



Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Thursday, June 13, 2019

- **Weak US inflation data strengthen expectations for Fed rate cuts** ([link](#))
- **US credit spreads widen as rising hedging costs deter foreign buyers** ([link](#))
- **Levels of non-performing loans continue to drop at European banks** ([link](#))
- **Chinese banks' yield premium on short-term funding rises to highest since January** ([link](#))
- **Crude oil prices rise after tanker attack in the Middle East** ([link](#))
- **Ecuador buys back 2020 bonds after re-tapping 2029 bonds** ([link](#))

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Crude oil prices rise on new geopolitical tensions

Recent price action has been relatively limited, as investors appear to be hesitant to take significant new bets in the face of rising geopolitical tensions and upcoming policy decisions. Protests in Hong Kong and a relative lack of progress in US-China trade negotiations have weighed somewhat on Asian markets. Reports of an alleged attack on two oil tankers in the Gulf of Oman have sent crude prices higher by about 3% this morning. Despite today's move, oil prices are still about 16% lower than the levels witnessed in April. Regarding upcoming policy decisions, market participants await next week's FOMC meeting and the G-20 meeting (June 28-29) for further clarity on US monetary policy and global trade. In the UK, voting to elect the new Tory leader begins today, with the first round of results expected by midday today. The final outcome will not be known until July, however.

Key Global Financial Indicators

Last updated: 6/13/19 1:28 PM	Level		Change from Market Close				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		2880	-0.2	2	2	4	15
Eurostoxx 50		3393	0.2	2	2	-2	13
Nikkei 225		21032	-0.5	1	-1	-8	5
MSCI EM		42	0.0	2	3	-9	7
Yields and Spreads			bps				
US 10y Yield		2.11	-2.3	-1	-29	-86	-58
Germany 10y Yield		-0.24	-0.7	0	-17	-73	-49
EMBIG Sovereign Spread		360	2	-4	-4	8	-54
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		62.0	0.0	0	1	-5	0
Dollar index, (+) = \$ appreciation		97.0	0.0	0	0	4	1
Brent Crude Oil (\$/barrel)		62.5	4.1	1	-11	-19	16
VIX Index (% change in pp)		15.9	0.0	0	-5	3	-10

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

United States

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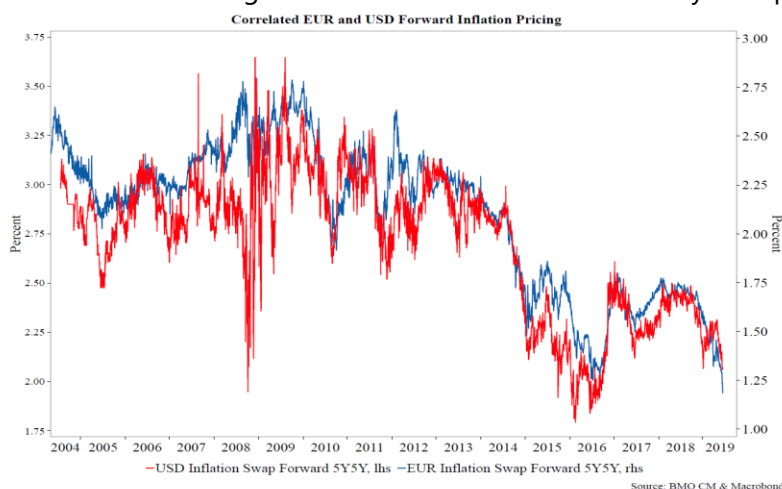
The events in Hong Kong weighed on global markets, but US stocks managed to limit their losses amid light trading. Treasury yields were lower by 2 to 3 bps across the curve, with short-term interest rate implied volatility remaining elevated. While the FOMC is broadly expected to remain on hold at next week's meeting, the committee is also expected to signal that it is close to its first rate cut. The upcoming rate cut cycle (if it is initiated over the next few FOMC meetings) would be unique because it would start with the policy rate already at a very low level. Policy rates are now only 225 bps above the effective lower bound, yet the typical rate cut cycle to fight recessions has involved 575 bps of cuts on average. The Fed often begins with a 50 bp cut and opinion is divided on whether history will repeat itself this cycle. Some think a 50 bp cut unlikely given the low level of rates, while others argue that a 50 bp hike will have a bigger impact than previous cycles. According to this view, starting with a 50 bp cut might enable the Fed to end its rate cut cycle earlier than usual and with some ammunition to spare.

