



- S&P downgrades France to AA- ([link](#))
- US Treasury market to face key test as T-Bill issuance declines ([link](#))
- Japan confirms record currency intervention in April and May ([link](#))
- Problems in US CRE sector may not be systemic risk for banks ([link](#))
- Credit spreads are narrowing in China ([link](#))
- Markets in Mexico hold steady ahead of historic election ([link](#))

[Mature Markets](#)








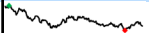



[Emerging Markets](#)

[Market Tables](#)

Markets rally on positive sentiment as global macro data meet forecasts

US equity index futures are up this morning after a rally in European stocks and a strong performance by equity markets in Asia overnight. The benign US inflation data released on Friday appear to have given some encouragement to market sentiment. S&P's downgrade of France's credit rating to AA- (in line with Fitch but below Moody's Aa2 rating) does not appear to have had much impact on local markets, at least so far. French OATs are trading in line with bunds and the CAC-40 equity index is rallying along with other euro area bourses. Stronger than expected PMI data helped equity markets in China post strong gains, while local credit spreads continued to narrow. Claudia Scheinbaum made history as she became the first female president of Mexico in line with poll expectations.

Key Global Financial Indicators

Last updated: 6/3/24 7:57 AM	Level		Change from Market Close				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		5278	0.8	0	3	23	10.64
Eurostoxx 50		5016	0.7	-1	2	16	11
Nikkei 225		38923	1.1	0	2	23	16
MSCI EM		42	-1.0	-3	-2	6	4
Yields and Spreads			bps				
US 10y Yield		4.46	-3.7	0	-5	77	58
Germany 10y Yield		2.62	-4.8	7	12	30	59
EMBIG Sovereign Spread		380	11	9	7	-97	-3
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		46.6	-0.2	-1	0	-7	-3
Dollar index, (+) = \$ appreciation		104.6	0.0	0	0	1	3
Brent Crude Oil (\$/barrel)		81.2	0.1	-2	-2	7	5
VIX Index (% change in pp)		13.1	0.2	1	0	-1	1

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

This is likely to be a very busy week, with the focus on Friday's US jobs report and the ECB meeting this Thursday for which markets have almost fully priced in a rate cut. Roughly two and a half rate cuts are expected from the ECB this year, compared to just one for the FOMC, which may account for the

growing disparity between US and euro area interest rates. With investors highly sensitive to interest rates at the moment, a stronger than expected US jobs report could be negative for markets as it could force the Fed into a more hawkish stance. Markets are divided on whether the Bank of Canada will deliver its first rate cut on Wednesday. Other countries with central bank meetings this week include India, Kenya, and Poland. The euro area is scheduled to report on jobs, inflation, and PMIs. PMI data will also be released in China. Elections to the European Parliament will be held this week, while the final results of India's election will be announced tomorrow.

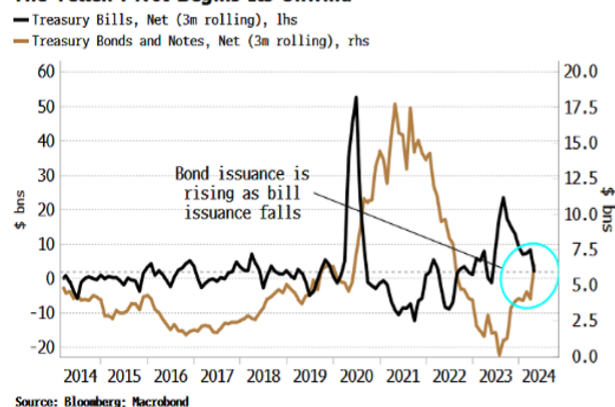
Mature Markets

[back to top](#)

