Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Friday, December 7, 2018

- **Equity markets claw back Thursday's large losses ([link](#))**
- **Dollar weakens after US jobs report underperforms expectations ([link](#))**
- **Investors are rapidly reducing bets for 2019 Fed rate hikes ([link](#))**
- **GMM Special Feature: A new Brexit monitor (see attachment)**

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

Markets steady after large losses

Caution prevailed in markets ahead of US payrolls this morning, as investors sought to digest the latest develoments in the US-China trade picture. Sanguine tweets from Trump about a US-China trade deal and US officials' attempt to de-politicize yesterday's arrest of Huawei's CFO helped most asset markets partially retrace the sizeable risk-off moves during Thursday's European and Asian sessions. In the US, equities pared heavy intra-day losses yesterday after large declines in Asia (-2%) and Europe (-3%). This morning, Asian and European shares have followed the US higher (+1-2%), but US equity futures are once again pointing lower. In fixed income, core government bond markets have mostly extended the recent rally as **market expectations for Fed rate hikes in 2019 continue to crumble**, with only 15 bps of hikes priced in for 2019.

Key Global Financial Indicators

Last updated: 12/7/18 8:12 AM	Level Last 12m	Level Latest	Change from Market Close 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		2696	-0.2	-2	-4	2	1
Eurostoxx 50		3077	1.0	-3	-5	-14	-12
Nikkei 225		21679	0.8	-3	-2	-4	-5
MSCI EM		41	1.3	-2	-2	-11	-14
Yields and Spreads					bps		
US 10y Yield		2.90	-1.8	-9	-34	53	49
Germany 10y Yield		0.25	1.8	-6	-19	-4	-17
EMBIG Sovereign Spread		400	2	2	35	111	115
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		62.2	-0.2	-1	-1	-9	-11
Dollar index, (+) = $ appreciation		96.9	0.1	0	1	5	5
Brent Crude Oil ($/barrel)		60.6	0.9	3	-16	-3	-9
VIX Index (%, change in pp)		22.4	1.2	4	6	12	11

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

United States

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Nonfarm payrolls for November came in at 155K, lower than the 198K consensus figure. The was also a small downward revision to the October print, from 250K to 237K. The unemployment rate remained steady at 3.7%, as expected, but average hourly earnings disappointed at 0.2% mom (0.3% expected). The participation rate was unchanged at 62.9%. Yields dipped shortly after the release of the data but quickly recovered. **The impact on the dollar, however, have been more lasting, with the DXY falling nearly 0.25% since the release.**

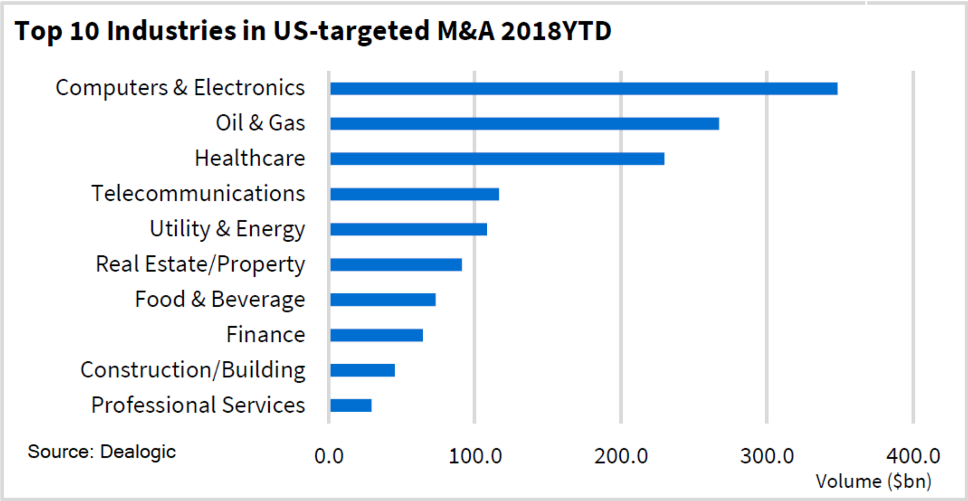
US markets were mostly lower as trade worries continue to dominate headlines. However, stocks did stage a significant recovery from their worst levels to prevent the kind of meltdown seen on Tuesday (SPX -0.15%). Trading volume was very heavy and trading in S&P 500 futures was halted several times early in the US session due to the sharp decline in futures prices, perhaps caused by pent up selling pressure after the Wednesday market closure. Liquidity improved after the stock market opened and the stocks began their rebound off the lows shortly before noon. Contacts reported that 2650 was the key support level for the S&P 500 identified by technical analysts and there was relief when the index closed well above that level. The Nasdaq actually ended with a fractional gain.

