Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Thursday, April 25, 2019

- **Argentina's currency and debt markets sold off aggressively on Wednesday (link)**
- **Deutsche Bank and Commerzbank end their merger discussions (link)**
- **Bank of Japan commits to maintaining "extremely low" interest rates (link)**
- **Bank of Canada signaled a significantly more dovish shift in its stance (link)**
- **An unexpected contraction in Korean GDP led to a sell-off in assets (link)**

US | Europe | Other Mature | Emerging Markets | Market Tables

Weaker risk sentiment and stronger dollar weigh on markets

After a strong start of the week, markets took a breather as a general weakening of risk sentiment weighed on financial markets. Despite the strong earnings season in the US, developed market equities were modestly lower on the day, with banking sector stocks continuing to underperform the general market on lower rate expectations and news of the failure of merger talks between two of Europe's largest banks. An increasingly dovish tilt by monetary authorities, including yesterday by the Bank of Canada and the Bank of Japan, weighed on global yields as did weaker inflation and survey data in other developed markets. Moreover, continued US dollar strength had a negative impact on emerging market assets, with EM currencies weaking across the board against the greenback and equities posting negative returns, most notably in China and Argentina. Whereas Chinese markets continue to digest the government's more cautious policy stance, investors in Argentina seemed fundamentally concerned about the potential outcome of upcoming presidential elections, with the Argentenian currency and debt markets selling off aggressively yesterday.

Key Global Financial Indicators

Last updated: 4/25/19 6:49 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		2927	-0.2	1	5	11	17
Eurostoxx 50		3489	-0.4	1	6	0	16
Nikkei 225		22308	0.5	1	6	0	11
MSCI EM		44	-0.6	-2	3	-5	12
Yields and Spreads				bps			
US 10y Yield		2.52	-4.7	-4	12	-50	-16
Germany 10y Yield		-0.01	-0.1	-4	2	-65	-26
EMBIG Sovereign Spread		347	1	7	-11	45	-67
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		62.1	-0.3	-2	-2	-10	0
Dollar index, (+) = $ appreciation		98.2	0.1	1	2	8	2
Brent Crude Oil ($/barrel)		75.3	1.0	5	12	2	40
VIX Index (%, change in pp)		13.4	0.2	1	-3	-4	-12

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

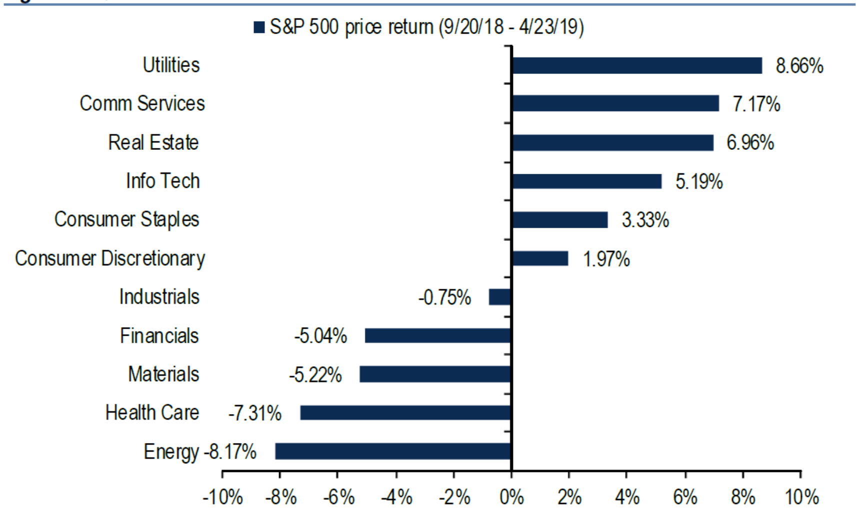
United States

back to top

US stocks pulled back from their record close with all major indexes closing in the red. However, the moves were relatively small as investors sifted through the mass of new earnings reports and it was the Treasury market that saw most of the action as a strong bid emerged. There was no obvious catalyst, but Treasury yields appeared to follow their developed market peers lower as the day was marked by several rate-dampening global news headlines, such as lower than expected inflation in Australia, a downbeat IFO survey in Germany and the BOC's unexpected dovish turn. The 10-year Treasury yield was down by 4 bps to its lowest level in nearly two weeks. Meanwhile, 132 of the S&P 500 companies have reported with 79% beating analysts' forecasts by an average of 4%. After the market close yesterday, Facebook and Microsoft also beat forecasts with their Q1 earnings. US equities are marginally up in early trading.