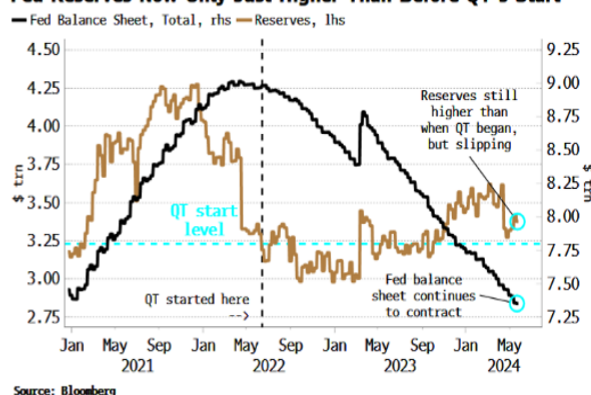
United States

The US Treasury market will face a key test as T-Bill issuance declines as a share of the Treasury's funding program. Last year, Treasury Secretary Yellen increased the supply of T-Bills to help reduce the volatility caused by a larger than expected Treasury funding announcement (the so-called "Yellen Pivot"). This helped cap the benchmark 10-year Treasury yield at 5% and pushed it down as low as 3.80% in December. However, this year, Treasury will shift to longer maturity notes and bonds as April saw the largest monthly decline in T-Bill issuance in over a year. With markets made nervous by the recent rise in the 10-year yield to 4.60% last week, the need to absorb a large supply of new Treasury notes and bonds could prove challenging. The situation is made more difficult by falling liquidity in the system as reserves decline and quantitative tightening by the Fed continues. Money market funds were big buyers of T-Bills and helped to keep demand for new Treasury issuance strong, but they are not allowed to buy longer maturity Treasury paper. Banks are also stepping back from the Treasury market, leaving the field to institutional and retail investors.

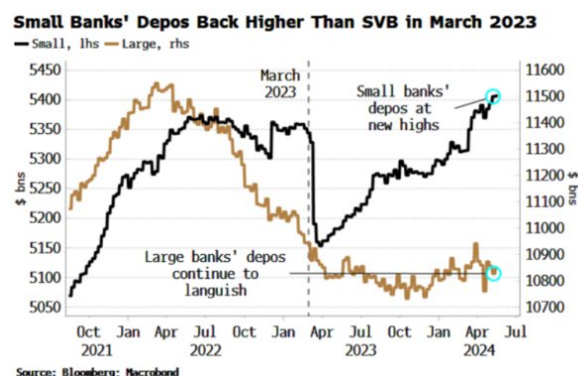
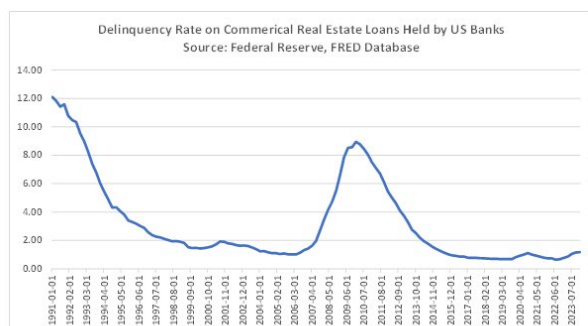
The Yellen Pivot Begins Its Unwind



Fed Reserves Now Only Just Higher Than Before QT's Start



Problems in the US commercial real estate (CRE) sector may not be systemic for banks, according to research from MSCI. Data from the Fed indicate that US banks hold \$3tn of CRE loans, while MSCI researchers find that just 1% of all bank CRE loans are in difficulty. Default on all these loans with a recovery rate of 50% would only hit 6% of the equity capital held by US banks, according to the MSCI analysis. The sector experiencing the greatest distress is large office buildings in major cities, and most banks have relatively low exposure to these kinds of loans, the MSCI analysts contend. Many banks have already set aside reserves against these loans to reduce the impact of any defaults. In addition, the latest Fed data shows that the default rate on CRE bank loans is very low at less than 1.2%. Meanwhile, deposit levels at the small banks that were in the spotlight during the Silicon Valley Bank (SVB) crisis are now back to pre-crisis levels. However, a significant increase in interest rates from current levels could change the game and expose banks to much higher credit risk.