Key Market Moves Since Monday December 3, 2018
12/6/18 4pm close

S&P 500	-3.44%
10yr Treasury	-9 bps
2yr Treasury	-4 bps
5yr TIPS Breakeven	-5 bps
December 2019 eurodollar future	-5 bps
December 2019 Fed Funds future	-7 bps
Euro-dollar	Dollar weaker by 0.3%

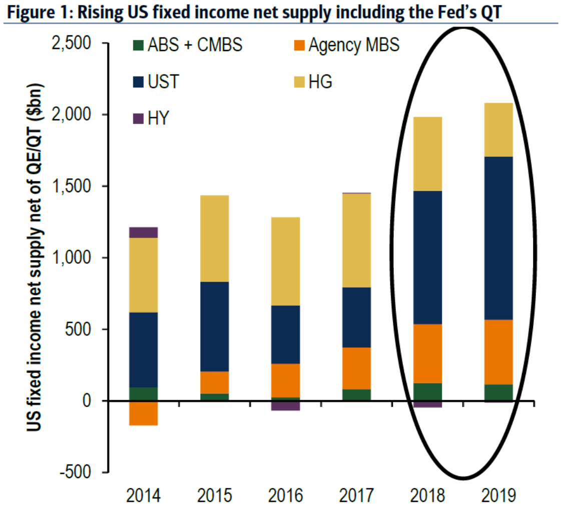
The stock market's travails meant another positive day for Treasuries. The ten-year Treasury note yield fell as low as 2.82% at the height of the equity selloff before ending at 2.88%. The two-year/five-year sector of the yield curve remained inverted although the 2-10 spread ended a tick higher. There was record trading volume in the December 2019 eurodollar futures contract whose yield fell by over 5 bps, a very large move. Market participants are rethinking their views of how quickly the Fed will hike rates. The December 2019 Fed Funds futures contract yield has fallen 18 bps since November 30th and the eurodollar futures curve is predicting just 16 bps of rate hikes in 2019. The less liquid Fed Funds futures curve has also repriced, predicting just 36 bps of rate hikes in 2019. Meanwhile, the stronger than expected ISM non-manufacturing number had little impact on the day's trading. The number came in at 60.7 versus the consensus forecast of 59, the third consecutive month above 60. This report followed a very strong manufacturing PMI number earlier in the week and a Beige Book report that highlighted tighter labor conditions. The market-based odds of a hike at the December 19 FOMC meeting fell to 69.1% from 78.6% a week ago, but most analysts expect the Fed to raise rates given the continued resilience of the economy.

US M&A volumes in 2018 were up 45% from the year before, with $1.66 tn of deals in the books. Dealogic data showed that April saw the highest volume with $208 bn of transactions. The biggest sector for new deals was computers and electronics followed by oil and gas. The largest US domestic deal of the year was Cigna's $69.82 bn offer to acquire Express Scripts. Some analysts view a surge in M&A activity as a symptom of late cycle behavior, while others argue that companies were probably trying to frontload their acquisitions to lock in lower funding costs ahead of next year's widely expected rate hikes.



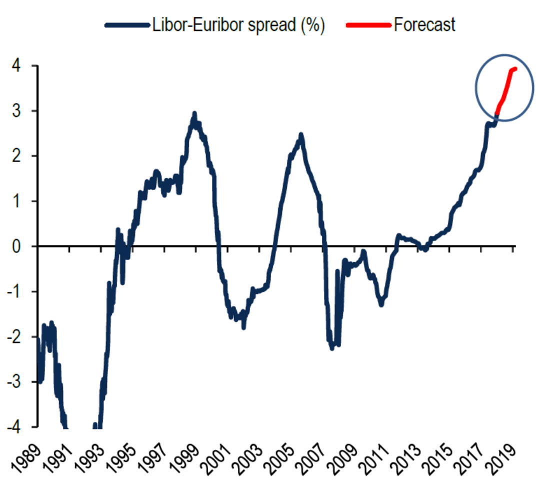
A key challenge for the US bond market next year is the need to absorb the higher supply of new bonds. The Fed's balance sheet runoff will increase the supply of Treasuries and mortgage-backed securities (MBS), and the Fed's rate hikes will probably raise bond market volatility. An additional headwind will likely be reduced foreign demand for dollar-denominated paper caused by higher dollar funding costs. Dollar funding will remain expensive as long as the major central banks follow divergent rate paths. These trends already played a major part in the bond market's performance in 2018, as higher bond supply, higher dollar funding costs and Fed rate hikes led to higher interest rates and wider credit spreads. Markets will have to contend with absorbing the higher supply in an increasingly difficult trading environment.

