Global Markets Monitor

Monetary and Capital Markets Department

Global Markets Analysis Division

Thursday, March 28, 2019

- **Renewed treasury rally weighs on global markets (link)**
- **Convexity hedging in US markets reinforces downwards pressure on rates (link)**
- **US investment grade fund inflows set for new record (link)**
- **UK MPs reject all motions presented yesterday (link)**
- **Lira depreciates 4% on lower central bank FX reserve figures (link)**

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

Bond yields catch their breath after recent sharp moves

Markets are enjoying relative stability today following the recent trend of plummeting sovereign bond yields and volatile equity markets. Equity markets are generally mixed this morning with most European exchanges little changed on the day. Sovereign bond yields also are little changed. The 10-year US treasury yield is edging slightly higher to just over 2.37% after declining 5 bps yesterday. Short-term interest rates are now pointing to expectations for one cut by the Fed this year. In Europe, yields are little changed with the German 10-year remaining in negative territory. The British pound is weakening on the day after parliament rejected a number of Brexit options. The Turkish lira is falling sharply once again this morning while implied yields in its forward market are reverting to more normal levels.

Key Global Financial Indicators

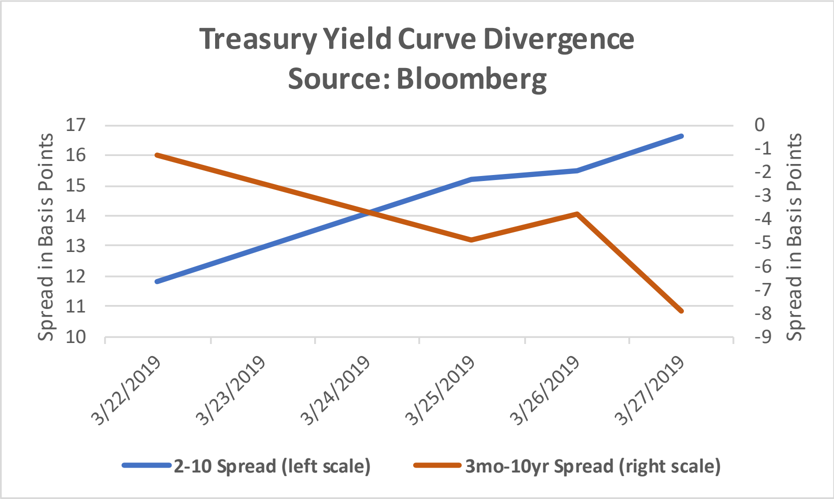
Last updated: 3/28/19 8:22 AM	Level: Last 12m	Level: Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		2805	-0.5	-1	1	8	12
Eurostoxx 50		3322	0.7	-1	1	0	11
Nikkei 225		21034	-0.1	-3	-2	0	5
MSCI EM		44	0.3	3	3	-11	12
Yields and Spreads					bps		
US 10y Yield		2.37	-5.7	-17	-34	-41	-31
Germany 10y Yield		-0.08	1.0	-12	-27	-59	-32
EMBIG Sovereign Spread		342	-1	-10	-16	47	-72
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		63.6	0.0	1	0	-10	2
Dollar index, (+) = $ appreciation		96.3	-0.2	-1	0	7	0
Brent Crude Oil ($/barrel)		67.1	0.8	-1	2	-4	25
VIX Index (%, change in pp)		15.4	-0.4	2	1	-8	-10

