Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Wednesday, March 13, 2019

- **Lowest 10-Treasury auction yield since January 2018 buoys US bond market (link)**
- **US corporate default rates expected to decline further, according to survey (link)**
- **UK's PM May's heavy Brexit defeat increases uncertainty even further (link)**
- **Chinese equities fall as US looks to retain option of raising tariffs (link)**
- **China relaxes rules on debt issuance of local government financing vehicles for refinancing (link)**

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

Markets tread water amid growth concerns and Brexit uncertainty

European bourses and S&P 500 futures traded flat this morning while Asian equities fell as market participants refocused on growth concerns amid on-going uncertainty about Brexit. Weaker-than-expected machine orders data in Japan and news that the US is expected to keep the option of increasing tariffs on Chinese imports open weighed on market sentiment. As a result, Asian equities sold-off with Japanese (Nikkei -1.0%; Topix -0.8%) and Chinese stocks (Shanghai -1.1%; Shenzhen -2.3%) underperforming. Meanwhile, Brexit uncertainty remains with the UK parliament voting later today on whether it supports exiting the EU without a deal. If that vote also fails, then MPs will vote tomorrow on whether the government should request an extension to the March 29 deadline. In emerging markets, the Argentine peso (-0.6%) continues to underperform. The central bank of Argentina raised the policy rate again on Tuesday by 230 bps to 62.1% (~1200 bps higher since the start of March) and announced it will switch back to two 7-day Leliq auctions per day until the end of the week as it continues to tighten peso liquidity.

Key Global Financial Indicators

Last updated: 3/13/19 8:09 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		2792	0.3	0	1	1	11
Eurostoxx 50		3314	0.3	0	3	-2	10
Nikkei 225		21290	-1.0	-1	1	-3	6
MSCI EM		43	0.1	-1	1	-14	9
Yields and Spreads					bps		
US 10y Yield		2.62	-3.8	-7	-8	-22	-6
Germany 10y Yield		0.07	1.5	-6	-5	-55	-17
EMBIG Sovereign Spread		349	-3	2	-2	57	-65
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		63.3	0.2	0	0	-11	2
Dollar index, (+) = $ appreciation		96.9	-0.1	0	0	8	1
Brent Crude Oil ($/barrel)		67.0	0.5	2	5	4	24
VIX Index (%, change in pp)		13.5	-0.2	-2	-2	-3	-12

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

United States

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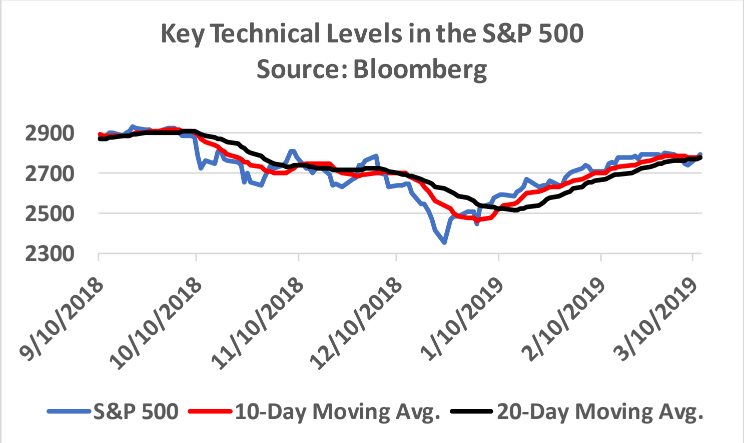
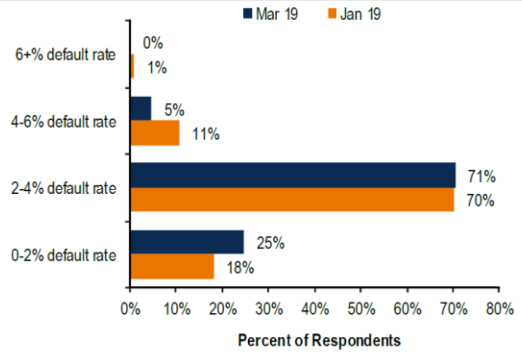
Treasuries rallied sharply into the eagerly awaited $24 bn 10-year note auction at 1pm, which was extremely well received. The auction saw the closing yield finish below the "When Issued" (WI) yield going into the auction (2.615% vs. 2.623%), a size of very strong demand. This was the lowest 10-year auction yield since January 2018. The lower than expected CPI print also contributed to the day's Treasury rally, which saw the 10-year push more than 4 bps lower to end below 2.60%, a large daily move by recent standards and suggestive of a strong bid for safe assets. In addition, key parts of the yield curve are flat or inverted. For example, the five-year yield is trading at the same level as Fed Funds Effective and 4 bps below the on-the-run one-year bill yield. Many investors view these as warning signals for risk assets. This morning, US **durable good orders** unexpectedly rose 0.4% in January (vs. -0.4% expected). Excluding transportation, however, orders declined 0.1% (vs. +0.1 expected). Treasury yields were little changed following the release.

