Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Thursday, January 31, 2019

- **FOMC changes policy statement, suggesting a pause in future rate hikes (link)**
- **The Fed issues special statement on balance sheet normalization (link)**
- **German Bund yield curve continues to flatten (link)**
- **Chinese bonds to enter Bloomberg-Barclays Global Aggregate Index (link)**
- **Chilean central bank hikes policy rates 25 bps to 3.0% (link)**

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Global rates decline as the Fed signals a pause

The Fed delivered a clearly dovish message both in terms of the future path of policy rates and in its balance sheet guidance. Changes to the policy statement language implied that Fed was reafy to pause its rate hike campaign for the time being. Implied rates now suggest that the next move will be a cut, reflecting the momentous shift that has taken place from six months ago when many were calling for multiple hikes in 2019. Global yields are lower, the dollar is appreciating, and equity markets are mostly higher, though losing steam as the European session progresses. Risk sentiment has also been supported by favorable headlines regarding the ongoing US-China trade talks, though nothing concrete has come out yet.

Key Global Financial Indicators

Last updated: 1/31/19 8:29 AM	Level Last 12m	Latest	Change from Market Close 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		2681	1.6	2	7	-5	7
Eurostoxx 50		3148	-0.4	1	5	-13	5
Nikkei 225		20773	1.1	1	4	-10	4
MSCI EM		43	1.5	4	9	-16	9
Yields and Spreads					bps		
US 10y Yield		2.67	-3.2	-4	-1	-3	-1
Germany 10y Yield		0.17	-1.5	-1	-7	-52	-7
EMBIG Sovereign Spread		369	-4	3	-45	105	-45
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		64.4	0.4	1	3	-10	3
Dollar index, (+) = $ appreciation		95.3	0.0	-1	-1	7	-1
Brent Crude Oil ($/barrel)		61.9	0.3	1	15	-10	15
VIX Index (%, change in pp)		17.5	-0.2	-1	-8	4	-8

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

United States

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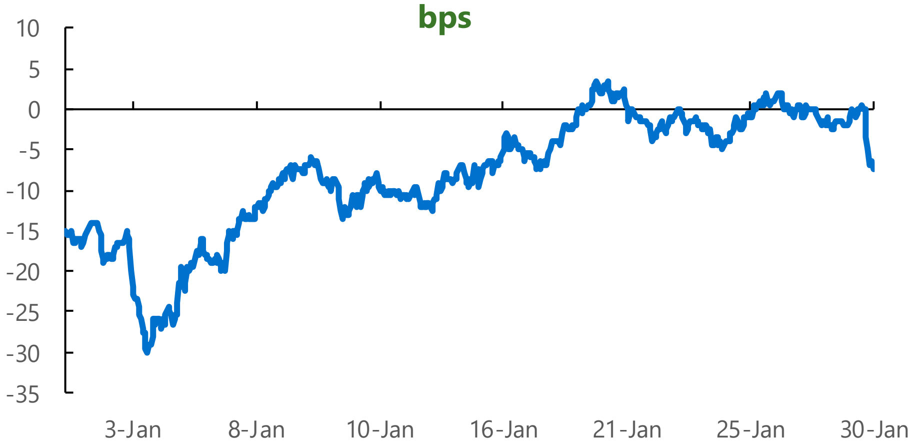
Markets rallied on dovish communication after the FOMC unanimously voted to leave the target range for the federal funds rate unchanged, as expected. However, in its policy statement released following the decision, the FOMC changed its language to say that they would be "patient" as they determine future interest rates, and they removed the "further gradual rate increase" guidance. Markets widely interpreted the language change to mean that the FOMC is pausing its rate hike campaign indefinitely. Following the statement release, the 2-year Treasury note yield declined 6 bps to 2.51% and the eurodollar futures curve inverted again, consistent with expectations that the Fed's next move could be a cut. On the day, equities rose 1.5% and the dollar weakened by -0.4% against other major currencies. Ten-year inflation breakeven rates rose by 5 bps.

