Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Wednesday, June 12, 2019

- **Hawkish trade rhetoric weighs on Chinese equities (link)**
- **Falling US real yields underline market expectations of multiple Fed rate cuts (link)**
- **Debt ceiling issue may resurface in September (link)**
- **US companies seek to repair balance sheets as credit cycle matures (link)**
- **Hong Kong equities fall amid protests over extradition law (link)**
- **Argentine assets surge on Macri's VP pick (link)**
- **Brazilian markets rally on progress towards pension reform (link)**

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

Trade tensions and oil slump prompt risk-off shift

Global risk assets are retreating from gains made over the past week, with equities down 0.5 to 1% in most major markets. Among the drivers were hawkish comments on trade, with US President Trump indicating that he is personally delaying an agreement with China until counterparts return to terms negotiated earlier this year. A spokesperson for the Chinese authorities reportedly noted that China is "not afraid of fighting a trade war." Asian equities were also affected by mass protests in Hong Kong over an extradition law to China. Moreover, a slide in oil prices (-2.5%) added to investor caution, driven by US inventory data that showed growing stockpiles. Oil prices have slumped about 20% since late April, with Brent down to $61 per barrel this morning. U.S. 10-year Treasury yields are trading a few basis points lower at 2.12% this morning, driven down further by US core CPI data that came in slightly lower than expected.

Key Global Financial Indicators

Last updated: 6/12/19 7:58 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		2886	0.0	3	0	4	15
Eurostoxx 50		3380	-0.6	1	1	-3	13
Nikkei 225		21130	-0.4	2	-1	-8	6
MSCI EM		42	-0.7	2	0	-9	8
Yields and Spreads					bps		
US 10y Yield		2.12	-2.3	-1	-35	-84	-56
Germany 10y Yield		-0.24	-1.0	-2	-20	-73	-48
EMBIG Sovereign Spread		357	5	-11	6	7	-57
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		62.2	-0.1	1	0	-5	0
Dollar index, (+) = $ appreciation		96.7	0.0	-1	-1	3	1
Brent Crude Oil ($/barrel)		60.7	-2.5	0	-14	-20	13
VIX Index (%, change in pp)		16.3	0.3	0	0	4	-9

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

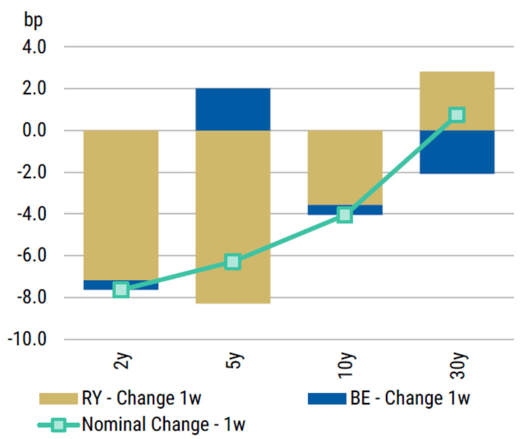
United States

back to top

More trade rhetoric from the US President derailed a promising early rally in US markets yesterday. Stocks ended the day with small losses as the S&P 500's five day winning streak came to an end. The mood remains nervous ahead of next week's FOMC meeting and the G20 summit on June 28-29. Treasury yields were higher early in the session but reversed course as stocks gave up their gains. The 10-year yield traded just below 2.18% before ending at 2.14%. Bond market volatility remains elevated as markets perceive a key turning point ahead: either the Fed will meet expectations with multiple rate cuts in coming quarters or a disappointed market could send rates sharply higher and take back more of the equity gains scored by the market from January through April. Meanwhile, the effective Fed Funds rate traded at 2.37%, just 2 bps above the Fed's Interest on Excess Reserves (IOER) of 2.35%, leading to speculation that the Fed may have to cut the IOER even further.