Table 9: Summary statistics for recent Fed rate cutting cycles

Cycle	Reason	FF Start (%)	FF End (%)	Total Cuts (bps)	Cuts in First Month (bps)	Cuts in First Year (bps)	Cycle Length (Months)
'89-'92	Recession	9.75	3.00	-675	-50	-150	40
'95-'96	Inflation	6.00	5.25	-75	-25	-75	7
'98	Market	5.50	4.75	-75	-50	-75	2
'01-'02	Recession	6.50	1.00	-550	-50	-475	11
'07-'08	Recession	5.25	0.25	-500	-50	-325	15

Source: BofA Merrill Lynch Global Research, Bloomberg

Deflationary forces in the euro area economy could spill over into US markets and some analysts are pointing to the continued trend of weak US inflation data as evidence that the process has already begun. These analysts are pushing back against the view, expressed by Fed Chair Powell, that the trend is "transitory". Instead, they point out that global forces, such as falling oil prices and weak euro area inflation, could reinforce domestic forces in pushing US inflation lower. For example, US 5-year/5-year forward inflation swaps are highly correlated with euro forward inflation swaps, a reflection of the deep links between major markets in the global financial system. Euro area forward swap yields haven fallen to a historic low of 1.2% and US forward swap yields could follow them down. Many analysts think the Fed will be forced to recognize these trends and initiate a new cycle of policy rate cuts. The cumulative implied



probability of a 25 bp rate cut by the July FOMC meeting, according to Bloomberg's model, has now reached 82%. Much will depend on the language used in the statement following the upcoming June 19 FOMC meeting. If a July cut really is in the cards, analysts expect the Fed to remove their language about patience and insert language that will send a signal to markets that they are ready to begin cutting rates.

US credit corporate credit spreads in both the investment grade (IG) and high yield (HY) sectors have widened sharply in recent weeks. Spreads have widened by 20 bps for IG bonds and 80 bps for HY bonds since mid-April. Rising hedging costs caused by the strong dollar have been exacerbated by the inverted yield curve. Foreign investors typically prefer shorter maturity foreign exchange basis swaps as hedges, but higher costs in the most popular three-month to one-year maturities have made holding US paper much less attractive. Other negative factors such as the widely reported “fallen angel” risk in the BBB sector and worries about the impact of the trade war on corporate profits have also played a role. The energy sector was among the worst performers in the wake of the recent plunge in oil prices.

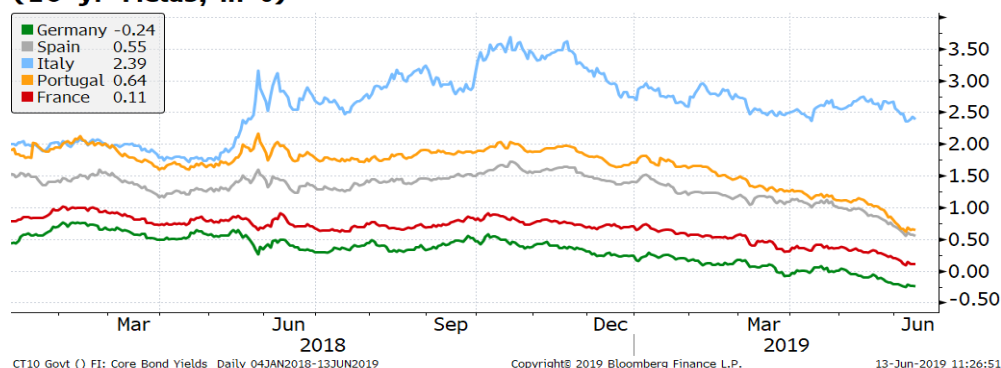
Europe

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European equities: EuroStoxx 600 (+0.2%), DAX (0.5%), CAC 40 (0.1%), Titans 20 (+0.7%), Ibex 35 (+0.3%). Bank stocks underperformed slightly with gains of 0.1%.