Tuesday's record close in the S&P 500 masked a trend of changing leadership among the sectors of the market. In the runup to the previous record on September 20, 2018 the ongoing rate hike cycle favored banks and other financials, whose stock prices enjoyed a strong boost due to expectations of higher net interest margins as rates moved up. The current rally has occurred in a very different environment in which the rate hike cycle has been replaced by a major dovish turn from the Fed. As a result, financials have been among the worst performers and their prices are actually well below their levels on September 20. Sectors that benefit from lower rates such as utilities and real estate have been among the strongest performers. Those that traditionally do well in a weaker economic environment such as communications services and consumer staples have also rallied. The outlier has been the healthcare sector, but its recent troubles were driven by expectations of policy changes from a potential new administration in 2020 rather than normal business considerations.

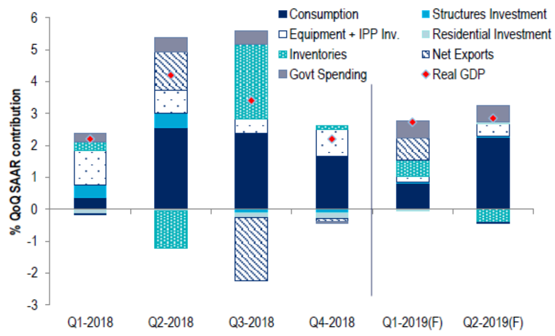
Figure 3: S&P 500 back to record level but rotation within



Source: Bloomberg

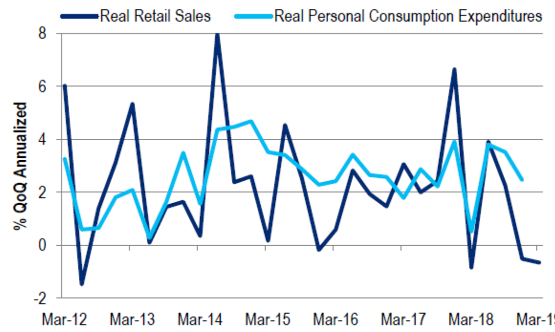
The Bloomberg consensus forecast for US GDP growth for all of 2019 is 2.4%, with estimates ranging from 0.4% to 3%. The first estimate of Q1 2019 GDP is due out on Friday and is expected to be the most consequential US data release of the week. The consensus forecast for Q1 is 2.2%, but several analysts expect a much stronger number such as the 2.7% level forecasted by Citi. Their predictions are based on a "Cinderella" scenario for the US economy, with continued growth but no immediate signs of inflation on the horizon. The latest runup in oil prices has raised TIPS breakeven yields, but even if they are sustained, the rise in oil prices will probably take a long time to feed through into higher inflation. Exports and inventories are expected to be the main drivers of Q1 strength, while consumption and business investment are expected to kick in by Q2.

Figure 1. Real GDP likely grew at a strong 2.7% pace in Q1



Source: Citi Research, BEA

Figure 2. Volatile monthly retail sales imply a soft growth rate of consumption in Q1



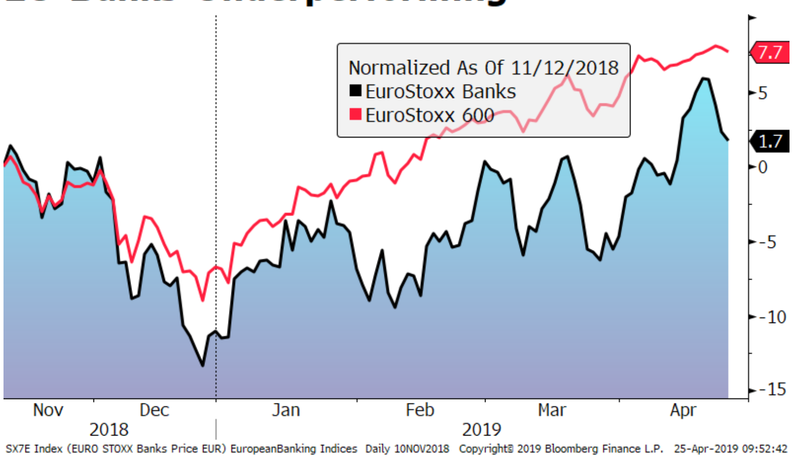
Source: Citi Research, BEA, Census Bureau