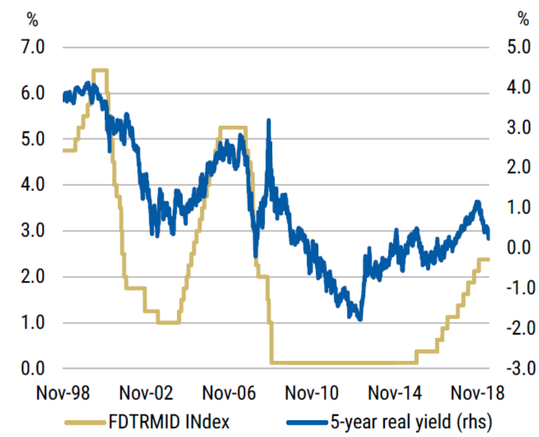
The recent rally in the US Treasury yields has been led by a sharp decline in real yields from the two-year to the ten-year sector of the yield curve. As nominal Treasury yields went down, the breakeven yields of Treasury Inflation Protected Securities (TIPS) were relatively steady, implying that the markets are less worried about inflation declining and more concerned about the potential headwinds from trade tensions and an already slowing US economy. If the Fed does ease, real rates have the potential to fall much further, as occurred in previous easing cycles. The FOMC engineered a significant change in real yields with just a change of rhetoric back in January and achieved more declines with additional dovish rhetoric later in the year. Five-year real yields are more than 60 bs below their levels at the end of last year and actual rate cuts could accelerate the path to even lower yields.

Exhibit 27: Moves in real yields and breakevens over the week



Source: Bloomberg, Morgan Stanley Research

Exhibit 28: 5-year real rates and fed funds target rate over 20 years



Source: Bloomberg, Morgan Stanley Research

In this morning's data, the core CPI for May was slightly lower than expected at 0.1% m/m (versus 0.2% consensus), while the 12-month change was also lower at 2% (vs. 2.1%). The headline CPI was on target at 0.1% m/m and the annual number was 1.8% (vs. 1.9%). Treasury yields dipped and the dollar was weaker immediately following the release.

The debt ceiling debate is likely to resurface at the end of September. The Treasury's latest Monthly Statement of the Public Debt (MSPD) showed that it used $215 bn of extraordinary measures after the debt ceiling was hit on March 1. JP Morgan forecasts that the Treasury has an additional $107 bn of extraordinary measures that will enable the authorities to keep going until mid-August. After this, the Treasury will have to run down its cash reserves, setting up the end of September as the likely next deadline for the debt ceiling showdown. Many analysts are worried that a debt compromise may be difficult to reach in the current fraught political environment and warn that market disruptions could ensue. So far, there has been little sign of worry in the US T-Bill market with maturities in late September and early October trading normally. However, market participants will be alert for any signs of rising yields in that section of the T-Bill yield curve.

Exhibit 8: Treasury used $250bn of extraordinary measures inMay and has $107bn of additional borrowing headroom...

Treasury borrowing capacity under extraordinary actions; Mar-May 2019 usage vs. Jun-Sep 2019 projections; $bn

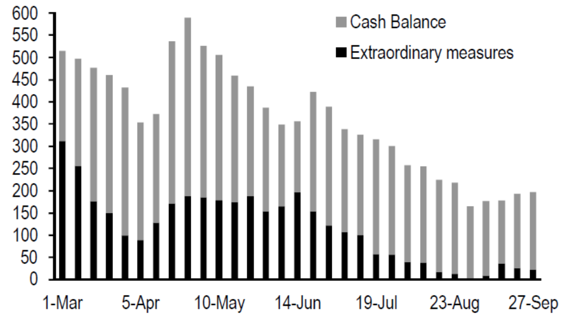
	O/S as of Feb 2019	O/S as of May 2019	Borrowing Headroom	
			Mar-May '19 Used	Jun-Sep' 19 Projected†
TSP	257	44	215	39
CSRDF/PSRHBF	950	913	35	40
Exchange Stabilization Fund	22	23	0	23
Federal Financing Bank	10	10	0	5
Total	1240		250	107

* Assumes Debt Issuance Suspension Period of 6 months: March 1 through August 31

Source: US Treasury, J.P. Morgan

Exhibit 9: ...and those are likely to be depleted around mid-August, though Treasury will still have $200bn in cash at this time, allowing borrowing to continue well into September

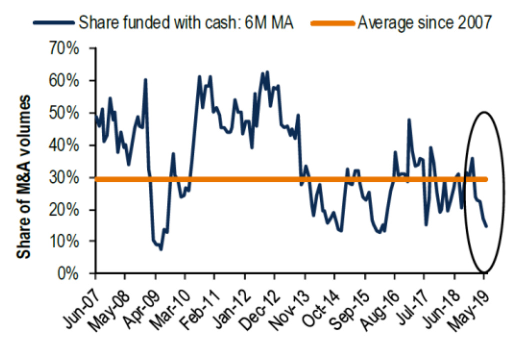
Projected estimates of Treasury's available resources; $bn



