- **Global risk assets retrace sharp overnight losses amid ongoing US-Iran tensions** (link)
- **Oil prices stabilize as investors hope US-Iran cease further military actions** (link)
- **German factory orders unexpectedly contract in November as weakness persists** (link)
- **Central Bank of Romania keeps policy rate at 2.5% as inflation remains stable** (link)
- **Social unrest stifles Chilean economic activity during Q4 2019** (link)

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

Investors remain tense amid heightened geopolitical risks

Overnight, military action in the Middle East initially toggled global markets into a risk-off mode, leading to sharp declines in US Treasury yields and prices of most risk assets, but most markets have so far rallied back this morning. Safe haven assets initially advanced with US Treasury yields down 6 to 8 bps across maturities, the yen strengthening almost 1%, and gold prices jumping almost 2%. G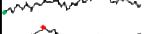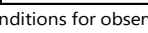lobal equity markets started universally down, with Asian and European indexes posting losses between 1.5 and 2%, while S&P 500 futures indicated sharp declines of 1.8%. However, the so far muted response from US officials coupled with signs from Iran that it had "concluded" its proportionate response to recent US actions in the region have driven most markets to retrace these initial reactions. European equities and S&P 500 futures are now marginally higher, 10-year US Treasury yields are now little changed at 1.82% and EU sovereign yields are higher. Oil prices, which initially saw Brent surge 4% higher to $71/barrel, have surrendered the gains with Brent crude oil prices now back down to $68/barrel. Analysts have cited that the situation in the Middle East remains fragile with markets likely to remain on edge until further signs of de-escalation emerge from US and Iranian authorities.

Key Global Financial Indicators

Last updated: 1/8/20 8:12 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		3237	-0.3	0	3	26	0
Eurostoxx 50		3768	0.2	1	2	23	1
Nikkei 225		23205	-1.6	-3	-1	15	-2
MSCI EM		45	-0.4	0	5	13	0
Yields and Spreads			bps				
US 10y Yield		1.82	0.9	-10	-2	-91	-10
Germany 10y Yield		-0.23	5.4	-5	6	-46	-5
EMBIG Sovereign Spread		299	-8	6	-20	-91	6
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		61.1	0.2	0	1	-3	0
Dollar index, (+) = $ appreciation		97.2	0.2	1	0	1	1
Brent Crude Oil ($/barrel)		67.9	-0.5	3	5	16	3
VIX Index (%, change in pp)		13.9	0.1	0	0	-7	0

Colors denote *tightening*/*easing* financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.
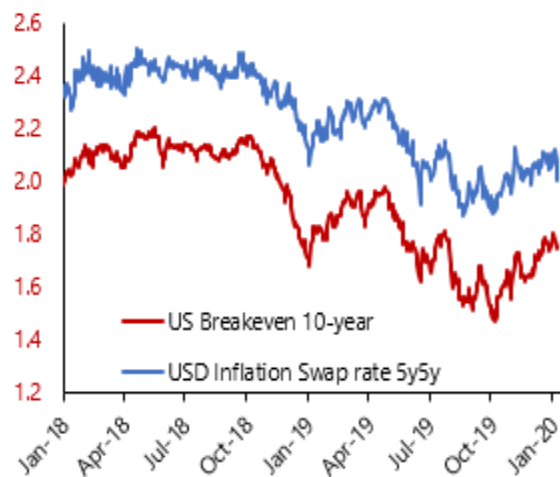
United States   <u>back to top</u>

Most assets moved in tight ranges yesterday as international politics hung over markets, but risk appetite quickly faded overnight amid further developments in the Middle East. The most notable move yesterday was in the dollar, which gained by 0.4%, benefitting from short covering amid some fading concerns about geopolitical tensions and favorable US economic data. The S&P 500 closed down 0.3%, with US Treasury yields rising up by 1-2 bps across the curve, which also steepened marginally ahead of the 10- and 30-year auctions over Wednesday and Thursday.

Overnight, an Iranian retaliatory missile strike on Iraqi-bases housing US forces initially sparked a dramatic risk-off response throughout the capital markets. The muted response by US officials coupled with signals from Iran that it had "concluded" its proportionate measures saw the markets retrace the initial reaction. S&P 500 futures are now marginally higher, the VIX has stabilized back down to 14, and 10-year US Treasury yields are now little changed at 1.82%. **In data releases this morning, the ADP employment report showed US firms added 202k jobs in December, beating forecasts for an increase of 160k jobs.** The November job gains were also revised up from 67k to 124k. The immediate reaction in markets was limited.

The NY Fed's term repo operation was also oversubscribed yesterday for the first time since mid-December, with bids worth $41 bn vs. the $35 bn offered. **Among key data releases on Tuesday**, the trade deficit declined by $3.8 bn in November to $43.1 bn from a downwardly revised $46.9bn in October, slightly more than expected. Imports (-1.0%) declined and exports (+0.7%) increased. The headline composite for the ISM nonmanufacturing survey increased from 53.9 in November to 55.0 in December, beating expectations by a half point.

