GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

FRIDAY, JUNE 14, 2024

LEAD EDITOR SANJAY HAZARIKA

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All unquiet on the western front

The market meltdown in Europe triggered by France's snap election is continuing, with local equity markets in full retreat and the euro weakening again. France's benchmark CAC-40 equity index has all but erased its gains for the year, with French banking giants BNP Baribas and Société Générale taking especially heavy losses. French OAT spreads to bunds have widened further and have ballooned by 26 bps since last Friday to their worst level since 2017. The political crisis in France is even taking its toll on US equity index futures, which are at risk of ending their record-breaking winning streak. US Treasury yields have followed euro area yields lower and the Swiss franc is stronger on safe haven flows.

Key Global Financial Indicators

Last updated: 6/14/24 8:06 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		5434	0.2	2	4	24	13.92
Eurostoxx 50		4860	-1.5	-4	-4	11	7
Nikkei 225		38815	0.2	0	0	15	16
MSCI EM		42	-0.2	-1	-2	4	5
Yields and Spreads					bps		
US 10y Yield		4.20	-4.8	-24	-24	41	32
Germany 10y Yield		2.35	-11.9	-27	-20	-10	33
EMBIG Sovereign Spread		390	5	-2	23	-55	7
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		46.0	-0.3	0	-2	-8	-4
Dollar index, (+) = $ appreciation		105.5	0.3	1	0	3	4
Brent Crude Oil ($/barrel)		83.3	0.7	5	1	14	8
VIX Index (%, change in pp)		12.8	0.8	1	-1	-1	0

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

Mature Markets

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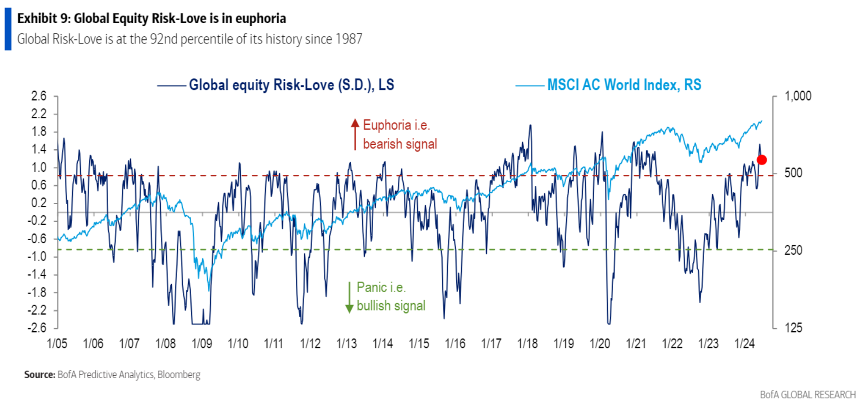
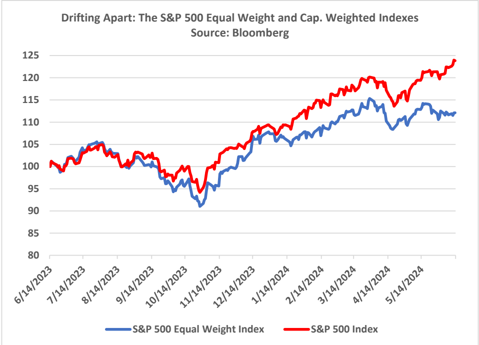
United States

Equity markets may be growing complacent, according to analysis by Bank of America. A proprietary indicator of investor optimism has reached its 92nd percentile, an outcome so extreme as to be characterized as "euphoria," by the analysts, and therefore a very bearish sign for the markets. The indicator combines surveys, technical analysis, valuation metrics, credit spreads and volatility, among other variables, and tends to be a good predictor of what markets might do in the future. Markets in the US, Europe and many emerging markets are indeed at or close to all-time highs, with the US once again delivering some of the best results and the S&P 500 delivering a record close for a fourth day in a row. With the inflation outlook still uncertain, there is a chance that central banks may have to stay hawkish for longer, potentially creating the risk of a major selloff. However, the analysts concede that the fundamentals behind the rally remain sound. Q1 earnings were robust, forecasts for the future are being revised higher and the global economy is still in decent shape.