Europe

back to top

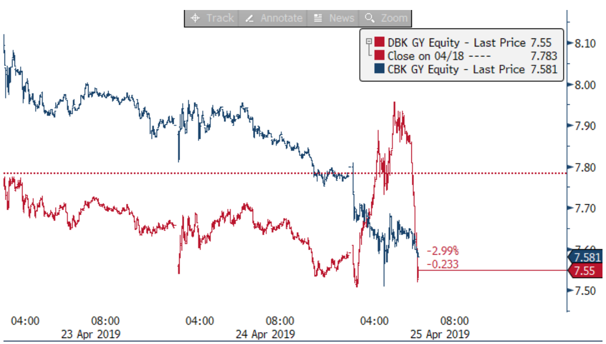
Equity indices are broadly but modestly lower for a second session with the EuroStoxx 600 falling 0.3%. Note, however, that this comes after a run of eight consecutive positive closes for the index. **DB (+2.3%) and Commerzbank (-2.3%) announced the end of merger talks**, blaming the failure on the challenges to integrate and restructuring costs. **UBS** (+1.2%) reported better-than-expected results, despite its 12% decline in Q1 revenues. **Barclays** (-1.5%) reported mixed results. In general, the European banking sector (+1.7%) has underperformed the broader EuroStoxx index (+7.7%) so far this year, and especially since the start of earnings season. **Sovereign debt yields are little changed.**

EU Banks Underperforming

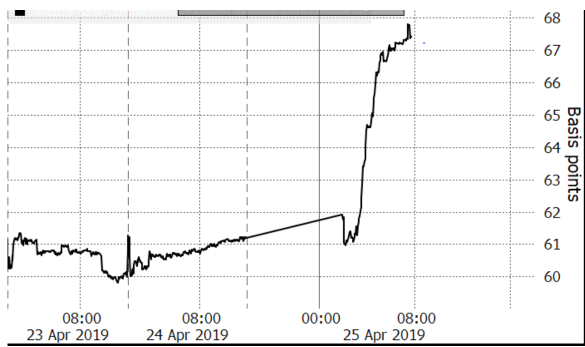


Deutsche Bank and Commerzbank jointly announced the end of merger discussions. This effectively ends formal discussions begun in March and a longer-running narrative in markets and the press. Bank managements concluded that implementation costs and risks to a combination are unacceptably high. Known costs include restructuring charges, additional capital charges (largely associated with increases in the combined entity’s G-SIB score) and union opposition. The operational risks of integrating the two entities– elimination of redundant branches and employees in Germany, potentially incompatible processes and IT systems, and others -- may have presented an even greater hurdle. Both troubled banks must now consider other strategic alternatives. For Deutsche, these may include partial business spin-offs to bolster capital, rationalizing under-performing businesses, and continued cost-cutting. Commerzbank may now entertain other bids; both ING and UniCredit have reportedly expressed interest. Shares of Deutsche Bank (which also pre-released headline 1Q19 results slightly above consensus) gained as much as 3.2% on the announcement before falling back to the opening price; and Commerzbank shares declined as much as 2.3%. In addition, the spread between the two banks’ 2028 senior-bonds widened by more than 4bps following the announcement. Deutsche’s 6% euro-denominated CoCo declined more than 1 percentage point, to about 87% of face value, the lowest since February 11.

Deutsche Bank and Commerzbank: Intraday share prices, 23 to 25 April 2019



Spread between yields on Deutsche Bank and Commerzbank top



Source: Bloomberg

United Kingdom

MPs voted down a motion to change the rules of the Conservative party and bring about an early leadership challenge to PM May. Although a near-term confidence vote has been averted, the party called for May to provide greater clarity about her departure timeline. She has promised to resign if parliament approves her Brexit deal, but has not yet clarified what she will do in the event the deal is not approved. Sterling has depreciated slightly on the day and continues to weaken, but the trend has been in line with the broad dollar appreciation move seen over the last few weeks.