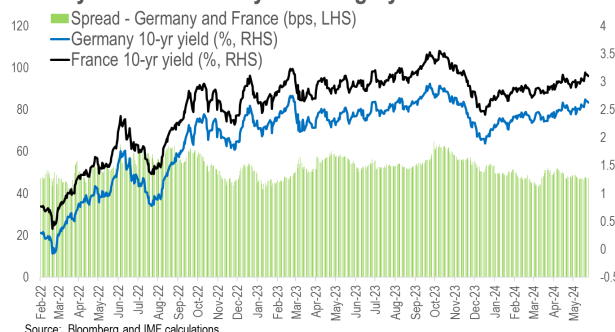


Euro Area

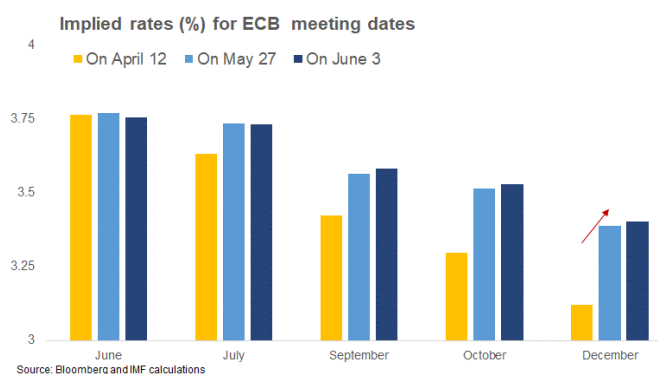
Euro area equity markets were trading higher this morning (Stoxx 600 Index +0.5%) with most sectors trading in the green. Data released this morning showed the eurozone's final manufacturing PMI marginally lower than previous estimates (47.3 versus previously estimated 47.4). **Euro area sovereign yields were lower (10y bund yield -4bps to 2.62%), while the euro was marginally weaker against the dollar (-0.1% at 1.08).** CFTC data show that **EUR net long positions have continued to increase for the third consecutive week** as short positions have decreased. Rabobank analysts note that while a 25bps rate cut is expected from the ECB this week, recent inflation data have resulted in heightened uncertainty about ensuing policy moves.

The initial market reaction to S&P's one-notch rating downgrade of French sovereign debt appears limited. S&P on Friday announced the downgrade of France's credit rating to AA-/stable, matching Fitch's rating, citing a deterioration of France's budgetary position. The rating agency noted that France's general government debt is now expected to increase more than previous forecasts while the rating agency now forecasts that France's budget deficit will remain above 3% of GDP in 2027. The French-German 10y government bond spread has remained below 50bps recently and this morning was little changed at around 47bps. Prime minister Attal commented that France will "continue to reform", adding that it would meet the goal of bringing the deficit below 3% of GDP. BofA analysts believe that S&P's downgrade will have a minimal direct effect on bank ratings, given that the top senior preferred debt rating for French banks remains one level lower than the new sovereign rating. Separately, **Fitch upgraded ratings on Ireland to AA from AA-**, with a stable outlook.

Germany and France: 10-yr sovereign yields



For the ECB meeting this week, a 25bps rate cut is widely expected, with the focus on communication and updated staff projections. Several analysts expect the ECB to remain cautious and to communicate that future rate cuts will be data dependent. Analysts from Credit Agricole do not foresee a major change in the ECB's macroeconomic projections but argue that communication on the central scenario could be more important than the scenario itself. Commerzbank analysts think that the ECB would likely have to point to its updated staff projections to justify the anticipated rate cut this week, given the upside surprise to euro area headline and core inflation that were released last Friday. Markets have become less convinced about how aggressively the ECB will cut this year and have scaled back ECB rate cut expectations for 2024 by roughly 25bps since the April ECB meeting. Markets are now pricing in roughly 60bps of easing this year.

