Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Tuesday, March 12, 2019

- **Credit investor sentiment strengthens, according to Bank of America survey (link)**
- **US Treasury yields expected to remain low (link)**
- **Pound volatile after EU/UK agree to slight Brexit amendment but UK attorney general says legal risk of Brexit is unchanged (link)**
- **EM corporate bond issuance remains elevated (link)**
- **Chinese stocks gain supported by potential lifting of foreign ownership caps on A-shares (link)**

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

Markets cautious amid Brexit uncertainty

European bourses and S&P 500 futures traded moderately lower this morning as yesterday's recovery in market sentiment showed signs of fading. Ahead of a key parliamentary vote later today, UK's PM May reached an agreement with the EU overnight to modify the Brexit deal slightly. This morning, however, UK's attorney general Cox published an update on his legal advice where he said that the legal risks of Brexit "remain unchanged". The pound was quite volatile as a result, appreciating 1% overnight but weakening 0.6% this morning. Elsewhere, emerging markets remained a bright spot, with Chinese (+1.1%) and Indian equities (+1.3%) among the best performing markets in Asia. Gains in Chinese equities were supported by news on potential adjustments to foreign ownership caps. In Latam, Brazil was the main outperformer yesterday, with the real appreciating by 0.6% against the dollar and the equity market rallying by 2.8% as the press reported news of constructive dialogue between the government and domestic lawmaker regarding pension reform. On the negative side, the Philippine peso (-1.1%) underperformed on comments by BSP Governor Diokno that he sees room to cut interest rates and that the peso is trading close to the upper end of government's forecast range.

Key Global Financial Indicators

Last updated: 3/12/19 8:24 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		2783	1.5	0	1	0	11
Eurostoxx 50		3295	-0.3	-1	3	-4	10
Nikkei 225		21504	1.8	-1	3	-1	7
MSCI EM		42	0.4	0	0	-15	9
Yields and Spreads				bps			
US 10y Yield		2.65	1.1	-7	-4	-22	-3
Germany 10y Yield		0.07	0.2	-10	-6	-56	-17
EMBIG Sovereign Spread		350	7	5	-7	61	-64
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		63.1	0.0	0	-1	-11	1
Dollar index, (+) = $ appreciation		97.2	0.0	0	1	8	1
Brent Crude Oil ($/barrel)		66.9	0.5	2	7	3	24
VIX Index (%, change in pp)		14.6	0.2	0	-1	-1	-11

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

United States

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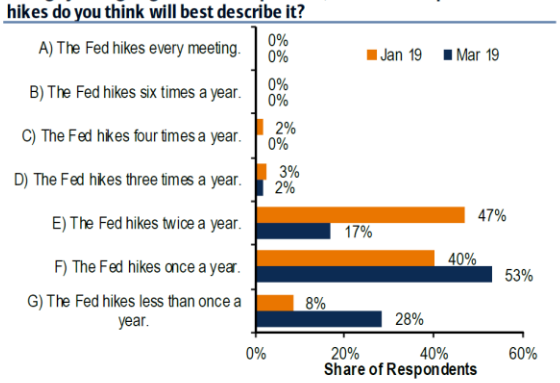
Global markets finally staged a rebound on Monday after a week of losses. Stronger than expected retail sales and talk of potential mergers gave a boost to US equities. The Nasdaq gained the most as technology stocks had the best performance and the S&P 500 also did well, crossing its 200-day moving average. However, the Dow posted a smaller gain because of the steep fall in the share price of Boeing after the crash of the second 737 Max aircraft and the grounding of 737 Max flights by China and Indonesia. Several US airline stocks also fell as they operate a number of the same aircraft.

Treasury yields were little changed on Monday and the auction of $38bn in three-year notes was lackluster. Extended Saudi production cuts lifted oil prices, although many expect this to be short lived. The International Energy Agency reported that the US will become the largest oil exporter in the world by 2021, boosted by shale oil production which has much lower production costs than Middle Eastern oil. President Trump presented a $4.7 tn 2020 budget that boosts defense and wall-related spending while cutting discretionary spending in multiple non-defense areas. Congress is expected to reject the proposal, raising the possibility of budget fights down the road and the possibility of another government shutdown. This morning, **headline CPI rose in February (+0.2% mom) in line with expectations but core CPI was slightly weaker than expected** at +0.1% mom (vs. +0.2% expected). US Treasury yields were marginally lower following the data release.