Source: US Treasury, J.P. Morgan

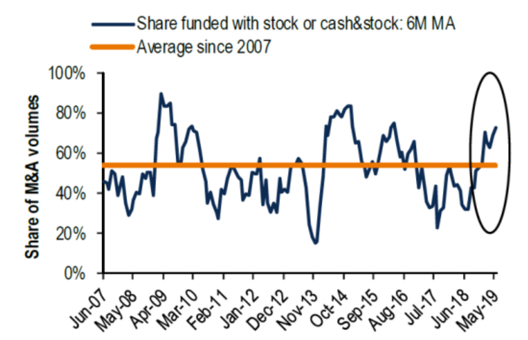
Some US companies are trying to avoid credit problems associated with the maturing credit cycle by repairing their balance sheets. Many are in deleveraging mode as they cut back on debt levels. The proportion of new merger and acquisition (M&A) transactions being funded with cash or debt is on the decline while the proportion of equity-funded transactions is now markedly higher than historical averages. The merger between Raytheon (RTN) and United Technologies (UTX) announced last weekend is an all-cash transaction, and spreads on UTX tightened by 20 bps this week as the merging companies announced they would target an A rating for the new company, up from RTX's current BBB+/Baa1 rating. In previous years, companies would fund M&A deals with cash or debt and their spreads would usually widen after the deal was announced.

Figure 5: The share of M&A funded by cash has declined ...



Note: based on deals of $1bn or larger for public North-American non-financial companies.
Source: BofA Merrill Lynch Global Research, Bloomberg

Figure 6: ... while the share funded with stock has increased



Note: based on deals of $1bn or larger for public North-American non-financial companies.
Source: BofA Merrill Lynch Global Research, Bloomberg

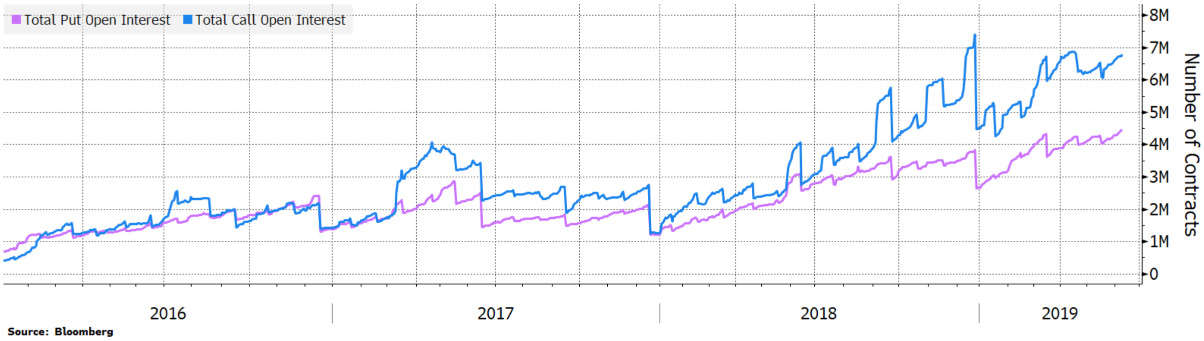
Europe

back to top

European stocks slipped today following Asian peers lower. The EuroStoxx 600, DAX, and CAC 40 indices all dropped about 0.5% when a risk-off mood took hold of investors worried about escalating political tensions in Hong-Kong and plummeting oil prices. Bank stocks (-1.3%) underperformed, as investors reassessed the outlook for European lenders. Nonetheless, the ratio of bullish to bearish bets on

European banks is now near a record high, as measured by put and call options on the EuroStoxx Banks Index.

Bullish vs. Bearish Bets on European Banks



Source: Bloomberg

SX7E Index (EURO STOXX Banks Price EUR) Bank: Put-Call OI 2 Daily 01JAN2016-12J

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Euro area sovereign bond markets are steady, with the German 10-year yield at -0.23% (-1 bp); French at 0.10% (-1 bp); Italian at 2.63% (-2 bp); Spanish at 0.57% (unchanged).