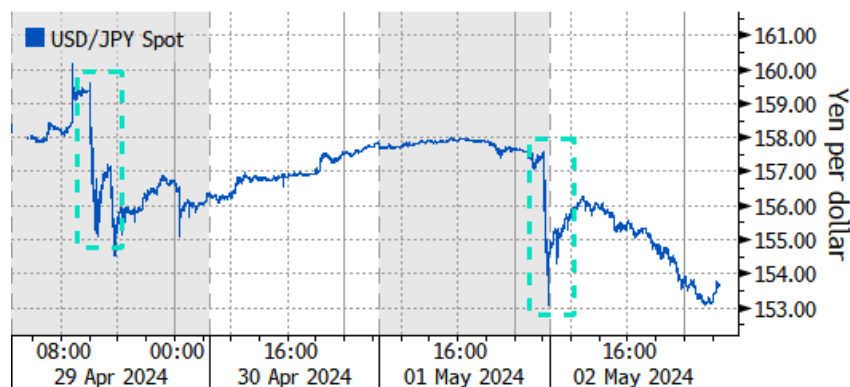


Japan

Japan's Ministry of Finance (MoF) confirmed its record currency intervention in April and May. The MoF's data showed the authorities spent a record ¥9.8 tn (\$62.2 bn) to support the Japanese yen against the US dollar in the five-week period between 26 April and 29 May, when the yen depreciated to the weakest in three decades past 160. This marked the MoF's first intervention since 2022, with the amount spent exceeding the ¥9.2 tn in the last intervention operations carried out in September and October 2022. It is suspected that the interventions took place on 29 April and 1 May, though the MoF did not disclose the operation dates. Analysts believe that foreign exchange intervention can credibly hamper speculative moves, but the Bank of Japan may need to pick the timing of further actions carefully to avoid repeated intervention at a similar scale, given that the recent intervention amount was about 5% of Japan's total foreign reserves.

Taking Action

Japan releases official figures showing it intervened in FX markets in p



Source: Bloomberg

Bloomberg

USDJPY Currency (USD-JPY X-RATE) yen 4 Days 3 Minutes Copyright© 2024 Bloomberg Finance L.P. 03-Jun-2024 15:28:39

Emerging Markets

[back to top](#)

EMEA equities traded mostly higher today, while currencies were mixed. Russia is expected to stay on hold at the next central bank meeting on June 7. **Most Asian equities rose (+2.6% on net), led by technology stocks, as the risk sentiment was buoyed by renewed hopes on rate cut and major chipmaker Nvidia's new upgrade plan.** Indian equities surged to a record high (+3.4%), after exit polls predicted a landslide victory for Prime Minister Modi's ruling party, as investors see it as positive for markets. **Latin American markets were generally weaker as currencies depreciated against the dollar and equities were mostly lower.** Argentina bucked the trend as the Merval equity index set a new record on hopes that the Senate will approve deregulatory measures.

Emerging Market Bond and Equity Flows

Weekly EM bond outflows accelerated while EM equities turned marginally negative for the week ending May 29th. Sentiment was dampened by renewed pressure from high-for-longer AE rates. **Bond outflows deepened to -\$1.0 bn (from -\$79mn)**, primarily from local currency funds (-\$730mn from -\$101mn) while hard currency funds flows turned negative (-\$289mn from +\$21mn). Bond outflows from actively managed funds also worsened (-\$1.0bn from -\$259mn) while inflows to Bond ETFs decelerated (+\$12mn from +\$180mn). **EM equity fund flows turned negative (-\$600mn from +\$1.7bn)** with outflows from both ETF (-\$194mn) and non-ETF funds (-\$407mn).

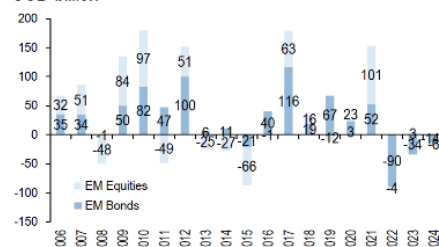
Weekly cross-asset flows

USD billion

Asset	8w flows (8w ago → current)	This wk	YTD
EM Bonds and Equities		-1.6	-19.5
EM Bonds		-1.0	-13.6
Hard Coy		-0.3	-6.8
Local Coy ^a		-0.7	-6.8
o.w. EM ex-China		-0.7	-5.8
o.w. China		0.0	-1.0
EM Equities		-0.6	-5.9
US HG		1.2	151.5
US HY		-0.6	7.1
Global Equities		0.8	64.2
EM Bond and Equity ETFs		-0.2	12.4
EM Bond ETFs		0.0	-2.3
EM Equity ETFs		-0.2	14.7
Non-resident EM flows ^a		-1.6	14.0