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

United States

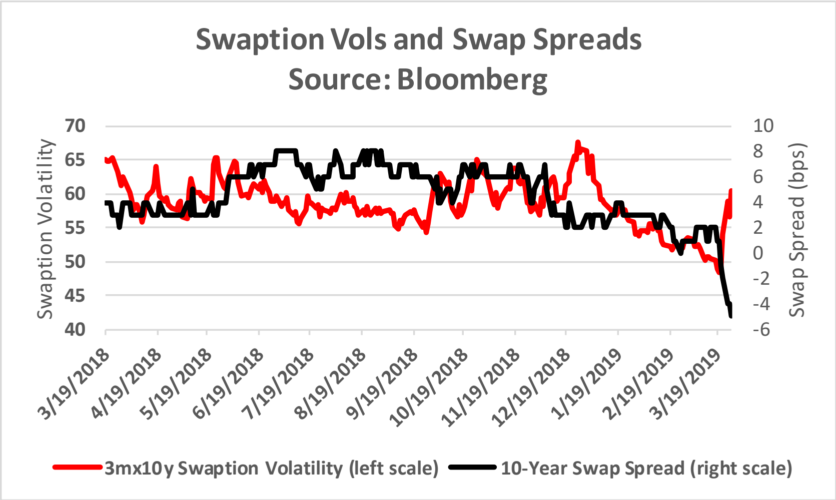
back to top

The extraordinary fall in developed market government yield continued Wednesday, keeping up the pressure on global markets. Treasury yields took their cue from Germany which saw its first 10-year bund auction with a negative yield since 2016, and where the 10-year bund yield has fallen below 10-year JGB's. In the US, the two-year yield ended at 2.21%, well below the Fed's target policy rate range of 2.25% to 2.50%. The 10-year yield fell as low as 2.35% intraday. The three-month T-Bill/10-year Treasury yield spread inverted for the first time since 2007 last Friday and had inverted further to nearly seven bps by intraday yesterday. The inversion has lasted four days. However, the two-year/10-year part of the yield curve went the other away and actually steepened from under 12 bps last Friday to 16 bps intraday. This kind of divergence is extremely unusual and was last seen in the mid-90's. Some analysts think the divergence will persist as long as markets think the Fed will cut rates sometime in 2019. The inversion is likely to end if the prospect of a 2019 cut fades away, they believe. Meanwhile, the consensus view is that the 2-10 curve is the more reliable predictor of a recession, as that part of the curve inverted prior to every recession since World War II.



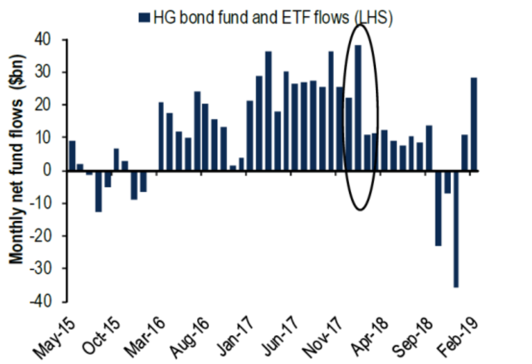
The latest estimate of US Q4 GDP came in at 2.2% this morning versus the 2.3% consensus forecast. Core PCE was 1.8% versus the 1.7% forecast. Both jobless claims and continuing claims were lower than expected. The market response was muted.

The dramatic decline in US Treasury yields has been exacerbated by technical factors within the wider US bond market. Falling yields triggered hedging flows from owners of mortgage-backed securities (MBS) who were forced to react to the risk of higher prepayments from home owners seeking to take advantage of the lower rates to refinance their mortgages. Many MBS investors hedge the risk of higher prepayments by taking on duration through the purchase of Treasury notes and bonds and Treasury futures. However, many investors also use interest rate swaps and other derivatives such as swaptions for this purpose. The strong demand for interest rate swaps forced swap yields below Treasury yields, so that the 10-year Treasury was trading at 2.35% while the 10-year swap yield was 2.30% yesterday. Negative swaps spreads are a rarity because swaps have credit risk while Treasuries are viewed as risk free. Meanwhile, the demand for swaptions has led to a spike in swaption volatilities. This in turn surprised many investors who had been betting on continued low interest rate volatility by selling options. This was a very successful strategy until last week, as the MOVE volatility index hit a record low of 42.5. However, the sharp decline in interest rates triggered the largest two-day increase in years as the index jumped to 56.



