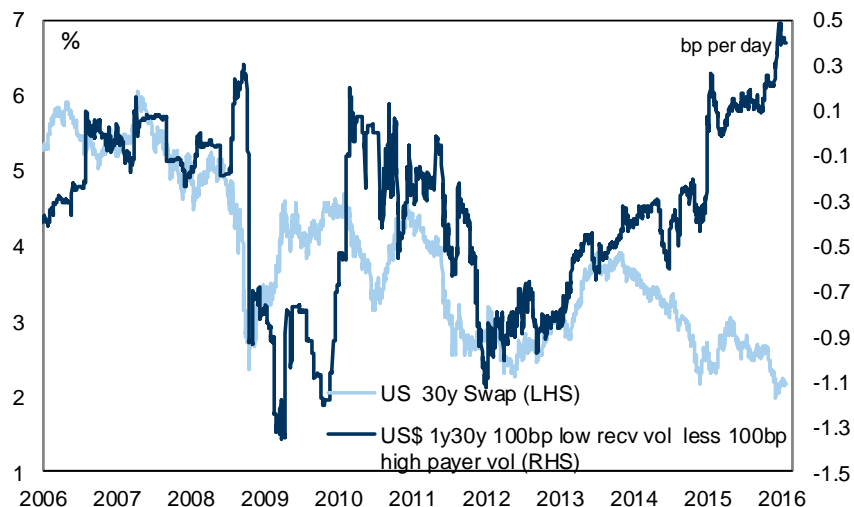


Source: Bloomberg, Haver Analytics, Goldman Sachs Global Investment Research

Investors Fear Further Bond Rally More than Selloff

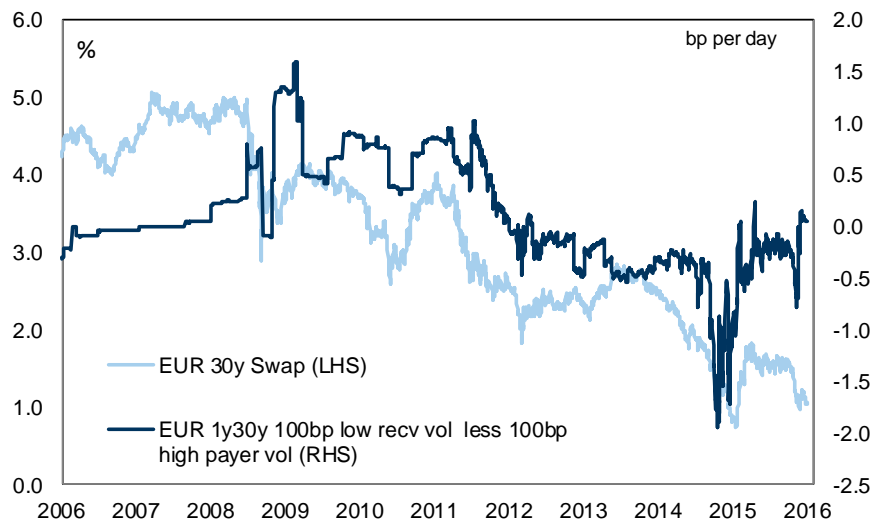
In Spite of Lower Yields, Investors Fear a Further Rally More than a Selloff...

US\$ 30y swap plotted against 1y30y 100bp out-of-the-money low recv. vol less 1y30y 100 bp out-of-the-money high payer vol