Market pricing of inflation expectations in the US has declined sharply in the last few days, with 5y5y inflation swaps down 11 bps this week. That said, they remain around 12 bps above the lows in October 2019. Further out along the curve, it is notable that the 30-year sector has been the laggard, and the 10s/30s breakeven curve has flattened sharply, by over 5bps. However, JPM analysts highlight that with new 10-year TIPS supply coming up in the next few weeks, there is room for the 10-year sector to underperform over the near term.

US Inflation Rates (10y breakeven; 5y5y inflation swap)

— US Breakeven 10-year
— USD Inflation Swap rate 5y5y

Source: Bloomberg

Exhibit 6: The 10s/30s breakeven curve has flattened sharply...
10s/30s breakeven curve, market and seasonally-adjusted; bp

— 10s/30s BE curve
— Seasonally-adjusted
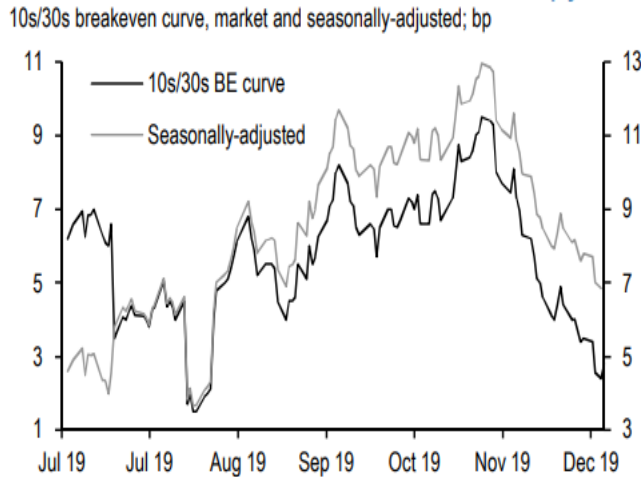
Source: J.P. Morgan

Goldman analysis shows that the monetary policy factor has accounted for all of the roughly 16% index level gain since October 2018. Lower growth expectations would have resulted in negative 10% returns, all else equal which was offset by the inflation factor as well as the model residual.

Exhibit 3: Factor Contributions to S&P 500 Return
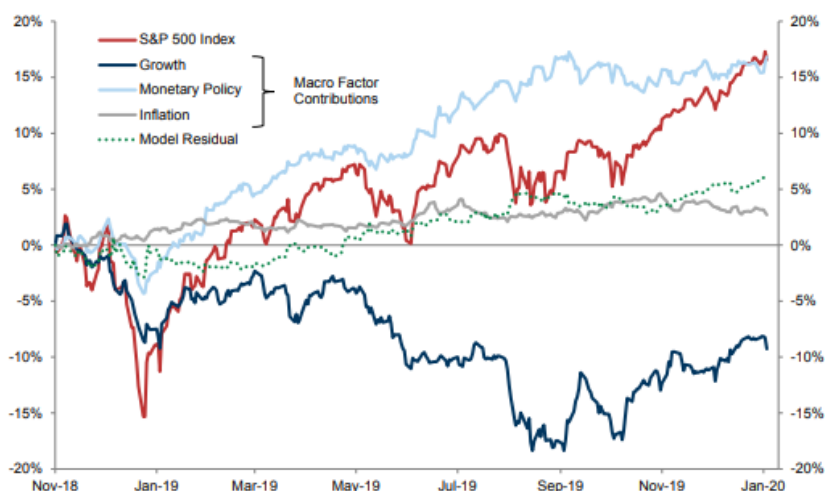
Source: Bloomberg, Goldman Sachs Global Investment Research

Investor positioning in the US financials is the most conservative since 2012, based on Morgan Stanley survey results. The negative shift seems to be driven by many overweights moving to equal-weight, along with a slight uptick in number of investors who entered 2020 underweight financials. Analysts highlighted that concerns on rates and recession risk is driving the net underweight positioning. The returns of the financial sector were similar to the broad S&P 500 over the last one year, though have underperformed in the last one month.
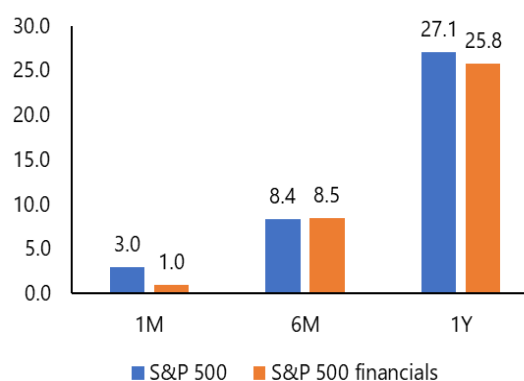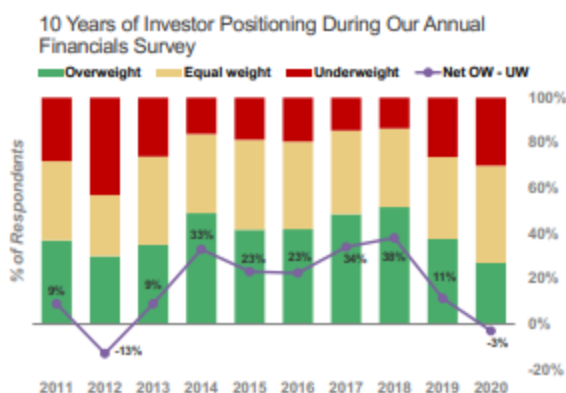
Local governments are selling the most taxable debt since 2010, driven in part by low rates and President Trump's tax-cut law. The sharp decline in rates in 2019 led to officials issuing taxable bonds to pay off the traditional municipal securities. This trend is expected to continue, with analysts forecasting that taxable municipal-debt sales are likely to rise to around $95 bn this year. Analysts also highlighted that these securities have drawn new investors to the market, that has helped support the prices despite the high supply.