Equity markets were mixed as the S&P 500 and the Nasdaq posted small gains on Tuesday but the Dow lost ground as Boeing weighed on the index for another day. The S&P 500 has breached its 10-day and 20-day moving average levels, which are viewed as bullish technical milestones by some investors. Monday's 1.5% rally was the best one-day gain for the index since the beginning of the rally that began on December 26. The rally has been broad-based, involving most stocks in the index, which is also viewed as a bullish sign. However, equity funds and ETFs have seen large net outflows this year, suggesting that many investors see this as a short-covering rally and are using the higher prices to get out. The persistently low Treasury yields and partial yield curve inversion are also viewed as reasons to be cautious.



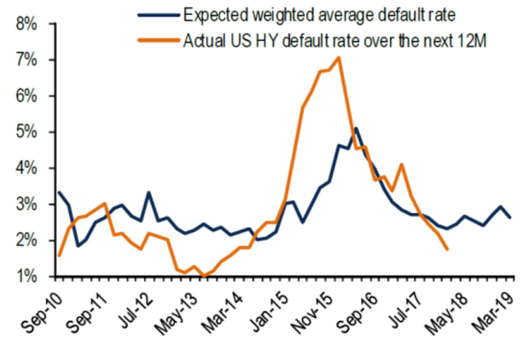
US corporate default rates are expected to decline in the next 12 months, according to the latest Bank of America survey of fixed income investors. On average, investors think the default rate will fall to 2.6% from the 2.9% level in the January survey. Interestingly, those who expect even lower defaults in the 0-2% range increased to 25% while those expecting higher defaults in the 4-6% shrank to 5%. The data show that the actual level of defaults occurring in the US high yield market has fallen below the weighted average forecast from the investor survey. These bullish trends have been reinforced by persistently low Treasury yields and strong corporate earnings in 2018. The survey found that investors have positioned themselves accordingly, increasing their longer duration credit holdings while reducing shorter duration positions. However, they are less bullish for 2019 as they expect good market conditions for the next three months but tougher conditions over the 12-month horizon. They think most of the potential for tighter spreads has already been realized.

Figure 29: Expectations of corporate default rate (LTM issuer scale) in 12 months



Source: BofA Merrill Lynch Global Research

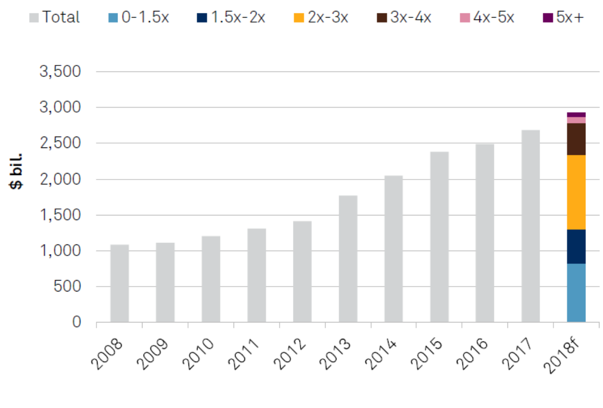
Figure 30: Expectations of default rate



Note: The expected weighted average default rate is calculated by equating 0-2% to 1%, 2-4% to 3%, 4-6% to 5% and 6+% to 8%, and then weighting the average based on the share of survey responses.
Source: BofA Merrill Lynch Global Research