...Both in the US and the Euro area

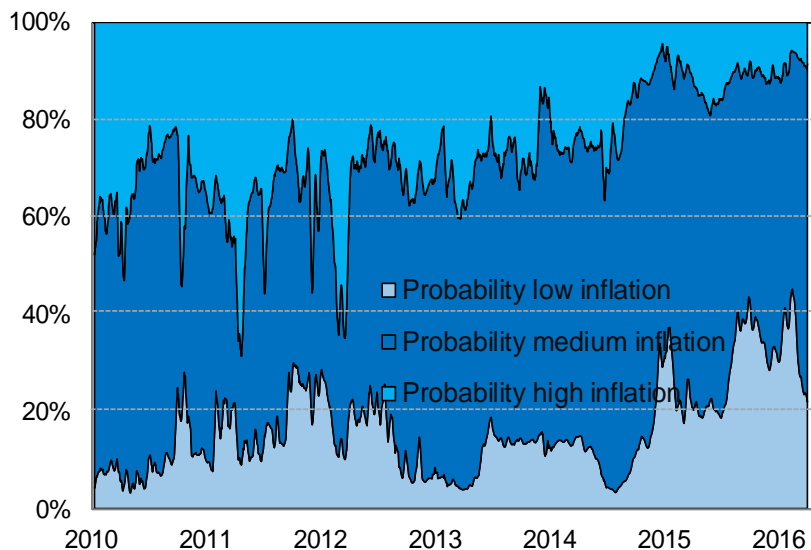
EUR 30y swap plotted against 1y30y 100bp out-of-the-money low recv. vol less 1y30y 100 bp out-of-the-money high payer vol



The Market Prices Persistent Low-flation

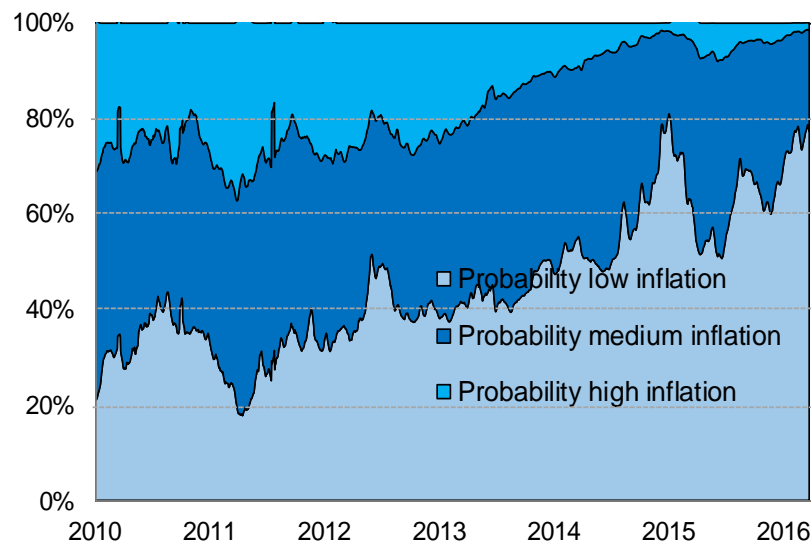
Market Still Assigns High Probability to Moderate Inflation in the US...

Option-implied probability distribution of 5-year inflation by strike 'clusters': low inflation ($\leq 1\%$), medium, and high ($\geq 3\%$)



...But Sees Very High Chance of Persistent Low-flation in the Euro area

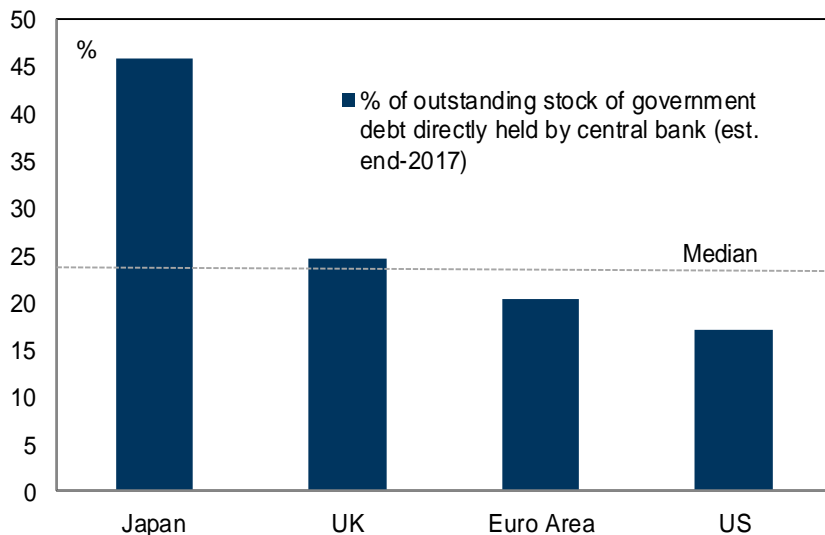
Option-implied probability distribution of 5-year inflation by strike 'clusters': low inflation ($\leq 1\%$), medium, and high ($\geq 3\%$)