Figure 1: Rising US fixed income net supply including the Fed's QT



Source: Federal Reserve, BofA Merrill Lynch Global Research

Figure 2: Widening Libor-Euribor leads to higher dollar hedging costs



Note: Using 3-month Libor and Euribor
Source: Bloomberg, BofA Merrill Lynch Global Research

Europe

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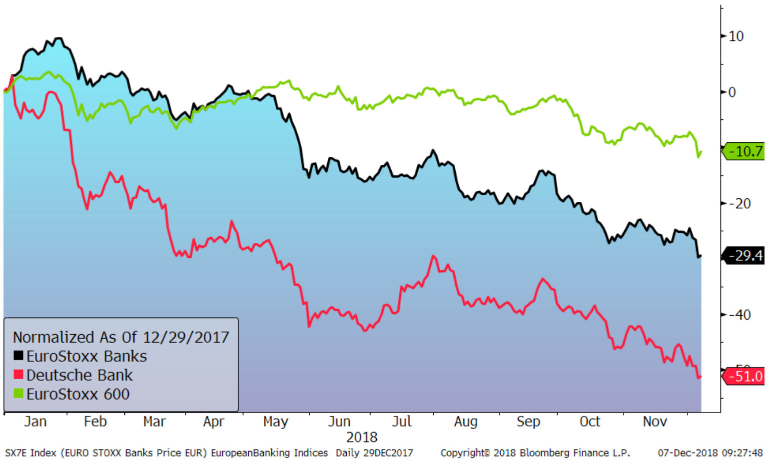
Equity markets are rebounding with the EuroStoxx 600 up 1.4% after having suffered its worst one-day decline since Brexit. The index is still down nearly 3% on the week. The banking sector is underperforming today (+0.4%) and on the week (-5.1%). Of note, **Deutsche Bank** remains under pressure after news that its money laundering scandal relating to Estonian customers would be worse than expected. The bank's shares are off -1.5% today and -4.7% on the week.

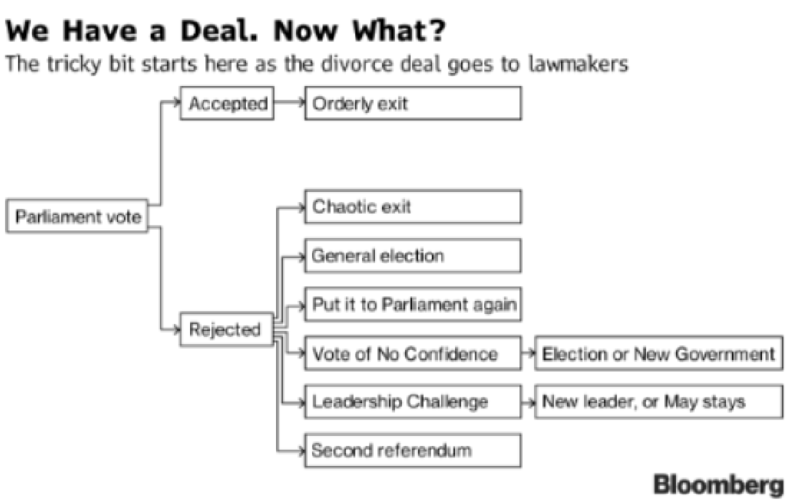
EU Banks and Deutsche Bank



Yields are stable across the region but falling in Italy. The 10-year bund yield is on net 7 bps lower on the week, at 0.25%, marking the fifth consecutive week of decline. For comparison, it was trading at 0.57% in early October and near 0.8% in February. The Italian 10-year is down 4 bps today, only partially offsetting yesterday's 14 bps increase, to a net of -6 bps on the week. There has been some speculation about the resignation of FM Tria, but reports are still in the rumor stage.

