Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Tuesday, December 4, 2018

Please note that the Global Markets Monitor will not be published tomorrow. Regular publication will resume on Thursday, December 6.

- **Treasury curve sees first inversion since the financial crisis (link)**
- **ECJ issues opinion that UK could unilaterally withdrawal from Article 50 (link)**
- **ECB to tweak its capital key next year (link)**
- **Fading optimism over US-China trade truce weighed on Asian equities (link)**
- **Mexico announced plans to buy back $1.8bn of airport related bonds (link)**
- **South African rand extends gains on positive GDP data (link)**

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Markets pare back gains as optimism over trade fades

Most global equity markets are in the red this morning as optimism from the G20 trade talks is fading amid differing reports on the agreement from US and Chinese sources. Reports from Chinese officials have so far failed to confirm some of the initial statements from President Trump on various Chinese commitments. Both sides however have concurred that the original January 1 date for implementing additional tariffs on Chinese imports has been deferred as talks progress. That itself has been enough to keep markets from fully reverting yesterday's gains. Chinese equities managed to increase slightly again today while European exchanges are mostly lower. Elsewhere, the British pound is strengthening this morning after an advisory opinion issued by the European Court of Justice that the UK can unilaterally withdraw from Article 50.

Key Global Financial Indicators

Last updated: 12/4/18 7:49 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		2790	1.1	4	2	6	4
Eurostoxx 50		3195	-0.6	1	-1	-11	-9
Nikkei 225		22036	-2.4	0	-1	-3	-3
MSCI EM		42	0.6	4	3	-9	-11
Yields and Spreads				bps			
US 10y Yield		2.96	-1.8	-10	-25	59	56
Germany 10y Yield		0.29	-1.6	-6	-14	-5	-14
EMBIG Sovereign Spread		390	-1	-11	32	101	105
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		62.8	-0.1	1	1	-9	-10
Dollar index, (+) = $ appreciation		96.5	-0.5	-1	0	5	5
Brent Crude Oil ($/barrel)		63.0	2.0	5	-14	1	-6
VIX Index (%, change in pp)		16.9	0.4	-2	-3	5	6