The growth of the BBB-rated US corporate debt may not be as alarming a trend as many believe. The lowest rated, BBB sector of the investment grade corporate bond market has grown from just over $1 tn in 2008 to nearly $3 tn by the end of last year, as shown in the chart from S&P. Many are worried that a large increase in "fallen angel" debt, i.e. bonds issued by formerly investment grade issuers that are downgraded to high yield debt could overwhelm the high yield bond market and cause wider disturbances in the financial system. However, the debt issued by highly levered companies (more than 4x EBITDA) is just 11% of the bonds outstanding, S&P data show. In addition, this is forecasted to shrink to just 5% of the market by the end of this year. Moreover, much of this high leverage debt is confined to a few sectors such as consumer products. The great majority of these BBB issuers are likely to retain their investment grade status if a recession occurs. S&P estimates that if the next recession has the same severity as the financial crisis, foreign angel volume may hit $200-250 bn. Although disruptive to the market, they would eventually be absorbed with no spillovers expected to the rest of the financial system.

Growth In 'BBB' Rating Category Debt (2008-2018); Debt/EBITDA 2018



Note: Includes privately rated companies. f--Forecast as of Nov. 28, 2018. EBITDA--earnings before interest, tax and depreciation and amortization expense.

Source: S&P Global Ratings

Europe

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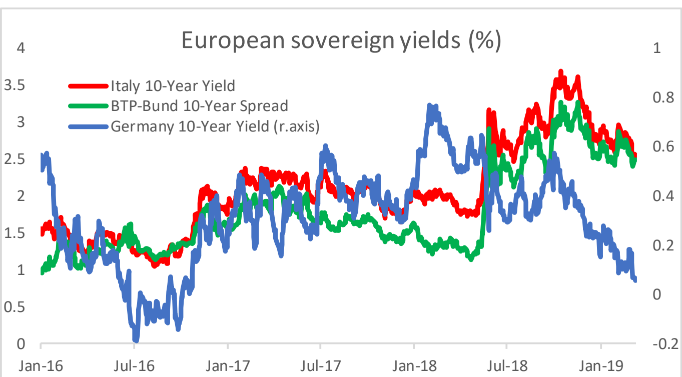
UK's PM May suffered another heavy defeat on her Brexit deal yesterday. The deal was defeated by a majority of 149 with 75 Conservative MPs voting against the deal. The large margin of defeat complicates the path ahead even further and raised doubts further about May's chances of leaving the EU with a deal. Parliament will vote later today on whether it supports exiting the EU without a deal. If that vote also fails, as it is widely expected to, then MPs will vote tomorrow on whether the government should request an extension to the March 29 deadline. Ahead of today's vote on "no deal", the government said that it would temporarily remove all tariffs on 87% of imported goods if the UK left the EU without a deal and will also unilaterally waive checks on the Irish border. A spokesman for EC president Tusk said that yesterday's vote increased the probability of a no deal scenario while EU chief negotiator Barnier said that "no deal" preparations are now more important than ever.

There was little market reaction to yesterday's Brexit vote, as a heavy defeat had become priced in after attorney general Cox published his view that the legal risks remained unchanged earlier in the day. Sterling fluctuated yesterday and ended the day 0.6% weaker against the dollar. It strengthened by 0.4% to above $1.31 this morning on speculation that a delay to the Brexit process was likely. **Equities on the continent were little changed again this morning.** The Euro Stoxx 50 was up 0.3% with mixed performance across sectors and the German DAX underperforming (-0.1%). Banks moved in line with the broader index as UK lenders underperformed. **Sovereign yields were flat across the curve**. While core yields have been stable in recent days, Bund yields continue to hover near recent lows. The 10-year is now at 0.07%, its lowest level since late 2016.