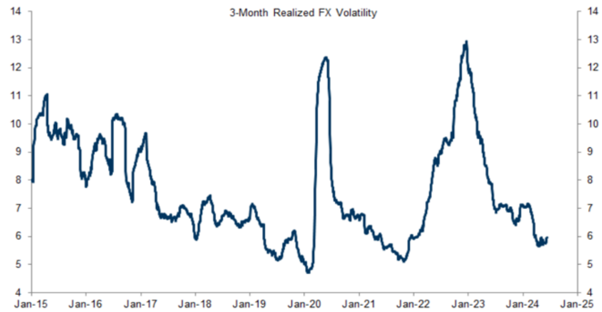


Another worrying trend for some analysts is that the equal weight version of the S&P 500 has significantly underperformed the regular market capitalization weighted index, unlike during the rally that occurred in Q4 2024 when the two indexes moved much more closely together. The former Magnificent Seven has shrunk to the Terrific Three as just three stocks—Apple, Microsoft and Nvidia—account for 15% of the index. This extreme concentration raises fears that a reversal in a small group of stocks could derail the entire market. However, other analysts are more optimisitc, pointing out that periods of rising concentration are usually associated with rising markets, although the bear market of 2022 shows that this is not always the case. Furthermore, the three companies continue to be highly profitable, justifying their valuations according to many market participants.



With the volatility of the US dollar versus a large basket of major foreign currencies close to historical lows, hedging costs in the FX market have been significantly reduced. Contacts report that some investors are seeking to build up hedges against a major depreciation of other currencies against the dollar. Despite the benign recent US inflation data, these investors are worried that the Fed may remain more hawkish than current expectations and that US interest rates and the dollar could move higher. Goldman analysts find that hawkish surprises usually result in significant dollar appreciation. Investors also believe that a Trump victory in the Presidential election could also boost the dollar due to higher US tariffs against other countries.

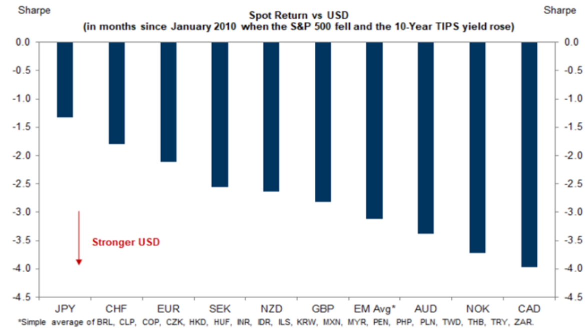
Exhibit 1: FX volatility has fallen back to historical lows



Note: FX volatility measured as a weighted-average of 15 USD-crosses (EUR, JPY, GBP, CNY, CAD, AUD, CHF, HKD, SGD, KRW, INR, MXN, NZD, SEK, TWD) based on 2022 turnover from the BIS.

Source: Bloomberg, Goldman Sachs Global Investment Research

Exhibit 2: Over the past 15 years, the Dollar strengthened on average against all major currencies in response to a hawkish policy shock

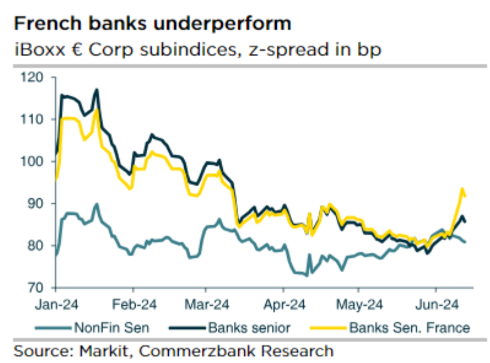


Source: Bloomberg, Goldman Sachs Global Investment Research

Euro Area

The meltdown continued as heightened political uncertainty sent markets into full retreat. Equities saw yet another day of heavy losses, with the Stoxx 600 index down a further 1.2 % and the Euro Stoxx 50 index falling by nearly 2%. The magnitude of the selloff sparked a safe haven bid for euro area government bonds as even French OATs saw a decline in yields. The euro depreciated again to 1.0689 versus the dollar. However, despite the government bond rally, the French-German 10y government bond spread was wider again by 4 bps to 74bps, the worst level since 2017. The spread has ballooned by 26 bps since last Friday. The Italian-German 10y spread (+6bps) was wider at 153bps, highlighting contagion concerns.