Eurodollar Futures Mar 2019-Mar 2020 Spread, bps



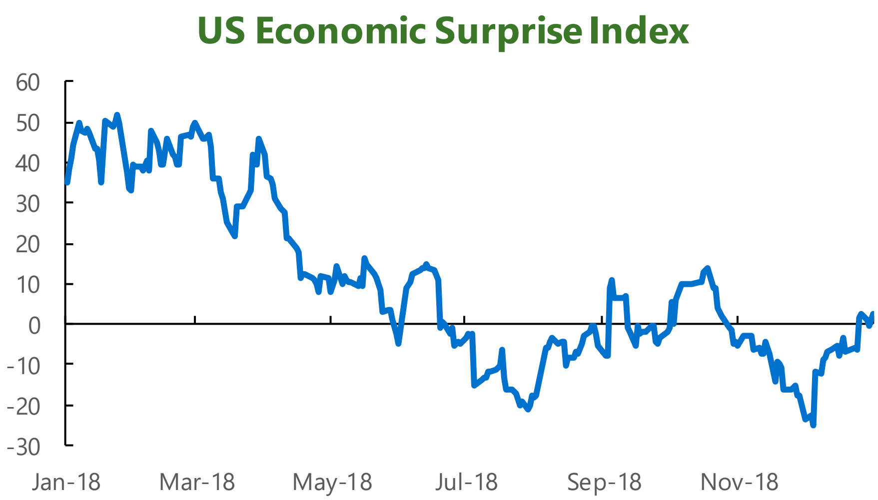
Source: Bloomberg

The FOMC elaborated on its policy framework. In a separate special statement (link) the Fed said they will continue to implement monetary policy in a regime where "an ample supply of reserves ensures that control over the level of the federal funds rate and other short-term interest rates is exercised primarily through the setting of the Federal Reserve's administered rates". Market contacts suggest the Fed will likely abandon notions of fully returning to its pre-GFC corridor system, when daily market operations changed reserve supply to keep overnight rates at its policy rate target. Instead, the Fed appears ready to keep a larger balance sheet, with Interest on Excess Reserves (IOER) and the Reverse Repurchase Agreement Facility (RRP) keeping overnight rates in the target range instead. The Fed added that it is "prepared to adjust any of the details for completing balance sheet normalization in light of economic and financial developments". Some interpreted this to mean that the Fed could consider changing its current pace of balance sheet normalization. However, Chairman Powell later confirmed during the Q&A session of his press briefing that there were no decisions made on balance sheet policy in the meeting.

Treasury's Quarterly Refunding and the Treasury Borrowing Advisory Committee (TBAC) brought few surprises. Net T-bill supply is expected to increase from current levels through the end-of-March by a similar magnitude as occurred between October and December 2018.

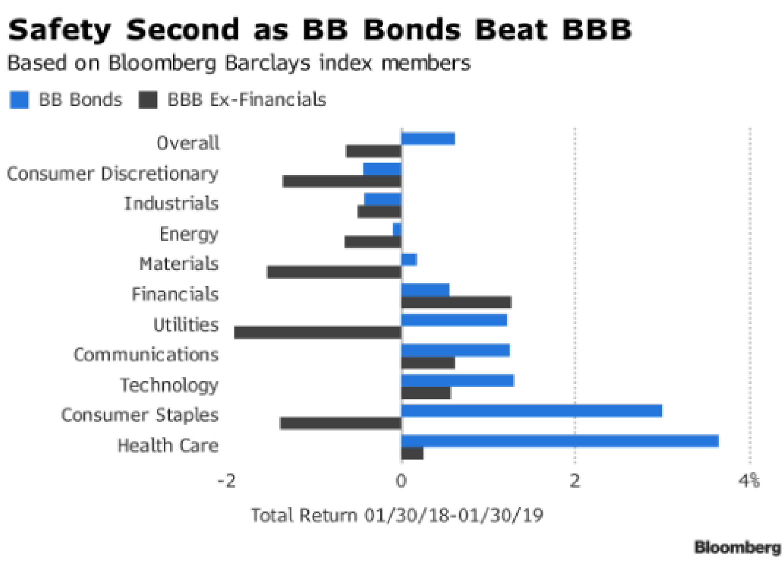
Citi's US economic surprise index turned positive. The level of the US economic surprise index has improved to positive territory from -25 at the beginning of the year, along with the slew of solid data last week such as PMI and initial jobless claims falling below 20,000 for the first time since November 1969.