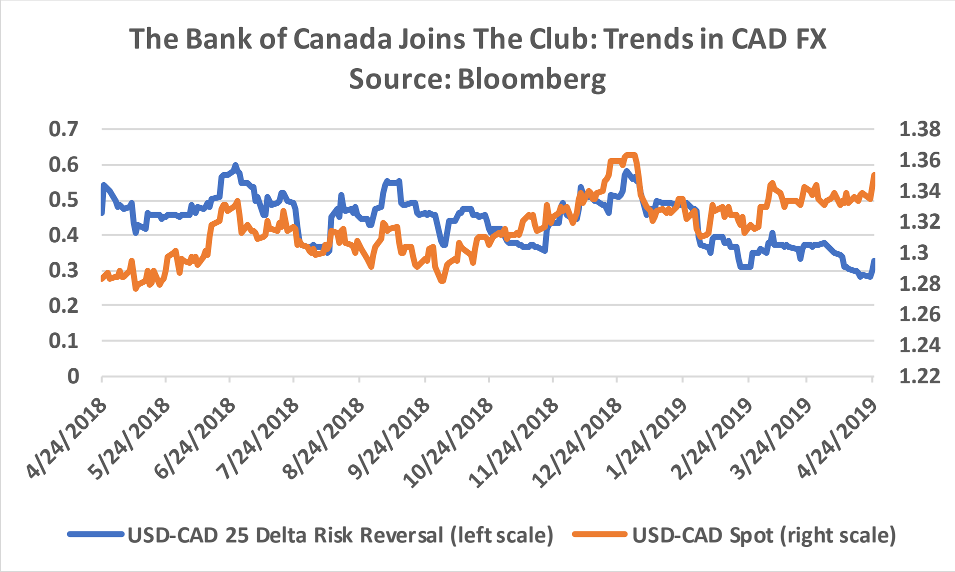
Other Mature Markets back to top

Japan

Japanese equities gained and the yen strengthened, boosted by Bank of Japan’s commitment to maintaining “extremely low” interest rates through at least around spring 2020. The Topix rose 0.5% while the yen appreciated by 0.3% against the dollar. In a move that surprised many observers, the BoJ altered its forward guidance following its policy meeting. It projects that it will not hit its 2% inflation target at least through March 2022 and noted in its policy statement that it was "making clearer its policy stance to continue with powerful monetary easing," vowing to maintain extremely low short- and long-term interest rates at least through around spring 2020. Previously, the BoJ had pledged to keep interest rates extremely low for "an extended period" while it monitors uncertainties surrounding the impact of a sales-tax hike scheduled to take place in October. Meanwhile, the second round of U.S-Japan trade negotiations begins in Washington, focusing on agriculture and vehicles.

Canada

The Bank of Canada stayed on hold at 1.75% as expected but signaled a dramatic shift away from its hitherto hawkish bias, joining dovish peers such as the Fed and the ECB. The BOC had been the last holdout among the major central banks in sticking to a policy of continued rate hikes, but a significant slowdown in the economy clearly prompted a change of heart. The bank slashed its 2019 GDP forecast to just 1.2% from 1.7% at the last monetary policy meeting, well below most private sector estimates. Its policy orientation shifted from a mild tightening bias to a purely neutral one. Markets were expecting a dovish tone but were surprised by the magnitude of the change in the bank's stance. The foreign exchange market reacted by a further weakening in the loonie and increased bets on more depreciation. The dollar has strengthened steadily against the loonie since the beginning of the year. In the FX options market, investors have bid up the price of dollar calls/loonie puts versus dollar puts/loonie calls in anticipation of even more depreciation in the future. The Canadian yield curve inverted, with the three-month bill yield trading at 1.68% versus the 10-year note yield of 1.67%.



Emerging Markets

back to top

Emerging markets were mostly in the red although losses were limited in most cases. Latin American equity markets suffered notable losses yesterday, with Argentina down 3.8% on election concerns and Brazil down by 1%. Local currencies also sold off. The Argentine peso depreciated to a new record low (43.94, -3.5% against the dollar). The Brazilian real (-1.8%) and the Mexican peso (-1 %) saw losses as well. As of market close, the spread on Argentina's 5-year CDS rose to 1300 bps, according to contacts. In Asia, Chinese equities extended their losses for a fourth day (Shanghai Composite: -2.4%; Shenzhen Composite: -3.4%) as investors continued to agonize over the prospect of reduced government stimulus amid a more positive outlook. Korean equities fell as much as 0.6% in early trading before stabilizing at -0.5% on the day (the tech-heavy Kosdaq lost 1.0%). Among currencies, the Korean won underperformed (-0.8%), sliding to its weakest level since March 2017 following a surprise contraction in Q1 GDP. Most EMEA stock markets saw modest losses this morning, including Poland (-0.7%) and Turkey (-0.5%). Currencies in the region were moderately weaker against the dollar with the Russian ruble (-0.8%) underperforming.