United Kingdom

In Brexit news, there is more speculation about the chance PM May could delay next week's vote in the House of Commons, but analysts see this as unlikely. A delay could buy her time to try to negotiate further concessions from the EU. However, reports suggest that EU officials are only willing to concede on minor tweaks to the deal currently on the table. It seems unlikely that any small change will be enough to improve her odds of getting the deal passed and avoiding the highly uncertain landscape that follows.



Separately, a report by the think tank Centre for European Reform estimates that exports of financial services to the EU could drop by nearly 60% under a FTA following Brexit. Export of insurance and pension services could be 19% lower. (Full report here).

Table 2: Estimated impact on UK services exports to EU (mode 1, 2 and 4) under an FTA					
	Transport services	Insurance & pension services	Financial services	Telecommunication, computer & information services	Other business services
Total UK exports to the EU (£bn, 2015)	11.5	4.0	23.6	7.6	22.2
Total UK exports to the EU under an FTA (£bn, 2015)	9.7	3.3	9.8	7.9	20.0
Total change (£bn, 2015)	-1.8	-0.7	-13.8	0.2	-2.2
Percentage change	-15%	-19%	-59%	3%	-10%

Source: Author's calculations, ONS Pink Book.

Other Mature Markets back to top

Japan

The yen pared recent gain (-0.1%) while equities edged higher. The Topix rose 0.6% and the Nikkei, 0.8% with retailers providing the biggest boost to the benchmark indices. Friday's gain was a welcome reprieve as the arrest of Huawei CFO renewed fears of trade tension between China and the US. These fears wiped out an estimated $256 bn in Topix's market valuation from Tuesday to Thursday, bringing the weekly loss on the Topix to 2.8%.

Emerging Markets[1] back to top

Asian currencies were mixed against the dollar. Fed Chair Powell's positive outlook on the US economy in a speech Thursday was juxtaposed against concerns for renewed tension between the US and China, providing little impetus for investors to take on sizable positions. The Indian rupee and the Indonesian rupiah outperformed. The decline in crude oil prices lifted the Indian rupee (+0.3%). Meanwhile, the rupiah gained a touch (+0.28%) following Thursday's 1.2% loss – the largest single day loss since June – and Bank Indonesia's interventions in the currency markets. The rest of the EM Asian currencies were little changed on the day. In **EMEA**, bourses were up 0.2-0.9% with Poland outperforming. In FX markets, the main mover was the South African rand depreciating 0.6% on the day and a total of near 2% on the week. In **Latin America**, Colombian equities underperformed (-1.3%) while Argentine equities outperformed (+0.8%). There were mixed trends within the currency space as well with the Chilean and Colombian pesos depreciating by 0.8% vs the US dollar, while the Mexican peso appreciated by 0.8%. Political headlines dominated in Brazil and Mexico. In Brazil, Paulo Guedes warned about risks of postponing the pension overhaul, while in Mexico Lopez Obrador highlighted that he won't cancel the oil overhaul and present the oil refinery plan over the weekend.

[1] Yesterday's story on Argentina should have emphasized that the country's monetary policy framework was changed, rather than revised. The story should have also noted that, as part of these changes, the board announced that both edges of the FX non-intervention zone will change 2% per month for 1Q19 (from 3% this quarter).