This index measures data surprises relative to market expectations and a positive reading mean that data releases have been stronger than market expectation and vice versa.



Source: Citi group, Bloomberg

Over the last 12 months, BB-rated corporate bonds have produced better total returns than BBB-rated bonds. However, there has been speculation by some that the growing proportion of US corporate debt rated just above junk is a crisis waiting to happen, and that further downgrades will lead to forced selling and losses as companies fall to junk. Based on bond index data, the volume of corporate bonds rated at the lowest end of investment grade keeps growing.



Europe

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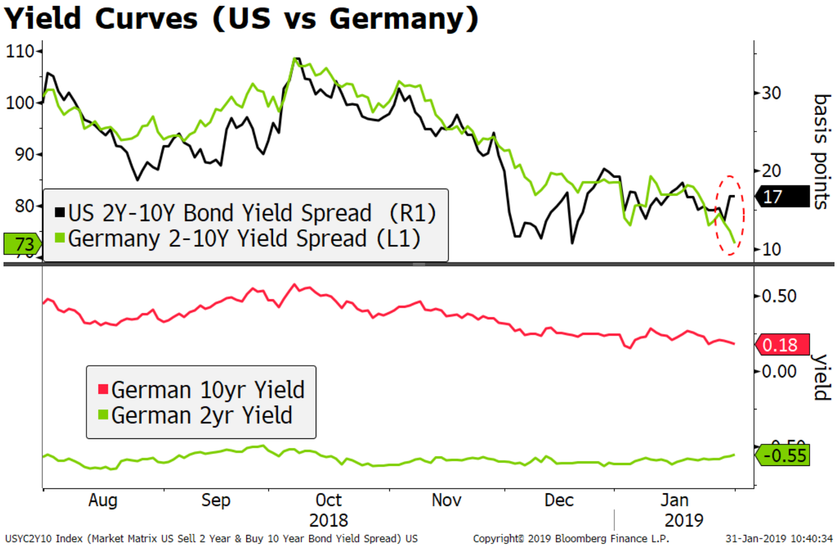
Regional equities are mixed as the vigorous post-Fed rally seen in the US and Asia faded. The EuroStoxx 600 is flat with small gains in France and Germany offsetting losses in Italy and Spain. The UK

FTSE 100 is up 0.5%. **Yields are mostly lower across core and Southern European countries, but moves have been small.**

Of note, the German yield curve (2- to 10-year) has continued its gradual flattening trend to 72 bps now, the lowest since late 2016, even as the slope of the US curve seems to have stabilized around the 15 bps level. The move has been led by a combination of falling 10-year Bund yields (-10 bps from the highs of the year) and small increases in the 2-year yields (+6 bps from the lows of the year). Contacts attributed the former to weaker growth prospect and the latter to investors initiating curve flattening trades.



Euro area GDP came in as expected at 1.2% yoy in Q4 according to the advance release, down from 1.6% in the previous quarter. Of note, growth came in slightly better than expected in Spain (+0.7% qoq) but disappointed in Italy (-0.2% qoq), leading the country into a technical recession in the second half of 2018.

There have been no major developments on Brexit. The most notable headlines came from the EU side, reinforcing their steadfast position about not renegotiating the deal currently on the table. EU officials are becoming more convinced that the exit data will be postponed, but there is no concrete news about this.