Source: Bloomberg
Note: Long-term sales only, excludes derivatives

Bloomberg

Spread (bps; LHS)
Yield to Maturity (%; RHS)
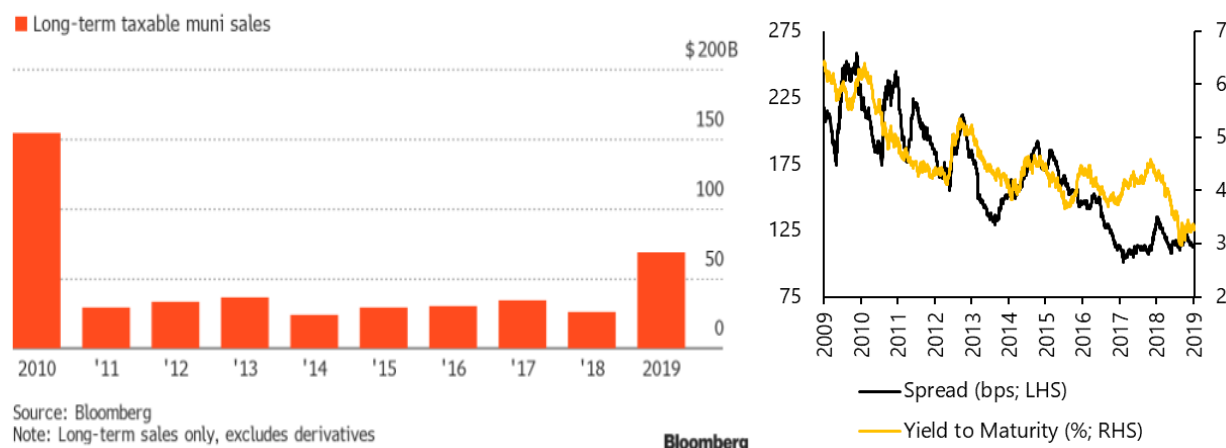
Europe   back to top

Equities were little changed. German 10-yr bund yields are up 5 bps at -0.24% as Germany issued new 10-yr debt. In contrast, 10-yr OAT yields are little changed at +0.03%. The euro was marginally weaker against the USD.

German factory orders fell 1.3% m/m in November, a stark contrast to the gain of 0.2% m/m expected. Factory orders are 6.5% lower y/y (compared to a revised -5.6% in October). Weaker new orders from both outside and inside the euro area drove a strong decline in foreign orders.

Germany: Factory orders, % change since Jan 2018
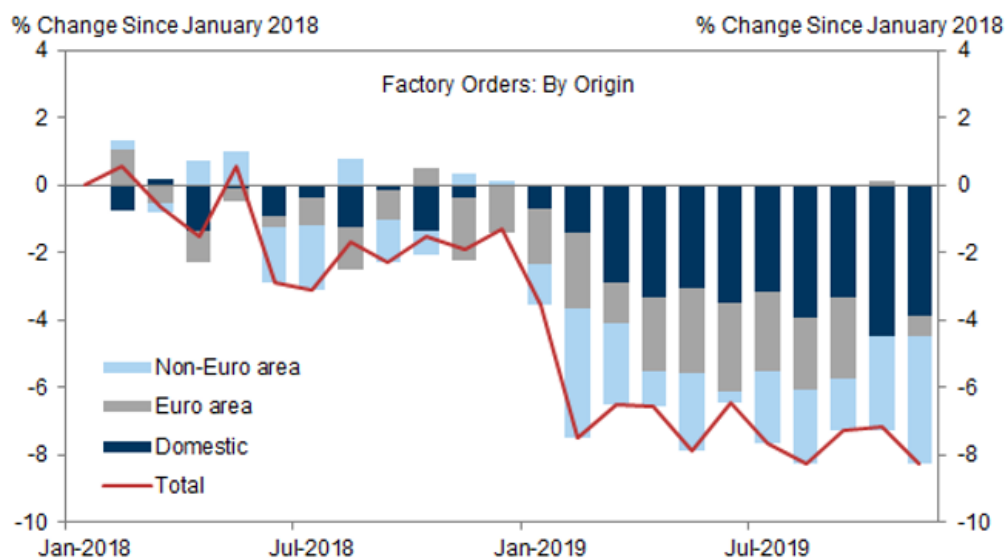
Source: Haver, Goldman Sachs

In contrast to German factory orders, the headline euro area EC sentiment index rose to 101.5 in December (101.4 expected), from 101.2 in November. An improvement of confidence in the services sector drove the small increase.