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

United States

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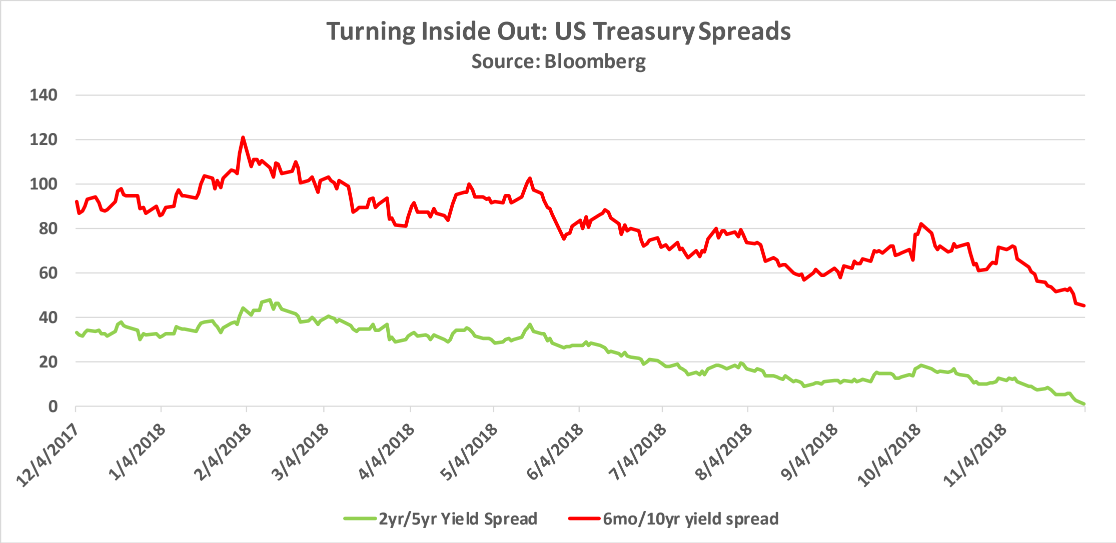
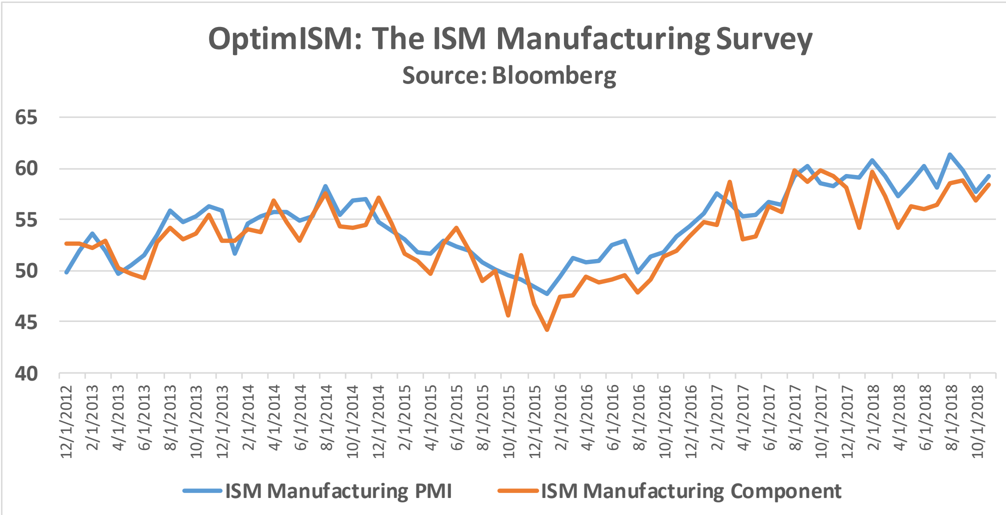
Markets rallied strongly Monday on hopes that trade risks will decline after the G-20 summit. All the major indexes were higher, and the advances were distributed across most sectors. Technology stocks saw the largest gains, as they were viewed as especially vulnerable to trade tensions. Despite the optimism, multiple analysts cautioned that the market was overreacting to the news and that risks remained high. In other news, Amazon briefly eclipsed Microsoft as the largest company in the world, a week after the latter overtook Apple. In other news, Morgan Stanley predicted that Ford will have to cut 25,000 jobs as part of an internal reorganization process. Last week, GM announced that 14,000 jobs would be lost as it phases out production of sedans and other non-SUV/truck/crossover vehicles.

The US Treasury curve saw its first inversion since the financial crisis when the five-year yield dipped briefly below the two-year yield. The bonds ended the day with the yield spread almost flat. Although curve inversions have preceded several US recessions in the past, few analysts expressed concerns on Monday as the inversion only occurred in a relatively small section of the curve. The spread between the 6-month bill and 10-year treasury for example remains significantly positive at 42 bps. Contacts attributed the two-year/five-year move to heavy buying in the belly of the curve, possibly due to the reversal of a butterfly trade. The two-year/ten-year yield spread also set a new post-crisis low of 15 bps. Meanwhile, Treasuries regained all the losses they sustained during the early morning surge in stocks and ended up in positive territory with yields slightly lower. The benchmark 10-year yield finished under 3% for the second day in a row, perhaps indicating that fixed income investors remain worried that trade tensions could flare up again.

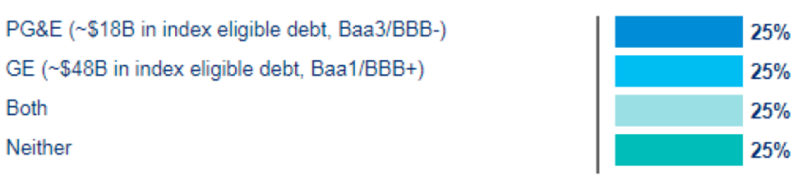


A stronger than expected ISM manufacturing report showed that US economic performance remains robust. The November number came in at a very strong 59.3 versus an already optimistic consensus forecast of 57.5. There were gains across the board, spanning the orders, production and employment sub-indexes of the overall measure. The prices paid index was another highlight, coming in notably lower than forecasts and hinting at cooling inflationary pressures. Construction was the only sector with an unexpected decline. Some survey respondents reported increased input costs due to international tariffs. The ISM headline measure has been in expansionary territory above 50 since September 2016.