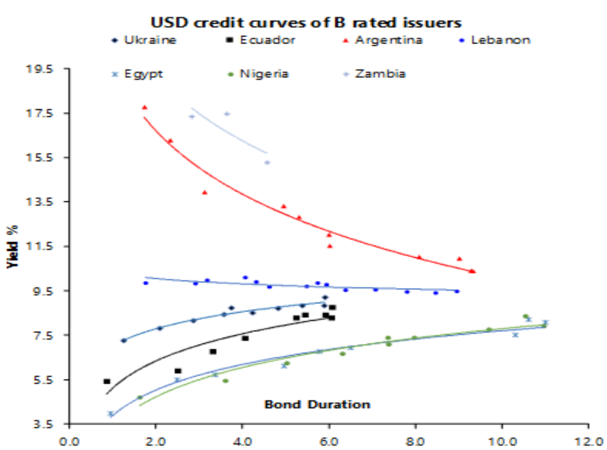
Key Emerging Market Financial Indicators

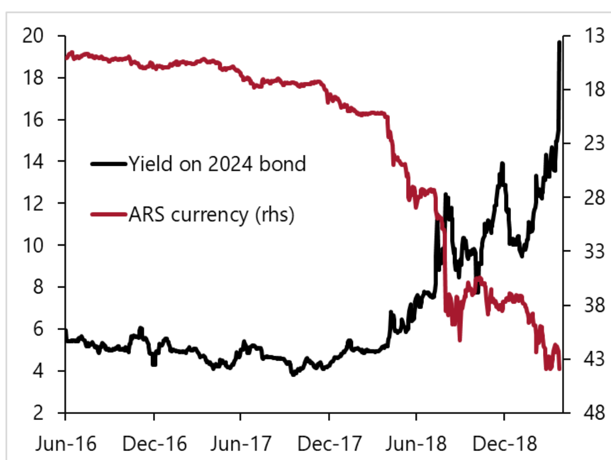
Last updated: 4/25/19 6:55 AM	Level: Last 12m	Level: index	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		43.77	-0.6	-2	3	-5	12
MSCI Frontier Equities		28.39	-0.9	-1	-1	-15	9
EMBIG Sovereign Spread (in bps)		347	1	7	-11	45	-67
EM FX vs. USD		62.14	-0.3	-2	-2	-10	0
Major EM FX vs. USD				%, (+) = EM currency appreciation			
China Renminbi		6.74	-0.3	-1	-1	-6	2
Indonesian Rupiah		14187	-0.6	-1	0	-2	1
Indian Rupee		70.22	-0.5	-1	-2	-5	-1
Argentine Peso		43.94	-3.5	-5	-4	-54	-14
Brazil Real		3.99	-1.8	-1	-3	-13	-3
Mexican Peso		19.13	-0.3	-2	-1	-1	3
Russian Ruble		64.81	-0.7	-1	-1	-4	8
South African Rand		14.53	-0.6	-3	-2	-14	-1
Turkish Lira		5.90	-0.4	-2	-6	-31	-10
EM FX volatility		8.28	0.0	0.0	-0.2	-0.3	-1.5

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

Argentina

Argentina's currency and debt markets sold off aggressively on Wednesday on concerns pertaining to the results of a looming presidential election. According to market contacts, the spread on the 5-year CDS rose to 1300 bps on Wednesday's close (equivalent to a 59% default probability), reaching a new record high since President Macri took office. The yield on the government's 2024 benchmark dollar sovereign bond rose to 19.7%, another new record high. Moreover, Argentina's sovereign yield curve inverted substantially (see graph below) as a rampant dollar and heightened election concerns led investors to ditch the nation's short-term debt. Analysts commented that the main driver of the move was uncertainty surrounding the upcoming presidential elections, as latest polls continued to show former President Cristina Fernández de Kirchner ahead in the polls. This stoked concerns that the country may be heading for its third default in less than two decades. Domestic equities fell 3.8% during the day, and the peso depreciated 3.6% to 43.94/USD, reaching a new record low.