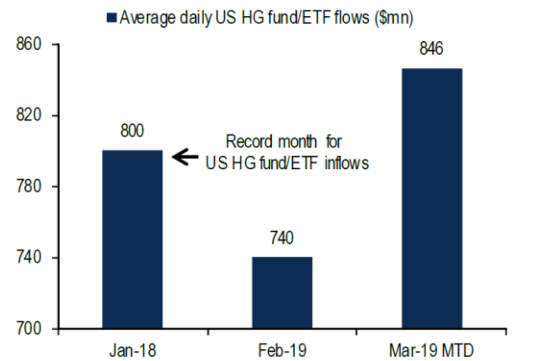
Inflows into US high grade funds and ETFs are on track to set a record this month. Based on recent data, the old record of $38.4 bn set in January 2018 will be broken if the rest of the week has the same average daily inflows seen so far in March. The average daily inflow was $846 mn compared to $800 mn in January 2018. Despite the recent equity selloff, spreads in the US corporate bond market have remained resilient and investor demand is very strong. While domestic investors have been in buying mode, especially for bank related debt, foreign investors are also flocking back into the market. Falling interest rates have lowered hedging costs for foreign investors, and speculation that the Fed could cut rates holds forth the prospect of even lower hedging costs as well as capital gains in the future.

Figure 1: Monthly flows for US high grade funds and ETFs



Source: BofA Merrill Lynch Global Research, EPFR global

Figure 2: Average daily flows by month



Source: BofA Merrill Lynch Global Research, EPFR global

Europe

back to top

European equities are higher: EuroStoxx 600 (+0.2%), DAX (0.4%), and CAC 40 (+0.3%). Bank stocks (-0.8%) are underperforming. **Euro area sovereign bond markets are steady.** German 10-year yields at -0.07% (+1 bp); French at 0.31% (+3 bps); Italian at 2.49% (+5 bps).

British MPs voted against every single option to end the stalemate in the Brexit process. The two motions closest to victory were those of a customs union with the EU and of a confirmatory referendum. May's Withdrawal Agreement may still be voted on Friday, and a second round of indicative votes on Brexit options is expected on Monday (it is still unknown; however, which options will be brought to the floor).

Sterling dropped 0.3% to the dollar, at $1.31. Ten-year UK yields are at 0.99% (-1 bp); FTSE 100 +0.7%, FTSE 250 +0.4%.