Euro area sovereign 10-year yields: Germany -0.24% (flat); France 0.11% (flat); Italy 2.39% (-4 bps); Spain 0.55% (-2 bps).

Selected Government Bond Yields (10-yr Yields, in %)

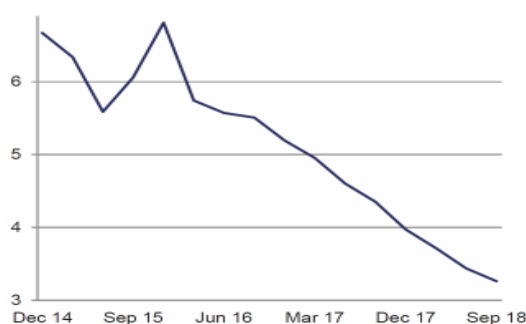


The European Commission has published two new statements on measures to deepen Europe's Economic and Monetary Union ([here](#) and [here](#)). **The EC reiterated the view that legacy non-performing loans (NPLs) are one of the main impediments to completing the Banking Union.** NPLs have declined markedly across the EU (reaching 3.3% by 2018Q3) although at a different rhythm by country. The two EC reports have been published ahead of the EU finance ministers summit tomorrow.

NPLs in % of total loans in selected countries			
	Q3 2017	Q3 2018	% change
Cyprus	32.1	21.8	-32.02%
Spain	4.7	4.0	-15.09%
Greece	46.7	43.5	-6.7%
Ireland	11.2	7.8	-30.21%
Italy	12.1	9.5	-21.54%
Portugal	14.6	11.3	-22.42%
Slovenia	10.8	6.9	-35.92%

Source: European Central Bank

EU total gross NPLs and advances
in % of total gross loans and advances, end-of-quarter values



In the UK, **Tory MPs will start voting today to find a successor to Theresa May**. The first round of results is expected by midday, with at least one candidate out of 10 to be eliminated. Ahead of the vote, front-runner Boris Johnson conceded that a no-deal Brexit would be “a last resort”. **UK financial markets are stable**, with the pound unchanged at \$1.27, 10-year gilt yields at 0.83% (-3 bps), and equities up 0.2%-0.5% in line with European peers.

Fund manager Neil **Woodford has promised investors in the Woodford Equity Income Fund that they will see a “much more liquid portfolio, but one that reflects the same investment strategy” when the fund reopens**. Redemptions of the £3.7-bn Woodford Equity Income Fund have been suspended since June 3. Recent data from Morningstar reveal that assets in Woodford’s Income Focus Fund have dropped about £100 mn to £371 mn since June 3.

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Japan

Equities (Nikkei -0.5%; Topix -0.8%) declined with electronics, autos and resources underperforming. Additionally, domestic business sentiment weakened to the lowest level in two years. The Business Survey Index of large companies across all industries fell to -3.7 in Q2 2019, down from -1.7 in Q1. **Ten-year JGB yields were flat at -0.12%, while yields on the 30-year rose 3 bps to 0.36% after a weak auction**. The yen was stable.

Emerging Markets [back to top](#)

Asian equities (-0.4%) declined on net. China (Shanghai 0.0%; Shenzhen +0.3%) and the Philippines (+0.3%) outperformed, while Taiwan Province of China (-0.5%) and Vietnam (-0.4%) posted the largest losses. In terms of sectors, tech was an underperformer on weaker chip demand trends and semiconductor capex. Asian currencies were stable. **EMEA equity markets are broadly lower**. Dubai (-1.5%) and Saudi Arabia (-1.0%) are underperforming on heightened geopolitical risks following another attack against oil tankers transiting the region. Turkish stocks are down 0.8% after President Erdogan said the controversial purchase of the S-400 Russian defense system was a “done deal,” risking sanctions from the US. **In Latin America, markets generally closed lower after 2 strong sessions**. Brazilian markets underperformed on weak economic reports, with the IBOV down 0.8% and the real 0.2% weaker. The sizable drop in oil prices weighed on Colombian markets, with the peso 0.4% weaker and the COLCAP down 0.5%. In contrast, Argentina staged another massive rally, as investors continued to celebrate President Macri’s VP pick of Pichetto, seeing him as a power broker to pass much-needed reforms. The Merval jumped 6%, the peso strengthened 2.3% to 43.6 per dollar and the dollar yield curve fell by up to 55 bps led by the intermediate curve.