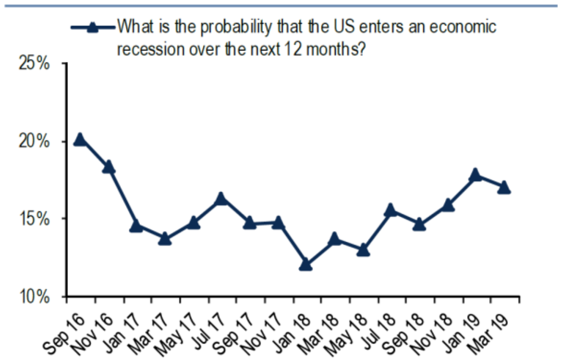
Investor sentiment turned positive early in 2019 and this month reached the highest level in nearly five years, according to the latest Bank of America survey of credit market investors. Although China, geopolitics and trade war were again flagged as the most important risks, investors are much less worried about them compared to earlier surveys. In addition, interest risk has faded to the background as a large majority of investors think the Fed will hike just once per year or less than once per year, suggesting that they expect one or fewer hikes in 2019. Investors continue to assign a low probability that the US will enter a recession in the next 12 months. However, due to the very strong rally that occurred in US credit markets in early 2019, investors do not expect much more spread tightening the rest of the year and predict more difficult trading conditions in the months ahead.

Figure 3: While acknowledging that the exact path of the coming rate hiking cycle is going to be data dependent, which overall pace of rate hikes do you think will best describe it?



Source: BofA Merrill Lynch Credit Investor Survey

Figure 4: What is the probability that the US enters an economic recession over the next 12 months?

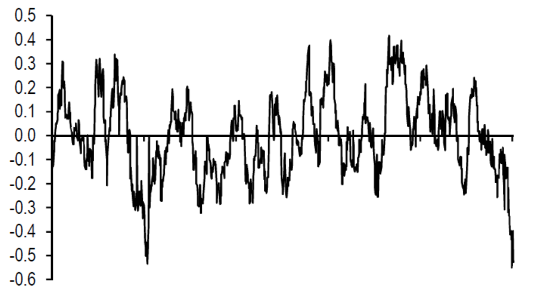


Source: BofA Merrill Lynch Credit Investor Survey

The consensus market view appears to support Bank of America's survey, predicting that the Fed will stay on hold for the next 12 months. The Fed Funds futures market predicts that rates will be slightly lower in December 2019 and that the Fed will cut rates once before December 2020. The much more liquid eurodollar futures market sees rates basically unchanged in December 2019 but also forecasts one rate cut by the end of the following year. JP Morgan's analysis of the forward overnight index swap (OIS) and the swaptions markets confirms the forecast of the Fed on hold through 2019 but finds just a 33% chance of the Fed staying on hold for 12 months. Their models assign equal weights to one rate hike or one rate cut in the coming 12 month period. The analysts conclude that **with the Fed out of the way for now, economic data weaker than expected and investors long the Treasury markets, Treasury yields should remain at the lower end of the trading range that has prevailed so far this year**. The 10-year Treasury started the year at 2.69% and has traded between 2.55% and 2.76% ever since, closing at 2.64% yesterday.

Exhibit 3: On balance, economic data continue to surprise to the downside

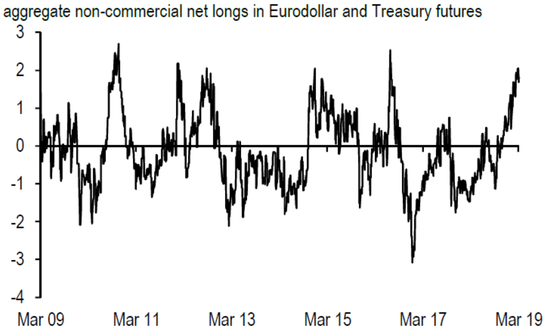
J.P. Morgan Economic Data Surprise Index; unitless



Source: J.P. Morgan

Exhibit 4: The combination of our Treasury Client Survey and CFTC data has not been this long since the summer of 2016...