Italian 10-year spreads to bunds are little changed year-to-date at 162 bps, but contacts are paying close attention to political developments. Regional elections in Emilia-Romagna and Calabria are scheduled on 26 January and are an important test for the governing coalition. Lega leader Salvini has scheduled over a hundred pre-election events in Emilia-Romagna, traditionally a PD stronghold. In 2019, coalition party PD lost several regional elections to Lega in 2019, with a particularly noteworthy loss in Umbria in a joint run with 5-star.

Italy: Lega continues to lead in the polls
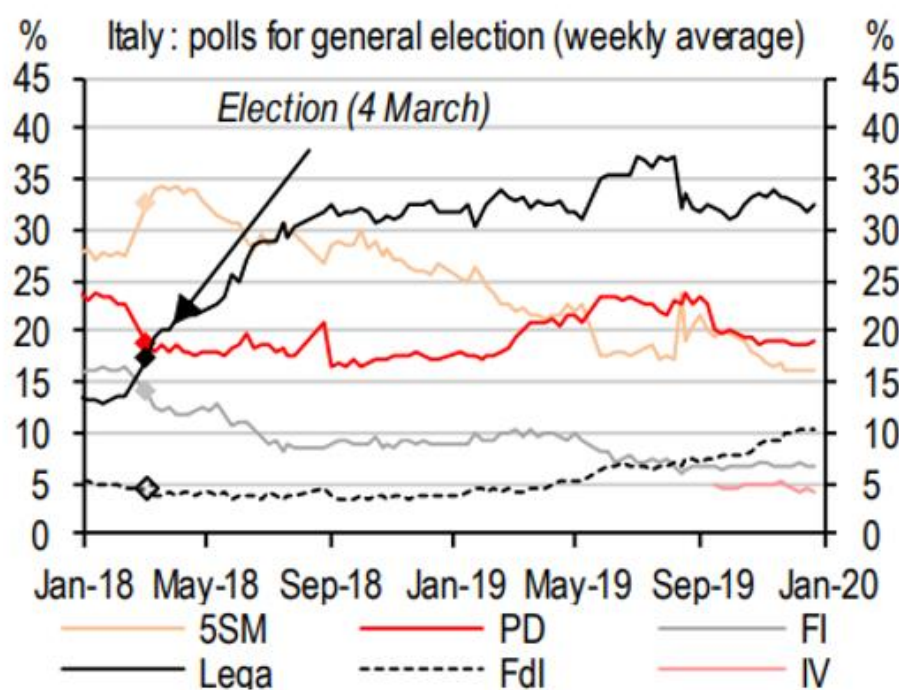
Source: HSBC calculations based on EMG, ScenariPolitici, SWG, Ixè, Demopolis, Piepoli, EMG, Demos&Pi, IPR, Lorien, Euromedia, CISE, Tecnè, Ipsos.

Greek PM Mitsotakis announced the closure of the IMF's Athens office, and wants to lower the primary surplus target for 2021. Greek 10-yr spreads over bunds trade near Italian levels at 163 bps (compared to Spain at 65 bps) and are little changed year-to-date.

United Kingdom
PM Johnson will meet EC President von der Leyen today to discuss a new Free Trade agreement. The U.K government reportedly wants to avoid any deal which requires the U.K. to maintain alignment with EU rules. BoE governor Carney also told the FT that there was no point in London, as a world financial center, being a rule taker from Brussels. **The debate on the Withdrawal Agreement Bill continues in the House of Commons ahead of a vote tomorrow before then moving to the Lords. The British pound trades around pre-election levels of $1.31.**

Other Mature Markets

Japan

Equities (-1.4%) fell on fears of an escalation in tensions between the US and Iran. Losses were broad-based across sectors. Separately, Japanese wages declined -0.2% y/y in November from flat in October, according to the labor ministry. **The 10-year JGB yield fell -1.2 bps to -0.02% while the yen was unchanged.**