Central Bank Bond Purchases Create 'Fiscal Space'

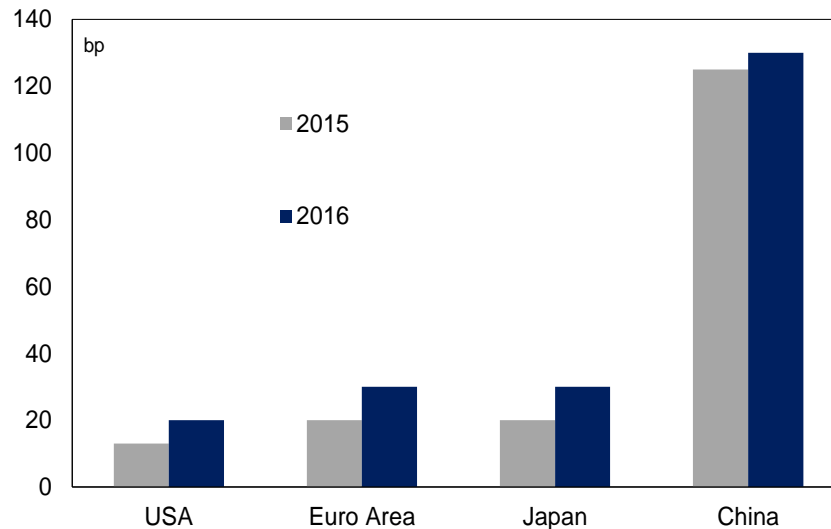
Government Debt Moves onto Official Sector Balance Sheet

Central Bank Ownership of Government Debt as % of Stock Outstanding



From 'End of Austerity' (2014-15) to Synchronous Modest Fiscal Expansion

Estimates of contribution of fiscal policy annual real GDP growth in selected countries