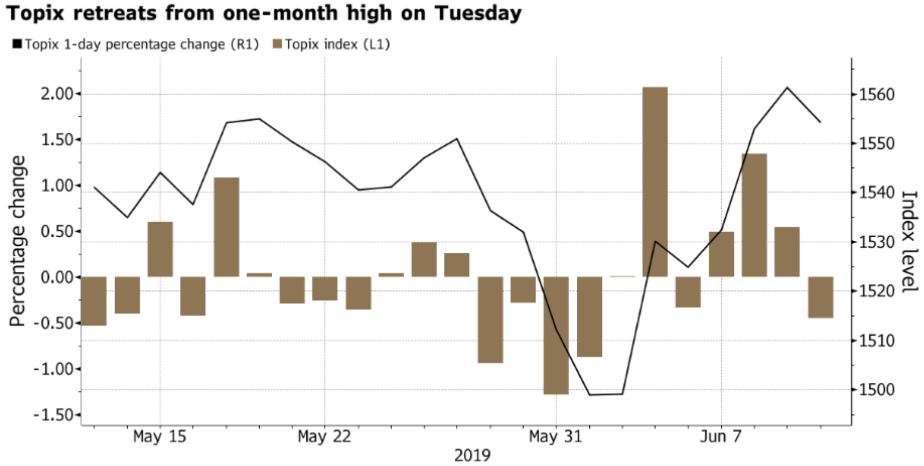
France would support Merkel as new head of the European Commission while Italy would endorse a French candidate for the ECB presidency. According to German newspapers president Macron would vote for chancellor Merkel if she decided to run for the post. Separately, Reuters reports that the Italian government would support a French national for the post of ECB president, as the move would likely free up the position currently held by Mr. Couré at the ECB's Governing Council. Italy would then seek to fill that post and thus retain some influence in the top decision-making body of the bank.

Other Mature Markets back to top

Japan

Equities fell (Nikkei -0.4%; Topix -0.5%), with electronics and telcos underperforming. Risk aversion saw the yen strengthen 0.2% while 10-year JGB yields edged down to -0.12%. Trade war concerns overshadowed the strength in machinery orders. Core machinery orders rose 5.2% m/m in April from 3.8% m/m in March, marking the third straight month of increase. Separately, a new draft mid-term economic plan, submitted by a government panel led by Prime Minister Shinzo Abe, indicated that Japan will go ahead with a sales tax hike in October. According to Bloomberg, the extra proceeds from the sales tax increase would be used to shore up social security funding and fund policies to tackle the low birth rate.

Topix retreats from one-month high on Tuesday



Source: TSE, Bloomberg

Emerging Markets

back to top

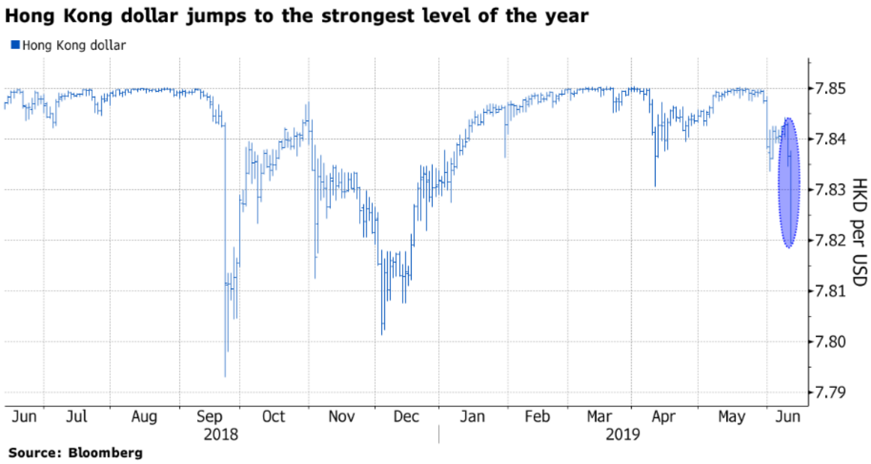
Emerging market assets are trading broadly lower today due to risk-off sentiment. In Asia, equities fell across the board (-0.6%), led by losses in Hong Kong (-1.7%). Hong Kong property developers were among the biggest losers amid a surge in interbank rates due to tighter liquidity. Analysts attributed the tighter liquidity to seasonal demand for cash near the quarter-end and ongoing protests against the extradition law, which could be sparking capital outflow concerns. The proposed law that could see Hong Kong residents extradited to China for trial sparked violent protests, with several hundred thousand people taking to the streets. Regional currencies were broadly stable, while the Hong Kong dollar strengthened 0.2%, the strongest level of the year. **In EMEA,** equity markets are mixed with Poland and the Czech Republic underperforming (both -0.6%) and other bourses mixed. The South African rand is underperforming in the FX space, depreciating 0.7% against the dollar, while other currencies are little changed.

