Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Tuesday, July 30, 2019

- **BoJ leaves monetary policy unchanged as expected (link)**
- **Pound remains under pressure as a higher risk of no-deal Brexit gets priced in (link)**
- **US investors' demand shifts to high yield corporate bonds from leveraged loans (link)**
- **Libor-OIS spread widens following last week's fiscal deal (link)**
- **China to promote debt-for-equity swaps for qualified private firms (link)**

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Markets fall from highs on trade worries and disappointing earnings

Equity markets are giving up some of their recent gains after disappointing earnings results from a few large firms, as well as lingering trade worries. European stocks headed sharply lower, helped by disappointing results from Bayer, Lufthansa and Reckitt Benckiser. Despite some positive earning results from US corporates later in the morning, including Xerox and Procter & Gamble, markets continued their weakness as President Trump issued tweets criticizing China for not folowing through on promised purchases of agricultural products. The tweets come as investors await updates on talks between US and Chinese trade negotiators that began on Tuesday in Shanghai. The British pound continued to weaken on the growing risks of a no-deal Brexit, and the market pricing of a rate cut by the BOE has risen to over 50% by the end of the year. The Bank of Japan kept interest rates unchanged as broadly expected, but highlighted external risks especially from increasing protectionism.

Key Global Financial Indicators

Last updated: 7/30/19 8:05 AM	Level: Last 12m	Level: Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		3021	-0.2	1	3	8	21
Eurostoxx 50		3464	-1.7	-2	0	-1	15
Nikkei 225		21709	0.4	0	2	-4	8
MSCI EM		43	0.4	-1	-1	-4	9
Yields and Spreads					bps		
US 10y Yield		2.05	-0.5	-3	5	-92	-63
Germany 10y Yield		-0.40	-0.7	-4	-7	-84	-64
EMBIG Sovereign Spread		330	2	2	-14	4	-84
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		62.7	0.1	0	0	-4	1
Dollar index, (+) = $ appreciation		98.1	0.0	0	2	4	2
Brent Crude Oil ($/barrel)		64.3	0.9	1	-3	-14	19
VIX Index (%, change in pp)		13.8	1.0	1	-1	0	-12

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

United States

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Equities slid lower Monday, declining from their historical high. Overall, it was a quiet trading session with small volume, as markets wait for fresh catalysts. VIX closed at 12.7, up 0.5%pt.

Treasury yields edged lower across tenors Monday with the 2-to-10-year yield curve flattening by 1bp. President Trump attacked the Fed once again, tweeting "a small rate cut is not enough." Kinks in the Treasury bill curve faded following the fiscal deal last week, as the possibility of technical default decreased.

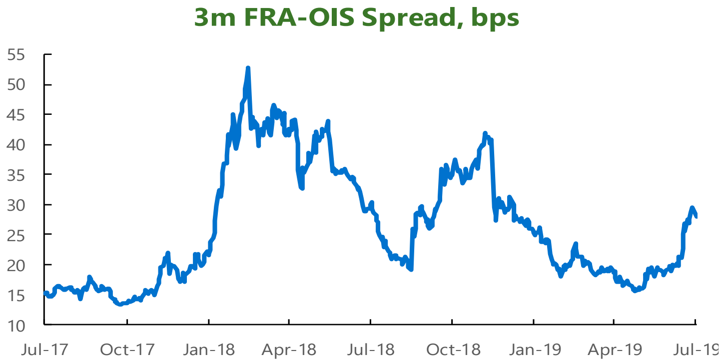
This morning, June personal spending was reported in line with expectation (0.3% m/m vs. 0.3% cons.), supported by solid income gains (0.4% m/m vs. 0.4% cons.). PCE deflator was slightly lower than expected (1.4% y/y vs. 1.5% cons.). The report was in line with Q2 GDP last week in which consumer spending was robust. In financial market, the Treasury 10-year yield rose by a half bp following the headline. The dollar was unchanged.

The Treasury announced that they currently expect to borrow $433 bn in marketable debt during the third quarter. The borrowing estimate is $274 bn higher than announced in April 2019. The increase in borrowing is primarily driven by changes in cash balance assumption, which has changed following the fiscal deal.