Investor sentiment in the US credit market remains strong despite the recent market volatility and spread widening. Polls of investors by Citi show that downgrade fears about companies with widely publicized credit difficulties are limited, and most investors favor retaining or even increasing their exposure to energy companies in the high yield (HY) market despite the collapse in oil prices. Many analysts think the supply of new bonds in 2019 for both the investment grade (IG) and HY markets will be lower than 2018, and credit rating agencies are forecasting that default rates and recovery rates will be better than in previous credit cycles. In addition, some believe that corporate credit spread widening in 2019 will be limited as the Fed's ultimate policy path may turn out to be more dovish than the FOMC's dot plot. These analysts forecast a soft landing for the economy and relatively stable end-of-cycle markets.

Figure 2. Will either PG&E or GE be downgraded to HY in the next 12 months?



Source: Citi Research

Figure 3. What do you think investors should be doing with HY energy exposure?

Source: Citi Research

Europe

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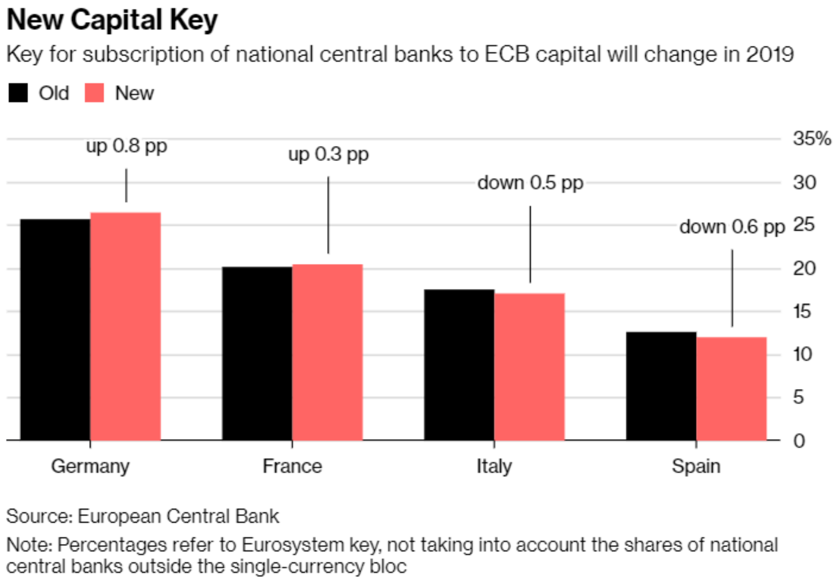
The EuroStoxx 600 is down 0.4%, with France and Italy (both -0.8%) underperforming. Banking sector stocks are underperforming (-1.2%), after having led the rally yesterday. **Fixed income markets are unchanged.**

The ECB will make a small adjustment in the capital key for next year, reducing the share of Italian, Spanish and Greek debt purchases. The share of German, French and Austrian debt to be purchased will increase slightly. These technical adjustments – based on size and population of economies – are scheduled for every five years or when a new member joins the bloc.