Other Mature Markets back to top

Japan

The yen appreciated (+0.3%) and equities gained as the Fed signaled a pause in its rate increases. The Topix rose 1.1%, the biggest move since Jan. 9th. Meanwhile, the auction of the 2-year note met strong demand and received a bid-to-cover ratio of 6.08x, the highest since June 2017. JGB yields ended slightly lower. The 2-year note fell 0.6 bps to -0.17% while the 10-year held steady at -0.008%. Strong foreign inflows have boosted JGBs and likely played a role in the latest auction. MOF's weekly flow data indicated foreign investors bought ¥604.3 bn ($5.6 bn) of JGBs last week.

Emerging Markets

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Emerging market assets broke out of recent ranges, boosted by yesterday's dovish Fed meeting. Asian currencies staged broad-based appreciations while equities gained as the Fed signaled that it is putting further rate increases on hold. The Indonesian rupiah outperformed, appreciating by 1.1% and broke through the key level of IDR14,000/USD to 13,973, a level last seen in June. In equities, China's Shenzhen Composite continued to underperform (-0.3%) while its Asian counterparts posted broad-based gains. EMEA equities also saw gains with Turkey (+1.2%) outperforming. Latin American assets were mixed yesterday, however. Argentinian (+1.5%) and Brazilian (+1.4%) equities had a good day while Chile (-0.5%) saw losses. Among regional currencies, the real weakened by 1.2% and the Mexican peso (-0.7%) was also down as Fitch Ratings downgraded Pemex to one level above junk bonds.

Key Emerging Market Financial Indicators

Last updated: 1/31/19 8:33 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		42.74	1.5	4	9	-16	9
MSCI Frontier Equities		28.35	0.6	2	8	-20	8
EMBIG Sovereign Spread (in bps)		369	-4	3	-45	105	-45
EM FX vs. USD		64.39	0.4	1	3	-10	3
Major EM FX vs. USD					**%, (+) = EM currency appreciation**		
China Renminbi		6.70	0.2	1	3	-6	3
Indonesian Rupiah		13973	1.1	1	3	-4	3
Indian Rupee		71.09	0.1	0	-2	-11	-2
Argentine Peso		37.13	1.0	1	1	-47	1
Brazil Real		3.66	0.7	3	6	-13	6
Mexican Peso		19.03	0.5	0	3	-2	3
Russian Ruble		65.30	0.3	1	7	-14	7
South African Rand		13.26	0.5	3	8	-11	8
Turkish Lira		5.19	0.8	2	2	-28	2
EM FX volatility		8.96	0.0	-0.1	-0.8	0.8	-0.8

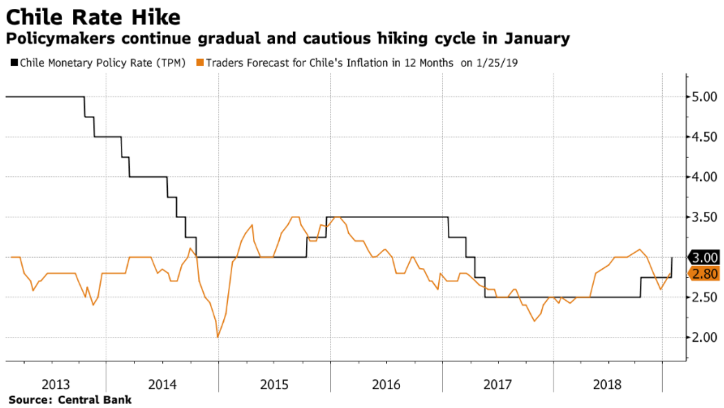
Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