Volatility Spike
Nikkei 225 option volatility surges amid Mideast tensions

Source: Bloomberg
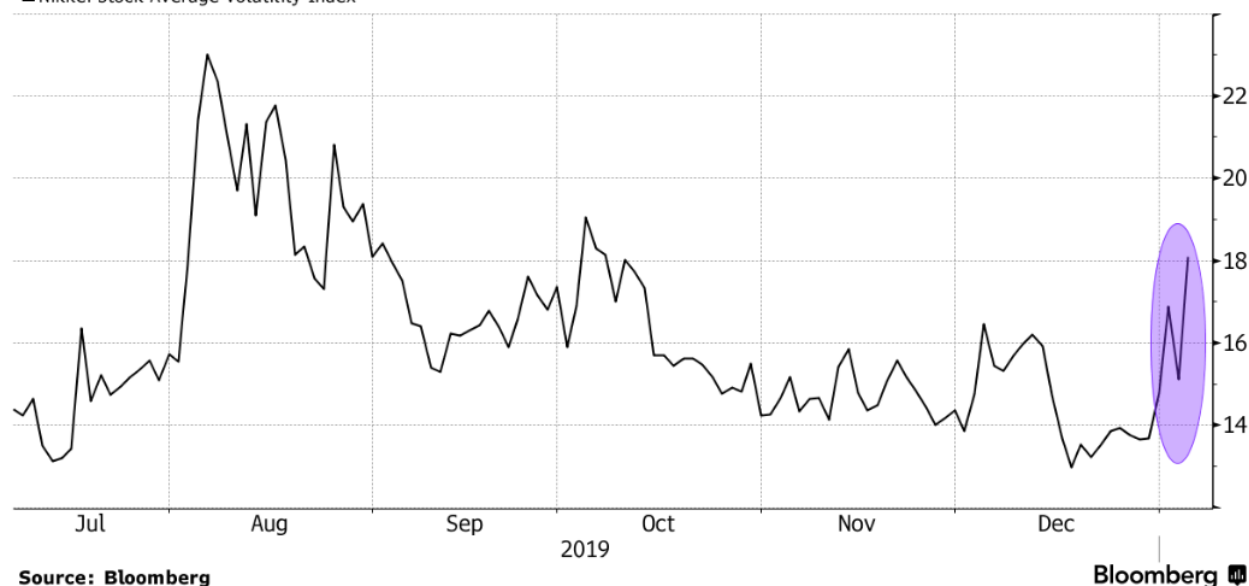
Emerging Markets

Asian equities (-0.6%) fell across the board on renewed geopolitical tensions in the Middle East. Although equities across Asia fell, stocks in Thailand (-1.6%), Malaysia (-1.4%) and the Philippines (-1.3%), alongside China (-1.2%) and Korea (-1.1%), underperformed. Regional currencies weakened, led by the Korean won and Thai baht (both -0.4%). **Equities in EMEA were mixed, however**, with the largest losses in Poland (-0.9%) and the UAE (-1.2%). Stocks in other GCC bourses fell by smaller amounts: Saudi Arabia (-0.4%), Qatar (-0.4%), Bahrain (-0.4%), and Kuwait (-0.1%). Most currencies weakened slightly to the dollar, by about 0.1% to 0.2%. **The Polish central bank is expected to hold rates at 1.5% later today, even as inflation picked up to 3.4% y/y in December. Latin American markets** were mostly lower on Tuesday. Argentina underperformed as the equity index fell 0.9%, followed by Mexico (-0.8%) and Colombia (-0.8%). Local currencies were mostly weaker but mainly traded in narrow ranges. Ten-year government bond yields rose 7 bps in Mexico and were mixed in other countries.

Key Emerging Market Financial Indicators

Last updated:	Level		Change				YTD
1/8/20 8:23 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		44.79	-0.3	0	5	13	0
MSCI Frontier Equities		30.22	0.1	0	1	12	0
EMBIG Sovereign Spread (in bps)		298	-9	5	-21	-92	5
EM FX vs. USD		61.14	0.3	0	1	-3	0
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.94	0.0	0	1	-1	0
Indonesian Rupiah		13900	-0.2	0	1	2	0
Indian Rupee		71.71	0.2	-1	-1	-2	0
Argentine Peso		59.76	0.1	0	0	-37	0
Brazil Real		4.06	0.2	-1	2	-8	-1
Mexican Peso		18.80	0.5	1	2	3	1
Russian Ruble		61.75	0.1	0	3	8	0
South African Rand		14.23	0.6	-2	3	-2	-2
Turkish Lira		5.95	0.4	0	-2	-8	0
EM FX volatility		6.66	0.0	0.0	-0.1	-2.8	0.1

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

Oil Markets

Crude prices initially surged following Iran's missile attacks against US-Iraqi military bases, with Brent hitting $71/barrel, but have since reversed the gains back down to $68/barrel. The muted response from US officials and signals that Iran had "concluded" its proportionate measures saw markets retrace the initial reaction. Various analysts have noted Iran's "measured" response in its attacks and thus hope for a stabilization of ongoing tensions. Besides new geopolitical developments in the region, oil traders are awaiting the release of the EIA's crude oil inventory report later today.

Oil Prices and U.S. Inventories

WTI Oil - last price (R1)	63.0
Brent Crude - last price (R1)	68.8
U.S. Inventories - Thousands barrels on 12/27/19 (L1)	0.430M