In Latin America, local markets posted a strong session on idiosyncratic factors yesterday, shrugging off the weakness in the US markets. Argentine assets surged after President Macri announced to pick Senator Pichetto as his VP running mate, with short-term sovereign yields down over 80 bps for local currency bonds and over 200 bps for dollar bonds. Brazilian markets were boosted by progress on pension reform, with the real 1% stronger. Chilean markets benefitted from higher copper prices, with the currency appreciating 1%.

Key Emerging Market Financial Indicators

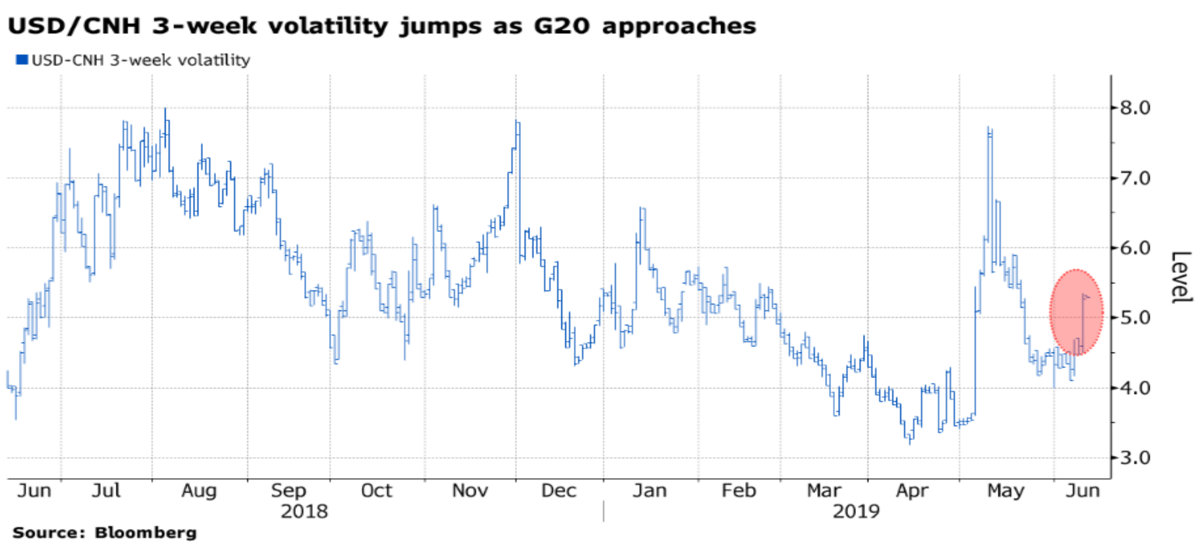
Last updated:	Level		Change				
6/12/19 7:45 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		42.08	-0.8	2	0	-9	8
MSCI Frontier Equities		29.91	0.5	3	4	-6	14
EMBIG Sovereign Spread (in bps)		357	5	-11	6	7	-57
EM FX vs. USD		62.19	-0.2	1	0	-5	0
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.92	-0.1	0	-1	-7	-1
Indonesian Rupiah		14235	0.0	0	1	-2	1
Indian Rupee		69.35	0.1	0	2	-3	1
Argentine Peso		44.70	0.4	0	1	-42	-16
Brazil Real		3.86	0.8	0	4	-4	0
Mexican Peso		19.15	-0.1	2	0	8	3
Russian Ruble		64.56	0.3	1	1	-3	8
South African Rand		14.77	-0.7	1	-3	-10	-3
Turkish Lira		5.79	0.1	-1	5	-21	-9
EM FX volatility		8.43	0.0	-0.3	-0.3	-1.1	-1.3