China

The RMB extended its recent appreciation to its strongest level in 6 months amid optimism for a US-China trade deal. The onshore RMB gained as much as 0.38% intraday before settling at RMB 6.71/USD (+0.1%) while the offshore CNH was unchanged at 6.72. The onshore CNY has gained 1.5% over the past 7 days, driven by expectations for a trade deal between the US and China. News that President Trump will meet with Vice Premier Liu He on Thursday further added to the optimism. **Central government bond (CGB) yields fell, reversing recent increases following news of index inclusion.** Bloomberg indicated that RMB-denominated government and policy bank bonds will be added to the Bloomberg Barclays Global Aggregate Index from April and phased in over 20-month period. When fully accounted for in the index, these bonds will be fourth largest currency component after the dollar, euro and yen. By one estimate, this inclusion could result in $120.6 bn of total inflows by the end of the phase-in period. Yield on the 2-year note fell 2 bps to 2.48% while the 3-year note fell 5 bps to 2.57%.

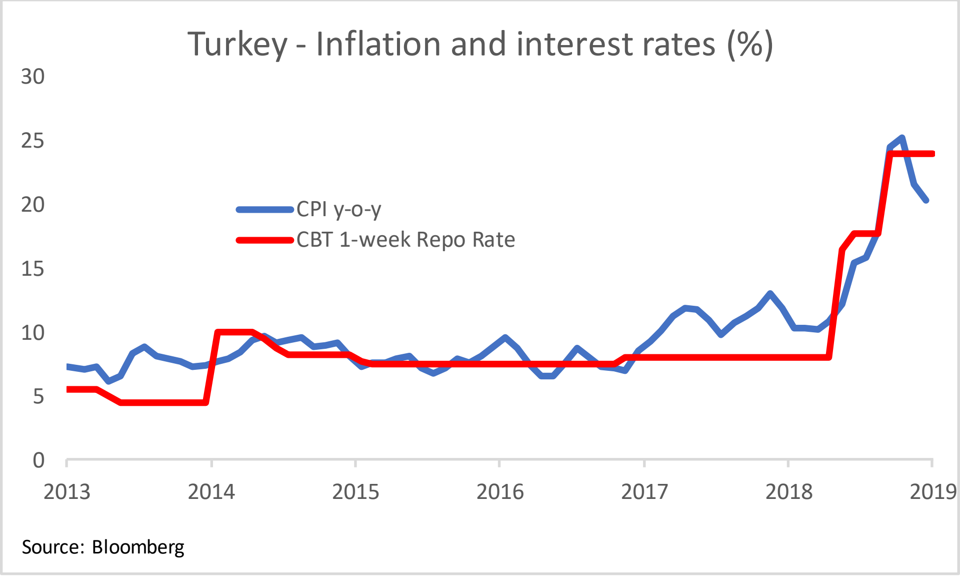
Chile

The monetary policy committee raised the policy rate by 25 bps to 3% as policymakers look past below-target inflation to expectations for strong growth and investments. The hike was in line with economist expectations surveyed by Bloomberg. Chile's recent growth numbers have beaten analyst forecasts amid a surge in mining and falling unemployment. While lower oil costs are credited with keeping headline inflation under the 3% target, core inflation has been rising since May. Market participants expect policy rates to reach 4 % within the next 2 years, according to a central bank survey from January 25.