Average 1-year z-score of net longs in J.P. Morgan Treasury Client Survey and aggregate non-commercial net longs in Eurodollar and Treasury futures



Source: CFTC, J.P. Morgan

Europe

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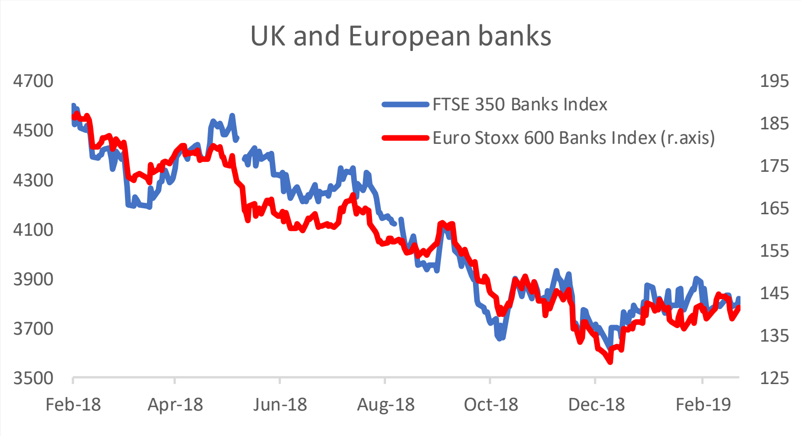
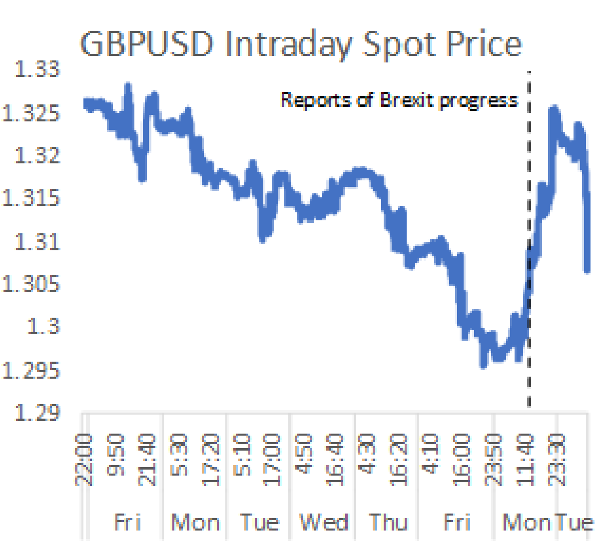
Equities traded modestly lower in the continent with all eyes on today's Brexit developments. The Euro Stoxx 600 was up 0.2% with real estate and consumer stocks outperforming. Banks moved in line with the overall index despite British lenders getting a boost from hopes of a Brexit breakthrough. **Sovereign yields rose across the continent with the UK seeing the biggest move**. The 10-year Gilt yield was up 5 bps to 1.23% on Brexit hopes and stronger than expected GDP for January (0.5% m-o-m, 0.2% expected) while other countries saw a rise of 2-3 bps.

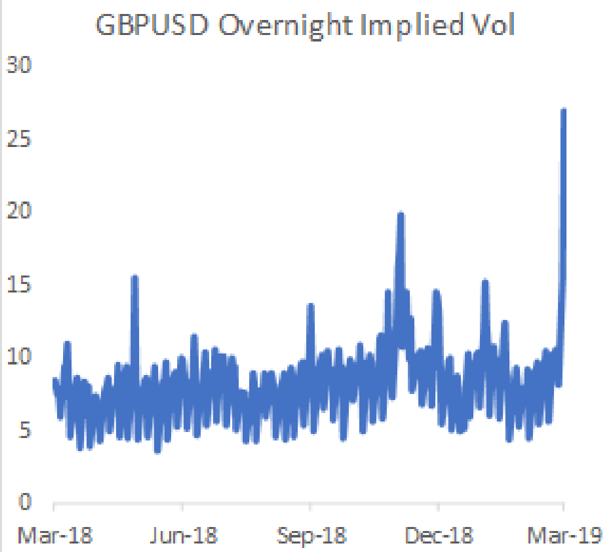


Source: Bloomberg

The UK and the EU have reached an agreement to modify the Brexit deal slightly. The modification involves a "legally binding instrument" that ensures either party could leave the so-called backstop if an independent arbitrator ruled that the other party had acted in bad faith. The UK also published a unilateral statement on their interpretation of the backstop while the parties issued a separate joint statement declaring their intention to pursue "alternative arrangements" to the backstop over the coming 20 months. The measures fall short of many MPs demands that a clear time limit be put in place, but it is unclear whether the changes will suffice ahead of a parliamentary vote on the deal later today. **Attorney general Cox published an update on his legal advice this morning where he said that overall the changes "reduced the risks" surrounding the backstop but that "the legal risks remain unchanged".** The pound strengthened sharply last night on news of the deal but retreated this morning following Cox's announcement. Meanwhile, overnight implied volatility has shot up ahead of today's vote.



