FINANCIAL TIMES

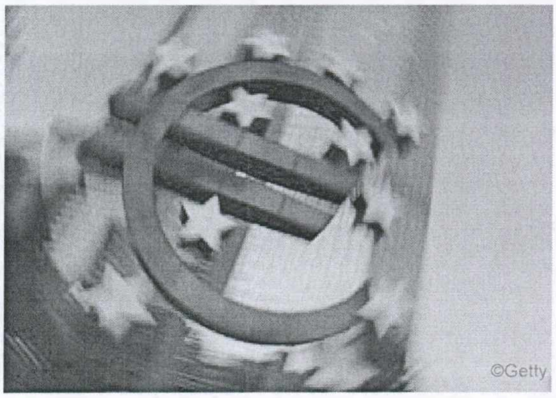
GLOBAL MARKET OVERVIEW

Last updated: June 29, 2012 10:30 pm

Stocks and euro surge on EU summit deal

186

By Vivianne Rodrigues in New York



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Friday 22.00 BST: The euro, stocks and commodities surged after European leaders agreed on action to help reduce Italy's borrowing costs and ease the rules on using bailout funds to support Spanish banks.

Investors favoured so-called growth assets and sold haven products in the belief that the EU summit in Brussels delivered tangible measures that can help reduce anxiety over the region's fiscal condition, a crisis that has been damaging global economic growth.

Some of these moves were pared slightly at one point after Angela Merkel, the German chancellor, reiterated that she believed such aid should carry conditions. Her comments highlighted the differences of approach within the eurozone and possible political difficulties ahead.

But that was only a temporary wobble and the market mood remained staunchly bullish.

The "summit of EU leaders resulted in some surprisingly positive steps toward addressing the 17 -member bloc's two-year old debt crisis," said Omer Esiner, chief market analyst at Commonwealth Forex.

"Steps toward a closer banking union in Europe and measures to bring down soaring debt costs for troubled nations like Spain and Italy are indeed positive developments and resulted in a broad-based unwinding of defensive long-US dollar positions and short euro/risk asset positions," he said.

The market reaction was swift after news of the EU deal broke. The euro rose 1.7 per cent to $1.2658, having recorded its biggest daily gain in eight months and leading a rally in growth-focused currencies such as the Aussie dollar, which was up almost 2 per cent.

In equities, Wall Street's S&P 500 rose 2.5 per cent in its best daily performance since the start of the year.

Friday's rally helped US stocks end the month 3.9 per cent higher, but for the quarter the broad measure declined 3.6 per cent.

The FTSE All-World equity index rose 3 per cent after the Asia-Pacific region advanced 2.1 per cent.

The FTSE Eurofirst 300 rose more than 2.5 per cent with French and Italian banks in fine fettle on reduced fears about eurozone debt exposure. Madrid's Ibex 35 gained more than 4 per cent and Rome's MIB has added 6.6 per cent.

The US dollar index, which usually follows an inverse correlation to broader market optimism, fell 1.4 per cent, helping gold to rally $47 to $1,598 a troy ounce.

A similar reaction was seen in fixed income as traders shed German Bunds and US Treasuries, pushing yields up 10 basis points to 1.60 per cent and 6bp to 1.64 per cent, respectively.

Industrial commodities saw big gains, with copper adding 14 cents to $3.47 a pound as Brent crude jumped 6.8 per cent to $97.62 a barrel as hopes built that the reduction of eurozone tensions can help support global demand.

The easing of eurozone angst was clearly expressed in the section of the European sovereign bond market that has been most exercising traders of late.

The yields on Italian and Spanish benchmark paper tumbled, down 36 basis points to 5.81 per cent and off 51bp to 6.44 per cent, respectively.

Yet notes of caution are already starting to seep into the market regarding the summit's impact.

Charles Diebel, head of market strategy at Lloyds Banking Group, said in a note to clients that the markets' focus would now shift to expectations of more monetary accommodation from the European Central Bank. "This, combined with some direct bond market support could generate a more sustained risk-on in coming weeks."

He added: "The outcome of the summit is positive but is in reality just one more step along a very long road for a solution to the crisis."

Meanwhile, various reminders of the global economy's underlying weakness have been smothered by the "europhoria".

Data released on Friday showed Japanese manufacturing shrank in June for the first time in seven months. German retail sales in May unexpectedly dropped 0.3 per cent.

In the US, the final reading of June consumer sentiment showed households at their least optimistic since December (it should be noted that another survey of midwest business activity was a tad firmer than forecast).

For now, though, such macroeconomic concerns are being put to one side. This was seen in the Vix index, a measure of expected US equity market volatility that is considered a gauge of investor fear. It slumped 12 per cent to 17.3, well below the high of nearly 27 seen at the start of the month.

Additional reporting by Jamie Chisholm in London

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