EM bond and equity fund flows

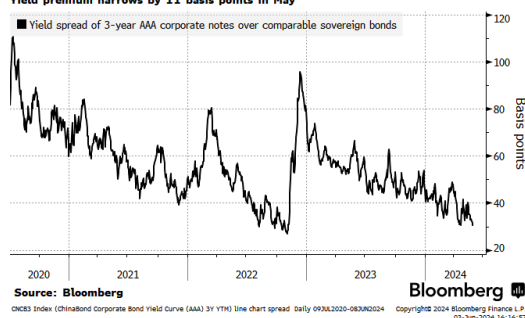
USD billion



China

Contraction in credit spreads of Chinese high-grade bonds in May was the largest in two years. Bloomberg data show that credit spreads between 3-year AAA-rated corporate bonds and government bonds narrowed 11 bps in May, marking a decline in two straight months. Analysts think investors are demanding less risk premium, as the issuers left on the market are mostly state-owned enterprises and leading private enterprises that are seen as more creditworthy. Separately, **Caixin May PMI data pointed to the fastest manufacturing activities expansion in almost two years.** The figure beat the market estimate (May: 51.7, consensus: 51.6, prior: 51.4), in contrast to the official index, which surprisingly indicated a contraction of manufacturing activities in May. According to the Caixin survey, both supply and demand of manufacturing continued to expand, with consumer sector output reporting vigorous growth.

China's Onshore Corporate Bond Spreads Shrink
Yield premium narrows by 11 basis points in May



Mexico

Markets were generally calm ahead of the elections held over the weekend. Mexican peso implied volatility remains low, suggesting that markets are not expecting results to be disruptive. The one-week, and one-month implied volatility increased marginally in the past week but is still relatively low when compared to April levels (*left chart*). This could indicate that markets expect policy continuity despite the potential of a reduced Congressional majority. A capital flow analysis by HSBC also indicated that non-residents holdings (*right chart*) of Mexico's local currency government bonds have been largely stable in recent weeks. Non-resident investors are also favoring long-dated MBonos, with increased holdings of bonds maturing beyond 5 years in the past month.