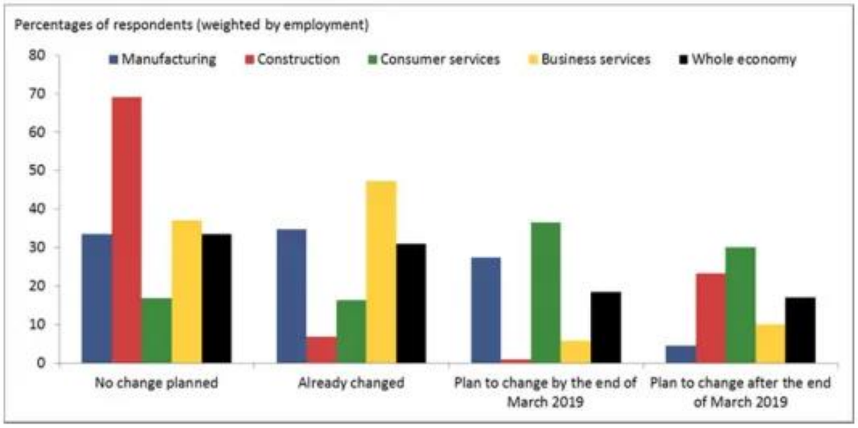
United Kingdom

The pound spiked on a headline from the EU court suggesting that the UK could unilaterally withdrawal from Article 50. The legal opinion came from the ECJ's advocate general, but it is non-binding. The opinion provides a boost to pro-EU MPs and may support growing discussions about a second referendum, but contacts still find it difficult to foresee what will transpire after PM May's deal is voted (and most likely rejected) next week. The pound is up 0.7% against the dollar at $1.28, gilt yields are flat and the FTSE 100 is down 0.4%.

The Loan Market Association (LMA) issued a paper emphasizing the risk of substantial market disruption in the loans market that could arise from a "no deal" Brexit. It noted roughly €40 bn of lending provided this year by UK institutions to European companies in EU27, and that UK lenders accounted for 8-14% of total syndicated loan volume across major countries in the region. The LMA noted that a hard Brexit could see existing cross-border loans needing to be repaid early or restructured. (full paper here). **Separately, a report by the BoE regional agents found that the majority of Britain's companies have not yet made any preparations for Brexit.** Under one-third of the 369 companies surveyed had taken actions such as setting up new legal entities, relocating offices or changing their sourcing and supply chains. Business services (which includes banks) were the most likely category to have started preparations, while construction was the least likely.

Chart A Just under a third of companies have already made some change to their business plans to prepare for Brexit [(a)]

Have companies adjusted their business plans since the EU Referendum?



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Japan

The yen surged, posting its largest single-day gain in more than two weeks while equities tumbled. The yen gained 0.7% to 112.91, outperforming its G10 peers as optimism over the U.S.-China trade truce faded and the dollar extended its losses. Amid yen strength, equities fell sharply. Both the Nikkei and the Topix shed 2.4%, their first declines in more than a week as exporters underperformed. Meanwhile, **the JGB yield curve flattened further**, with yield on the 2-year note unchanged at -0.14% while the 30-year bond fell 2 bps to 0.78%, its lowest level since August. The yield spread between the 30-year bond and the 2-year note has narrowed from 106 bps in early October to 92 bps currently.

Emerging Markets back to top

Key Emerging Market Financial Indicators

Last updated: 12/4/18 7:51 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		41.91	0.6	4	3	-9	-11
MSCI Frontier Equities		27.96	1.3	3	1	-16	-16
EMBIG Sovereign Spread (in bps)		390	-1	-11	32	101	105
EM FX vs. USD		62.84	-0.1	1	1	-9	-10
Major EM FX vs. USD				%, (+) = EM currency appreciation			
China Renminbi		6.84	0.7	2	1	-3	-5
Indonesian Rupiah		14292	-0.3	2	5	-5	-5
Indian Rupee		70.51	-0.1	0	4	-9	-9
Argentine Peso		36.52	3.4	6	-2	-52	-49
Brazil Real		3.83	0.5	1	-3	-15	-13
Mexican Peso		20.33	0.2	1	-2	-8	-3
Russian Ruble		66.35	0.2	1	0	-11	-13
South African Rand		13.58	0.8	3	4	0	-9
Turkish Lira		5.31	-1.2	-1	0	-27	-29
EM FX volatility		9.71	0.0	-0.5	-0.5	1.8	1.9

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

Emerging market equities were mixed this morning after yesterday's strong session. Asian stocks apart from China (+0.4%) were mostly slightly lower (India -0.4%, Malaysia -0.3%). The main indices in EMEA were little changed, including Turkey (+0.4%), Russia (+0.1%), and South Africa (+0.1%). Local currencies are mixed but mostly little changed against the dollar. Yesterday, Latin American stocks joined the broader risk-on rally. EMBIG spreads declined by 3 bps, led by the 7-bps decline for the HY sector.