Analysts expect more volatility in French interest rates in the runup to the election, with the euro expected to remain under pressure. Next week brings the possibility of more risk, as the European Commission could place France under an excessive deficit procedure (EDP). Should French spreads widen further, speculation may grow that the ECB will use its Transmission Protection Instrument (TPI) to calm funding markets. However, a country cannot be in an EDP to benefit from TPI. Elsewhere, French equities were sharply lower, down a further 2.3% this morning and are now down 0.2% on a year-to-date basis.

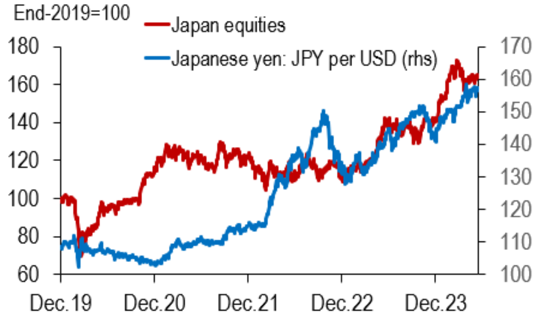


French banking sector credit has repriced significantly in the midst of the turmoil and could remain vulnerable over the coming months. According to Commerzbank analysts, while there are different dynamics at play in the French government bond market relative to the spread widening witnessed in 2017, with fiscal concerns dominating rather than fears of France leaving the European Union, French banks could continue to underperform against the wider banking sector if volatility persists. The analysts note that contagion to other countries is limited so far but the sheer size of the French banking sector but the situation could become problematic given the size of the French banking sector and its relative weighting in credit indices.

Japan

The Bank of Japan (BOJ) is to begin bond sales (quantitative tightening or QT) in July, although few details were provided. This was a surprise for markets, as a majority of those surveyed expected sales to begin this month. The yen sold off and government bond yields went up immediately following the news, although they recovered somewhat afterwards. There was a major change in the market's estimate of the odds of a rate hike at the July 30 meeting, which fell to 45% from 75% two days ago. The new consensus appears to be that the BOJ will not begin QT and cut the policy rate at the same meeting. The number of rate hikes expected by the market in 2024 has fallen from three to two. Meanwhile, local stocks followed US equities higher.

Japan: equities and yen



Sources: Bloomberg and IMF staff calculations

Emerging Markets

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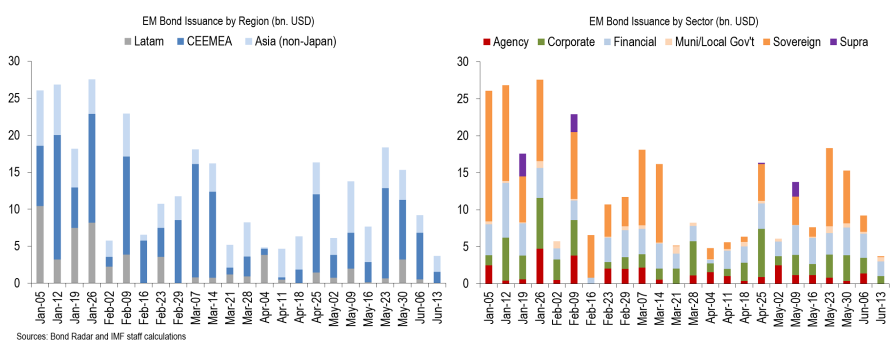
EMEA markets were down in the midst of the global selloff. Currencies were weaker. **Most stocks in Asia were down, with Vietnam and Indonesia seeing marked declines.** Investors were worried about the expansionary fiscal plans announced by the incoming president. In contrast, Taiwan POC was higher due to a rally in the semiconductor sector. **In Latin America, the Colombian peso depreciated by nearly 3% on Thursday as it surpassed the peso's weekly losses.** Stocks in Mexico were sharply lower again despite incoming President Sheinbaum's pledge to increase tax revenues to reduce the budget deficit.