Source: Bloomberg

Other Mature Markets

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Japan

Equities (Nikkei -1.0%; Topix -0.8%) declined, while 10-year JGB yields fell 1.3bps to -0.06%. Disappointing core machine orders weighed on sentiment. **Machine orders printed at -5.4% mom in January (from -0.1% mom in December), marking the third month of consecutive declines**. Meanwhile, at the BoJ's regular monetary operation, the central bank left its bond purchase amounts unchanged. It bought JPY480 bn of 5-10 year bonds, JPY180 bn of 10-25 years and JPY 50bn of bonds with above 25-year tenor. The yen was stable on the day.

Emerging Markets

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Key Emerging Market Financial Indicators

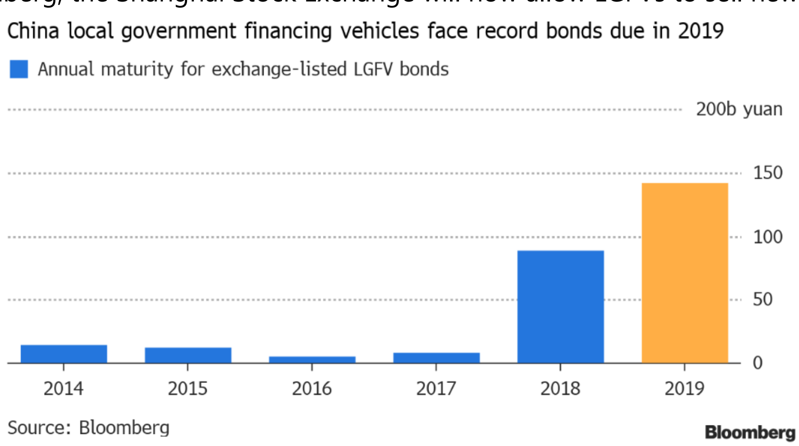
Last updated:	Level		Change				
3/13/19 8:05 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		42.64	0.1	-1	1	-14	9
MSCI Frontier Equities		28.35	-0.1	-1	-1	-19	8
EMBIG Sovereign Spread (in bps)		349	-3	2	-2	57	-65
EM FX vs. USD		63.26	0.2	0	0	-11	2
Major EM FX vs. USD				%, (+) = EM currency appreciation			
China Renminbi		6.71	0.0	0	1	-6	3
Indonesian Rupiah		14265	0.0	-1	-1	-4	1
Indian Rupee		69.54	0.2	1	2	-7	0
Argentine Peso		41.51	-0.6	-4	-9	-51	-9
Brazil Real		3.80	0.2	1	-1	-14	2
Mexican Peso		19.28	0.3	0	1	-4	2
Russian Ruble		65.47	0.2	1	2	-13	6
South African Rand		14.31	0.3	0	-2	-17	0
Turkish Lira		5.46	-0.1	-1	-3	-29	-3
EM FX volatility		8.11	0.0	0.0	-0.8	0.4	-1.7

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

China

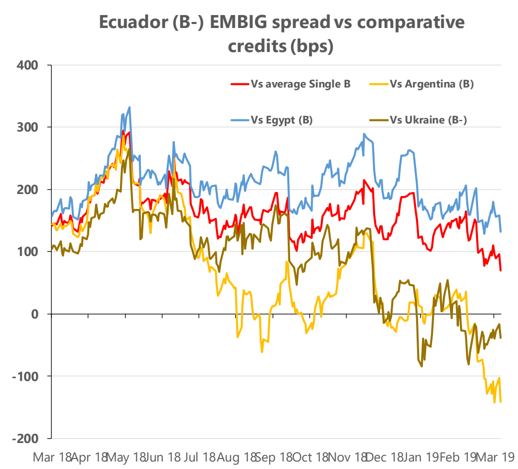
Chinese equities (Shanghai -1.1%; Shenzhen -2.3%) underperformed on uncertainty surrounding a US-China trade deal. In a testimony before the Senate Finance Committee, US Trade Representative Robert Lighthizer said that the US is considering China's request to roll back trade tariffs. However, he also stated that the US must keep the option of increasing tariffs on Chinese imports open, should Beijing violate terms in the trade agreement. While mentioning that the US and China have made 'real progress' in trade negotiations, he said that he cannot predict success at this point. **The onshore RMB was stable, but the offshore RMB depreciated -0.2%.**