Not Much Sign of Election Nerves

Mexican peso implied volatility

■ 1 Month ■ 3 Month ■ 6 Month



Source: Bloomberg

Mexico foreign bond positions onshore

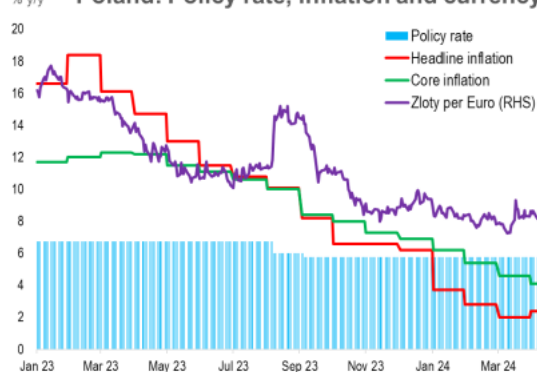


Source: Banxico, Bloomberg, HSBC

Poland

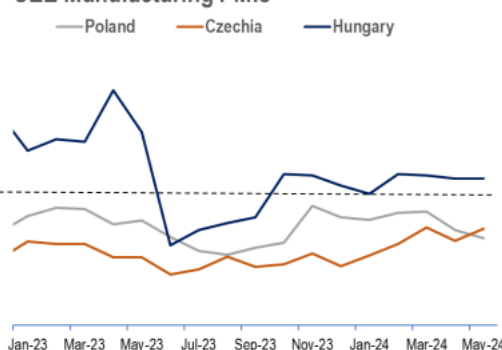
The zloty was marginally weaker (-0.2%) against the euro this morning, trading at 4.28/€, as the central bank of Poland (NBP) is expected to hold the policy rate unchanged at 5.75% at its upcoming MPC meeting on Wednesday (June 5). Today's May manufacturing PMI print surprised to the downside as it stayed at 45, from 45.9 in April and against a (median) estimate of 47.2. May CPI inflation was at 2.5% y/y, in line with the NBP's target, and below market expectations (consensus 2.8% y/y). Analysts at JP Morgan estimate that core inflation declined in May to 3.8% y/y, from 4.1% y/y in April, but that services inflation reached 8%. **Goldman Sachs analysts continue to expect stable underlying disinflation in the second half of 2024, which will eventually lead the NBP to resume rate cuts later this year.** ING has a constructive view on the zloty which they see appreciating against the euro to trade below 4.26/€.

Poland: Policy rate, inflation and currency



Source: Bloomberg and IMF calculations

CEE Manufacturing PMIs



Source: Bloomberg and IMF calculations

This monitor is prepared under the guidance of Jason Wu (Assistant Director), Charles Cohen (Deputy Division Chief), Nassira Abbas (Deputy Division Chief), and Caio Ferreira (Deputy Division Chief). Fabio Cortes (Senior Economist), Sanjay Hazarika (Senior Financial Sector Expert), Esti Kemp (Financial Sector Expert-London Representative), Johannes S Kramer (New York Representative), Benjamin Mosk and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Yingyuan Chen (Financial Sector Expert), Andrew Ferrante (Research Assistant), Deepali Gautam (Research Officer), Phakawa Jeasakul (IMF Resident Representative in Hong Kong SAR), Harrison Kraus (Research Assistant), Yiran Li (Research Assistant), Xiang-Li Lim (Financial Sector Expert), Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), Mustafa Oguz Caylan (Research Officer), Sonal Patel (Senior Financial Sector Expert-London Representative), Silvia Ramirez (Senior Financial Sector Expert), Patrick Schneider (Financial Sector Expert), Ying Xu (Economist), Dmitry Yakovlev (Senior Research Officer), and Akihiko Yokoyama (Senior Financial Sector Expert). Javier Chang (Senior Administrative Coordinator), Lauren Kao (Administrative Coordinator), and Srujana Sammeta (Administrative Coordinator) are responsible for the word processing and production of this monitor.

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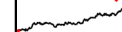








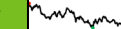

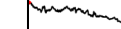


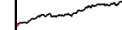
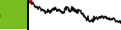


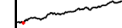


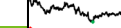
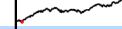



Global Financial Indicators

6/3/24 7:58 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		5278	0.8	0	3	23	11
Europe		5016	0.7	-1	2	16	11
Japan		38923	1.1	0	2	23	16
China		3589	0.2	-1	0	-7	5
Asia Ex Japan		70	-1.0	-3	-1	5	5
Emerging Markets		42	-1.0	-3	-2	6	4
Interest Rates			basis points				
US 10y Yield		4.46	-3.7	0	-5	77	58
Germany 10y Yield		2.62	-4.8	7	12	30	59
Japan 10y Yield		1.07	-0.1	4	17	66	46
UK 10y Yield		4.27	-4.7	1	5	12	73
Credit Spreads			basis points				
US Investment Grade		116	0.0	-1	-1	-49	-18
US High Yield		350	0.5	7	4	-148	-35
Exchange Rates			%				
USD/Majors		104.63	0.0	0	0	1	3
EUR/USD		1.08	0.0	0	1	1	-2
USD/JPY		156.8	-0.3	0	2	12	11
EM/USD		46.6	-0.2	-1	0	-7	-3
Commodities			%				
Brent Crude Oil (\$/barrel)		81.2	0.1	-2	-2	12	7
Industrials Metals (index)		161	0.5	-2	3	13	13
Agriculture (index)		61	0.1	-2	2	-7	-3
Implied Volatility			%				
VIX Index (%, change in pp)		13.1	0.2	1.2	-0.3	-1.5	0.7
Global FX Volatility		6.9	0.1	0.1	-0.4	-1.5	-1.2
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		102	-0.6	2	4	-35	-2
Italy		130	-1.6	1	-2	-46	-38
Portugal		58	-1.8	-4	-6	-11	-5
Spain		71	-1.4	-4	-6	-29	-25