Cash Balance Assumptions	April - June Quarter Prior	Current	Change	July - September Quarter Prior	Current	Change
Opening Balance	$334	$334	$0	$270	$264	-$6
Closing Balance	$270	$264	-$6	$85	$350	$265
Impact on Borrowing	-$64	-$70	-$6	-$185	$86	$271

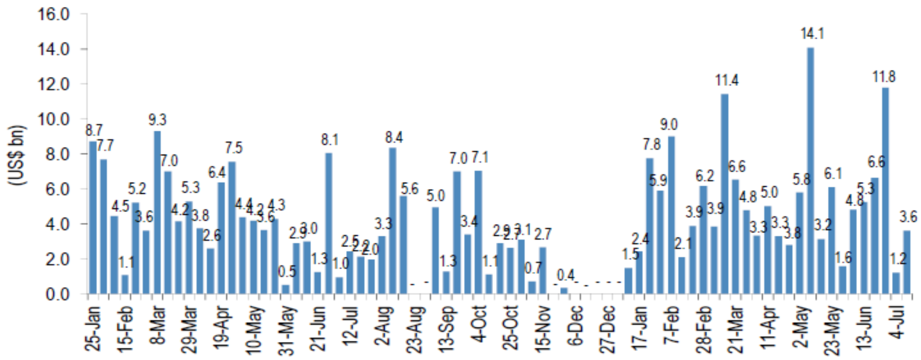
Source: US Department of the Treasury

Libor-OIS spread increased in forwards. The FRA-OIS spread reached 30bps, as a divided House passed a two-year budget deal last week that would allow the government to keep borrowing to cover its debts. Market participants expected that the debt limit resolution would result in elevated T-bill supply that would likely push interbank funding rates higher, as happened last year. Some analysts, however, are skeptical on the room for further widening from here, at least for now, as the resumed bill issuance this time around is expected to be much more moderate unlike the episode in early 2018. On the demand-supply balance in the dollar funding market, bank CP/CD issuance tends to be slow, while flows into prime MMFs will likely persist in the near-term, as has been the case throughout this year.



Investor demand has shifted to high yield bonds from leveraged loans. The year-to-date weekly average for gross issuance volume in high yield corporate bonds is $5.5 bn, which totals $160.8 bn compared with $132.3 bn that priced over the same period last year, according to JPMorgan. A higher level of primary market activities has been supported by expectations for a more dovish monetary policy stance by the Fed. Meanwhile, leveraged loan primary market activity has decreased; the year-to-date gross loan volume totals $178.1 bn compared with $510.6 bn over the same period last year. Demand for loans tends to decrease when investors expect a lower rate environment as their coupons are typically on a floating rate basis. On the flows in the secondary market, similarly to the primary market, high yield bond funds reported a $1.3 bn inflows during the week ending July 24, a seventh consecutive inflow, while leveraged loan funds reported a $414 mn outflow for the week, a 36th successive outflow.

Figure 2: Weekly high yield new issue volume increased w/w



Source: J.P. Morgan.

Europe

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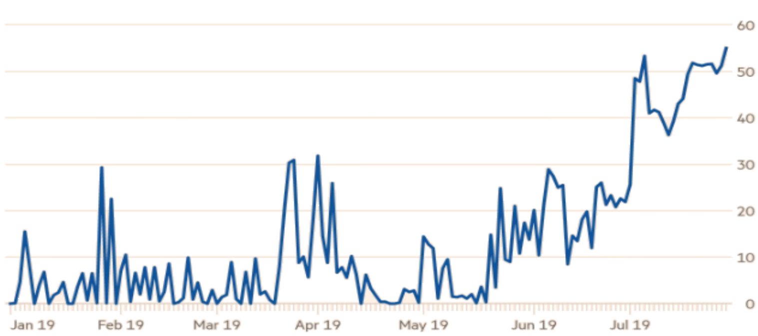
United Kingdom