Source: Bloomberg

Brazil

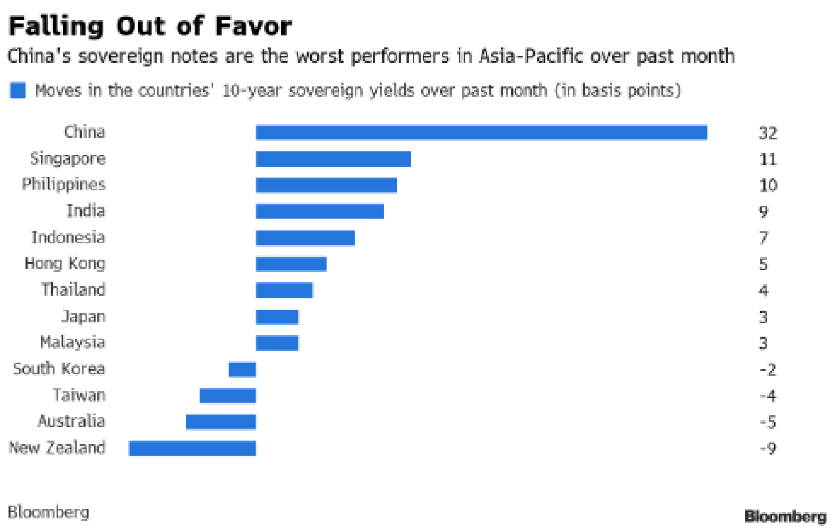
Late on Tuesday, Brazil President Bolsonaro's much-vaunted pension reform cleared its first legislative hurdle in a much-delayed congressional committee vote. The Lower House Constitution and Justice Committee voted 48 against 18 that the bill was constitutional and could proceed through to Congress. The reform package will now be reviewed by a congressional commission, before proceeding to the Chamber of Deputies and Senate. Many analysts believed that the bill could be passed by the third quarter of 2019. Despite the positive news, Brazilian assets generally traded down on the back of a broader risk-off sentiment, with equities declining by about 1% and the real weakening by close to 2% on the day.

South Korea

Korean won underperformed (-0.8%), sliding to its weakest level since March 2017 following a surprise contraction in Q1 GDP. GDP growth fell by 0.3% q-o-q (consensus: +0.3%), its sharpest contraction on a quarterly basis in a decade, after an expansion of 1.0% in Q4 2018. Korean equities fell as much as 0.6% in early trading before stabilizing at -0.5% on the day (the tech-heavy Kosdaq lost 1.0%). Reacting to the sharp depreciation of the Korean won, Deputy Finance Minister Kim Hoe Jeong indicated that the authorities will take "active measures", including smoothing operations in FX market in case of "abnormal" moves.

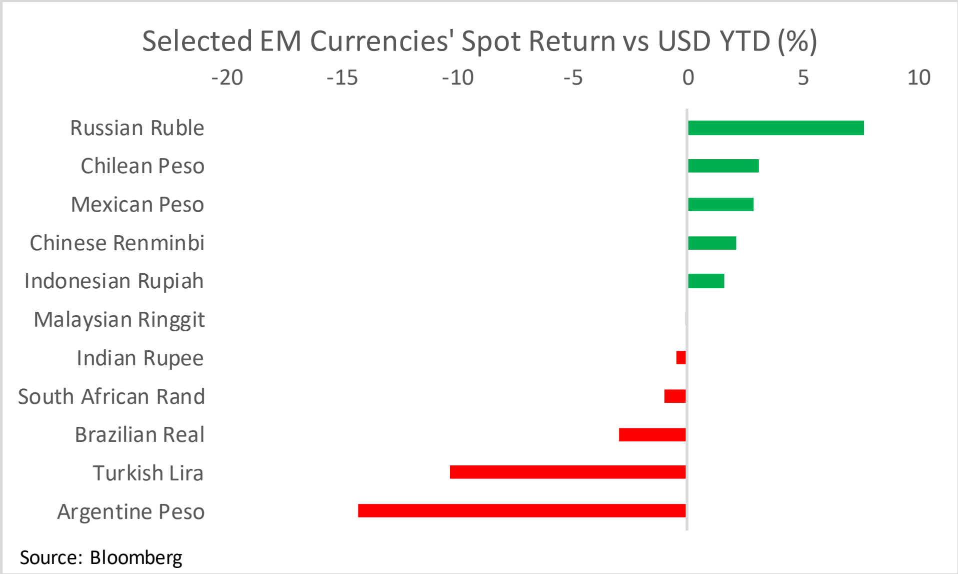
China

Chinese equities extended their losses for a fourth day as investors continued to agonize over the prospect of reduced government stimulus amid a more positive outlook. The Shanghai Composite shed 2.4%, taking it to its weakest level for the month. Market contacts noted that sentiment toward Chinese equities has weakened following last week's Politburo meeting as investors reduced their expectations for further policy support. Meanwhile, government bond yields were mixed following recent increases. The 10-year note fell 3 bp to 3.39% while the 5-year note rose 2 bps to 3.11%. Notably, the yield on 10-year CGB has risen by 32 bps since late March, making CGBs one of the worst performers in government bonds in Asia.