Source: Bloomberg



Source: Bloomberg

Italian banks reduced bad loans at a rapid pace in January, despite the ongoing slowing of the economy. Bank of Italy data shows that the yoy change in NPLs reached -32.5% in January, the second successive month of big declines. The progress was primarily reached by offloading assets through securitization with the NPL ratio reaching a seven-year low of 6.5%. The country's bad loan stock now stands at approximately €100 bn, compared to more than double that amount in early 2017. Meanwhile, Bank of Italy data also showed that banks reduced corporate loans by 0.7% yoy in January while increasing their holdings of BTPs by 1.6%.

Other Mature Markets back to top

Japan

Equities (Nikkei +1.8%; Topix +1.5%) rose, with the tech sector leading gains. The increase came despite poor economic data as the Finance Ministry's quarterly business survey for Japan's largest manufacturers printed at -7.3 for Q1, versus 5.5 in 2018Q4, which was the worst since 2014Q2. Additionally, machine tool orders dropped to -29.3% yoy for February from -18.8% yoy in January, adding to the weaker economic outlook. On monetary policy, BoJ Deputy Governor Masayoshi Amamiya stated that the central bank should focus on hitting its 2.0% inflation target for now and can exit smoothly when it is needed. **The risk-on environment saw 10-year JGB yields rise 0.5 bps to -0.04%, while the yen depreciated 0.2%.**

Emerging Markets

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Key Emerging Market Financial Indicators

Last updated: 3/12/19 8:20 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		42.42	0.2	0	0	-15	9
MSCI Frontier Equities		28.39	0.8	0	-1	-19	9
EMBIG Sovereign Spread (in bps)		350	7	5	-7	61	-64
EM FX vs. USD		63.07	0.0	0	-1	-11	1
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.71	0.2	0	1	-6	2
Indonesian Rupiah		14267	0.2	-1	-1	-4	1
Indian Rupee		69.71	0.3	1	1	-7	0
Argentine Peso		41.26	-0.2	-3	-8	-51	-9
Brazil Real		3.84	0.1	-2	-3	-15	1
Mexican Peso		19.39	0.1	-1	-1	-4	1
Russian Ruble		65.78	0.2	0	0	-13	5
South African Rand		14.33	0.1	-1	-4	-17	0
Turkish Lira		5.46	-0.2	-1	-4	-30	-3
EM FX volatility		8.14	0.0	0.0	-0.7	0.4	-1.6

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

EM Corporate bond issuance

EM corporate supply in February 2019 totaled $33 bn, which was on par with last year but materially higher compared to the historical average of $23 bn. Analysts expect activity to remain elevated in the coming months. Asia ($23.4 bn) accounted for the bulk of the monthly supply, with China at $18.9 bn contributing 59%. Analysts expect the primary market to remain active given supportive markets. Among issuers, corporates in Turkey and Saudi Arabia have accelerated their issuance plans, taking advantage of the strong market. In GCC, issuance is expected to pick up until index inclusion to EMBIG is complete in September. Supply from Asia will also pick up in the coming weeks thanks to the onshore market in China opening up. In Latin America, supply continues to be driven by refinancing needs, as companies have significant spare capacity with less need for investment, while M&A activity is unlikely to pick up this year. So far **in March**, the largest bond issuances came from Koc Holdings in Turkey and Eurochem in Russia each issuing around $0.7 bn.

Exhibit 19: EM corporate net financing to remain low in 2019

(US$ bn)	2016	2017	2018	2019YTD	2019F
Gross issuance (a)	328	485	372	68	380
Estimated cash flows (b = c+d)	204	257	267	32	296
Amortizations (c)	118	173	171	17	208
Coupons (d)	86	84	96	15	88
Net issuance (e = a-c)	210	312	201	51	172
Net financing (f = a-b = e-d)	124	228	106	36	84
Tender/buyback/calls (g)	55	83	86	5	62
Net issuance after tender/buyback/calls (j = e-g)	154	229	116	46	110
Net financing after tender/buyback/calls (k = f-g)	68	145	20	31	22

Source: J.P. Morgan, Bloomberg, Bond Radar; Data as of March 6, 2019.