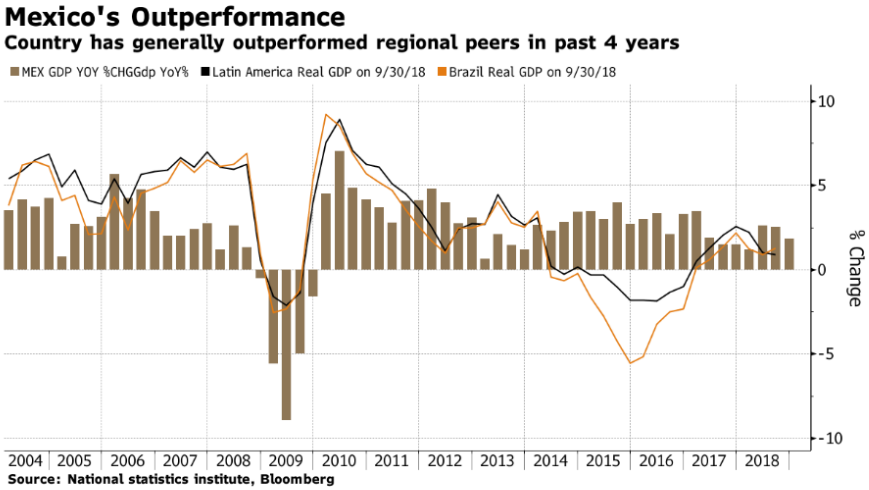
Turkey

The central bank indicated it remains reluctant to ease monetary policy in its latest inflation report. The report, released yesterday, saw a reduction in the bank's inflation forecast, with year-end inflation now expected to be 14.6% versus 15.2% previously. Annual inflation declined to 20.3% in the latest data release having peaked at 25.2% in October. However, Governor Cetinkaya said that the bank would "continue to maintain the level of tightness necessary to achieve single-digit inflation in the shortest period of time possible". Investors have welcomed the bank's relative hawkishness with the lira appreciating a total of 2.4% in the last three days. The currency is currently trading at its strongest level against the dollar since late November.



Mexico

Mexico's GDP grew 0.3% qoq in Q4 2018, according to the preliminary estimate. This is consistent with the expected soft deceleration of the economy, after it expanded 0.8% qoq in the previous quarter. Latin America's second-largest economy is expected to cool slightly this year as U.S. growth slows and Mexico's new president works to implement his policies. Slowing demand for imports in December, as well as a January fuel shortage triggered by President Obrador's crackdown on fuel theft, may also weigh on the economy this year. Final figures are scheduled to be published on February 25.



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Global Financial Indicators

Last updated:	Level		Change				
1/31/19 8:29 AM	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		2681	1.6	2	7	-5	7
Europe		3148	-0.4	1	5	-13	5
Japan		20773	1.1	1	4	-10	4
China		2585	0.3	0	4	-26	4
Asia Ex Japan		68	1.9	3	8	-16	8
Emerging Markets		43	1.5	4	9	-16	9
Interest Rates					basis points		
US 10y Yield		2.67	-3.2	-4	-1	-3	-1
Germany 10y Yield		0.17	-1.5	-1	-7	-52	-7
Japan 10y Yield		0.01	0.0	-1	0	-8	0
UK 10y Yield		1.23	-2.2	-3	-4	-28	-4
Credit Spreads					basis points		
US Investment Grade		123	-1.4	-6	-24	41	-24
US High Yield		441	-0.7	-4	-80	107	-80
Europe IG		70	-3.0	-6	-17	27	-17
Europe HY		307	-13.1	-20	-45	69	-45
EMBIG Sovereign Spread		369	-4.0	3	-45	105	-45
Exchange Rates					%		
Dollar Index (DXY)		95.31	0.0	-1	-1	7	-1
USDEUR		1.15	0.1	2	0	-7	0
USDJPY		108.6	0.4	1	1	1	1
EM FX vs. USD		64.4	0.4	1	3	-10	3
Commodities					%		
Brent Crude Oil ($/barrel)		62	0.3	1	15	-10	15
Industrials Metals (index)		118	0.8	4	8	-15	8
Agriculture (index)		43	0.3	0	3	-11	3
Implied Volatility					%		
VIX Index (%, change in pp)		17.5	-0.2	-1.4	-8.0	3.9	-8.0
10y Treasury Volatility Index		3.7	-0.1	-0.3	-0.8	-0.6	-0.8
Global FX Volatility		7.9	0.0	0.0	-1.1	-0.1	-1.1
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		370	-3.6	-26	-45	66	-45
Italy		242	1.2	-6	-8	109	-8
Portugal		147	-0.9	0	-1	20	-1
Spain		105	-1.7	-1	-13	32	-13