Key Emerging Market Financial Indicators

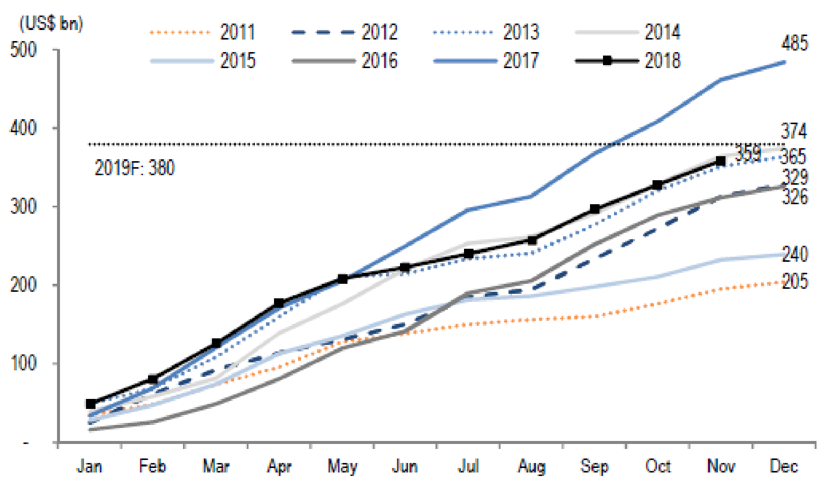
Last updated: 12/7/18 8:05 AM	Level Last 12m	Level index	Change 1 Day	Change 7 Days	Change 30 Days	Change 12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		40.64	1.4	-2	-2	-11	-14
MSCI Frontier Equities		27.93	0.7	1	1	-16	-16
EMBIG Sovereign Spread (in bps)		400	2	2	35	111	115
EM FX vs. USD		62.17	-0.3	-1	-1	-9	-11
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.88	0.0	1	1	-4	-5
Indonesian Rupiah		14480	0.3	-1	1	-6	-6
Indian Rupee		70.81	0.1	-2	3	-9	-10
Argentine Peso		37.73	-0.1	0	-5	-54	-51
Brazil Real		3.91	-0.8	-1	-5	-16	-15
Mexican Peso		20.37	-0.1	0	-2	-7	-3
Russian Ruble		66.71	0.2	1	-1	-11	-14
South African Rand		14.14	-0.6	-2	-2	-3	-12
Turkish Lira		5.33	0.2	-2	1	-28	-29
EM FX volatility		10.13	0.0	0.0	0.2	2.1	2.3

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

EM corporate bond issuance

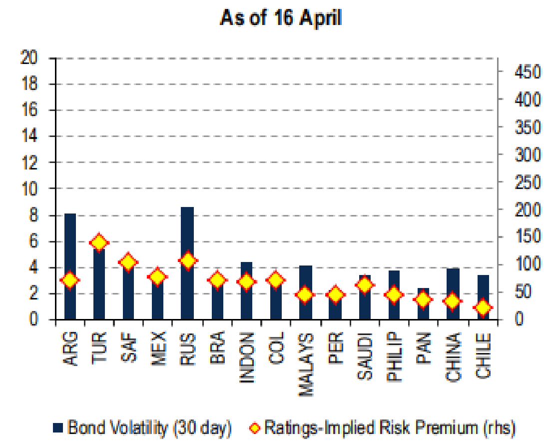
EM corporate supply in November was recorded at $30.1 bn, inline with historical run-rates ($32.8 bn) but below the $52.9 bn issuance in November last year. Asia ($25.7bn) accounted for the lion's share of the monthly supply followed by limited contribution from EM Europe ($2.1bn), Latin America ($2.0bn) and Middle East & Africa ($0.7bn). JPM analysts expect the 2019 EM corporate external bond issuance to be at $380bn, which would be a slight pick up from 2018 levels (YTD issuance at $359bn). However, despite the supportive supply technicals, analysts have highlighted that there could still be concerns over the ability of HY issuers to refinance maturing bonds given the challenging market environment.

Figure 1: EM corporate external bonds – modestly higher supply of $380bn forecast for 2019



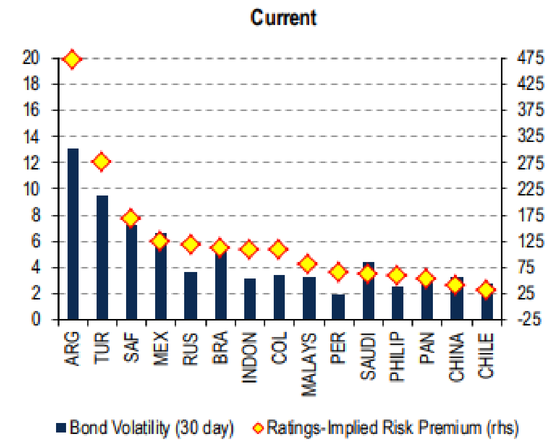
Ratings-implied risk premiums and volatility for USD-denominated EM bonds have both increased considerably since the start of the year. BofA analysts note that while both bond volatility and ratings-implied risk premiums (the CDS-implied probably of default less the rating grade's historical default rate) were clustered together at a low level pre-April selloff, there is a lot more dispersion now with lower-rated countries exhibiting generally higher volatility and risk premiums.