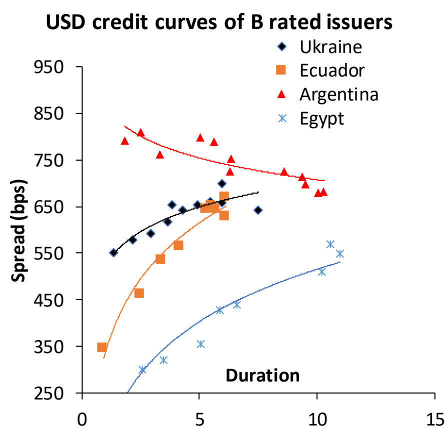
Regarding the bond market, **China relaxed bond issuance rules for local government financing vehicles (LGFV).** According to Bloomberg, the Shanghai Stock Exchange will now allow LGFVs to sell new bonds for refinancing, if revenues from local governments account for more than 50% of their overall revenues. LGFVs are facing record amounts of maturing debt in 2019. Previously LGFVs that receive a high share of revenues from local authorities were not allowed to issue debt on this platform amid efforts by regulators to curb the increase in debt.



Ecuador

On Monday, in line with market expectations the IMF board approved a $4.2 bn program for Ecuador over the next 3 years. Ecuador dollar debt spreads continue to tighten (~30 bps this week). Many details of the program have not been released yet and market analysts highlight that despite the recent rally investor perception is still cautious on whether President Moreno is fully committed in implementing some of the tougher measures in the program. Even though credit spreads have tightened substantially compared to Argentina, they remain ~100 bps wider compared to other EM single-B rated issuers. Additionally, the overall tightening in spreads its distorted by the repricing in near term maturities. Market analysts attribute the substantial curve steepening to expectations of a debt liability management exercise in the short end.

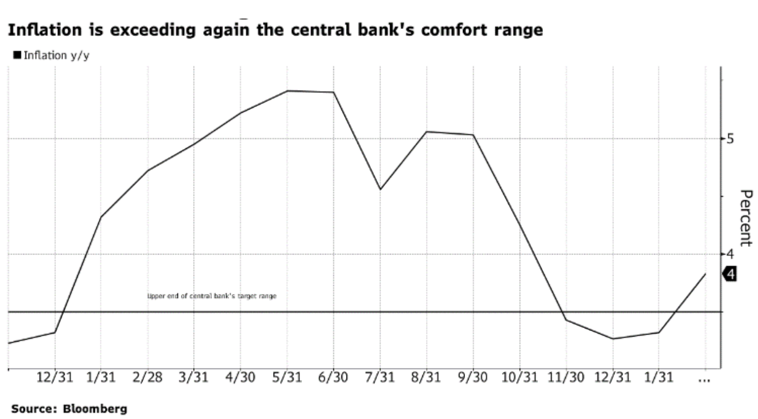


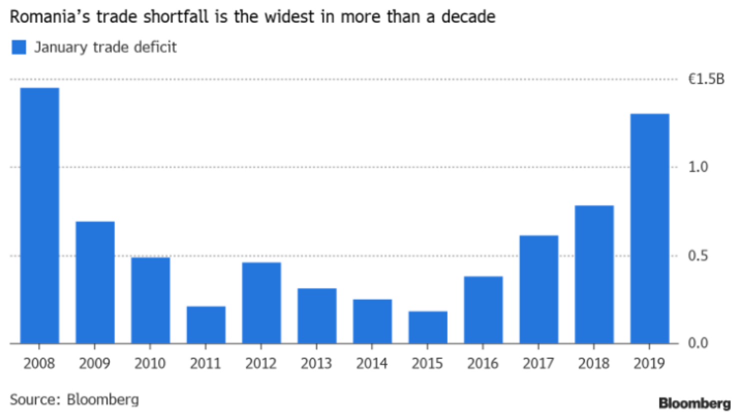


Source: Bloomberg

Romania

Recent macroeconomic data releases point to higher inflation and possible further rate hikes. Romanian industrial production for January surprised at +0.8% year-on-year, compared to -1.0% expected (on a monthly basis, however, IP for January was -1.6% vs. -0.9% expected). CPI inflation in February has accelerated to 3.8% year-on-year, thus exceeding the central bank's target band of 1.5% to 3.5%, while the trade deficit for January came in at its largest level since 2008 at over €1.25 bn. Analysts attributed the widening of the trade deficit to surging imports on the back of tax cuts and higher public wages. The Romanian leu appreciated 0.3% to the euro this morning but is 2.4% weaker year-to-date.