China

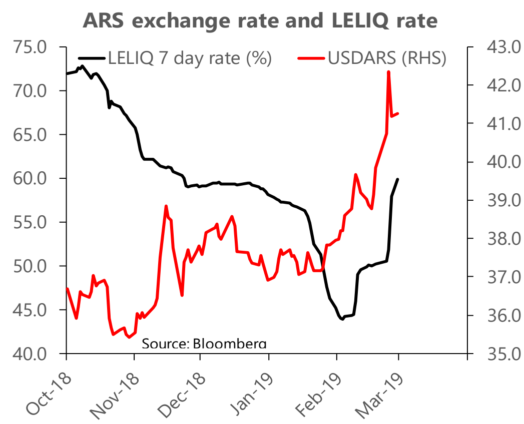
Chinese equities (Shanghai +1.1%; Shenzhen +1.7%) rose on very high volumes. According to Xinhua News, China Securities Regulatory Commission Deputy Chairman Yan Qingmin stated that **the authorities are considering raising foreign A-share holding caps**. He also stated that China remains committed to opening up the stock market. This could negate the risk of stalling inflows from MSCI's decision to remove some stocks from its benchmarks when the limits were reached. According to Bloomberg, Chinese equities have been buoyed by inflows to exchange-traded funds since MSCI's announcement to expand the weighting of onshore shares in its index. Separately, **the PBoC is studying the impact of overhauling its benchmark interest rates on loan pricing by banks.** According to Reuters, the central bank is assessing the impact from replacing the benchmark lending and deposits rates with the loan prime rate and 7-day interbank pledged repo rate respectively, but a timeframe is unclear.

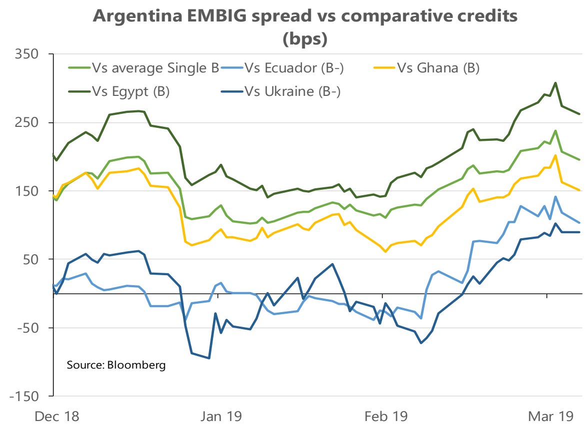
Xtrackers Harvest CSI 300 China A-Shares ETF sees biggest inflow since inception

Source: Bloomberg

Argentina

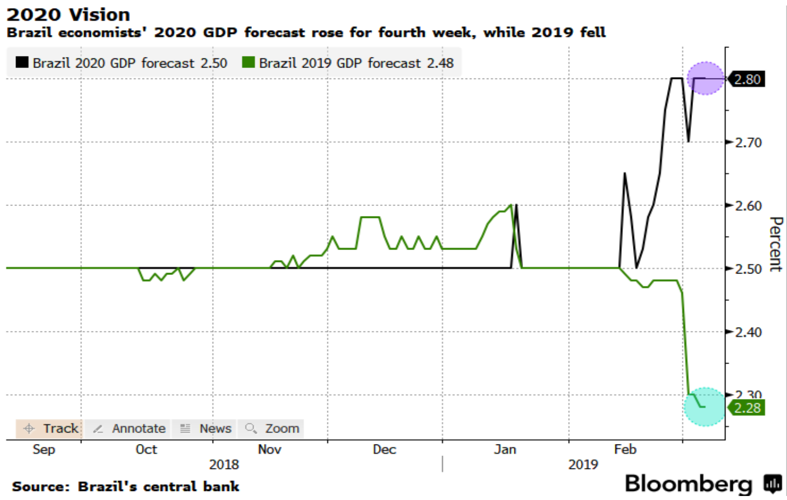
Investor sentiment has improved over the last two trading sessions, but credit spreads on dollar and the currency are still significantly wider/weaker compared to mid-February. After a strong rebound last Friday, the peso was largely unchanged on Monday. Credit spreads on dollar debt tightened by ~30 bps. The central bank increased the benchmark interest rate again by ~200 bps following a~600 bps increase on Friday. The benchmark rate is now more than 1500 bps higher compared to mid-February (LHS chart). Investor sentiment has deteriorated over the last few weeks as investors are focusing on heightened inflation and political risks. Analysts expect the CPI for February to increase by at least 3.6% m-o-m after surprising investors to the upside in January (2.9% vs 2.5% consensus). On the political front, according to market analysts the latest presidential polls show a tight runoff of President Macri against former President Cristina Fernandez De Kirchner. Over the coming months several provincial elections are scheduled which are seen as barometer for the presidential election in October. The first election was last Sunday in Neuquen and the candidate supported by Cristina Fernandez de Kirchner came in second. On balance, this outcome lowered the "political risk premium" according to market analysts.