EM Bond Issuance

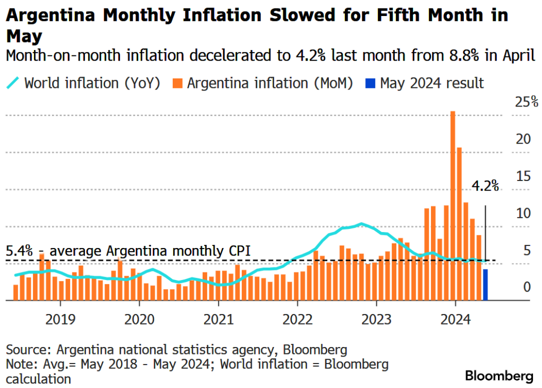
Issuance reached $3.7bn this week, bringing YTD issuance to $310bn. Notable issuance included $107mn in Romanian euro denominated sovereign bonds maturing in 2028. By sector, financials led with 53% of the share, followed by corporates at 28%, and municipals at 16%. Within financial companies, the Bank of China issued $412mn in CNH denominated bonds maturing in 2026 and 2027. MTD EM issuance has reached $12.9bn so far, compared to $61.2bn issued in May.

Largest Issuers: China and Financial Sector



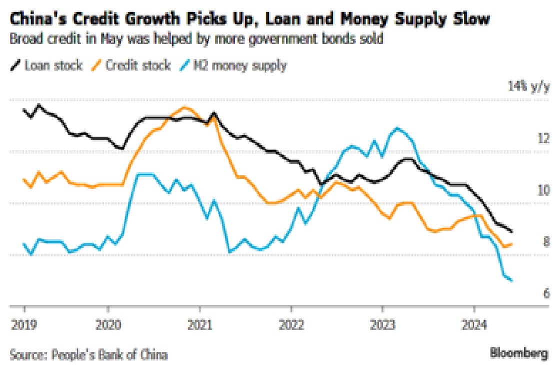
Argentina

In May, Argentina's monthly inflation slowed to its lowest level since early 2022, reaching 4.2% m/m, below the 5% estimate. Annual inflation is still at an enormously high level 276% y/y, but it is starting to improve. This is a positive development for President Milei, following the passage of most of his economic reforms through Congress early Thursday morning after an overnight session. Argentine sovereign dollar bonds across tenors rose at least 2 cents on the dollar, and stocks closed up (+0.2%). Milei is set to meet with IMF head Georgieva on the sidelines of the G7 summit in Italy on Friday, according to press reports.



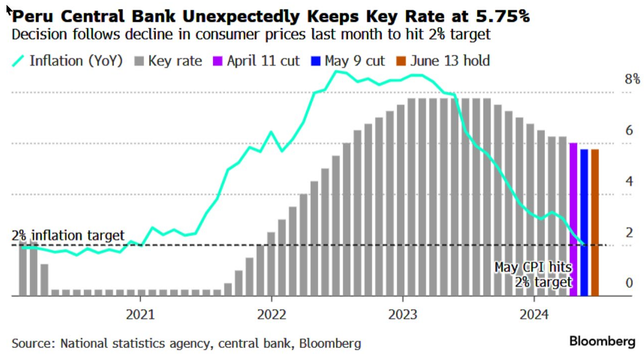
China

China sold 50-year government bonds at record low yield amidst robust demand. This was part of China's one trillion yuan special sovereign notes issuance for 2024, which continues to receive strong demand. 35bn yuan ($4.8bn) of these 50Y government bonds were sold at a yield of 2.53%, lower than Bloomberg estimates of 2.58%, and the offering was five times oversubscribed. Separately, **China's onshore corporate bond spreads narrowed to the lowest since November 2022.** The yield premium for three-year AAA rated corporate yuan bonds over comparable sovereign debt shrank to +27.6bps. Apart from Chinese issuers, inexpensive financing has also attracted global issuers with businesses in China to issue panda bonds, most recently Bayer AG and BMW China Capital. Panda bond sales totaled 94.5bn yuan ($13bn) as of June 13, which is more than two-thirds of the 2023 total, Bloomberg calculated. **On data releases**, new aggregate financing expanded in May to 14.8tn yuan ($1.9tn) year to date, following a surprise contraction in April.