CL1 Comdty (Generic 1st 'CL' Future) Oil: Brent WTI Inventory Daily 02JAN2019-0   Copyright© 2020 Bloomberg Finance L.P.   08-Jan-2020 11:11:00
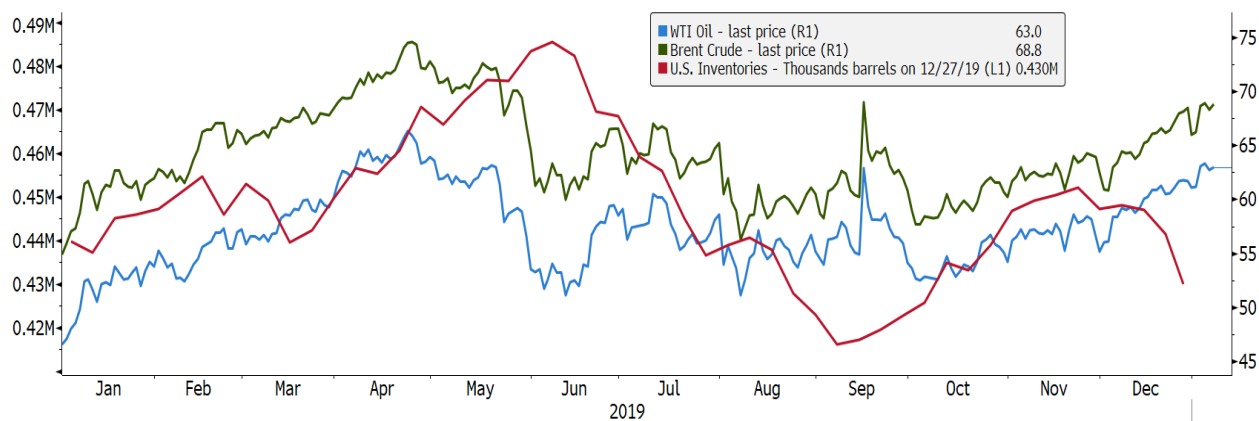
Emerging Market Bond Issuance
EM corporate issuance declined last week to $0.1 bn, from $0.3 bn the week before, while there was no EM sovereign issuance. Full-year EM bond issuance was $673 bn, with corporate debt and sovereign debt accounting for 74% and 26%, respectively. From a regional perspective, China was the largest EM corporate debt issuer last year, accounting for 43% ($196.7 bn). Of the total sovereign bonds issued in 2019, 32% were issued by the Middle East and 21% were issued by Latin America.

Corporate Issuance by Region (USD&EUR) in $US bn

Sovereign Issuance by Region (USD&EUR) in $US bn
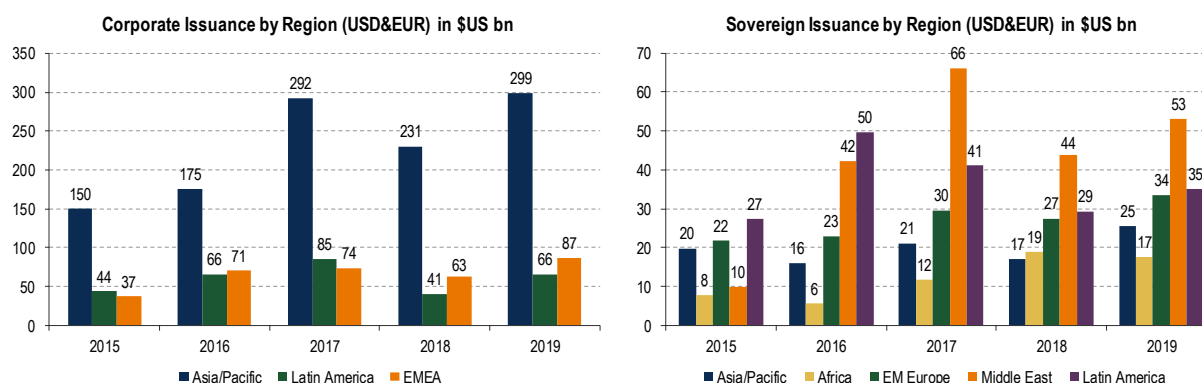
Source: BofA Merrill Lynch Global Research, Bond Radar, Bloomberg

Romania
The Central Bank of Romania lefts its main policy rate unchanged at 2.50%, as anticipated. Interest rates have been at the current levels since May 2018, when the CBR concluded a tightening cycle aimed at slowing down price increases. Since then, inflation has stabilized and it is now trailing at around 3.8% year-on-year.

Romania: Selected Indicators
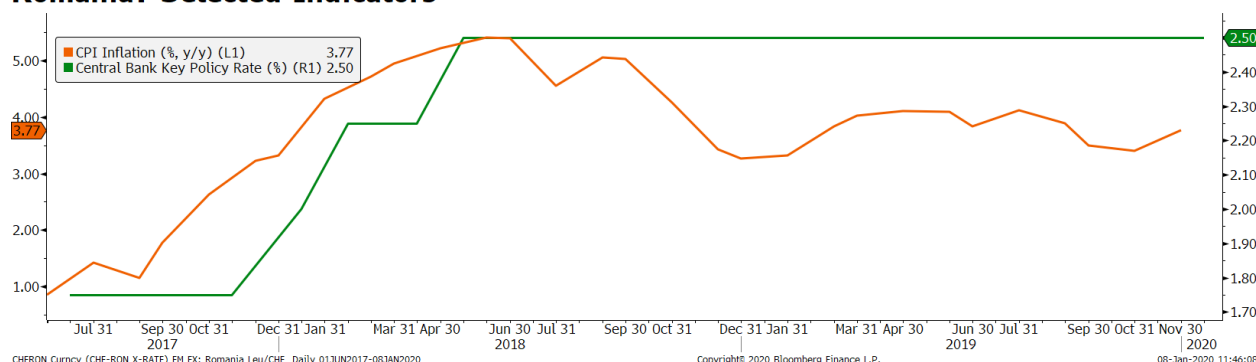
China

China aims to ease funding conditions for small and medium-sized companies. The statement from the State Council's financial and development committee emphasized the need to ease the funding burden of these firms given their important role in job creation and growth. The committee repeated previous pledges to make monetary policy more effective, deepen reforms in the financial sector and recapitalize small commercial banks. **Equities fell 1.2% on concerns over US-Iran tensions. The RMB was little changed after appreciating to the highest level since August yesterday.**