Chart 11: 10y bond volatility vs. risk premium



Source: BofA Merrill Lynch Global Research, Bloomberg, Moody's, S&P, Fitch.
Note: Volatilities calculated for ARGENT 28, TURKEY 28, SOAF 28, INDON 28, BRAZIL 28, MEX 28, RUSSIA 28, COLOM 27, MALAYS 26, KSA 28, PHILIP 28, PERU 27, CHINA 27, PANAMA 28, CHILE 28.

Chart 12: 10y bond volatility vs. risk premium



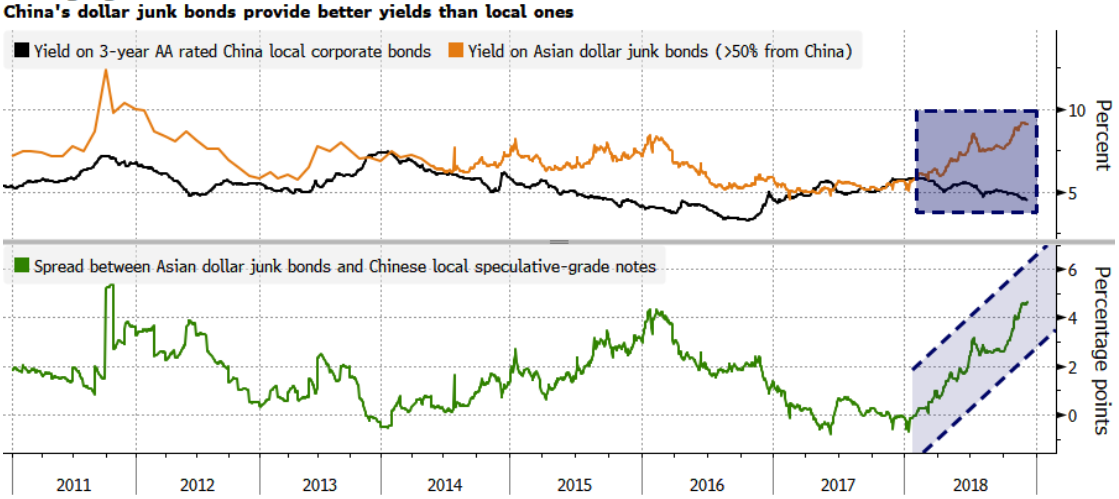
Source: BofA Merrill Lynch Global Research, Bloomberg, Moody's, S&P, Fitch.
Note: Volatilities calculated for ARGENT 28, TURKEY 28, SOAF 28, INDON 28, BRAZIL 28, MEX 28, RUSSIA 28, COLOM 27, MALAYS 26, KSA 28, PHILIP 28, PERU 27, CHINA 27, PANAMA 28, CHILE 28.

China

Foreign currency reserves in November rose despite concerns for capital outflows amid trade tensions and a slowing economy. FX reserves rose $8.6 bn to $3.062 tn in November, exceeding consensus estimates of $3.044 tn. Foreign inflows into Chinese equities helped to maintain some stability in the level of FX reserves. By one estimate, inflows into the onshore equity market totaled around RMB 50 bn in November, more than reversing the outflows seen in October. **The RMB was little changed on the day,** with both the onshore CNY and offshore CNH holding steady at 6.884.

Yield differential between Chinese junk bonds onshore and offshore reached its widest level in 7 years. A softening economy, combined with concerns for rising defaults have pushed yields on dollar-denominated bonds offshore higher. Meanwhile, targeted policies to stoke private sector lending and to support private enterprises have supported risk appetite among domestic investors, driving down yields on RMB-denominated securities. Analysts noted offshore bonds' high yields could attract investors to these securities and help narrow the large yield differentials.