Turkey

The lira continued to weaken despite the central bank's decision to keep interest rates unchanged. The bank's decision, which was expected by most analysts, was accompanied by a change in language which was interpreted as dovish. Governor Cetinkaya had previously pledged to wait for a "convincing" reduction in inflation before easing policy while the new statement said the bank "will be determined to keep inflation in line with the targeted path". The lira, which is among the worst performing emerging market currencies this year, weakened sharply after the announcement and was down 1.7% on the day.



List of GMM Contributors (Global Markets Analysis Division, MCM Department)

Anna Ilyina
Division Chief
Peter Breuer
Deputy Division Chief
Will Kerry
Deputy Division Chief
Evan Papageorgiou
Deputy Division Chief
Sergei Antoshin
Senior Economist
John Caparusso
Senior Financial Sector Expert
Sally Chen
Senior Economist
Fabio Cortés
Senior Economist
Mohamed Jaber
Senior Financial Sector Expert
David Jones
Senior Financial Sector Expert
Sanjay Hazarika
Senior Financial Sector Expert
Juan Solé
Senior Economist
Jeffrey Williams
Senior Financial Sector Expert
Akihiko Yokoyama
Senior Financial Sector Expert
Dimitris Drakopoulos
Financial Sector Expert
Tryggvi Gudmundsson
Economist
Henry Hoyle
Financial Sector Expert
Robin Koepke
Economist
Thomas Piontek
Financial Sector Expert
Rohit Goel
Financial Sector Expert
Jochen Schmittmann
Economist
Ilan Solot
Financial Sector Expert
Martin Edmonds
Senior Data Mgt Officer
Yingyuan Chen
Senior Research Officer
Piyusha Khot
Research Assistant
Xingmi Zheng
Research Assistant

Global Financial Indicators

Last updated: 4/25/19 6:51 AM	Level Last 12m	Level Latest	Change 1 Day	Change 7 Days	Change 30 Days	Change 12 M	YTD
Equities					%		%
United States		2927	-0.2	1	5	11	17
Europe		3489	-0.4	1	6	0	16
Japan		22308	0.5	1	6	0	11
China		3124	-2.4	-4	3	0	25
Asia Ex Japan		72	-1.1	-1	4	-4	14
Emerging Markets		44	-0.6	-2	3	-5	12
Interest Rates					basis points		
US 10y Yield		2.52	-4.7	-4	12	-50	-16
Germany 10y Yield		-0.01	-0.1	-4	2	-65	-26
Japan 10y Yield		-0.03	0.6	0	5	-10	-3
UK 10y Yield		1.15	-2.3	-4	17	-39	-12
Credit Spreads					basis points		
US Investment Grade		111	-0.4	1	-12	13	-36
US High Yield		397	3.5	8	-30	62	-124
Europe IG		59	0.3	2	-10	3	-28
Europe HY		254	2.3	7	-29	-25	-99
EMBIG Sovereign Spread		347	1.0	7	-11	45	-67
Exchange Rates					%		
USD/Majors		98.24	0.1	1	2	8	2
EUR/USD		1.11	-0.2	-1	-2	-8	-3
USD/JPY		111.8	0.3	0	-2	-2	-2
EM/USD		62.1	-0.3	-2	-2	-10	0
Commodities					%		
Brent Crude Oil ($/barrel)		75	1.0	5	12	2	40
Industrials Metals (index)		118	-0.7	-2	-1	-13	8
Agriculture (index)		39	-0.1	-2	-5	-20	-6
Implied Volatility					%		
VIX Index (%, change in pp)		13.4	0.2	0.8	-3.0	-4.5	-12.1
10y Treasury Volatility Index		3.9	0.0	0.3	-1.3	-0.4	-0.7
Global FX Volatility		6.4	0.0	0.3	-0.9	-1.3	-2.5
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		331	-0.2	2	-49	-4	-85
Italy		267	2.5	9	14	153	17
Portugal		119	0.9	4	-13	11	-29
Spain		110	1.3	5	-3	43	-8