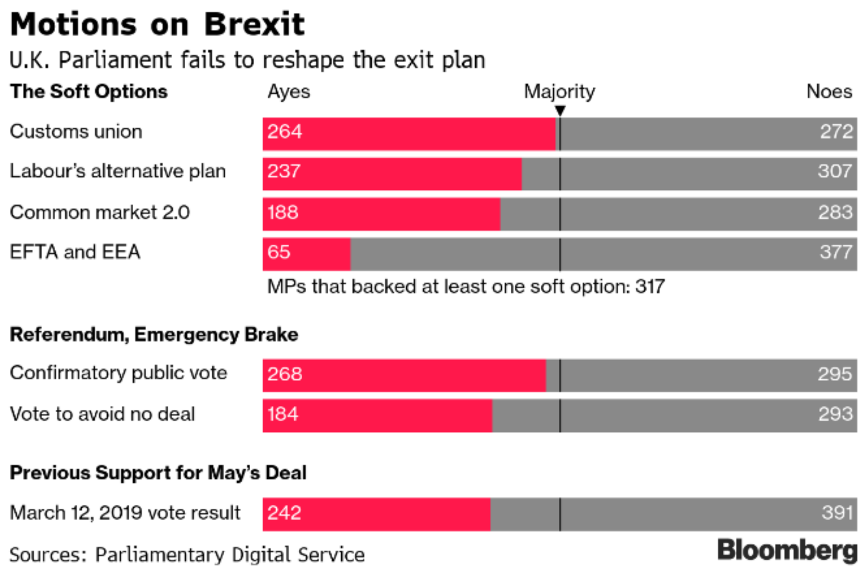


Figure 1. Results of the First Round of Indicative Votes on 27 March

Letter	Title (Sponsor)	Summary	Acceptable to EU?	For	Against
M	Second referendum (Beckett)	Arranges a confirmatory referendum on whatever Brexit deal Parliament approves. Not a way forward on its own.	EU would surely grant the necessary extension	268 (49%)	295
D	Norway Plus (Boles)	Softest version of Brexit almost equal to EU membership minus voting rights. However, would still aim to replace customs union with customs arrangements	Probably yes, but requires consent from EFTA members	188 (40%)	283
L	Revocation to avoid no deal (Cherry)	Parliament would revoke Article 50 TEU and stay in the EU in order to avoid no-deal	UK's choice	184 (39%)	293
J	Customs union (Clarke)	Minimum condition for open border in Ireland	Will depend on details	264 (49%)	272
K	Labour's alternative plan (Corbyn)	Customs union and benefits of single market, but with immigration control and without state aid rules	Looks like cherry-picking	237 (44%)	307
H	EFTA and EEA (Eustice)	Similar to Norway Plus, but without a customs union	Probably yes, but requires consent from EFTA members	65 (15%)	377
O	Contingent preferential arrangements (Fysh)	Managed no-deal, similar to "Malthouse arrangement"	Contradicts EU guidelines due to the absence of backstop	139 (25%)	422
B	No deal on 12 April (Baron)	Does not preclude leaving with a deal	Yes	160 (29%)	400

Sources: Bloomberg and Citi Research

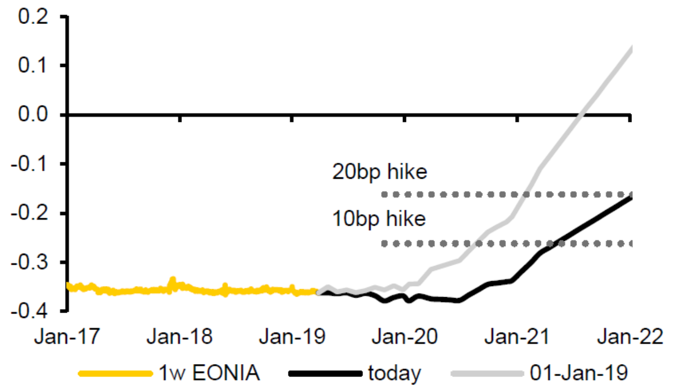
Separately, **European Council president Donald Tusk has urged the European Parliament to be open to requests for a long Brexit extension**, noting that “an increasing majority” of Britons want to remain in the EU.

Following Draghi’s remarks that the ECB will reflect on the implications of negative interest rates, **market participants speculate that a tiered system of deposit rates could be introduced by the ECB.** Under such scenario, the ECB would either reduce the negative rate it charges banks for excess reserves, or even pay them a positive rate for part of their deposits at the central bank. Currently, banks pay around €7 bn per year to the ECB for parking money in its deposit facility. **Markets have also slashed their expectations**

of a rate hike in 2020, with Eonia forwards now pricing in only 6 bps of tightening by end-2020, compared to about 20 bps a fortnight ago. The implicit lift-off date has been pushed back to Spring 2021.

Low rates for ever?

1w EONIA and forwards, in bp



Source: Bloomberg, Commerzbank Research

Other Mature Markets

back to top

Japan

The yen strengthened while equities tumbled amid growing concerns surrounding global economic growth. Further declines in sovereign bond yields – with the 10-year Treasury falling to its lowest level since December 2017 and the benchmark 10-year German Bund falling further below zero – underscored growth concerns. The yen gained 0.4% while the Topix shed 1.7%, making Japanese equities the worst performer among developed markets. While the Topix is still up 5.9% for Q1, its rebound is less than its U.S. and European peers. Notably, foreign investors sold a net ¥2.4 tn of Japanese equities in Q1 thus far; the outflow was even more notable as last year's sell off was the biggest since 1987.