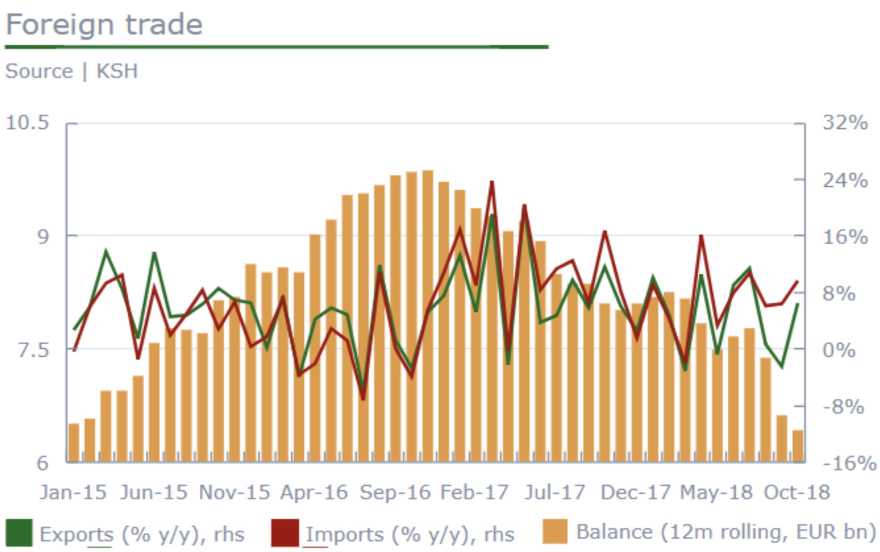
Diverging Path
China's dollar junk bonds provide better yields than local ones



Source: Bloomberg Barclays indexes, ChinaBond
CNCBR3 Index (ChinaBond Corporate Bond Yield Curve (AA) 3Y YTM) AA vs Asia HY D Copyright© 2018 Bloomberg Finance L.P. 07-Dec-2018 14:10:44

Hungary

The trade surplus fell 44.2% yoy in October, down 24.5% yoy on a cumulative basis since January. The 12-month rolling trade balance fell from near €10 bn in late 2016 to €6.5 bn now. The pace of growth of imports (+9.7%) continues to exceed that exports (+6.6%) by a considerable margin, though some analysts think this could improve in coming months if the fall in energy prices is sustained. But exports are likely to remain subdued given the slowdown in demand from the euro area. Still, the currency performed relatively well this year, depreciating just 3.8% against the euro, slightly more than the Polish zloty but nowhere near the losses suffered in Turkey (-25%), Russia (-9.0%) and South Africa (-7.5%).



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

Anna Ilyina
Division Chief
Peter Breuer
Deputy Division Chief
Will Kerry
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
Rebecca McCaughrin
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
Jochen Schmittmann
Economist
Ilan Solot
Financial Sector Expert
Nour Tawk
Economist
Martin Edmonds
Senior Data Mgt Officer
Yingyuan Chen
Senior Research Officer
Rohit Goel
Research Officer
Piyusha Khot
Research Assistant
Xingmi Zheng
Research Assistant