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations.
Data source: Bloomberg.

back to top

Emerging Market Financial Indicators

Last updated: 4/25/2019 6:56 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)						
	Level		Change (in %)					Level		Change (in basis points)				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.					
China		6.74	-0.3	-0.5	-1	-6	2		3.4	0.5	1	24	-13	19
Indonesia		14187	-0.6	-1.0	0	-2	1		7.8	1.6	6	6	74	-38
India		70	-0.5	-1.2	-2	-5	-1		7.6	-3.9	4	13	-27	11
Philippines		52	0.2	-0.7	1	0	1		5.3	-0.9	-1	-16	16	-101
Thailand		32	-0.3	-0.9	-2	-2	1		2.6	-1.1	0	5	20	-2
Malaysia		4.14	-0.2	0.1	-2	-5	0		3.9	-1.7	-3	1	-32	-22
Argentina		44	-3.5	-4.7	-4	-54	-14		25.0	183.6	277	120	772	201
Brazil		3.99	-1.8	-1.3	-3	-13	-3		8.2	8.1	-8	-2	-16	2
Chile		673	-0.7	-1.7	1	-11	3		4.1	-1.6	-3	-13	-62	-40
Colombia		3195	-0.5	-1.1	-2	-13	2		6.2	5.7	9	11	12	-28
Mexico		19.13	-0.3	-1.7	-1	-1	3		8.2	3.6	8	18	64	-49
Peru		3.3	-0.4	-0.8	-1	-3	1		5.4	4.4	3	4	13	-33
Uruguay		35	-0.4	-0.4	-3	-18	-6		10.7	9.9	24	30		3
Hungary		289	-0.4	-1.6	-3	-11	-3		2.0	-2.4	-5	16	45	-18
Poland		3.86	-0.2	-1.2	-2	-10	-3		2.3	-0.3	1	6	-17	3
Romania		4.3	-0.2	-0.9	-2	-11	-5		4.3	-2.0	-4	22	21	1
Russia		64.8	-0.7	-1.4	-1	-4	8		8.0	0.4	4	5	96	-41
South Africa		14.5	-0.6	-3.3	-2	-14	-1		9.4	4.4	11	-16	55	-21
Turkey		5.90	-0.4	-1.7	-6	-31	-10		19.9	45.7	66	253	703	298
US (DXY; 5y UST)		98.2	0.1	1.3	2	8	2		2.31	-0.2	-6	13	-53	-20

	Equity Markets							Bond Spreads on USD Debt (EMBIG)						
	Level		Change (in %)					Level		Change (in basis points)				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
								basis points						
China		3124	-2.4	-4	3	0	25		175	-1	1	-1	-4	-19
Indonesia		6373	-1.2	-2	-1	5	3		182	1	3	-18	2	-54
India		38731	-0.8	-1	2	12	7		155	-2	-1	-6	17	-41
Philippines		7894	0.6	1	0	4	6		85	-1	0	-14	-15	-36
Malaysia		1636	-0.1	1	-1	-12	-3		127	-2	1	-3	7	-35
Argentina		29747	-3.8	-6	-10	-1	-2		958	0	104	188	556	143
Brazil		95045	-0.9	1	1	12	8		245	-3	-2	-7	13	-28
Chile		5201	-0.3	-1	0	-8	2		126	-1	-1	-10	3	-40
Colombia		1600	0.3	2	0	3	21		174	-1	-3	-18	3	-54
Mexico		45045	-0.2	1	5	-6	8		294	-1	0	-10	43	-60
Peru		20703	-0.6	-1	-1	-3	7		125	-1	2	-18	-19	-43
Hungary		43256	-0.7	1	4	14	11		108	-7	0	-23	5	-40
Poland		60583	-0.6	-1	1	2	5		45	-7	1	-20	-4	-40
Romania		8409	0.5	2	6	-7	14		199	0	0	-1	64	-22
Russia		2583	0.2	1	3	15	9		203	-1	0	-18	0	-49
South Africa		58895	-0.4	0	6	3	12		306	2	14	-15	60	-59
Turkey		95745	-0.4	-3	-4	-11	5		505	4	2	16	196	76
Ukraine		561	0.1	5	1	18	0		644	19	49	5	186	-143
EM total		44	-0.6	-2	3	-5	12		347	1	7	-11	45	-67

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.