Sterling continues to depreciate, weakening nearly 2% against the dollar over the last two sessions and close to 3% since Boris Johnson became Prime Minister. The move has been mostly a result of Johnson's hardening stance towards Brexit negotiations with the EU, leading investors to price in a higher chance of a no-deal outcome. The pound is now at its weakest level against the dollar since early 2017, and the weakest against the euro since mid-2017. The reaction can also be seen in fixed income markets where yields have declined by more than most EU counterparts this week, especially at the shorter end of the curve. Two-year gilt yields are down 5 bps over the last two sessions to 0.44%, the lowest level since early 2018, while 10-year yields are back to their lowest since the EU referendum in 2016. In tandem, **investors are pricing in a higher chance of easing by the BOE, with the implied probability of a rate cut this year increasing to 55%.**

Rising odds of 2019 Bank of England rate cut

Implied probability (%)



Source: Bloomberg

Europe

The EuroStoxx 600 is down 0.5%, led by a 1.5% decline in the Italian MIB. The UK FTSE 100 continues to outperform; despite growing pessimism over a favorable Brexit outcome, the weaker pound has supported the export-heavy index. **Fixed income markets are little changed,** with no reaction to France's slightly lower-than-expected Q2 GDP (1.3% y/y vs. 1.4% consensus)**.** The only notable move is a 4 bps increase across the Italian sovereign debt curve amid incoming supply and more headlines about tensions within the governing coalition.

Sweden

The krona is underperforming, depreciating 0.5% against the euro on the back of surprisingly weak growth data. Q2 preliminary GDP came in at 1.4% y/y, down from 2.1% in the previous quarter and well below the 1.9% expected. The decline was driven by a contraction in gross fixed capital formation and, to a lesser extent, weak external trade. The data cast doubts on Riksbank's intentions to continue tightening monetary policy. Yields are down by as much as 4 bps across the sovereign curve.

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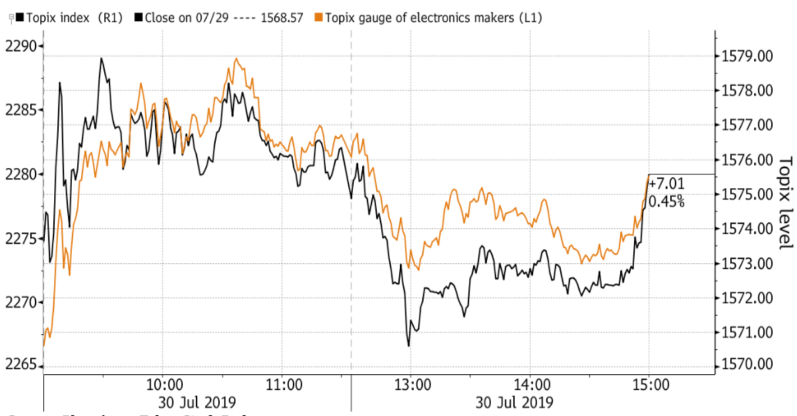
Japan

The Bank of Japan (BoJ) left its monetary policy unchanged as expected. The monetary policy statement was unchanged, but the summary of the quarterly outlook report that accompanied the policy decision recognized heightened external risks to growth especially in regard to protectionism. A concluding comment was added about not hesitating to ease further if there is a greater possibility that momentum towards the price stability target will be lost. Analysts interpreted the language adjustments as lowering the bar for easing in the second half of the year. **10-year JGB yields fell 0.6 bps to -0.16% while the yen strengthened 0.1%. Equities (+0.5%) rose for the first time in three days with tech stocks outperforming.**

Electronics makers provide the biggest boost to the Topix



Source: Bloomberg, Tokyo Stock Exchange

Emerging Markets back to top

Price action in EM was mixed overnight. Asian equities (+0.2%) rose on net with few developments to catalyze stocks. While Indonesia (+1.1%) outperformed, Vietnam (-1.2%) and Thailand (-0.6%) paced losses. Regional currencies broadly appreciated, with the Philippine peso (+0.5%) and Thai baht (+0.4%) outperforming. **In EMEA,** equity markets are mostly rangebound with Dubai (+0.5%) outperforming and Czech Republic (-0.4%) underperforming. In FX markets, the Turkish lira continues to appreciate, rising 0.7% on the day and 2.5% over the last five trading sessions. **Latin American equity markets** were generally higher on Monday. Argentina outperformed as the Merval rose 1.9%, followed by the Mexican equity index (+1.5%). Local currencies were generally lower, with the Colombian peso down 1.4% and the Argentine peso down 1%. 10-year government bond yields rose 7 bps in Colombia and were slightly lower in other countries.