Emerging Markets

back to top

Asian currencies extended their recent depreciation against the dollar amid growth concerns. The Indonesia rupiah underperformed, weakening by 0.3% while the offshore RMB outperformed, holding steady on the day. **Bank Negara Malaysia lowered its 2019 growth forecast** and pledged to support the economy as global risks mount, laying the groundwork for a rate cut. The central bank estimated 2019 growth to reach 4.3% to 4.8%, lower than its November estimate of 4.9% and down from 4.7% in 2018. **The ringgit weakened by 0.1%** on the day. **Equities, though mixed, were overshadowed by losses in the Chinese and Korean bourses** as concerns over the slowdown in global growth weighed on market sentiment (Shanghai: -0.9%, Kospi: -0.8%). In **EMEA**, equity markets were mostly higher albeit modestly, while currencies were unchanged. The most notable price action happened in Turkey (see details below) with the currency depreciating sharply after new FX reserve figures, while rates and equities remain very volatile. **Latin American** markets weakened yesterday driven by global growth worries, lower oil prices, and growing idiosyncratic risks. In Argentina, investor confidence continued to deteriorate. The peso's depreciation accelerated yesterday amid poor liquidity conditions, with the currency dropping 3% and closing at a record low of 43.89. Argentine equities fell 1.3%. In Brazil, political tensions intensified further signaling dimmer prospects for pension reform. The real tumbled 3.1%, equities tanked 3.6%, and 10-year bond yields jumped 29 bps. In other countries, the weakening in markets was much less pronounced. Mexican stocks managed to close slightly higher on better-than-expected economic data.

Key Emerging Market Financial Indicators

Last updated:	Level		Change				
3/28/19 8:34 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		42.20	0.4	-3	-1	-11	8
MSCI Frontier Equities		28.23	-0.6	-2	-1	-19	8
EMBIG Sovereign Spread (in bps)		363	5	22	24	63	-51
EM FX vs. USD		62.43	-0.5	-2	-2	-12	0
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.74	-0.2	-1	-1	-7	2
Indonesian Rupiah		14243	-0.2	-1	-1	-3	1
Indian Rupee		69.34	-0.7	-1	2	-6	1
Argentine Peso		43.89	-2.8	-7	-12	-54	-14
Brazil Real		3.97	0.7	-4	-5	-16	-2
Mexican Peso		19.38	-0.1	-3	-1	-6	1
Russian Ruble		65.20	-0.5	-2	1	-11	6
South African Rand		14.69	-0.6	-3	-4	-20	-2
Turkish Lira		5.57	-4.4	-2	-4	-28	-5
EM FX volatility		9.22	0.0	1.4	1.0	1.2	-0.6

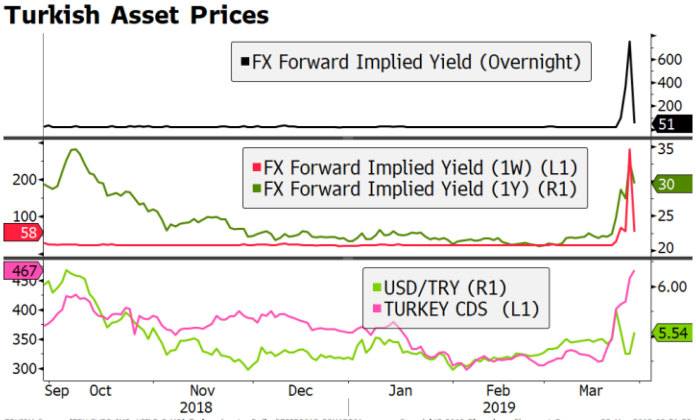
Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

