Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Friday, May 10, 2019

- **US announces increase in tariff rate on $200 bn of Chinese goods (link)**
- **US Fed funds rate heads lower following IOER cut and as repo rates recede (link)**
- **Nationalization ruled out for the moment for Italy's Banca Carige (link)**
- **Chinese equities rise even as new US tariffs take effect (link)**
- **Turkish central bank suspends one-week repos, tightening monetary policy (link)**
- **Chile's central bank leaves policy rates unchanged, as expected (link)**

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US increases tariffs on Chinese goods, but market remains hopeful for a trade deal

With no deal reached before the US-imposed midnight deadline, the US increased its tariff rate on $200 bn of Chinese goods from 10% to 25%. The announcement was widely anticipated and had been mostly priced in during this week's trading. As such, markets largely took the official announcement in stride, with most Asian equity indices appreciating on the day. Market participants also noted that while China has vowed to retaliate, it has not yet taken any action aside from expressing "deep regret". With that in mind, many have concluded that the increased tariff rate may be more of a negotiating tool than an actual policy measure. It is broadly expected that a trade deal between China and the US will still be reached in the coming days, and that the increased tariff rate will only be applied briefly if at all.

Key Global Financial Indicators

Last updated: 5/10/19 8:12 AM	Level Last 12m	Latest	Change from Market Close 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		2871	-0.3	-2	-1	5	15
Eurostoxx 50		3366	0.4	-4	-2	-6	12
Nikkei 225		21345	-0.3	-4	-2	-5	7
MSCI EM		42	2.0	-5	-6	-12	7
Yields and Spreads					bps		
US 10y Yield		2.44	-4.1	-8	-2	-52	-24
Germany 10y Yield		-0.04	0.5	-7	-2	-60	-28
EMBIG Sovereign Spread		354	3	13	11	24	-60
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		61.9	0.0	-1	-2	-9	-1
Dollar index, (+) = $ appreciation		97.4	0.0	0	0	5	1
Brent Crude Oil ($/barrel)		70.9	0.7	0	-1	-8	32
VIX Index (%, change in pp)		19.5	0.4	7	6	6	-6

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

United States

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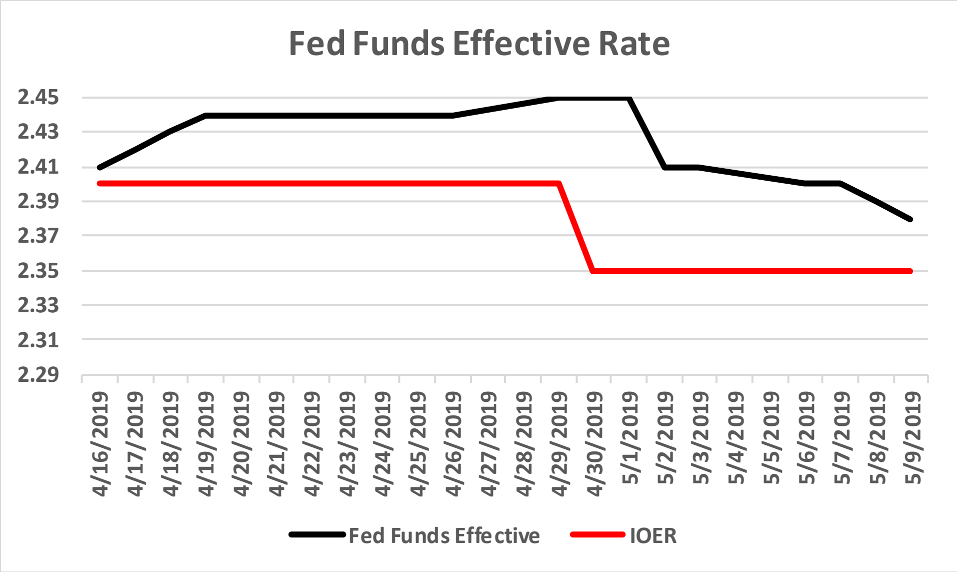
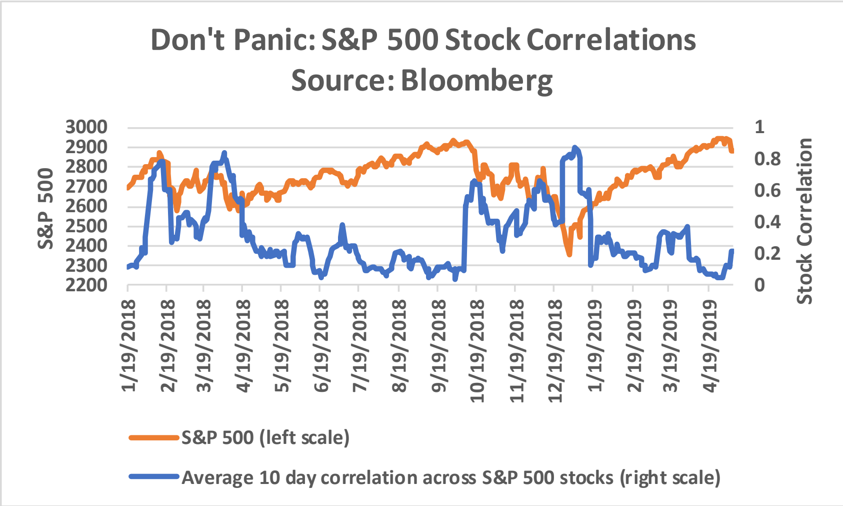
With the passage of the midnight deadline for a trade deal, tariffs on $200 bn of Chinese imports are scheduled to be increased from 10% to 25%. However, the impact is expected to be delayed, since the tariff will only be applied to Chinese goods exported to the US on or after May 10. The tariff measures also exempt goods that are in transit to the US before May 10, and as sea freight can take several weeks to cross the Pacific, any potential tariff increase may not be applied until June. China has vowed to retaliate but market participants have largely been encouraged by the fact that talks are continuing today and in the coming days.