Chile

Chilean economic activity was strongly affected by the social crisis and the economy has remained weak. Economic activity fell 3.4% y/y and 3.3% y/y in October and November, respectively. Manufacturing production declined 5.8% in October but recovered in November (+3.2% y/y), while retail sales suffered two consecutive drops (-12.1% in Oct. and -9.8% in Nov.). Analysts expected Chile's economic activity to continue to weaken in 2020 and have lowered GDP forecasts by 0.1% for 2019. Despite the pessimistic outlook, Chilean assets saw gains yesterday as domestic equities were up 0.6% and the peso appreciated 0.4% against the dollar.

Chart 1: Social & economic crisis severely affected activity indicators
3mma, yoy
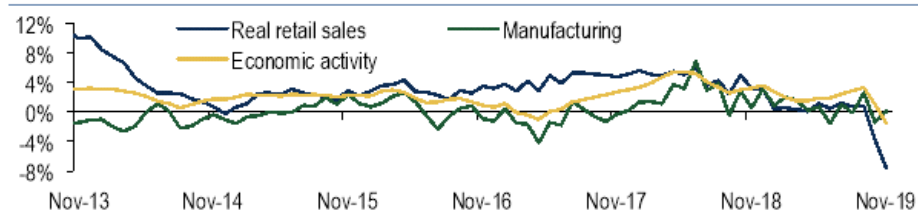
Source: Haver Analytics

List of GMM Contributors

Global Markets Analysis Division, MCM Department

Anna Ilyina *Division Chief*	**Dimitris Drakopoulos** *Financial Sector Expert*	**Jochen Schmittmann** *Senior Economist*
Peter Breuer *Deputy Division Chief*	**Mohamed Jaber** *Senior Financial Sector Expert*	**Can Sever** *Economist (Economist Program)*
Will Kerry *Deputy Division Chief*	**David Jones** *Senior Financial Sector Expert*	**Juan Solé** *Senior Economist*
Evan Papageorgiou *Deputy Division Chief*	**Sanjay Hazarika** *Senior Financial Sector Expert*	**Jeffrey Williams** *Senior Financial Sector Expert*
Sergei Antoshin *Senior Economist*	**Frank Hespeler** *Senior Financial Sector Expert*	**Akihiko Yokoyama** *Senior Financial Sector Expert*
John Caparusso *Senior Financial Sector Expert*	**Rohit Goel** *Financial Sector Expert*	**Yingyuan Chen** *Senior Research Officer*
Sally Chen *Senior Economist*	**Henry Hoyle** *Financial Sector Expert*	**Piyusha Khot** *Research Assistant*
Fabio Cortés *Senior Economist*	**Thomas Piontek** *Financial Sector Expert*	**Xingmi Zheng** *Research Assistant*
Reinout De Bock *Economist*	**Patrick Schneider** *Research Officer*	

Disclaimer: This is an internal document produced by the Global Markets Analysis Division (GA) of the Monetary and Capital Markets Department. It reflects GA staff's interpretation and analysis of market views and developments. Market views presented may or may not reflect a consensus of market participants. GA staff do not independently verify the accuracy of all data and events presented in this document.

Global Financial Indicators

Last updated: 1/8/20 8:14 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		3237	-0.3	0	3	26	0
Europe		3768	0.2	1	2	23	1
Japan		23205	-1.6	-3	-1	15	-2
China		3067	-1.2	1	5	21	1
Asia Ex Japan		74	0.4	1	5	15	0
Emerging Markets		45	-0.4	0	5	13	0
Interest Rates			basis points				
US 10y Yield		1.82	0.9	-10	-2	-91	-10
Germany 10y Yield		-0.23	5.4	-5	6	-46	-5
Japan 10y Yield		0.00	0.3	1	0	-1	1
UK 10y Yield		0.79	-0.3	-3	2	-49	-3
Credit Spreads			basis points				
US Investment Grade		107	0.1	9	-6	-39	9
US High Yield		399	-0.5	6	-46	-62	6
Europe IG		44	-0.2	0	-3	-41	0
Europe HY		211	-1.5	4	-10	-133	4
EMBIG Sovereign Spread		299	-8.0	6	-20	-91	6
Exchange Rates			%				
USD/Majors		97.23	0.2	1	0	1	1
EUR/USD		1.11	-0.3	-1	0	-3	-1
USD/JPY		108.7	-0.3	0	0	0	0
EM/USD		61.1	0.2	0	1	-3	0
Commodities			%				
Brent Crude Oil ($/barrel)		68	-0.5	3	5	16	3
Industrials Metals (index)		115	0.3	1	3	4	1
Agriculture (index)		41	-0.2	-1	3	-4	-1
Implied Volatility			%				
VIX Index (%, change in pp)		13.9	0.1	0.1	0.3	-6.5	0.1
10y Treasury Volatility Index		4.3	-0.1	0.1	-0.2	-0.1	0.2
Global FX Volatility		5.8	0.0	-0.2	-0.2	-2.8	-0.2
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		162	-6.1	-3	-18	-249	-3
Italy		162	-3.8	3	-1	-110	3
Portugal		60	-5.2	-3	-11	-100	-3
Spain		64	-4.4	-2	-14	-65	-2