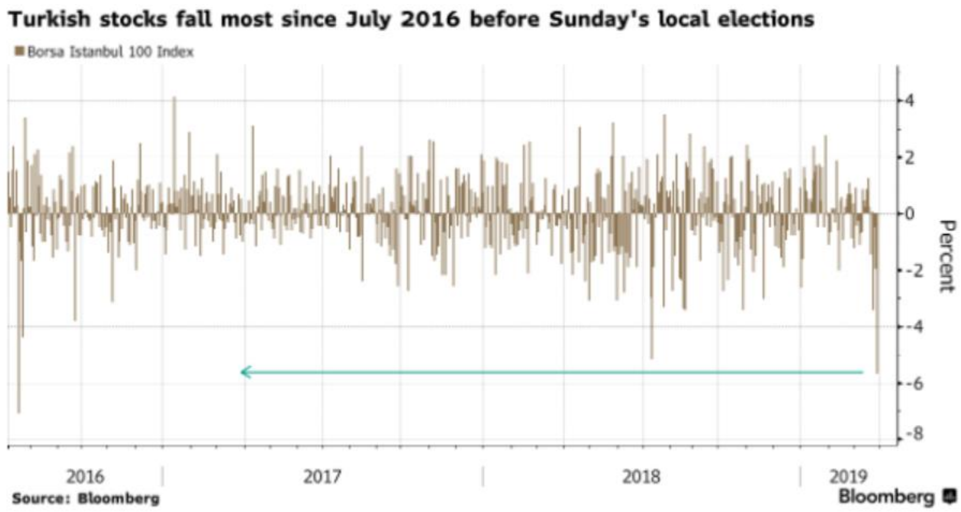
Turkey

Funding markets remain very volatile and the lira sold off, in part due to new FX reserve figures. The implied rate on overnight forwards hit a whopping 1340% intraday yesterday but is now at 51%, according to indicative pricing on Bloomberg as of mid-morning in London (first chart). The lira depreciated 4% today, but is still 3.5% away from its weakest level seen last week. In the equity space, the BIST index is up 0.6% this morning after falling 5.7% yesterday, the largest one-day decline since July 2016 (second chart). Adding to concerns, data released by the CB earlier today showed that net FX reserves dropped further to $24.7 bn for the week ending in March 22, from $28.5 in the previous week, bringing the total decline in the last three weeks to nearly $10 bn. Some analysts saw this as evidence that the bank has been intervening to stabilize the lira ahead of the elections.

Amid all the tension in funding markets, lender Akbank successfully closed a 1-year syndicated loan deal worth $700 mn from foreign investors, rolling over 77.8% of the 1-year loan taken last year. It paid about LIBOR+250, which is 120 bps above the March 2018 loan, but 25 bps lower than Akbank's last 1-year syndicated loan deal in September 2018.