Global Financial Indicators

Last updated: 12/7/18 8:16 AM	Level Last 12m	Latest	Change 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		2696	-0.2	-2	-4	2	1
Europe		3077	1.0	-3	-5	-14	-12
Japan		21679	0.8	-3	-2	-4	-5
China		2606	0.0	1	-1	-20	-21
Asia Ex Japan		66	-1.3	-2	-1	-11	-13
Emerging Markets		41	1.3	-2	-2	-11	-14
Interest Rates					basis points		
US 10y Yield		2.90	-1.8	-9	-34	53	49
Germany 10y Yield		0.25	1.8	-6	-19	-4	-17
Japan 10y Yield		0.06	-0.5	-3	-6	0	1
UK 10y Yield		1.27	2.7	-9	-26	2	8
Credit Spreads					basis points		
US Investment Grade		132	3.2	5	26	37	41
US High Yield		438	13.8	18	77	59	63
Europe IG		85	-1.3	5	19	37	41
Europe HY		341	-6.7	13	60	107	107
EMBIG Sovereign Spread		400	2.0	2	35	111	115
Exchange Rates					%		
Dollar Index (DXY)		96.86	0.1	0	1	3	5
USDEUR		1.14	0.0	1	0	-3	-5
USDJPY		112.8	-0.1	1	1	0	0
EM FX vs. USD		62.2	-0.2	-1	-1	-9	-11
Commodities					%		
Brent Crude Oil ($/barrel)		61	0.9	3	-16	-3	-9
Industrials Metals (index)		115	0.7	0	-1	-7	-17
Agriculture (index)		43	0.3	1	-1	-10	-9
Implied Volatility					%		
VIX Index (%, change in pp)		22.4	1.2	4.3	6.0	12.2	11.3
10y Treasury Volatility Index		4.2	0.2	0.4	0.2	0.5	0.7
Global FX Volatility		8.8	0.0	0.3	0.7	1.1	1.4
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		397	-4.7	2	11	-51	29
Italy		290	-6.6	0	1	152	131
Portugal		156	-1.9	4	7	3	4
Spain		121	-1.9	2	5	9	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: 12/7/2018 8:07 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		6.88	0.0	1.2	1	-4	-5		3.3	-1.2	-8	-25	-70	-71
Indonesia		14480	0.3	-1.2	1	-6	-6		8.2	4.3	13	-18	139	155
India		71	0.1	-1.7	3	-9	-10		7.5	-4.1	-16	-37	25	4
Philippines		53	0.1	-0.6	0	-4	-5		6.3	0.2	-6	-36	147	143
Thailand		33	0.0	0.3	0	-1	-1		2.7	-1.9	-7	-16	39	42
Malaysia		4.17	0.0	0.4	0	-2	-3		4.1	-1.4	-5	-4	18	22
Argentina		38	-0.1	0.1	-5	-54	-51		23.3	6.0	34	-29	751	723
Brazil		3.91	-0.8	-1.2	-5	-16	-15		8.6	-7.1	5	-9	-29	-44
Chile		675	0.5	-0.4	0	-3	-9		4.6	-4.8	-7	-20	-31	-20
Colombia		3180	0.2	1.7	-2	-5	-6		6.7	-2.2	-7	-16	41	42
Mexico		20.37	-0.1	0.0	-2	-7	-3		9.2	-2.6	2	58	181	152
Peru		3.4	0.1	0.2	0	-4	-4		5.8	0.9	4	-7	50	57
Uruguay		32	-0.2	0.0	2	-10	-10		11.0	2.1	20	32		238
Hungary		284	-0.1	0.5	-1	-6	-9		2.3	-7.5	-8	-36	101	104
Poland		3.77	-0.2	0.6	0	-5	-8		2.4	-5.1	-8	-11	-24	-26
Romania		4.1	0.1	0.5	0	-4	-5		4.2	3.0	-4	-15	40	39
Russia		66.7	0.2	0.6	-1	-11	-14		8.5	3.4	5	10	107	118
South Africa		14.1	-0.6	-1.9	-2	-3	-12		9.7	9.6	21	0	-5	41
Turkey		5.33	0.2	-2.1	1	-28	-29		17.4	29.6	84	11	518	550
US (DXY; 5y UST)		97	0.1	-0.4	1	3	5		2.76	0.7	-5	-32	62	55

	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		2606	0.8	1	-1	-20	-21		190	-2	0	7	45	38
Indonesia		6126	0.3	1	3	2	-4		228	-2	1	5	58	62
India		35673	1.0	-1	1	8	5		180	3	5	12	71	70
Philippines		7461	1.3	1	6	-9	-13		116	-3	6	3	20	21
Malaysia		1681	-1	0	-2	-2	-6		149	-5	1	6	41	39
Argentina		32020	1.1	3	2	19	6		724	1	20	120	359	374
Brazil		88583	0.5	-1	1	22	16		271	1	2	16	36	37
Chile		5140	0.8	1	-2	5	-8		162	-1	3	10	43	43
Colombia		1390	0.1	1	-2	-4	-8		212	0	1	13	34	38
Mexico		41987	2.3	0	-11	-11	-15		346	0	1	36	104	101
Peru		19323	1	0	0	0	-3		172	0	7	6	35	35
Hungary		39328	-1.3	-2	3	3	0		149	-1	-1	25	63	61
Poland		58576	0.3	1	1	-6	-8		75	-3	-1	23	36	28
Romania		8665	0.0	0	0	13	12		226	2	10	38	104	112
Russia		2428	1.2	1	-1	15	15		246	1	3	14	64	68
South Africa		51179	-1.1	1	-6	-12	-14		363	10	7	24	81	109
Turkey		93349	-1.9	-2	-2	-12	-19		475	3	8	48	171	186
Ukraine		575	-0.1	-1	-2	89	82		735	10	20	135	269	280
EM total		24	-0.9	-2	-2	-8	-9		400	2	2	35	111	115

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