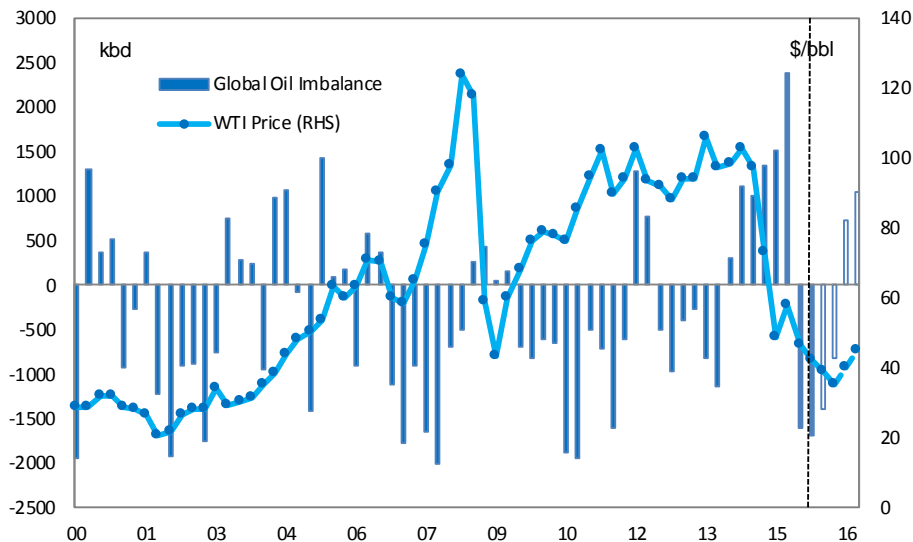


Source: Bloomberg, Goldman Sachs Global Investment Research

Global Risk Sentiment Sensitive to Oil Prices

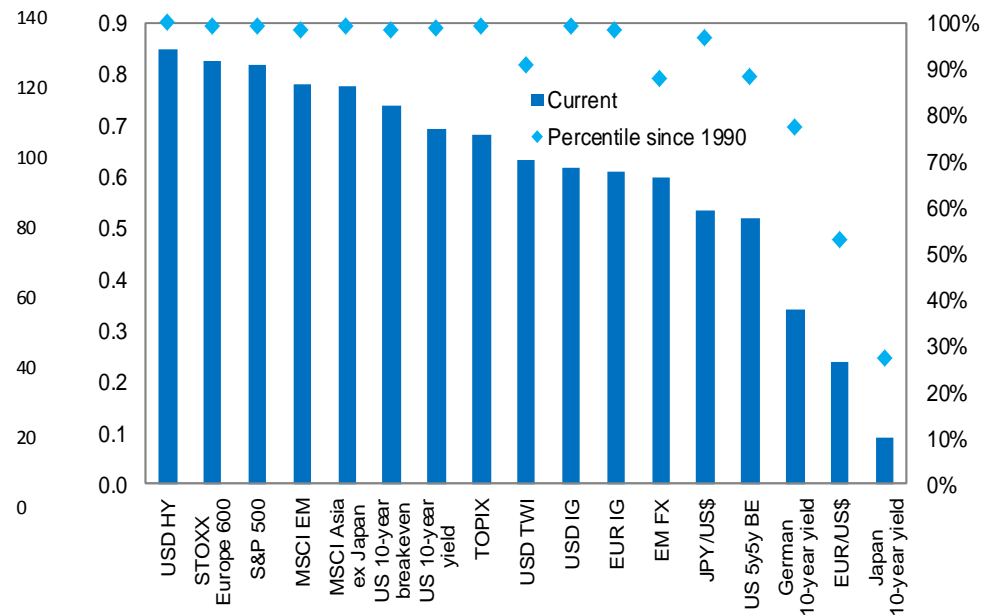
Oil Market Imbalances to Narrow from H2-16 Onwards

Global Oil Market Imbalances, WTI Price and GS WTI Forecast



Broader Asset Classes Increasingly Correlated to Oil

3m Rolling Absolute Correlation of Weekly Returns to WTI

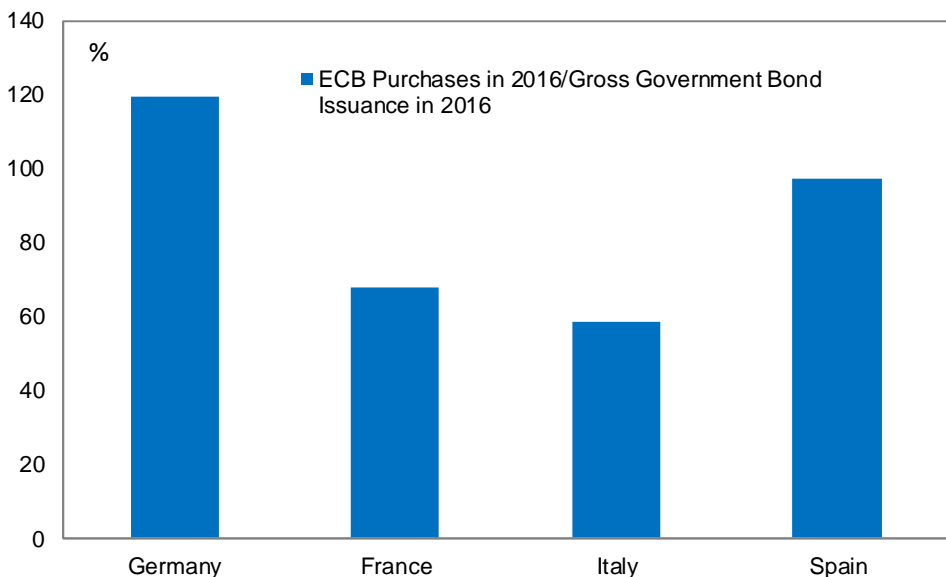


Source: IEA, EIA, JODI, China NBS, Datastream, Haver Analytics, Goldman Sachs Global Investment Research