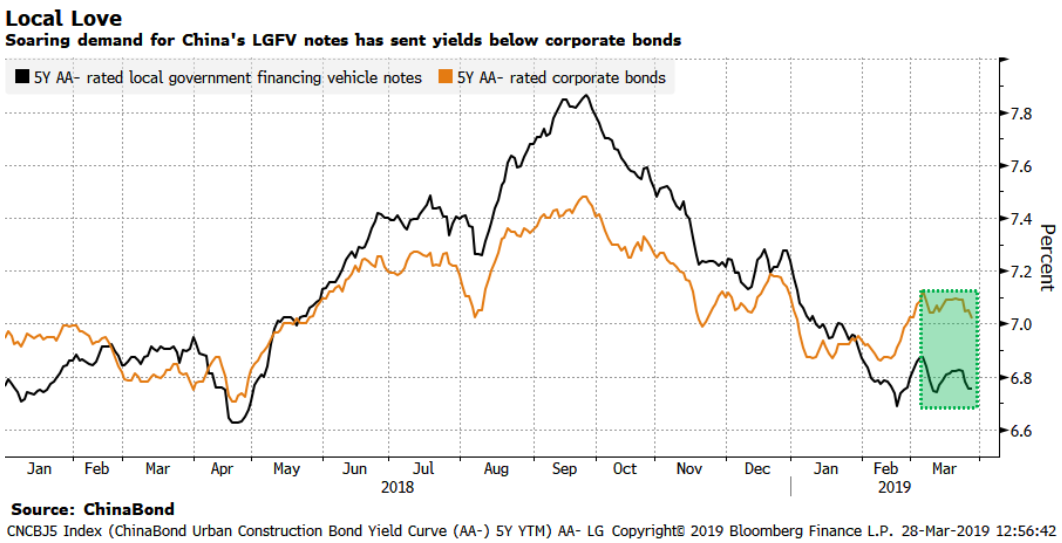
Turkish Asset Prices





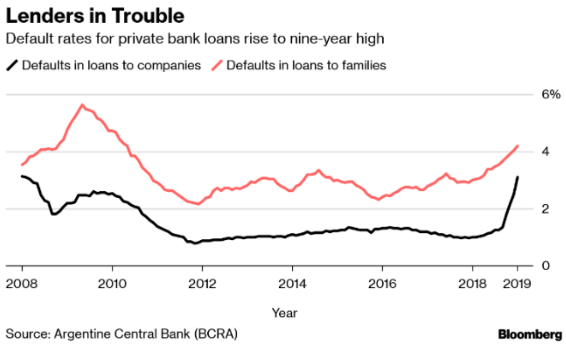
China

LGFV borrowing costs fell below similarly-rated corporate bonds amid expectations that they will remain default free. While investors shunned LGFV debt in 2018 as the authorities pushed through deleveraging initiatives, bond issues from local government financing vehicles (LGFV) have seen renewed and robust interest this year amid expectations that the authorities' focus on growth stabilization will support LGFVs. At the height of deleveraging concerns last September, LGFV debt traded with a positive spread of about 50 bps relative to similarly-rated corporate bonds; currently it is about 25 bps below their counterparts, just shy of the record reached in August 2016. LGFV bonds have seen no defaults thus far, compared to rising credit events from private borrowers. Moreover, the Shanghai Stock Exchange is reportedly set to relax rules governing LGFV bond issuance related to refinancing, easing potential strains that could arise from RMB 500 bn (US$75 bn) of LGFV debt come due this year. **The RMB held steady on the day. Equities reversed previous gains, ending the day lower** (Shanghai: - 0.9%).



Argentina

Non-performing loans continued to climb, reaching a nine-year high. After three quarters of economic contraction, banks' balance sheets started to weaken notably. The negative impact is reportedly greater on banks predominantly lending to households and to SMEs. The central bank said that bank NPLs have climbed to a nine-year high (figure). The Association of Specialized Banks (ABE) has asked the central bank for the reductions in reserve requirements and in loan loss provisions, according to Bloomberg. Another bank association—Adeba which represents larger banks—has reportedly shared the same concerns. The Argentine banks are also worried about the international requirements that take effect in 2019 to raise provisions for problem loans.



Mexico

Trade and unemployment data were better-than-expected. The trade balance improved more than expected in February to +$1.2 bn (consensus: +$0.3 bn) from -$4.8 bn the prior month. The seasonally adjusted unemployment rate fell to 3.42% in February (consensus: 3.54%) from 3.49% the previous month. Mexican equities rose 0.3% on positive economic data, in contrast with substantial declines in the regional markets. However, the currency fell 1.3% and the long-term bond yield rose 5 bps.

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Global Financial Indicators

Last updated: 3/28/19 8:22 AM	Level Last 12m	Latest	Change 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		2805	-0.5	-1	1	8	12
Europe		3322	0.7	-1	1	0	11
Japan		21034	-0.1	-3	-2	0	5
China		3091	-0.2	1	12	-6	24
Asia Ex Japan		69	0.9	-2	0	-9	9
Emerging Markets		44	0.3	3	3	-11	12
Interest Rates					basis points		
US 10y Yield		2.37	-5.7	-17	-34	-41	-31
Germany 10y Yield		-0.08	1.0	-12	-27	-59	-32
Japan 10y Yield		-0.09	-0.5	-5	-7	-13	-9
UK 10y Yield		0.98	0.0	-8	-32	-39	-30
Credit Spreads					basis points		
US Investment Grade		121	-0.2	0	1	19	-26
US High Yield		431	-1.3	19	26	70	-90
Europe IG		69	0.7	1	7	7	-18
Europe HY		281	3.7	12	4	-10	-72
EMBIG Sovereign Spread		342	-1.0	-10	-16	47	-72
Exchange Rates					%		
USD/Majors		96.34	-0.2	-1	0	7	0
EUR/USD		1.12	-0.1	-1	-1	-9	-2
USD/JPY		110.4	0.1	0	1	-3	-1
EM/USD		63.6	0.0	1	0	-10	2
Commodities					%		
Brent Crude Oil ($/barrel)		67	0.8	-1	2	-4	25
Industrials Metals (index)		121	0.1	0	0	-6	11
Agriculture (index)		40	-0.2	-1	-1	-15	-3
Implied Volatility					%		
VIX Index (%, change in pp)		15.4	-0.4	1.7	0.6	-7.5	-10.1
10y Treasury Volatility Index		4.7	-0.1	1.2	0.8	0.6	0.1
Global FX Volatility		7.5	0.0	0.5	0.4	-0.3	-1.5
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		386	0.1	17	38	1	-29
Italy		257	3.9	16	0	123	7
Portugal		137	2.7	13	8	23	-11
Spain		117	3.0	11	18	46	-1