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



China

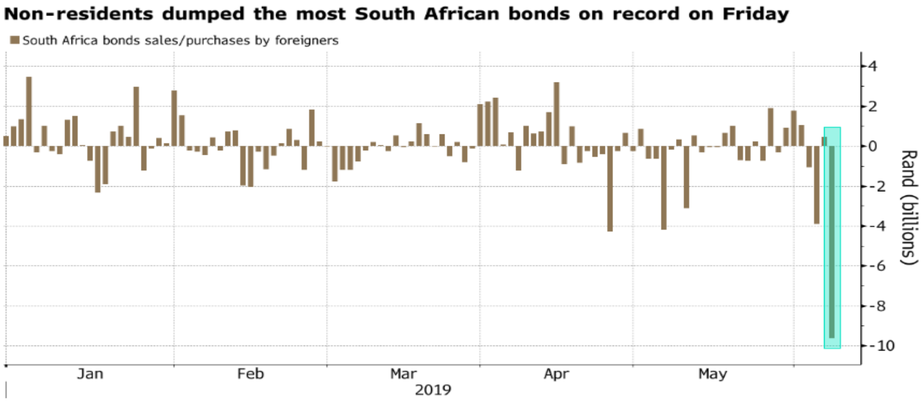
Chinese equities fell 0.6% amid hawkish trade comments by US President Trump. Trump said that he is personally holding up a trade deal with China and he will not proceed with new trade talks unless Beijing agrees to terms previously agreed upon. This came a day after he threatened to raise tariffs to 25% or even much higher than 25% on $300 bn of Chinese goods if Chinese President Xi does not meet with him at the upcoming G20 summit in Japan. China meanwhile responded that it is "not afraid of fighting a trade war," vowing a tough response should the US insist on escalating trade tensions. **While the onshore and offshore RMB were stable amid a stronger fixing by the central bank, the offshore yuan's three-week implied volatility rose amid uncertainty ahead of the G20 meeting.** Separately, CPI inflation rose to 2.7% y/y in May from 2.5% y/y in April. This was largely driven by food prices, with core inflation remaining below 2.0%, while the PPI was muted at 0.6% y/y in May.



South Africa

The local currency bond market suffered a record day of outflows on Friday, with Foreigners selling about $0.6 bn, the most on record since 1996. Concerns over the integrity of the country's oil state-owned oil company Eskom were probably the main driver, not helped by negative comments from rating agencies on the company. Analysts also noted the recent debate about the central bank's mandate, with some government official arguing for the institution to play a more active role in helping state companies.

Longer-dated yields increased more than 20 bps over the last two weeks but have already retraced most of it over the last three sessions thanks to better global risk appetite. Similarly, the rand and local stocks have performed roughly in line with assets in other EM countries.

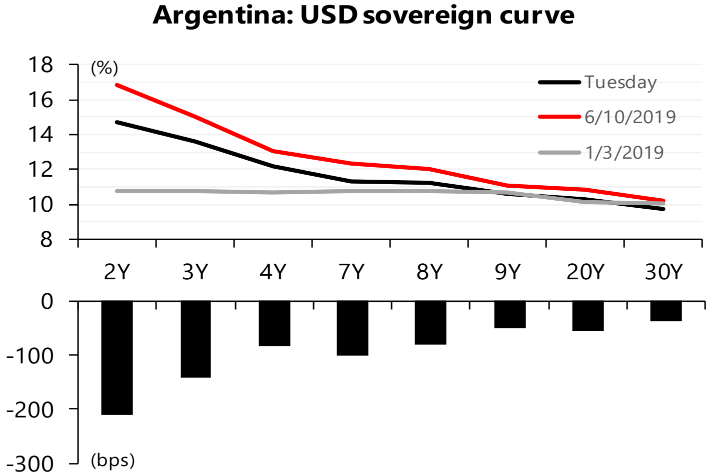


Turkey

The central bank kept its benchmark one-week repo rate unchanged at 24%, as expected. The decision comes as a relieve to some analysts concerned about the risk of a premature rate cut. Before the central bank meeting, officials at the Treasury department announced that the country's credit guarantee fund will launch a TRY 25 bn ($4.3 bn) lending initiative. Loans of up to 36-months maturity will have an interest rate of 400 bps above CPI inflation, while loans with 48-months maturity will go for CPI+4.5ppts. The new initiative was seen as backdoor easing by the government. Equities are up 0.4% on the day and the lira is little changed with most investors concerned about the re-run of the Istanbul mayoral elections taking place on June 23.

Argentina

Argentine assets surged after President Macri picked Senator Pichetto as his VP candidate. The Merval index jumped 3.7% with the peso 0.4% stronger to 44.7 per dollar. Yields on dollar-denominated sovereign bonds fell sharply across the curve, with the 2-year yield plummeting over 200 bps to 14.35% shortly after the announcement. The local currency yield curve fell as well, with 3-month and 1-year yields down over 80 bps to 52.4% and 68% respectively, while the longer-dated yields remained stable.

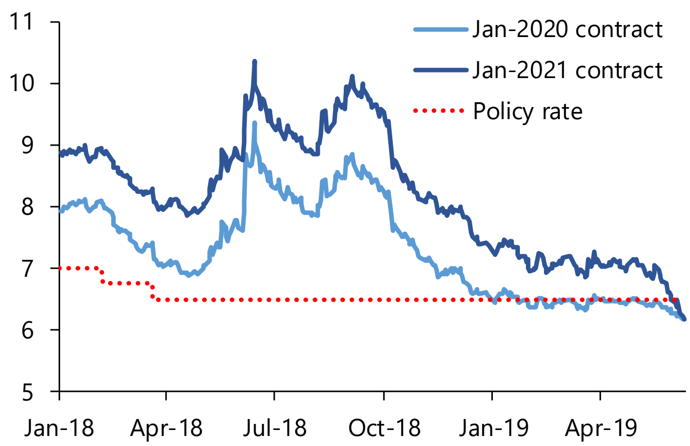


Source: Bloomberg.