The ECB Is Gluing EMU Bond Markets Together

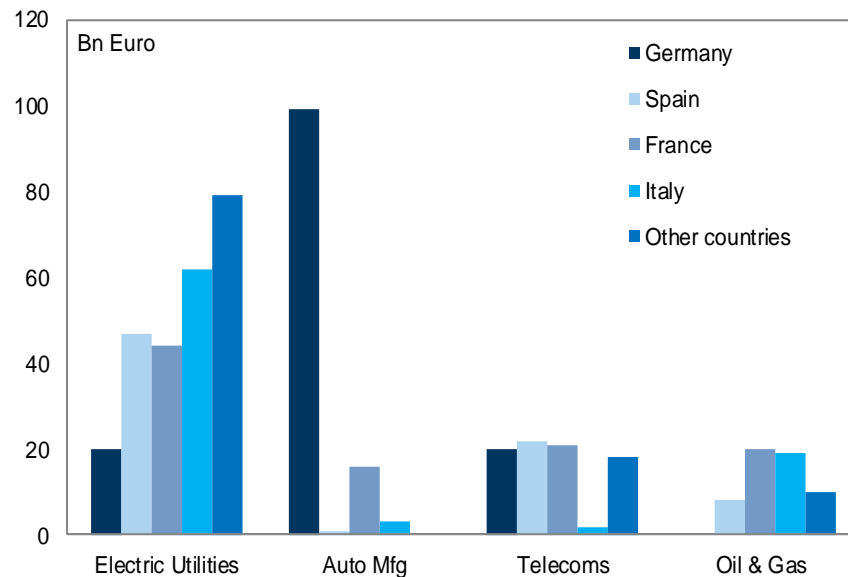
ECB is Absorbing a Large Share of Gross Government Issuance

Estimated ECB purchases under PSPP for 2016 as percentage of gross bond issuance



The Inclusion of Corporates Should Mitigate 'Scarcity' Issues

Breakdown of Pool of Corporate Credit Eligible for ECB Purchase



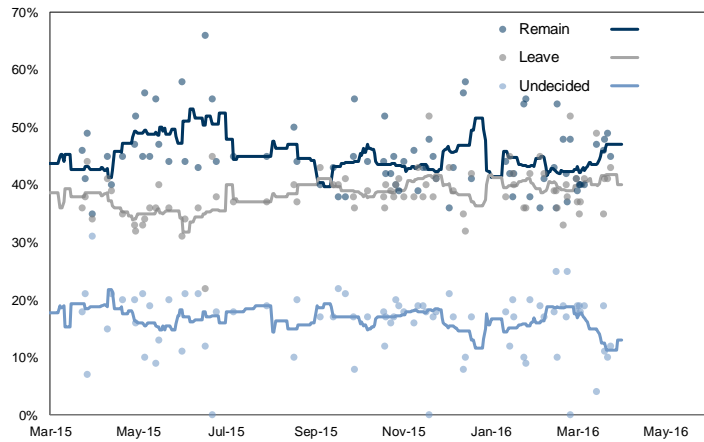
Source: Haver Analytics, Goldman Sachs Global Investment Research