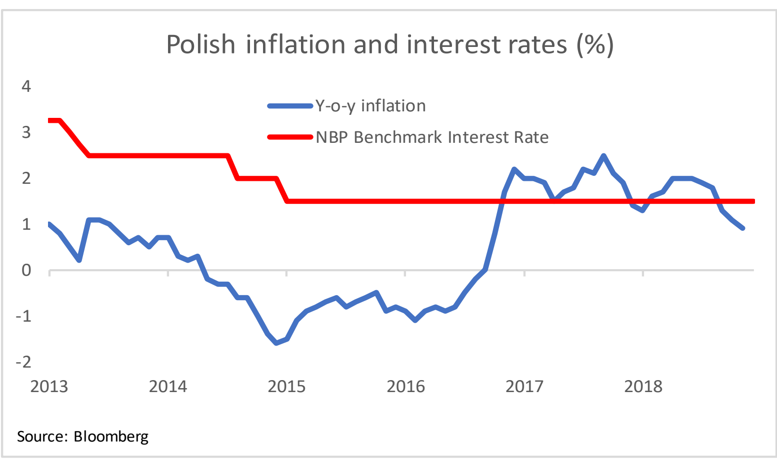
Brazil

According to the weekly survey compiled by the central bank, economists increased their economic growth forecast for 2020 for a fourth consecutive week on hopes that pension reform will boost growth next year. On the other hand, analysts' estimates for GDP growth in 2019 have fallen nearly a quarter percentage point to 2.28% from a month ago to the lowest in two years. The reduction in 2019 forecast, followed the release of GDP data at the end of February which showed that the economy grew at its weakest quarterly pace since the third quarter of 2017.



Poland

The central bank raised its GDP projections yesterday as the fiscal impulse is set to support growth in the short term. The bank now expects growth this year to come in at 4% (up from 3.6% previously) and 3.7% next year (3.4% previously). The bank also said that the effect of the fiscal stance on growth would be greater than on inflation. CPI data for February will be released on Friday and is expected to show an increase in annual inflation from 0.9% to 1.2%. The central bank decided to keep interest rates unchanged at 1.5% last week, as widely expected.



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Global Financial Indicators

Last updated: 3/12/19 8:23 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		2783	1.5	0	1	0	11
Europe		3295	-0.3	-1	3	-4	10
Japan		21504	1.8	-1	3	-1	7
China		3060	1.1	0	15	-8	23
Asia Ex Japan		69	1.9	0	1	-13	9
Emerging Markets		42	0.4	0	0	-15	9
Interest Rates					basis points		
US 10y Yield		2.65	1.1	-7	-4	-22	-3
Germany 10y Yield		0.07	0.2	-10	-6	-56	-17
Japan 10y Yield		-0.03	0.5	-4	-2	-8	-3
UK 10y Yield		1.19	1.3	-10	1	-30	-9
Credit Spreads					basis points		
US Investment Grade		119	-0.1	0	-2	26	-28
US High Yield		415	-1.8	13	-9	70	-106
Europe IG		61	-0.7	1	-10	13	-26
Europe HY		280	-2.8	5	-28	33	-72
EMBIG Sovereign Spread		350	7.0	5	-7	61	-64
Exchange Rates					%		
USD/Majors		97.22	0.0	0	1	8	1
EUR/USD		1.13	0.2	0	-1	-9	-2
USD/JPY		111.3	0.0	1	-1	-4	-1
EM/USD		63.1	0.0	0	-1	-11	1
Commodities					%		
Brent Crude Oil ($/barrel)		67	0.5	2	7	3	24
Industrials Metals (index)		121	1.4	-1	5	-9	11
Agriculture (index)		40	0.1	-3	-6	-20	-4
Implied Volatility					%		
VIX Index (%, change in pp)		14.6	0.2	-0.2	-0.9	-1.2	-10.9
10y Treasury Volatility Index		3.8	0.1	0.1	0.1	-0.4	-0.8
Global FX Volatility		7.2	0.0	0.1	-0.6	-0.4	-1.8
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		381	16.0	27	1	28	-34
Italy		250	0.5	-4	-21	113	0
Portugal		125	0.1	-4	-26	6	-23
Spain		110	1.3	11	-1	33	-8