EM Asia

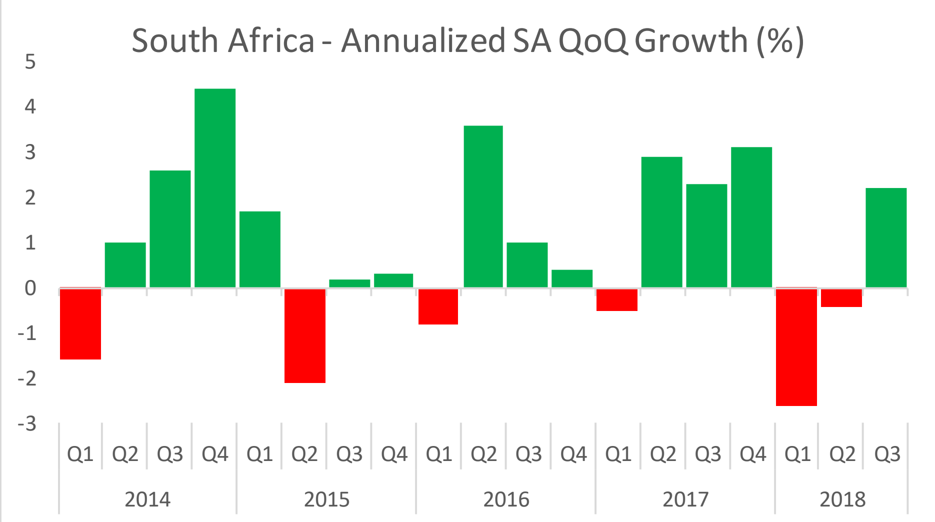
Short-lived optimism regarding the China-US trade truce weighed on Asian equities. The MSCI Asia ex Japan index held steady after gaining 2% yesterday. While Chinese (+0.4%) and Indonesian (+0.5%) shares posted modest gains, most of the other bourses suffered losses (e.g. Korea: -0.8%; Australia: -1.0%; Singapore: -0.7%; Malaysia: -0.3%). Media appearances by US officials, including Treasury Secretary Mnuchin and economic adviser Kudlow, cast doubts over the durability of the agreement between Presidents Trump and Xi. Meanwhile, **currencies extended their gains against the dollar**, with the RMB once again pacing gains (onshore CNY: +0.6%; offshore CNH: +0.5%) while the Indonesian rupia underperformed (-0.3%).

China

The RMB extended its gains despite renewed doubts over the future of a sustained truce in the trade war. The onshore CNY gained 0.62% to 6.8407 per dollar, taking its 2-day gain to 1.7%, the biggest in over a decade. While equity market gains were modest (the Shanghai Composite gained 0.3%), **bonds rallied amid expectations that a stronger RMB could provide more room for policy easing**. The yield on the 10-year central government bond fell 6 bps to 3.30%, its lowest level since April 2017; by contrast, the short end of the curve was little changed, with the 2-year note holding steady at 2.66%. Bloomberg reported that **the Shanghai-London stock connect is slated to start in mid-December**. According to a LSE presentation in November, there are 216 Shanghai-listed firms eligible to issue shares in London. Last week, Huatai Securities became the first Chinese business to receive regulatory approval for a London listing.