'Brexit' Risk For Now Mostly Limited to UK Assets

Polls Still Too-Close-To-Call

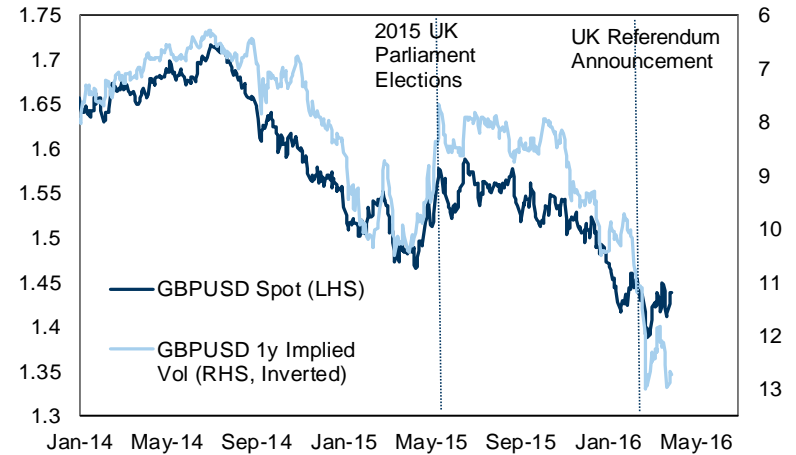
30 Day Average of Brexit Polls

Source: ORB, YouGov, BMG Research, ICM, ComRes, Survation, Ipsos Mori, The Times, TNS, Panelbase, GQRR, Pew, Opinium, TNS-BMRB