Key Emerging Market Financial Indicators

Last updated: 6/13/19 1:26 PM	Level		Change				YTD
	Last 12m	index	1 Day	7 Days	30 Days	12 M	
Major EM Benchmarks			%				%
MSCI EM Equities		41.63	0.0	2	3	-9	7
MSCI Frontier Equities		30.13	0.7	4	8	-4	15
EMBIG Sovereign Spread (in bps)		360	2	-4	-4	8	-54
EM FX vs. USD		62.01	0.0	0	1	-5	0
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.92	-0.1	0	-1	-8	-1
Indonesian Rupiah		14280	-0.3	0	1	-2	1
Indian Rupee		69.51	-0.2	0	1	-3	0
Argentine Peso		43.68	2.3	3	3	-41	-14
Brazil Real		3.85	0.5	1	4	-3	1
Mexican Peso		19.17	0.0	3	0	8	2
Russian Ruble		64.61	0.4	1	1	-3	7
South African Rand		14.88	0.0	1	-4	-11	-4
Turkish Lira		5.88	-1.3	-2	3	-21	-10
EM FX volatility		8.37	0.0	-0.3	-0.8	-1.1	-1.4

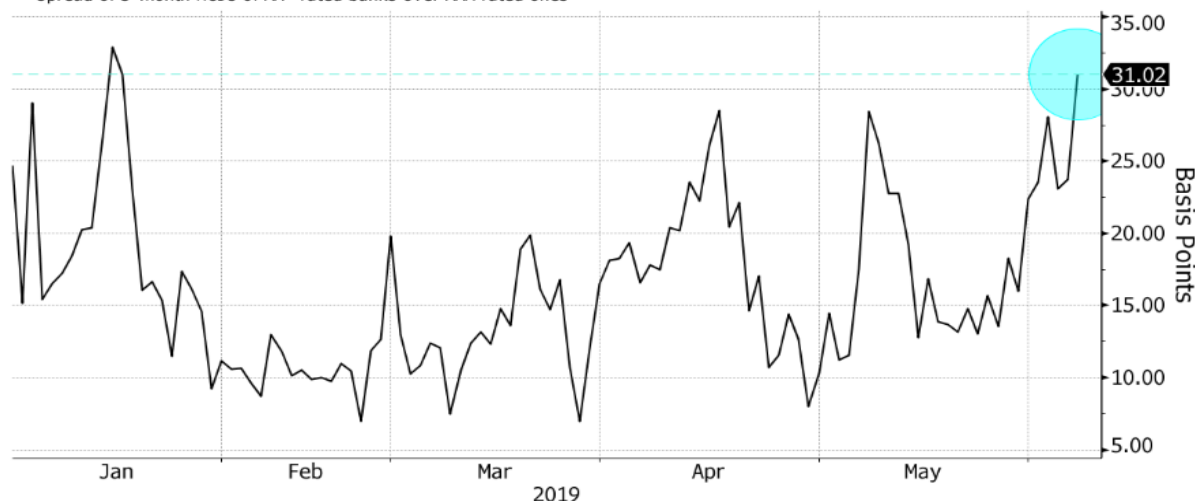
Colors denote **tightening**/easing financial conditions for observations greater than ± 1.5 standard deviations. Data source: Bloomberg.

China

The yield premium on negotiable certificates of deposits of lower-rated smaller banks rose to the highest levels in 5 months. Negotiable certificate of deposits (NCDs) are a type of short-term funding that small banks are more reliant upon. According to Bloomberg, the spread between AAA rated and AA+ rated 3-month NCDs hit 31 bps. The differentiation in risk was also seen in the muted success rate of NCD offerings by rural commercial lenders compared to bigger banks, according to Shenyin Wanguo Group Co. Last month the Chinese authorities took over a regional lender, Baoshang Bank, on credit concerns. Separately, China's credit growth was stable in May, coming in at 10.6% y/y versus 10.4% y/y in April, with 56% of total new bank loans driven by mortgage lending. **The RMB and equities were little changed (Shanghai 0.0%; Shenzhen +0.3%).**