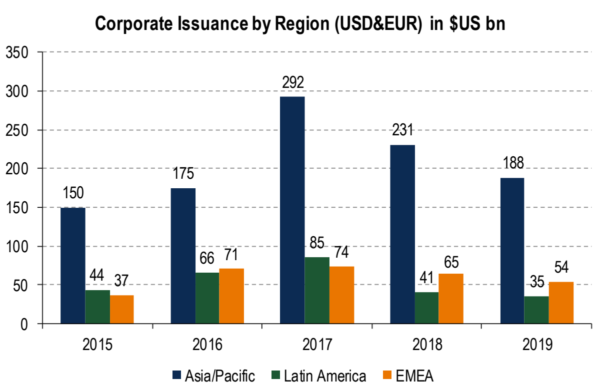
Key Emerging Market Financial Indicators

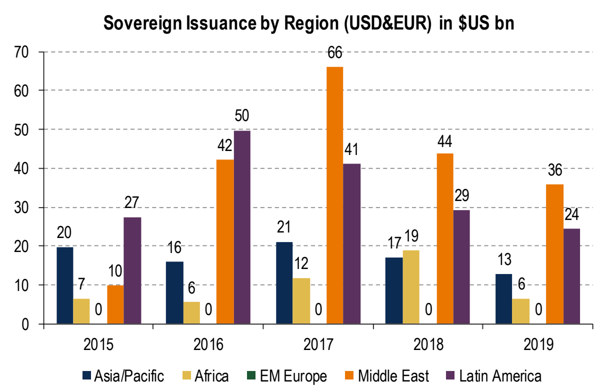
Last updated: 7/30/19 8:09 AM	Level: Last 12m	Level: index	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		42.62	0.4	-1	-1	-4	9
MSCI Frontier Equities		30.49	0.8	2	3	3	17
EMBIG Sovereign Spread (in bps)		330	2	2	-14	4	-84
EM FX vs. USD		62.75	0.1	0	0	-4	1
Major EM FX vs. USD					%, (+) = EM currency appreciation		
China Renminbi		6.88	0.2	0	0	-1	0
Indonesian Rupiah		14028	-0.1	0	1	3	3
Indian Rupee		68.86	-0.2	0	0	0	1
Argentine Peso		43.83	-1.1	-3	-3	-38	-14
Brazil Real		3.78	-0.1	0	2	-1	3
Mexican Peso		19.03	0.1	1	0	-3	3
Russian Ruble		63.28	0.3	0	-1	-2	10
South African Rand		14.16	0.0	-2	0	-7	1
Turkish Lira		5.56	1.0	3	2	-12	-5
EM FX volatility		6.98	0.0	0.1	-1.3	-3.1	-2.8

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

EM Bond Issuance

EM corporate issuance for last week edged up to $12.4 bn, from $7.5 bn the week before, while EM sovereign issuance increased from $2 bn the week before to $6.6 bn. The year to date total issuance of $389.7 bn was approximately 20% more than 2018 issuance over the same period. Of the total corporate bonds issued, 58% ($7.2 bn) were investment grade bonds and 42% ($5.2 bn) were high yield bonds. Last week's sovereign issuance was placed by Mexico ($3.6 bn) and Oman ($3 bn).