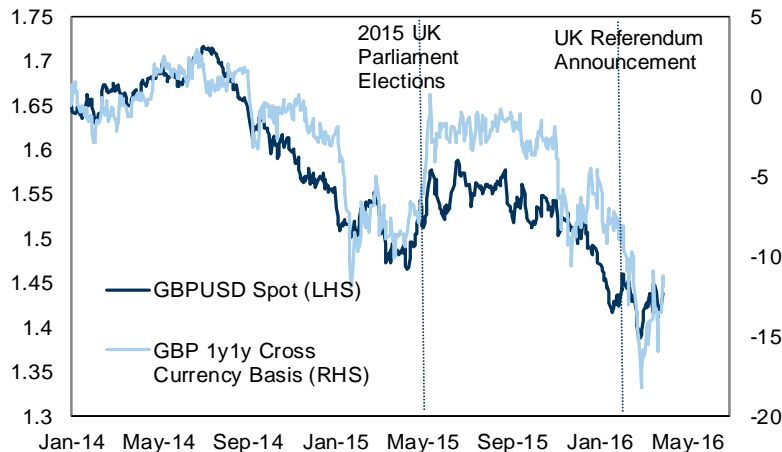
Brexit Concerns have Increased GBP Vols

GBP USD plotted with GBP USD 1y1y Implied Vol



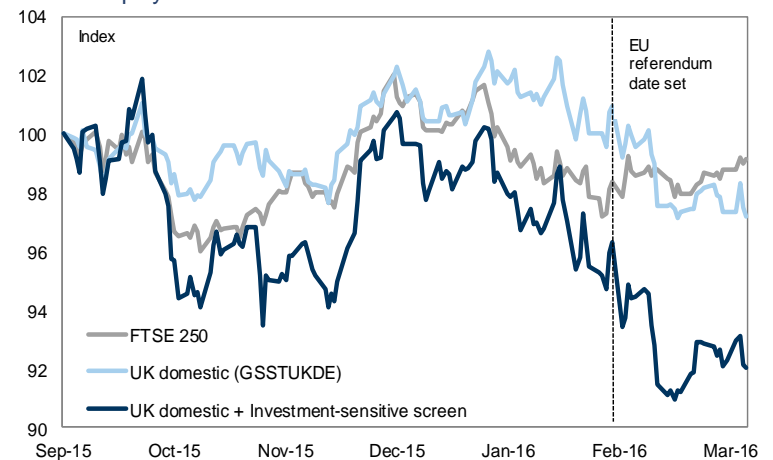
..& Driven Cross-Currency Basis Lower

GBP USD plotted with 1y1y Cross Currency Basis



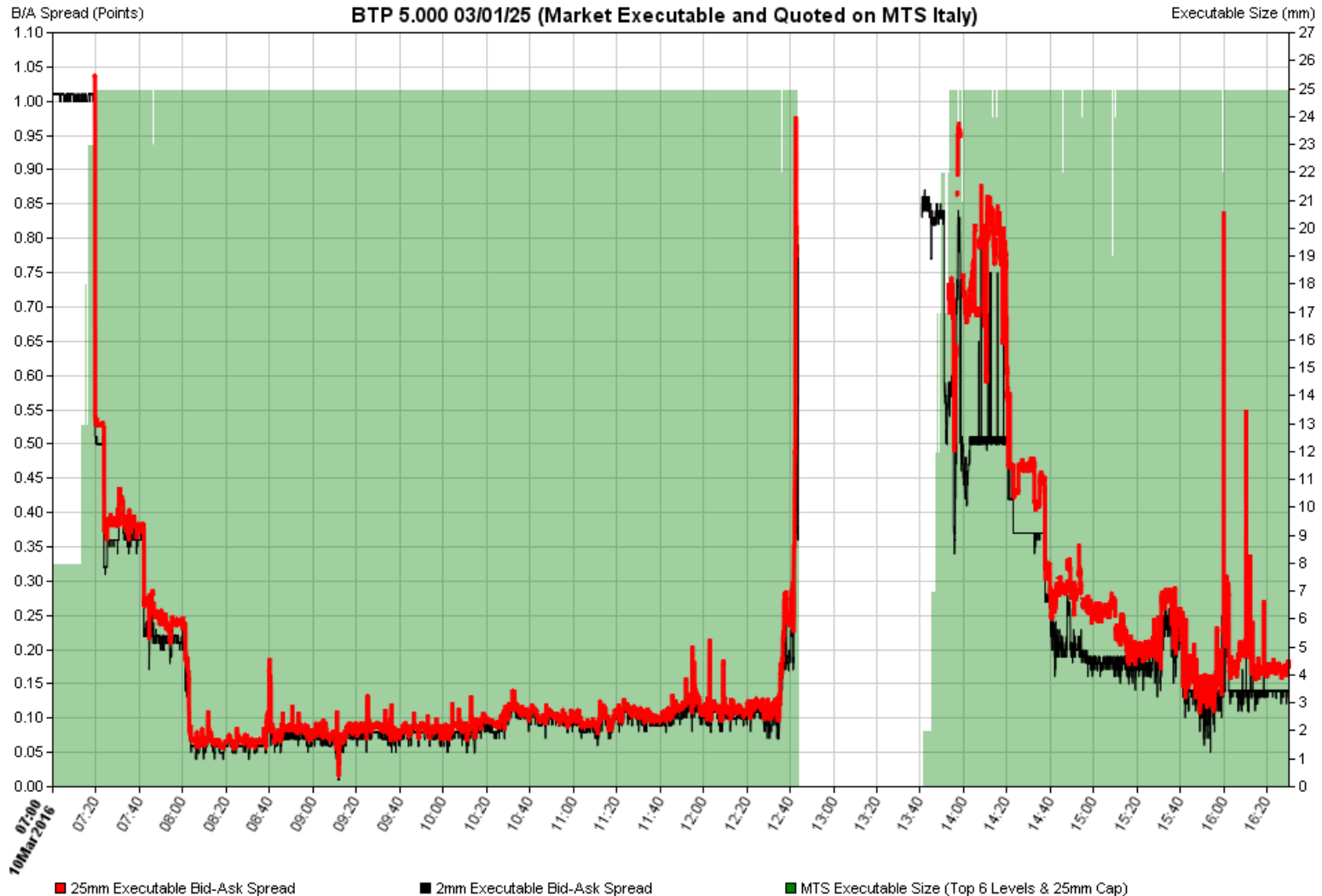
UK Equities Are Pricing Brexit Risk