Investors demand higher yield for lower rated NCDs

■ Spread of 3-month NCDs of AA+ rated banks over AAA rated ones



Source: China Foreign Exchange Trading System

Ecuador

Ecuador plans to buy back bonds due in 2020 through funds raised by issuing additional bonds due in 2029. The \$1.125 bn transaction, will result in the repurchase of 78% of the 2020 bonds, was largely welcomed by investors, as the transaction could reduce lingering supply risks and ease near-term funding needs. The liability management framework announced earlier this month could be helpful to improve Ecuador's rating outlook. It is currently rated B3 and B- by Moody's and Fitch, and carries a negative outlook from both agencies, precisely because of concerns about their short-term debt-servicing capacity.

Middle East

Oil prices increased about 3% after an attack against two oil tankers in the Gulf of Oman. The US blamed Iran for the attack, saying it used naval mines or torpedoes, an accusation Iran denied. This followed an alleged sabotage attack against four vessels in the region, two of which were Saudi oil tankers. Dubai's equity index bore the brunt of the negative sentiment from the event, falling 1.5%, but Saudi stocks were down 1.0%. Brent prices were trading at a 4-month low (\$60 per barrel) before the incident, but it's now trading at \$61.3 per barrel.

Brent crude climbs on suspected Gulf of Oman attack



Source: Bloomberg

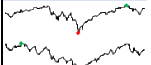



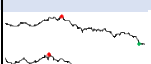
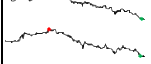
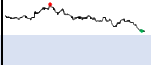
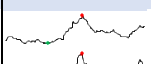
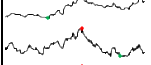
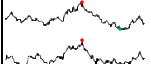

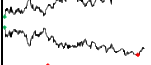
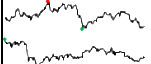

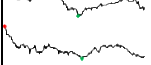


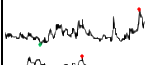


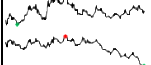

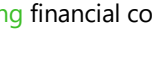





Brazil

Interest rates continued to fall after retail sales disappointed. Retail sales fell by a more-than-expected 0.6% mom (vs. expected -0.1% mom) in May, with prior readings also revised lower. Five of the eight measured retail sales categories declined over the month. On an annual basis, sales rose 1.7% yoy, partly helped by the base effects from the 2018 trucker strike. The interbank DI futures curve steepened, as the front end fell another 3 bps, pricing in a full 25 bps rate cut by year-end.

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Global Financial Indicators

Last updated: 6/13/19 1:28 PM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		2880	-0.2	2	2	4	15
Europe		3393	0.2	2	2	-2	13
Japan		21032	-0.5	1	-1	-8	5
China		2911	0.0	2	0	-5	17
Asia Ex Japan		67	-1.4	1	1	-13	6
Emerging Markets		42	0.0	2	3	-9	7
Interest Rates			basis points				
US 10y Yield		2.11	-2.3	-1	-29	-86	-58
Germany 10y Yield		-0.24	-0.7	0	-17	-73	-49
Japan 10y Yield		-0.11	-0.2	1	-7	-17	-12
UK 10y Yield		0.83	-3.7	1	-27	-54	-45
Credit Spreads			basis points				
US Investment Grade		131	0.4	2	10	28	-16
US High Yield		449	1.0	-22	13	115	-72
Europe IG		62	0.3	-4	-6	-7	-26
Europe HY		272	-0.5	-20	-19	-27	-80
EMBIG Sovereign Spread		360	2.0	-4	-4	8	-54
Exchange Rates			%				
USD/Majors		96.96	0.0	0	0	4	1
EUR/USD		1.13	0.0	0	1	-4	-2
USD/JPY		108.4	0.1	0	1	2	1
EM/USD		62.0	0.0	0	1	-5	0
Commodities			%				
Brent Crude Oil (\$/barrel)		62	4.1	1	-11	-19	16
Industrials Metals (index)		111	-0.1	0	-2	-22	1
Agriculture (index)		42	0.6	1	13	-12	1
Implied Volatility			%				
VIX Index (% change in pp)		15.9	0.0	0.0	-4.7	3.0	-9.5
10y Treasury Volatility Index		4.8	0.1	-0.3	0.4	0.7	0.2
Global FX Volatility		6.7	0.0	-0.2	-0.4	-1.1	-2.3
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		293	-5.8	-22	-70	-117	-123
Italy		261	-6.3	-12	-16	28	11
Portugal		88	-1.7	-4	-35	-59	-60
Spain		78	-3.0	-7	-28	-15	-39