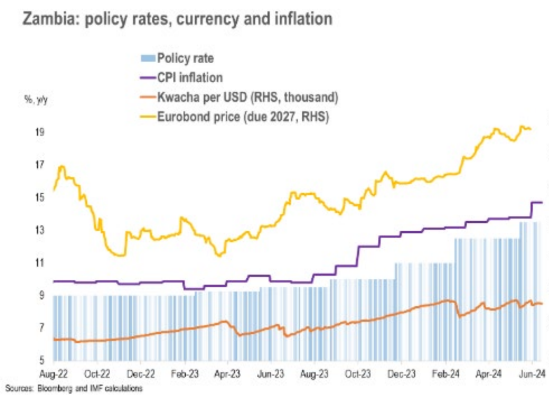
Peru

Peru's central bank surprised markets as it kept interest rates unchanged at 5.75% Thursday night, citing concerns over persistent core inflation. Nine out of ten analysts surveyed by Bloomberg had expected a 25 bps cut. Equity markets were down (-1.2%) at the close before the evening announcement, while the sol was up slightly. Although headline inflation has fallen to 1.66% y/y, core inflation is still hovering at 3.1% y/y. The Finance Ministry has urged the central bank to cut borrowing costs faster to boost economic growth given that Peru's economy shrank -0.6% in 2023, the second-worst decline in 33 years.



Zambia

Zambia used the G20 Common Framework mechanism to restructure its eurobonds alongside debt owed to other governments, most notably China. The country has however not yet restructured $3.3bn in debt owed to commercial banks, the largest of which are to China Development Bank and Industrial and Commercial Bank of China Ltd., amidst individual talks with those creditors in the absence of a negotiating committee. As a result, Fitch Ratings said it would assign a CCC+ rating to the restructured bonds and maintain Zambia's long-term foreign-currency debt credit rating in default. Similarly, S&P will maintain a selective default status on Zambia's foreign currency debt rating until the country concludes renegotiations with commercial creditors. Moody's Ratings said it will review its assessment after the bond exchange, warning about the impact of the ongoing drought, which is hurting agriculture and energy production and adds additional fiscal pressure, increasing likelihood of a re-default.



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Global Financial Indicators

6/14/24 8:07 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
United States		5428	0.2	2	3	24	14
Europe		4860	-1.5	-4	-4	11	7
Japan		38815	0.2	0	0	15	16
China		3542	0.4	-1	-4	-11	3
Asia Ex Japan		72	-0.2	0	-1	4	8
Emerging Markets		42	-0.2	-1	-2	4	5
Interest Rates				basis points			
US 10y Yield		4.20	-4.8	-24	-24	41	32
Germany 10y Yield		2.35	-11.9	-27	-20	-10	33
Japan 10y Yield		0.94	-3.1	-3	-1	51	33
UK 10y Yield		4.04	-8.6	-23	-14	-36	50
Credit Spreads				basis points			
US Investment Grade		126	2.2	7	7	-34	-8
US High Yield		365	5.7	13	17	-85	-21
Exchange Rates				%			
USD/Majors		105.53	0.3	1	0	3	4
EUR/USD		1.07	-0.4	-1	-1	-1	-3
USD/JPY		157.0	0.0	0	0	12	11
EM/USD		46.0	-0.3	0	-2	-8	-4
Commodities				%			
Brent Crude Oil ($/barrel)		83.3	0.7	5	2	18	9
Industrials Metals (index)		151	-1.0	-1	-7	2	6
Agriculture (index)		60	-0.7	0	-1	-11	-5
Implied Volatility				%			
VIX Index (%, change in pp)		12.8	0.8	0.6	-0.6	-1.1	0.3
Global FX Volatility		7.2	0.0	0.1	0.1	-0.7	-0.9
EA Sovereign Spreads				10-Year spread vs. Germany (bps)			
Greece		131	12.8	26	28	-1	27
Italy		158	11.4	24	24	-6	-9
Portugal		79	7.1	18	15	10	16
Spain		93	7.5	20	14	-3	-4