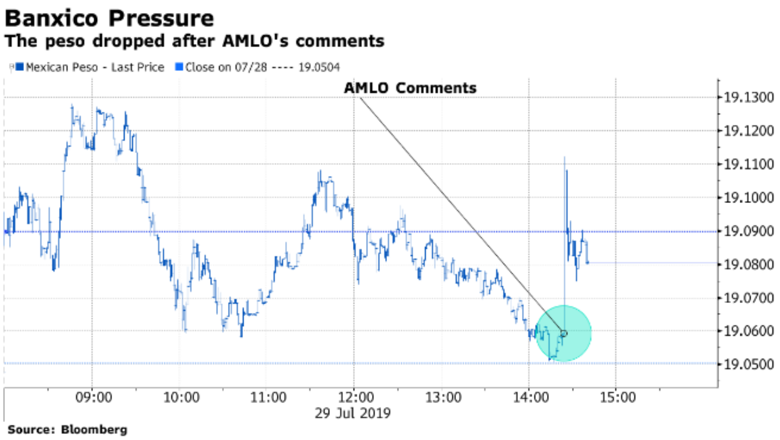
Source: BofA Merrill Lynch Global Research, Bond Radar, Bloomberg

China

Chinese regulators will promote debt-for-equity swaps for qualified private companies to reduce debt risks. According to Xinhua News, a guidance jointly released by various agencies stated that the country will strengthen the role of financial asset investment firms in the swap program. The authorities will also step up pilot swap projects for preferential companies while enhancing asset pricing of swaps. **Chinese equities (Shanghai +0.4%; Shenzhen +0.5%) rose with financials outperforming.** The onshore and offshore RMB (+0.1%) rose slightly. **On trade, China rebutted US President Trump's criticism of its developing nations status under WTO rules.** The state media argued that the demand by the US for the WTO to update the developing nations definition is "absurd" and was an "old trick".

Mexico

During an interview with Bloomberg, President Lopez Obrador commented that it is essential for Mexico to lower interest rates to boost economic growth while pointing out he respects Banxico autonomy. The peso slightly weakened following this comment. Due to high core inflations, Banxico has kept its interest rate at 8.25%. In other economic news, the unemployment rate printed at 3.54% sa in June, slightly higher than market expectations and 3.53% sa in the previous month.



South Africa

Non-residents have divested from local assets at the fastest pace on record for the first seven months of the year. Foreign sales of equities and bonds so far this year have amounted to $4.8 bn, according to Bloomberg data. The move has been attributed to the countries darkening fiscal outlook, in large part associated to the embattled state-owned energy company, Eskom. Warnings from rating agencies and the risk of more rating cuts have also weighed on sentiment. Moody's is the only rating company to keep South Africa as investment grade.

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
Frank Hespeler
Senior Financial Sector Expert
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: 7/30/19 8:07 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		3021	-0.2	1	3	8	21
Europe		3464	-1.7	-2	0	-1	15
Japan		21709	0.4	0	2	-4	8
China		2952	0.4	2	-1	3	18
Asia Ex Japan		69	-0.5	-1	-1	-5	9
Emerging Markets		43	0.4	-1	-1	-4	9
Interest Rates					basis points		
US 10y Yield		2.05	-0.5	-3	5	-92	-63
Germany 10y Yield		-0.40	-0.7	-4	-7	-84	-64
Japan 10y Yield		-0.15	-0.7	-1	1	-25	-15
UK 10y Yield		0.64	-1.3	-5	-19	-70	-64
Credit Spreads					basis points		
US Investment Grade		117	0.7	0	-3	17	-30
US High Yield		433	1.9	-4	-7	93	-88
Europe IG		51	2.0	3	0	-12	-36
Europe HY		256	9.3	13	7	-32	-97
EMBIG Sovereign Spread		330	2.0	2	-14	4	-84
Exchange Rates					%		
USD/Majors		98.06	0.0	0	2	4	2
EUR/USD		1.12	0.1	0	-1	-5	-3
USD/JPY		108.5	0.2	0	0	2	1
EM/USD		62.7	0.1	0	0	-4	1
Commodities					%		
Brent Crude Oil ($/barrel)		64	0.9	1	-3	-14	19
Industrials Metals (index)		115	-0.8	0	1	-6	5
Agriculture (index)		40	-0.6	-1	-4	-11	-4
Implied Volatility					%		
VIX Index (%, change in pp)		13.8	1.0	1.2	-1.3	-0.5	-11.6
10y Treasury Volatility Index		4.4	0.1	0.0	-0.3	0.4	-0.2
Global FX Volatility		6.6	0.0	0.1	-0.2	-1.4	-2.4
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		245	2.1	5	-32	-98	-170
Italy		202	5.3	6	-41	-32	-48
Portugal		82	1.0	1	2	-50	-66
Spain		76	0.9	1	4	-22	-42