South Africa

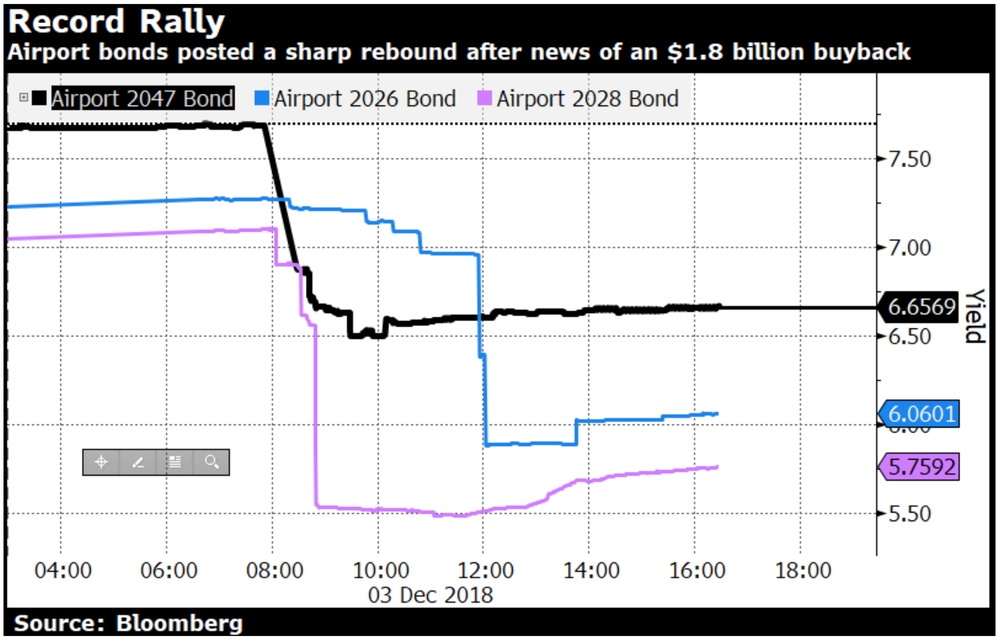
The rand extended solid gains after GDP figures for Q3 exceeded expectations. Headline growth came in at 1.1% y-o-y as opposed to an expected rate of 0.5%. On an annualized q-o-q basis, growth amounted to 2.2% after having spent the previous two quarters in negative territory. Manufacturing and agriculture were the biggest growth drivers, but analysts warned that the economy's growth potential remains weak. The currency gained 1% against the dollar on the news after a strengthening of 1.3% yesterday. It is now at its strongest level since August. Equities were broadly flat after yesterday's outside gains of 2.8%.



Source: Bloomberg

Mexico

Bonds sold to finance the Mexico City airport rallied sharply after the government announced plans to buy back $1.8 bn of the outstanding debt. Yields on airport bonds maturing in 2047 fell 98 basis points to 6.65 percent. As per the statement released, the Ministry of Finance will offer to repurchase part of the bonds in cash and will ask bondholders to modify some agreements. Analysts highlighted that this could be a key step in calming the markets. Mexico's 10-year sovereign spread declined by 7 bps today but has increased by about 70 bps since October 26th to 9.09 percent now.



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Global Financial Indicators

Last updated: 12/4/18 7:49 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		2790	1.1	4	2	6	4
Europe		3195	-0.6	1	-1	-11	-9
Japan		22036	-2.4	0	-1	-3	-3
China		2666	0.4	4	0	-19	-19
Asia Ex Japan		68	2.3	4	4	-9	-10
Emerging Markets		42	0.6	4	3	-9	-11
Interest Rates					basis points		
US 10y Yield		2.96	-1.8	-10	-25	59	56
Germany 10y Yield		0.29	-1.6	-6	-14	-5	-14
Japan 10y Yield		0.07	-1.2	-2	-6	3	3
UK 10y Yield		1.33	1.8	-6	-16	4	14
Credit Spreads					basis points		
US Investment Grade		126	-2.1	6	19	29	35
US High Yield		412	-11.0	-10	49	34	37
Europe IG		82	2.0	2	12	34	37
Europe HY		328	7.0	-12	40	100	94
EMBIG Sovereign Spread		390	-1.0	-11	32	101	105
Exchange Rates					%		
Dollar Index (DXY)		96.53	-0.5	-1	0	4	5
USDEUR		1.14	0.4	1	0	-4	-5
USDJPY		112.8	0.8	1	0	0	0
EM FX vs. USD		62.8	-0.1	1	1	-9	-10
Commodities					%		
Brent Crude Oil ($/barrel)		63	2.0	5	-14	1	-6
Industrials Metals (index)		117	0.5	4	-1	-9	-16
Agriculture (index)		43	-0.2	3	-2	-11	-9
Implied Volatility					%		
VIX Index (%, change in pp)		16.9	0.4	-2.2	-2.7	5.2	5.8
10y Treasury Volatility Index		3.8	-0.1	-0.2	-0.8	-0.3	0.2
Global FX Volatility		8.3	0.0	-0.2	0.0	0.7	0.9
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		395	5.0	-9	7	-109	26
Italy		287	2.7	-7	-3	149	128
Portugal		152	1.7	-2	6	-4	0
Spain		121	2.3	1	6	14	7