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: 1/8/2020 8:24 AM	Exchange Rates Level Last 12m	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Local Currency Bond Yields (GBI EM) Level Last 12m	Latest	Change (in basis points) 1 Day	7 Days	30 Days	12 M	YTD
	vs. USD		(+) = EM appreciation					% p.a.						
China		6.94	0.0	0.3	1	-1	0		3.1	-0.8	0	-9	2	0
Indonesia		13900	-0.2	-0.2	1	2	0		7.1	-4.4	-2	-8	-99	-2
India		72	0.2	-0.7	-1	-2	0		6.9	0.6	-1	-8	-69	-1
Philippines		51	0.0	-0.2	0	3	0		4.3	-0.7	-3	1	-201	-3
Thailand		30	-0.5	-1.2	0	6	-1		1.5	0.6	-10	-17	-110	-10
Malaysia		4.10	-0.2	-0.2	1	0	0		3.3	0.4	-6	-10	-77	-6
Argentina		60	0.1	0.2	0	-37	0		56.8	-336.0	-581	-3446	3460	-581
Brazil		4.06	0.2	-0.7	2	-8	-1		6.2	-2.5	-1	13	-184	-1
Chile		771	-0.2	-2.3	1	-12	-2		3.3	2.1	2	-47	-111	2
Colombia		3262	0.4	0.5	5	-3	0		5.9	-4.5	-2	2	-63	-2
Mexico		18.80	0.5	0.5	2	3	1		6.9	3.5	-1	-11	-165	-1
Peru		3.3	0.1	-0.3	2	1	0		4.4	0.1	-8	-10	-128	-8
Uruguay		37	0.2	-0.2	1	-13	0		10.8	-1.8	-6	-41		-6
Hungary		298	-0.2	-1.0	1	-6	-1		1.1	3.0	-4	10	-101	-4
Poland		3.82	-0.3	-0.6	2	-2	-1		1.9	9.4	6	16	-35	6
Romania		4.3	-0.3	-0.7	0	-5	-1		4.0	1.0	-4	-19	-16	-4
Russia		61.8	0.1	0.4	3	8	0		6.1	0.0	1	-12	-229	1
South Africa		14.2	0.6	-1.5	3	-2	-2		9.5	3.8	3	-13	9	3
Turkey		5.95	0.4	-0.1	-2	-8	0		11.8	-17.2	8	-17	-523	8
US (DXY; 5y UST)		97	0.2	0.9	0	1	1		1.62	0.7	-7	-4	-96	-7

	Equity Markets Level Last 12m	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Bond Spreads on USD Debt (EMBIG) Level Last 12m	Latest	Change (in basis points) 1 Day	7 Days	30 Days	12 M	YTD
								basis points						
China		3067	-1.2	1	5	21	1		177	1	1	-5	-8	1
Indonesia		6226	-0.9	-1	1	-1	-1		161	-6	5	-12	-55	5
India		40818	-0.1	-1	1	13	-1		126	1	1	0	-68	1
Philippines		7736	-1.3	-1	-1	0	-1		72	-7	6	-8	-34	6
Malaysia		1589	-1.4	0	1	-5	0		107	-2	-5	-15	-49	-5
Argentina		41116	-0.9	-1	12	25	-1		1914	-7	144	-407	1188	145
Brazil		116937	-0.2	1	5	27	1		218	-9	3	-13	-33	3
Chile		4914	0.6	5	4	-6	5		141	-8	8	-5	-9	8
Colombia		1664	-0.8	0	3	22	0		168	-11	5	-11	-31	5
Mexico		44158	-0.8	1	5	1	1		296	-9	4	-18	-32	4
Peru		20475	-0.5	-1	3	6	0		112	-9	5	-12	-44	5
Hungary		44728	0.5	-3	1	10	-3		92	-6	7	-2	-41	6
Poland		57648	-1.1	0	3	-2	0		23	-5	6	1	-38	5
Romania		9872	-0.1	-1	-1	32	-1		174	-1	0	-13	-37	0
Russia		3105	0.8	2	6	29	2		145	-10	14	-5	-75	14
South Africa		57274	-0.2	0	4	10	0		316	-12	-4	-32	-8	-4
Turkey		112972	0.3	-1	4	25	-1		401	-10	0	-24	-29	0
Ukraine		510	0.0	0	0	-8	0		388	-14	-32	-108	-367	-32
EM total		45	-0.3	0	5	13	0		298	-9	5	-21	-92	5

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

back to top