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

Emerging Market Financial Indicators

Last updated: 6/3/2024 8:00 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		7.25	-0.1	0.0	0	-2	-2		2.2	0.0	-1	-12	-59	-28
Indonesia		16230	0.1	-1.0	-1	-8	-5		6.9	-3.0	-4	-28	52	41
India		83	0.4	0.0	0	-1	0		7.4	-5.9	0	-12	(8.6)	14
Philippines		59	-0.3	-1.0	-2	-4	-6		5.5	-5.0	-7	-24	-43	-11
Thailand		37	0.0	-0.7	0	-6	-7		2.8	-0.5	1	-7	21	15
Malaysia		4.71	0.0	0.1	1	-2	-2		4.0	13.3	14	10	34	31
Argentina		896	-0.1	-0.5	-2	-73	-10		40.3	197.4	522	5	-6913	-4607
Brazil		5.25	-0.8	-1.5	-1	-4	-7		11.8	-5.9	10	33	55	143
Chile		918	0.0	-1.4	5	-12	-4		5.3	-2.0	14	-1	12	44
Colombia		3868	-0.1	0.1	1	15	0		8.5	0.0	11	11	2	81
Mexico		17.47	-2.6	-4.6	-3	0	-3		9.3	0.0	10	14	89	85
Peru		3.7	0.6	0.5	1	-1	-1		7.1	-0.4	1	-5	-17	39
Uruguay		39	0.0	-0.5	-1	0	0		9.2	3.5	4	8	-82	-34
Hungary		361	-0.5	-1.9	0	-4	-4		6.7	-1.0	-20	-5	-118	88
Poland		3.95	-0.2	-0.6	2	6	0		5.2	-5.5	-16	-7	-5	76
Romania		4.6	0.0	-0.1	1	1	-2		6.6	0.1	2	-4	-17	42
Russia		89.3	1.2	-0.4	2	-9	0							
South Africa		18.7	0.6	-1.7	-1	3	-2		9.8	-11.0	2	-12	-22	67
Türkiye		32.20	0.2	-0.1	0	-34	-8		27.6	-2.0	-16	-131	1562	85
US (DXY; 5y UST)		105	0.0	-0.1	0	1	3		4.47	-3.4	-5	-3	63	63

	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		3589	0.2	-1	0	-7	5		132	-8	-4	-62	-26		
Indonesia		7036	0.9	-2	-1	6	-3		97	3	0	-51	1		
India		76469	3.4	1	4	22	6		91	1	-9	-54	-25		
Philippines		6471	0.6	-2	-2	-1	0		86	3	2	-33	6		
Thailand		1346	0.0	-1	-2	-12	-5		0	0	0	0	0		
Malaysia		1597	0.0	-1	0	16	10		78	0	-3	-19	-7		
Argentina		1651417	0.5	9	14	368	78		1346	-105	126	-1264	-567		
Brazil		122098	-0.5	-2	-5	8	-9		213	1	1	-56	-2		
Chile		6633	-0.1	-3	1	17	7		116	0	-3	-23	-9		
Colombia		1400	-0.3	-1	1	22	17		303	-9	-1	-107	32		
Mexico		55179	-0.3	0	-3	4	-4		298	-1	-9	-103	-36		
Peru		30220	-0.6	0	4	38	16		150	-4	0	-34	6		
Hungary		69467	2.3	0	2	45	15		145	3	-5	-94	-4		
Poland		87157	1.0	-1	3	33	11		95	2	4	-48	-2		
Romania		17633	0.3	-1	2	45	15		178	1	-4	-80	-23		
South Africa		77478	1.0	-2	1	0	1		338	20	3	-128	30		
Türkiye		10446	0.4	-2	2	104	40		278	2	6	-291	-36		
EM total		42	2.2	-3	-2	6	4		370	35	41	-50	25		

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

[back to top](#)