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

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Emerging Market Financial Indicators

Last updated: 12/4/2018 7:51 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		6.84	0.7	1.7	1	-3	-5		3.3	0.2	-3	-17	-65	-65
Indonesia		14292	-0.3	1.6	5	-5	-5		8.1	-4.0	-2	-36	125	142
India		71	-0.1	0.4	4	-9	-9		7.7	1.3	-10	-20	41	21
Philippines		53	-0.5	-0.1	1	-4	-5		6.3	-1.1	-5	-30	150	148
Thailand		33	0.4	1.2	1	0	0		2.8	1.0	-1	-11	44	48
Malaysia		4.15	0.5	1.0	1	-2	-2		4.2	-1.1	-2	1	21	25
Argentina		37	3.4	6.4	-2	-52	-49		22.9	4.2	-80	32	722	692
Brazil		3.83	0.5	1.3	-3	-15	-13		8.6	0.6	-3	-7	-47	-46
Chile		669	0.0	1.0	2	-3	-8		4.6	0.7	-6	-18	-21	-16
Colombia		3189	1.4	1.7	0	-6	-6		6.7	-3.7	-9	-22	41	43
Mexico		20.33	0.2	0.8	-2	-8	-3		9.2	-8.9	-13	39	184	148
Peru		3.4	0.1	0.0	0	-4	-4		5.8	3.3	3	-19	48	54
Uruguay		32	0.6	1.5	2	-9	-10		10.8	-4.9	4	-3		224
Hungary		283	0.3	1.2	0	-7	-9		2.3	3.0	-10	-38	107	109
Poland		3.75	0.3	1.3	1	-6	-7		2.5	0.0	-10	-12	-29	-23
Romania		4.1	0.4	1.1	0	-4	-5		4.2	-2.0	-10	-27	26	40
Russia		66.3	0.2	1.1	0	-11	-13		8.4	-6.4	-26	-1	94	106
South Africa		13.6	0.8	2.5	4	0	-9		9.5	-2.2	-5	-24	-37	23
Turkey		5.31	-1.2	-0.8	0	-27	-29		16.8	-15.8	11	-168	446	487
US (DXY; 5y UST)		97	-0.5	-0.9	0	4	5		2.82	0.2	-7	-21	68	61

	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		2666	0.4	4	0	-19	-19		189	2	-1	12	45	37
Indonesia		6153	0.6	2	4	3	-3		226	3	-3	14	54	60
India		36134	-0.3	2	3	10	6		178	3	5	11	68	68
Philippines		7704	2.3	4	8	-5	-10		112	2	-2	7	16	17
Malaysia		1695	0	1	-1	-1	-6		148	2	-3	19	41	38
Argentina		31889	1.3	4	1	19	6		702	2	-1	93	348	352
Brazil		90231	0.4	3	2	23	18		267	1	-8	22	31	33
Chile		5144	0.8	0	1	3	-8		160	-1	5	27	42	41
Colombia		1406	1.9	2	1	-3	-7		210	2	-10	28	34	36
Mexico		42082	0.8	7	-7	-11	-15		338	-4	-12	41	104	93
Peru		19362	1	2	1	-2	-3		167	2	1	19	32	30
Hungary		40598	0.1	3	9	7	3		145	-1	-1	28	59	57
Poland		59081	-0.2	4	5	-5	-7		74	1	1	19	34	27
Romania		8709	-0.5	2	2	12	12		216	-1	7	27	93	102
Russia		2436	-0.2	4	2	15	15		239	1	-10	25	57	61
South Africa		52050	-0.1	1	-4	-13	-13		350	1	-14	16	71	96
Turkey		94958	0.0	2	1	-10	-18		460	1	-10	19	153	171
Ukraine		578	0.0	0	1	90	84		709	-2	-8	111	254	254
EM total		25	0.0	4	2	-6	-7		390	-1	-11	32	101	105

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