Armenia

The Armenian Central Bank kept its key policy rates unchanged. The refinancing rate was kept at 5.75%, the repo rate at 7.25%, and the deposit rate at 4.25%. In its statement, the central bank noted that the 12-month inflation rate for February stood at 1.9% still below the bank's target. The Armenian dram was 0.4% stronger to the dollar today.

List of GMM Contributors (Global Markets Analysis Division, MCM Department)

Anna Ilyina
Division Chief
Peter Breuer
Deputy Division Chief
Will Kerry
Deputy Division Chief
Evan Papageorgiou
Deputy Division Chief
Sergei Antoshin
Senior Economist
John Caparusso
Senior Financial Sector Expert
Sally Chen
Senior Economist
Fabio Cortés
Senior Economist
Mohamed Jaber
Senior Financial Sector Expert
David Jones
Senior Financial Sector Expert
Sanjay Hazarika
Senior Financial Sector Expert
Rebecca McCaughrin
Senior Financial Sector Expert
Juan Solé
Senior Economist
Jeffrey Williams
Senior Financial Sector Expert
Akihiko Yokoyama
Senior Financial Sector Expert
Dimitris Drakopoulos
Financial Sector Expert
Tryggvi Gudmundsson
Economist
Henry Hoyle
Financial Sector Expert
Robin Koepke
Economist
Thomas Piontek
Financial Sector Expert
Rohit Goel
Financial Sector Expert
Jochen Schmittmann
Economist
Ilan Solot
Financial Sector Expert
Nour Tawk
Economist
Martin Edmonds
Senior Data Mgt Officer
Yingyuan Chen
Senior Research Officer
Piyusha Khot
Research Assistant
Xingmi Zheng
Research Assistant

Global Financial Indicators

Last updated: 3/13/19 8:06 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		2792	0.3	0	1	1	11
Europe		3314	0.3	0	3	-2	10
Japan		21290	-1.0	-1	1	-3	6
China		3027	-1.1	-2	11	-9	21
Asia Ex Japan		70	0.6	-1	2	-12	10
Emerging Markets		43	0.1	-1	1	-14	9
Interest Rates					basis points		
US 10y Yield		2.62	-3.8	-7	-8	-22	-6
Germany 10y Yield		0.07	1.5	-6	-5	-55	-17
Japan 10y Yield		-0.04	-1.4	-4	-4	-10	-5
UK 10y Yield		1.19	2.4	-4	1	-30	-9
Credit Spreads					basis points		
US Investment Grade		119	0.3	1	-2	26	-28
US High Yield		417	-0.3	15	-8	71	-104
Europe IG		60	-1.0	-2	-10	11	-28
Europe HY		273	-4.4	-5	-34	21	-79
EMBIG Sovereign Spread		349	-3.0	2	-2	57	-65
Exchange Rates					%		
USD/Majors		96.86	-0.1	0	0	8	1
EUR/USD		1.13	0.1	0	0	-9	-1
USD/JPY		111.4	0.0	0	0	-4	-2
EM/USD		63.3	0.2	0	0	-11	2
Commodities					%		
Brent Crude Oil ($/barrel)		67	0.5	2	5	4	24
Industrials Metals (index)		122	0.3	0	5	-9	11
Agriculture (index)		40	-0.5	-1	-5	-19	-3
Implied Volatility					%		
VIX Index (%, change in pp)		13.5	-0.2	-2.2	-2.1	-2.8	-11.9
10y Treasury Volatility Index		3.8	0.1	0.0	0.2	-0.3	-0.8
Global FX Volatility		7.1	0.0	-0.1	-0.8	-0.6	-1.9
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		375	-7.3	13	-3	23	-40
Italy		250	1.3	4	-16	112	0
Portugal		128	0.2	-1	-19	10	-20
Spain		112	0.6	14	1	34	-5