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: 7/30/2019 8:09 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	0.2	0.0	0	-1	0		3.2	0.1	0	-7	-30	1
Indonesia		14028	-0.1	-0.3	1	3	3		7.3	6.4	7	-14	-63	-83
India		69	-0.2	0.1	0	0	1		6.7	-4.1	7	-26	-131	-73
Philippines		51	0.3	0.5	0	4	3		4.6	-0.8	-7	-23	-125	-166
Thailand		31	0.2	0.3	0	8	5		2.0	0.0	-6	-25	-70	-63
Malaysia		4.13	-0.2	-0.3	0	-2	0		3.6	-0.2	-1	-3	-50	-50
Argentina		44	-1.1	-3.1	-3	-38	-14		30.3	-9.8	36	164	1007	733
Brazil		3.78	-0.1	-0.3	2	-1	3		6.6	-1.8	-7	-29	-280	-156
Chile		697	-0.3	-1.2	-3	-8	0		3.0	-2.3	-11	-33	-184	-145
Colombia		3285	-1.4	-3.3	-2	-13	-1		5.7	9.1	6	-11	-83	-85
Mexico		19.03	0.1	0.8	0	-3	3		7.6	-3.5	0	0	-21	-113
Peru		3.3	-0.1	-0.5	0	-1	2		4.5	0.0	6	-39	-108	-127
Uruguay		34	-0.2	1.8	3	-11	-5		9.7	-8.6	-41	-81		-103
Hungary		294	0.2	-0.4	-2	-6	-5		1.3	0.4	-6	-29	-101	-87
Poland		3.85	0.1	-0.8	-2	-5	-3		1.9	2.2	-3	-20	-68	-40
Romania		4.2	0.1	-0.2	-1	-7	-4		3.7	1.0	-12	-36	-92	-52
Russia		63.3	0.3	-0.1	-1	-2	10		7.1	2.1	-1	-15	-44	-128
South Africa		14.2	0.0	-1.6	0	-7	1		9.4	-4.5	32	19	22	-20
Turkey		5.56	1.0	2.9	2	-12	-5		15.1	-14.4	-86	-181	-359	-177
US (DXY; 5y UST)		98.1	0.0	0.4	2	4	2		1.83	-1.5	0	7	-102	-68

	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		2952	0.4	2	-1	3	18		177	1	-1	-3	-7	-17
Indonesia		6377	1.2	0	0	6	3		169	2	2	-18	-10	-67
India		37397	-0.8	-2	-5	0	4		133	-1	-4	-15	-25	-63
Philippines		8150	-0.5	-1	2	5	9		69	1	3	-10	-33	-52
Malaysia		1643	0.0	-1	-2	-7	-3		115	0	-2	-12	-20	-47
Argentina		42785	1.9	10	2	46	41		790	8	5	-39	239	-25
Brazil		103483	0.6	0	2	29	18		204	2	-3	-29	-59	-69
Chile		5001	0.4	0	-1	-7	-2		128	1	0	-6	-4	-38
Colombia		1585	0.3	-1	2	2	20		171	1	3	-10	-5	-57
Mexico		41277	1.5	0	-4	-17	-1		324	2	-4	-5	58	-30
Peru		20692	0.0	0	0	2	7		115	1	0	-9	-27	-53
Hungary		40941	-0.2	-1	2	14	5		90	-1	1	0	-20	-58
Poland		59519	-0.3	-2	-1	-1	3		36	0	2	-5	-22	-49
Romania		8981	-0.2	-1	2	11	22		183	3	-6	-1	38	-38
Russia		2726	-0.1	1	-1	19	15		187	1	0	-18	-3	-65
South Africa		57561	-0.8	-1	-1	0	9		296	2	30	13	26	-69
Turkey		102369	-1.0	0	6	6	12		445	1	-15	-34	24	16
Ukraine		541	0.0	0	0	7	-3		473	6	30	-35	-29	-314
EM total		43	0.4	-1	-1	-4	9		330	2	2	-14	4	-84

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