UK Equity Performance After EU Referendum Announcement



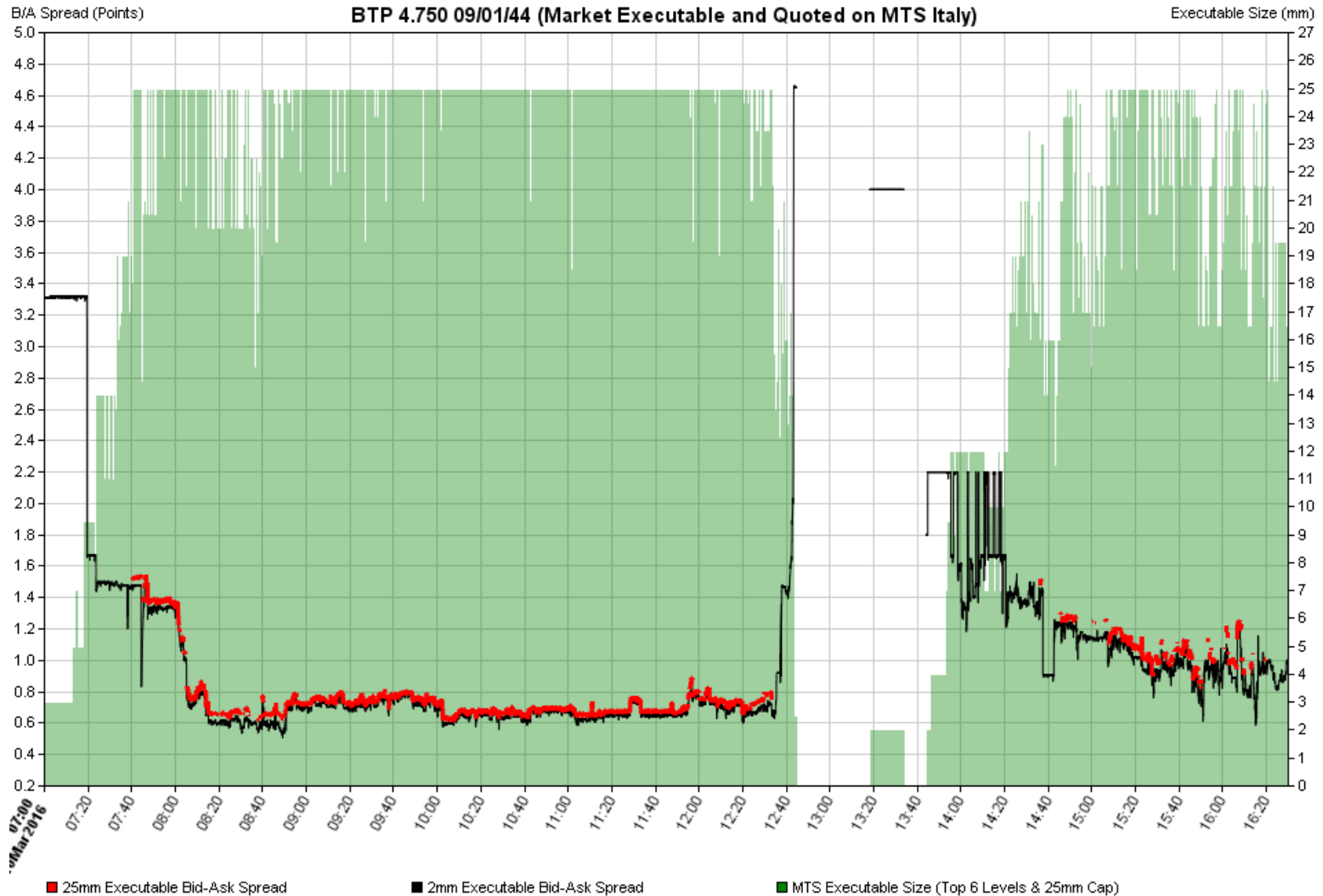
European Government Bond Liquidity

A Case Study of BTPs on ECB Meeting Day



European Government Bond Liquidity

A Case Study of BTPs on ECB Meeting Day



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