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

Emerging Market Financial Indicators

Last updated: 6/14/2024 8:08 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		7.26	0.0	-0.1	0	-1	-2		2.2	-1.0	0	-4	-49	-31
Indonesia		16412	-0.9	-1.3	-2	-9	-6		7.2	21.3	30	17	94	72
India		84	0.0	-0.2	0	-2	0		7.3	0.0	-3	-22	(19.8)	4
Philippines		59	-0.1	-0.2	-1	-5	-6		5.4	-14.9	-22	-26	-58	-27
Thailand		37	0.1	0.3	0	-5	-7		2.8	-1.5	-4	-9	3	7
Malaysia		4.72	-0.2	-0.6	0	-2	-3		3.9	0.0	0	-5	14	13
Argentina		902	-0.1	-0.4	-2	-73	-10		43.0	-241.0	50	489	-6848	-4335
Brazil		5.37	0.0	-0.4	-4	-10	-10		12.2	-3.9	-4	46	79	176
Chile		918	-0.3	-1.0	1	-12	-4		5.2	0.0	-4	-6	21	27
Colombia		4146	-2.8	-5.1	-6	1	-7		8.4	0.0	20	12	40	77
Mexico		18.59	-1.1	-1.0	-9	-8	-9		9.6	0.0	-10	38	128	114
Peru		3.8	0.0	-0.5	-1	-3	-2		7.0	0.3	4	-6	-11	36
Uruguay		39	-0.2	-0.7	-2	-2	-1		9.2	0.1	2	6	-68	-32
Hungary		373	-0.8	-2.7	-4	-8	-7		6.6	7.0	12	4	-80	82
Poland		4.09	-1.1	-2.5	-4	0	-4		5.2	-1.0	-2	2	-8	72
Romania		4.7	-0.5	-1.1	-1	-2	-3		6.6	1.7	-3	3	-8	38
Russia		89.3	-1.6	-0.3	2	-6	0							
South Africa		18.3	0.5	3.1	0	0	0		9.4	-2.0	-28	-43	-40	28
Türkiye		32.64	-1.0	-0.8	-1	-28	-10		28.6	-3.0	64	133	1083	182
US (DXY; 5y UST)		106	0.4	0.7	1	3	4		4.20	-4.3	-26	-25	21	35

	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	7 Days	30 Days	12 M	YTD
								basis points					
China		3542	0.4	-1	-4	-11	3		138	2	-2	-47	-20
Indonesia		6735	-1.4	-2	-8	1	-7		103	2	5	-36	7
India		76993	0.2	0	4	21	7		93	0	0	-41	-23
Philippines		6384	-0.1	-2	-4	-2	-1		90	0	4	-19	10
Thailand		1307	-0.4	-2	-6	-16	-8		0	0	0	0	0
Malaysia		1607	-0.2	-1	-1	16	10		78	-1	-1	-16	-7
Argentina		1605208	2.4	7	14	324	73		1424	-172	174	-889	-489
Brazil		119568	-0.3	-3	-7	0	-11		230	3	17	-16	15
Chile		6486	-0.8	-2	-4	13	5		124	0	9	-2	-1
Colombia		1386	0.4	-2	-1	18	16		316	3	26	-38	45
Mexico		52276	-1.3	-4	-9	-5	-9		318	7	21	-68	-16
Peru		29326	-1.2	-2	-2	31	13		153	-1	13	-12	9
Hungary		69626	-0.6	0	1	39	15		158	4	13	-62	9
Poland		83534	-0.2	-2	-5	25	6		104	2	9	-28	7
Romania		17861	0.0	-1	3	48	16		195	6	17	-41	-6
South Africa		77121	1.0	0	-2	-1	0		326	-22	3	-66	18
Türkiye		10471	0.8	3	3	95	40		293	1	20	-176	-21
EM total		42	-0.2	-1	-2	4	5		383	-5	58	-4	37

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

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