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: 3/13/2019 8:04 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	0.0	0.0	1	-6	3		3.2	0.6	-3	11	-72	-5
Indonesia		14265	0.0	-0.9	-1	-4	1		8.0	-6.6	2	-6	95	-20
India		70	0.2	1.1	2	-7	0		7.5	-0.7	-4	-4	-34	2
Philippines		53	0.1	-1.0	-1	-1	0		5.5	-2.7	-5	-22	56	-84
Thailand		32	0.1	0.8	-1	-1	2		2.6	0.5	-3	2	24	-1
Malaysia		4.09	-0.1	0.1	0	-5	1		3.9	-0.6	-5	-4	-6	-17
Argentina		42	-0.6	-4.0	-9	-51	-9		22.2	63.7	66	181	550	-82
Brazil		3.80	0.2	0.9	-1	-14	2		8.0	-5.0	-19	15	-34	-12
Chile		665	0.3	-0.8	0	-9	4		4.3	0.4	-8	-4	-52	-16
Colombia		3149	1.0	-1.6	-1	-10	3		6.3	-2.5	-14	-15	-14	-23
Mexico		19.28	0.3	0.4	1	-4	2		8.1	-2.9	-14	-36	53	-57
Peru		3.3	0.3	0.4	1	-1	2		5.5	-3.4	-8	-13	54	-24
Uruguay		33	-0.2	-1.5	-2	-14	-2		10.5	0.1	25	24		-25
Hungary		278	0.4	0.3	2	-10	1		2.1	0.4	-3	5	40	-12
Poland		3.80	0.2	0.0	1	-11	-2		2.3	-0.9	-5	6	-29	1
Romania		4.2	0.3	-0.5	0	-11	-4		4.1	7.0	1	-8	10	-18
Russia		65.5	0.2	0.7	2	-13	6		8.1	-1.3	-2	8	125	-34
South Africa		14.3	0.3	-0.3	-2	-17	0		9.4	3.3	2	-10	72	-16
Turkey		5.46	-0.1	-0.6	-3	-29	-3		16.3	17.8	48	109	366	-56
US (DXY; 5y UST)		96.9	-0.1	0.0	0	8	1		2.43	2.0	-7	-9	-19	-8

	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		3027	-1.1	-2	11	-9	21		179	-1	-1	-3	15	-15
Indonesia		6378	0.4	-1	-1	-1	3		200	-4	4	6	18	-36
India		37752	0.6	3	5	12	5		164	0	-3	-10	37	-32
Philippines		7766	0.2	-1	-2	-8	4		97	-3	4	10	-7	-24
Malaysia		1678	0.4	-1	0	-10	-1		129	-1	2	3	19	-33
Argentina		33681	-0.3	0	-9	2	11		742	-2	-3	79	342	-73
Brazil		97828	-0.2	3	2	13	11		238	-3	-2	0	2	-35
Chile		5289	-0.2	1	-2	-6	4		134	-4	2	0	13	-32
Colombia		1533	0.5	1	4	4	16		191	-2	2	-1	13	-37
Mexico		41741	-0.3	-1	-1	-14	0		309	-3	-12	-10	66	-45
Peru		20747	0.4	1	3	0	7		137	-2	1	-3	-7	-31
Hungary		40755	0.4	-1	1	5	4		118	-2	5	9	16	-30
Poland		59670	0.0	-1	0	-3	3		56	-3	2	4	3	-29
Romania		7863	-0.5	-1	2	-9	6		200	0	6	5	73	-21
Russia		2453	-0.6	-1	-1	6	4		212	-3	1	-6	45	-40
South Africa		55718	0.0	-1	2	-6	6		302	-2	8	0	59	-63
Turkey		101422	-0.3	-2	0	-14	11		425	-3	7	24	114	-4
Ukraine		545	-1.7	-3	-4	54	-3		643	1	-18	-86	208	-144
EM total		43	0.1	-1	1	-14	9		349	-3	2	-2	57	-65

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