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: 6/13/2019 1:26 PM	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	-8	-1		3.3	1.7	3	-4	-36	10
Indonesia		14280	-0.3	-0.1	1	-2	1		7.8	-1.1	-26	-27	35	-34
India		70	-0.2	-0.3	1	-3	0		7.1	-2.2	-3	-36	-99	-32
Philippines		52	0.2	-0.2	1	3	1		5.0	0.0	-3	-10	-41	-126
Thailand		31	0.2	0.3	1	3	4		2.4	-2.1	-7	-22	-27	-27
Malaysia		4.17	-0.2	0.2	0	-4	-1		3.7	0.3	-1	-11	-51	-38
Argentina		44	2.3	2.8	3	-41	-14		30.2	-71.2	-234	214	1219	722
Brazil		3.85	0.5	0.8	4	-3	1		7.2	2.9	-31	-76	-281	-91
Chile		696	-0.4	-0.2	0	-8	0		3.4	0.6	-32	-67	-141	-103
Colombia		3268	-0.3	1.2	1	-12	0		5.9	-2.1	-17	-35	-50	-65
Mexico		19.17	0.0	2.7	0	8	2		7.8	1.2	-28	-44	-17	-94
Peru		3.3	-0.1	0.3	0	-2	1		5.0	-6.6	-19	-39	-75	-77
Uruguay		35	0.0	-0.4	0	-11	-8		11.1	-0.6	-2	20		38
Hungary		285	0.0	-0.2	1	-5	-2		1.8	-2.1	-2	-38	-46	-45
Poland		3.77	0.0	0.4	2	-4	-1		2.1	-1.7	1	-22	-46	-14
Romania		4.2	0.0	0.1	1	-5	-3		4.1	0.0	-1	-11	-41	-12
Russia		64.6	0.4	0.7	1	-3	7		7.5	0.0	-12	-43	25	-92
South Africa		14.9	0.0	0.8	-4	-11	-4		9.4	3.3	-7	9	-16	-18
Turkey		5.88	-1.3	-1.8	3	-21	-10		18.4	-65.4	-173	-401	218	155
US (DXY; 5y UST)		97.0	0.0	-0.1	0	4	1		1.86	-1.2	-2	-32	-97	-65

	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		2911	2.6	2	0	-5	17		181	1	0	5	-2	-13
Indonesia		6273	-0.3	3	2	5	1		194	2	-1	0	-6	-42
India		39741	-0.1	1	7	11	10		153	-1	-3	2	-3	-43
Philippines		8052	0.1	1	4	4	8		84	2	1	-4	-33	-37
Malaysia		1644	-0.7	0	3	-7	-3		132	1	1	7	-14	-30
Argentina		40931	2.2	16	27	35	35		848	-3	-105	-95	335	33
Brazil		98321	-0.4	2	7	36	12		243	1	-8	-11	-82	-30
Chile		5068	1.4	2	2	-8	-1		135	1	-4	2	-6	-31
Colombia		1513	-0.7	2	0	-3	14		189	0	-9	-9	-13	-39
Mexico		43800	0.7	1	2	-6	5		332	1	-4	18	29	-22
Peru		20408	-0.1	2	2	-3	5		130	0	-3	-10	-34	-38
Hungary		40669	-1.2	-1	0	13	4		99	1	-1	-6	-35	-49
Poland		59154	0.4	1	5	1	3		55	2	-5	6	-11	-30
Romania		8566	-0.2	-1	5	3	16		189	-1	-8	2	21	-32
Russia		2755	0.5	2	10	21	16		213	3	1	-4	-13	-39
South Africa		58915	0.7	3	5	1	12		323	3	2	10	24	-42
Turkey		90797	-3.5	0	5	-3	-1		530	5	-4	-14	104	101
Ukraine		552	-0.2	0	-3	21	-1		580	2	-22	-96	42	-207
EM total		42	0.0	2	3	-9	7		360	2	-4	-4	8	-54

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