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: 1/31/2019 8:33 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		6.70	0.2	1.3	3	-6	3		3.1	-1.0	0	-12	-91	-11
Indonesia		13973	1.1	1.4	3	-4	3		8.3	0.3	2	15	169	15
India		71	0.1	0.0	-2	-11	-2		7.5	1.4	-2	12	-10	10
Philippines		52	0.5	1.4	1	-2	1		5.8	-2.3	-6	-55	101	-55
Thailand		31	0.5	1.6	4	0	4		2.6	1.6	-1	-3	30	-3
Malaysia		4.10	0.3	1.2	1	-5	1		4.0	0.1	1	-5	10	-5
Argentina		37	1.0	0.7	1	-47	1		21.2	-7.7	0	-176	558	-176
Brazil		3.66	0.7	3.2	6	-13	6		7.9	5.2	5	-22	-80	-22
Chile		659	1.3	1.8	5	-9	5		4.5	0.4	-6	0	-31	0
Colombia		3135	0.9	1.2	4	-10	4		6.5	-1.6	-10	0	26	0
Mexico		19.03	0.5	-0.1	3	-2	3		8.5	12.5	-10	-20	87	-17
Peru		3.4	0.1	-0.3	0	-4	0		5.7	1.1	-1	3	92	1
Uruguay		32	0.4	0.3	0	-13	0		10.4	1.9	1	-34		-34
Hungary		275	0.0	2.6	2	-9	2		2.1	-1.5	-7	-9	71	-10
Poland		3.72	0.4	2.1	1	-10	1		2.2	-0.2	-4	-3	-53	-4
Romania		4.1	0.6	2.6	-1	-9	-1		4.4	-3.0	-8	18	49	17
Russia		65.3	0.3	0.7	7	-14	7		8.1	-3.7	-1	-34	97	-34
South Africa		13.3	0.5	3.5	8	-11	8		9.4	-4.4	-11	-13	19	-15
Turkey		5.19	0.8	1.5	2	-28	2		15.5	-32.5	-87	-155	356	-139
US (DXY; 5y UST)		95	0.0	-1.3	-1	7	-1		2.48	0.0	-7	-3	-3	-3

	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		2585	0.3	0	4	-26	4		189	6	7	-5	34	-5
Indonesia		6533	1.1	1	5	-1	5		203	2	1	-29	54	-33
India		36257	1.9	0	1	1	1		186	4	3	-7	81	-10
Philippines		8007	0.3	-1	7	-9	7		103	1	6	-18	20	-18
Malaysia		1684	0	-1	0	-10	0		141	3	-3	-21	41	-21
Argentina		36039	1.5	4	19	3	19		690	1	27	-125	316	-125
Brazil		98074	1.4	2	12	15	12		238	-2	-5	-33	23	-35
Chile		5419	-0.5	0	6	-7	6		145	-1	-1	-21	39	-21
Colombia		1450	0.8	2	9	-7	9		197	1	-1	-31	46	-31
Mexico		43631	-0.2	0	5	-14	5		330	2	14	-24	107	-24
Peru		20067	0	2	4	-5	4		147	-1	-3	-21	29	-21
Hungary		41035	0.4	0	5	2	5		134	-1	-2	-14	55	-14
Poland		60200	0.6	-1	4	-9	4		67	-1	2	-18	26	-18
Romania		7053	0.1	-1	-4	-16	-4		220	3	3	5	113	-1
Russia		2526	0.6	2	7	10	7		223	5	6	-26	64	-29
South Africa		54446	0.6	2	3	-9	3		312	-3	-6	-53	94	-53
Turkey		104700	0.5	3	15	-12	15		409	-9	0	-20	132	-20
Ukraine		552	0.0	0	-1	65	-1		694	7	36	-93	322	-93
EM total		43	1.5	4	9	-16	9		369	-4	3	-45	105	-45

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