Brazil

Local markets rallied as pension reform efforts move forward. The chairman of the house committee on pension reform confirmed a session will be held on Thursday dedicated to the proposal and anticipates the committee voting on the bill in the first week of July, easing concerns that recent allegations against Justice Minister Moro would affect the progress. Local rates continue to fall amid growing market expectations that the central bank may foreshadow a rate cut in 2019H2 at next week's COPOM meeting. The real strengthened 1% to 3.85 per dollar with the IBOV index up 1.5%, led by materials and energy.

Brazil: DI futures

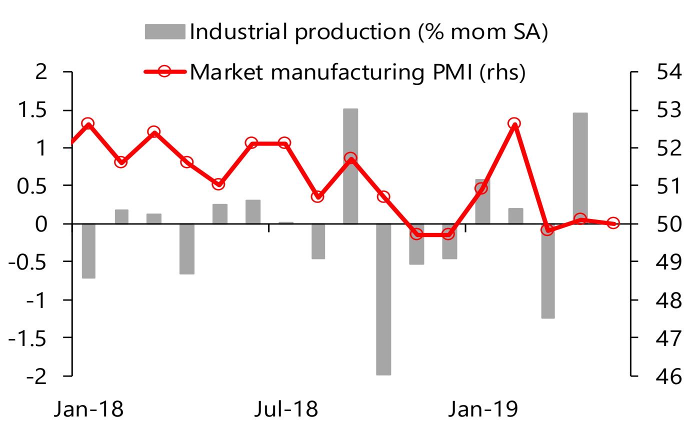


Source: Bloomberg

Mexico

Risk assets extended gains for a second day as industrial production rebounded in April after plunging in March. IP expanded 1.5% m/m, marking the largest monthly gain since mid-2015 and well above the expected 0.5% m/m. The result was supported by construction (+2.2% m/m), manufacturing (+0.6% m/m) and utilities (+1.6% m/m), boding well for factory output and Q2 GDP. Nevertheless, most IP components continue with a declining trend in annual terms (IP -0.4% yoy). However, PMI data suggest softer activity in May while the impact from the tariff spat with the US is yet to be seen. The peso closed 0.5% stronger to 19.13 per dollar.

Mexico: industrial production



Source: Bloomberg

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Global Financial Indicators

Last updated: 6/12/19 7:57 AM	Level Last 12m	Level Latest	Change 1 Day	Change 7 Days	Change 30 Days	Change 12 M	YTD
Equities					%		%
United States		2886	0.0	3	0	4	15
Europe		3380	-0.6	1	1	-3	13
Japan		21130	-0.4	2	-1	-8	6
China		2909	-0.6	2	-1	-6	17
Asia Ex Japan		68	1.1	2	-1	-12	7
Emerging Markets		42	-0.8	2	0	-9	8
Interest Rates					basis points		
US 10y Yield		2.12	-2.1	-1	-35	-84	-56
Germany 10y Yield		-0.24	-0.9	-2	-20	-73	-48
Japan 10y Yield		-0.11	-0.2	1	-6	-17	-11
UK 10y Yield		0.86	-0.2	-1	-28	-54	-42
Credit Spreads					basis points		
US Investment Grade		128	1.1	-3	12	25	-19
US High Yield		441	-2.2	-38	24	100	-80
Europe IG		62	1.4	-4	-6	-10	-25
Europe HY		274	5.3	-15	-17	-32	-79
EMBIG Sovereign Spread		357	5.0	-11	6	7	-57
Exchange Rates					%		
USD/Majors		96.73	0.0	-1	-1	3	1
EUR/USD		1.13	-0.1	1	1	-4	-1
USD/JPY		108.4	0.2	0	1	2	1
EM/USD		62.2	-0.1	1	0	-5	0
Commodities					%		
Brent Crude Oil ($/barrel)		61	-2.5	0	-14	-20	13
Industrials Metals (index)		111	-0.3	1	-3	-22	1
Agriculture (index)		41	-0.1	1	11	-15	-1
Implied Volatility					%		
VIX Index (%, change in pp)		16.3	0.3	0.2	0.3	4.0	-9.1
10y Treasury Volatility Index		4.5	0.1	-0.7	0.5	0.1	-0.1
Global FX Volatility		6.7	0.0	-0.3	-0.2	-1.2	-2.2
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		299	-1.9	-19	-56	-106	-116
Italy		262	-0.8	-8	-11	25	12
Portugal		90	2.2	0	-26	-59	-58
Spain		82	0.8	-4	-20	-14	-36