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: 3/12/2019 8:22 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		6.71	0.2	-0.1	1	-6	2		3.1	-1.3	-3	10	-74	-5
Indonesia		14267	0.2	-1.0	-1	-4	1		8.0	-3.3	8	0	97	-14
India		70	0.3	1.1	1	-7	0		7.5	-1.4	-4	-2	-35	3
Philippines		53	-1.1	-1.2	-1	-2	0		5.5	2.1	-7	-19	63	-81
Thailand		32	0.1	0.4	-1	-1	2		2.6	-0.4	-4	2	23	-2
Malaysia		4.08	0.2	-0.2	0	-4	1		3.9	0.4	-5	-4	-5	-17
Argentina		41	-0.2	-3.4	-8	-51	-9		21.6	-23.7	3	88	495	-146
Brazil		3.84	0.1	-1.6	-3	-15	1		8.1	-11.1	-14	11	-29	-7
Chile		668	0.3	-1.7	-1	-10	4		4.3	0.3	-10	-1	-54	-16
Colombia		3179	-0.2	-2.6	-1	-10	2		6.3	-2.5	-13	-16	-17	-21
Mexico		19.39	0.1	-0.7	-1	-4	1		8.2	-5.7	-16	-35	55	-54
Peru		3.3	0.2	0.1	1	-1	2		5.5	-2.1	-6	-7	59	-20
Uruguay		33	-0.2	-1.3	-2	-14	-2		10.5	1.9	20	24		-25
Hungary		280	0.2	-0.4	0	-10	0		2.1	0.9	-5	7	38	-12
Poland		3.82	0.2	-0.4	0	-11	-2		2.3	2.0	-6	7	-28	2
Romania		4.2	0.0	-0.6	-1	-10	-4		4.0	-2.0	-14	-15	0	-25
Russia		65.8	0.2	0.0	0	-13	5		8.1	-0.4	1	9	126	-33
South Africa		14.3	0.1	-1.1	-4	-17	0		9.4	-0.6	-8	-13	70	-19
Turkey		5.46	-0.2	-1.3	-4	-30	-3		16.1	-0.9	31	92	372	-73
US (DXY; 5y UST)		97.2	0.0	0.4	1	8	1		2.45	1.2	-7	-4	-18	-6

	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		3060	1.1	0	15	-8	23		178	4	-1	-4	15	-16
Indonesia		6354	-0.2	-2	-1	-2	3		200	9	7	2	21	-36
India		37536	1.3	3	4	11	4		164	0	-2	-12	40	-32
Philippines		7748	0.5	1	-3	-8	4		95	8	5	6	-6	-26
Malaysia		1671	0.4	-1	-1	-10	-1		128	5	3	0	19	-34
Argentina		33791	2.3	-2	-10	2	12		736	4	-11	68	342	-79
Brazil		98027	2.8	3	2	13	12		239	8	1	0	13	-34
Chile		5299	0.5	1	-2	-6	4		134	8	3	-1	15	-32
Colombia		1526	1.5	1	4	3	15		191	9	2	-3	16	-37
Mexico		41876	0.7	-1	-3	-14	1		310	6	-9	-7	70	-44
Peru		20661	0.8	1	3	-1	7		138	9	3	-4	-5	-30
Hungary		40776	-0.1	0	1	5	4		116	9	7	6	16	-32
Poland		59668	0.3	0	-1	-4	3		55	10	5	6	1	-30
Romania		7904	-0.4	0	5	-8	7		200	1	7	3	75	-21
Russia		2462	-0.2	0	-3	6	4		213	6	1	-6	51	-39
South Africa		55482	-0.2	-1	3	-6	5		301	9	6	-8	65	-64
Turkey		101285	0.4	-2	-2	-14	11		432	8	12	17	127	3
Ukraine		556	0.0	0	-2	57	-1		647	1	-11	-93	214	-140
EM total		42	0.2	0	0	-15	9		350	7	5	-7	61	-64

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