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

back to top

Emerging Market Financial Indicators

Last updated: 3/28/2019 8:36 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		6.74	-0.2	-0.6	-1	-7	2		3.1	-1.1	-5	-3	-70	-9
Indonesia		14243	-0.2	-0.7	-1	-3	1		7.7	1.0	0	-16	77	-42
India		69	-0.7	-0.7	2	-6	1		7.4	-0.6	-5	-16	-14	-3
Philippines		53	-0.4	-0.2	-2	-1	0		5.4	-3.9	-7	-21	29	-92
Thailand		32	0.2	-0.4	-1	-2	2		2.5	-1.0	-10	-10	14	-11
Malaysia		4.08	-0.2	-0.5	0	-5	1		3.8	-0.1	-5	-14	-13	-25
Argentina		44	-2.8	-6.9	-12	-54	-14		27.0	158.6	383	584	1045	402
Brazil		3.97	0.7	-4.4	-5	-16	-2		8.3	19.4	48	50	15	19
Chile		681	0.3	-1.7	-4	-11	2		4.2	-2.6	-12	-18	-61	-30
Colombia		3179	-0.7	-2.8	-3	-12	2		6.2	0.8	-2	-23	-8	-36
Mexico		19.38	-0.1	-2.7	-1	-6	1		8.1	3.8	-4	-21	63	-63
Peru		3.3	-0.3	-0.7	-1	-3	2		5.4	3.8	-2	-22	43	-34
Uruguay		34	-0.9	-1.2	-3	-16	-4		10.4	-2.1	-11	16		-31
Hungary		286	-0.4	-3.1	-3	-11	-2		1.8	-10.0	-25	-29	22	-46
Poland		3.83	-0.2	-1.5	-1	-11	-2		2.2	-4.0	-4	-8	-24	-3
Romania		4.2	-0.1	-1.3	-2	-11	-4		4.0	-3.0	0	-3	18	-20
Russia		65.2	-0.5	-2.0	1	-11	6		8.0	4.6	0	-15	117	-45
South Africa		14.7	-0.6	-3.2	-4	-20	-2		9.5	-0.5	2	11	105	-7
Turkey		5.57	-4.4	-1.9	-4	-28	-5		19.9	157.8	334	440	683	297
US (DXY; 5y UST)		97.1	0.4	0.7	1	8	1		2.17	1.3	-17	-34	-43	-34

	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		2995	-0.9	-3	2	-4	20		175	3	-1	-5	4	-19
Indonesia		6481	0.6	0	1	6	5		199	6	12	7	18	-37
India		38546	1.1	0	7	17	7		160	-5	-5	-7	20	-36
Philippines		7876	0.2	-1	2	-1	5		93	2	3	8	-4	-28
Malaysia		1641	-0.1	-1	-4	-12	-3		130	4	2	3	6	-32
Argentina		32175	-1.4	-7	-7	3	6		795	5	64	95	377	-20
Brazil		91903	-3.6	-6	-4	10	5		263	5	27	30	22	-10
Chile		5174	-0.3	-2	-2	-5	1		136	1	4	7	9	-30
Colombia		1573	-2.1	-3	4	8	19		189	3	7	1	7	-39
Mexico		42948	0.3	0	0	-7	3		308	1	17	-10	57	-46
Peru		20997	-0.2	-1	2	2	9		139	0	6	5	-14	-29
Hungary		41418	0.2	-1	3	13	6		123	6	-2	13	16	-25
Poland		59920	0.1	-2	0	3	4		62	4	1	13	10	-23
Romania		8083	-0.5	0	5	-7	9		208	7	3	11	66	-13
Russia		2495	0.3	-1	0	11	5		226	3	13	15	44	-26
South Africa		56196	0.1	0	0	3	7		330	3	29	46	80	-35
Turkey		92579	0.8	-10	-11	-19	1		523	11	82	123	198	94
Ukraine		580	0.8	5	4	61	4		644	10	31	1	186	-143
EM total		42	0.4	-3	-1	-11	8		363	5	22	24	63	-51

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