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: 6/12/2019 7:52 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		6.92	-0.1	-0.2	-1	-7	-1		3.3	2.2	1	-5	-36	8
Indonesia		14235	0.0	0.3	1	-2	1		7.8	-5.4	-25	-26	36	-33
India		69	0.1	-0.1	2	-3	1		7.1	-0.8	-1	-34	-96	-30
Philippines		52	0.5	-0.1	1	2	1		5.0	1.5	-3	-10	-41	-126
Thailand		31	0.2	0.3	1	3	4		2.4	-0.7	-7	-20	-23	-25
Malaysia		4.16	0.1	0.4	0	-4	-1		3.7	2.0	-1	-12	-51	-38
Argentina		45	0.4	0.0	1	-42	-16		30.9	-81.5	-160	286	1308	794
Brazil		3.86	0.8	0.0	4	-4	0		7.2	-10.0	-20	-79	-279	-94
Chile		693	0.7	0.2	0	-9	0		3.4	-3.7	-35	-68	-140	-104
Colombia		3259	0.0	1.0	0	-12	0		5.9	-3.4	-21	-32	-46	-62
Mexico		19.16	-0.1	2.2	0	8	3		7.8	-6.5	-30	-45	-12	-95
Peru		3.3	0.2	0.7	0	-2	1		5.0	-6.1	-15	-32	-67	-70
Uruguay		35	0.1	-0.8	0	-11	-8		11.1	-5.1	-8	21		38
Hungary		284	-0.1	1.0	2	-4	-1		1.8	4.3	-2	-36	-39	-43
Poland		3.77	0.0	1.2	2	-3	-1		2.1	2.6	-3	-21	-48	-13
Romania		4.2	-0.1	0.8	2	-5	-3		4.1	2.0	0	-11	-43	-12
Russia		64.6	0.3	0.9	1	-3	8		7.5	-1.4	-17	-43	25	-92
South Africa		14.8	-0.7	0.8	-3	-10	-3		9.4	-7.9	-6	6	-18	-21
Turkey		5.79	0.1	-1.0	5	-21	-9		19.1	-13.6	-107	-336	312	220
US (DXY; 5y UST)		96.8	0.1	-0.6	-1	3	1		1.89	-2.8	1	-38	-92	-62

	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		2909	-0.6	2	-1	-6	17		180	5	-4	6	-4	-14
Indonesia		6276	-0.5	4	1	5	1		192	3	-8	5	-8	-44
India		39757	-0.5	-1	6	11	10		154	2	-1	3	-2	-42
Philippines		8031	0.0	-1	4	3	8		82	2	-7	1	-36	-39
Malaysia		1651	0.0	0	3	-6	-2		131	6	-2	8	-16	-31
Argentina		38345	5.2	11	15	25	27		855	2	-114	-40	350	40
Brazil		98960	1.5	2	5	36	13		244	3	-8	-1	-77	-29
Chile		5069	1.0	1	0	-9	-1		134	1	-8	7	-7	-32
Colombia		1520	1.4	2	-2	-2	15		190	3	-9	4	-16	-38
Mexico		43714	0.2	1	1	-6	5		328	3	8	22	19	-26
Peru		20389	0.5	2	1	-4	5		130	2	-7	-2	-34	-38
Hungary		40483	-1.8	-2	-1	11	3		97	7	-15	0	-36	-51
Poland		58627	-1.0	2	3	-1	2		52	15	-18	12	-16	-33
Romania		8589	-0.5	0	3	4	16		190	4	-17	2	23	-31
Russia		2752	0.0	2	9	21	16		209	4	-7	1	-17	-43
South Africa		58577	-0.3	3	3	1	11		317	5	-3	17	20	-48
Turkey		93290	0.5	3	5	-2	2		530	7	-1	1	112	101
Ukraine		553	0.0	0	-3	27	-1		572	7	-58	-76	42	-215
EM total		42	-0.8	2	0	-9	8		357	5	-11	6	7	-57

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