Markets took losses on Thursday but bounced off their lows following positive comments from President Trump. The S&P 500 fell as much as 1.5% but managed to recover most of its ground to end with a more modest 0.3% decline in above-average trading volumes. The 10-year Treasury yield sank to 2.42% before ending at 2.45%.

The Fed's 5 bps cut in the Interest on Excess Reserves (IOER) at the May 1st FOMC meeting has succeeded for now in pushing the Fed Funds Effective (FFE) rate closer to IOER. The FFE traded as high as 2.45% before the FOMC meeting but has now fallen to 2.38%, within 3 bps of IOER. Funding stress in the short-term money markets continues to fade away as April month-end recedes; the general collateral (GC) rate for overnight repo transactions is down to 2.45% from over 2.60% earlier in the month. Three-month LIBOR is also down to its lowest level since October.

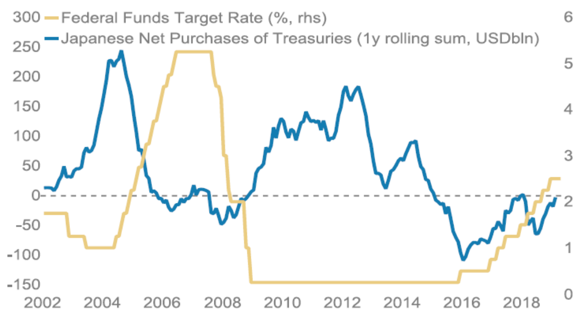


Spikes in correlation between stocks in the S&P 500 index appear to occur before and during major selloffs in the stock market in recent years. The February VIX flareup saw the average 10-day correlation across stocks in the index jump from 0.31 on February 2, 2018 to 0.61 on February 5 when the VIX shock occurred. The spike in correlation to 0.51 on October 10, 2018 from 0.09 the day before presaged the long market selloff of Q4 of last year. The correlation rose as high as 0.87 during the latter episode. The current correlation of 0.22 is higher than in recent days but still relatively low by historical standards, suggesting that markets are not yet in panic mode.



Japanese investors have been a key source of demand in the US credit markets, snapping up not just investment grade corporate bonds but also high yield bonds and leveraged loans. They tend to switch out of Treasuries during Fed rate cycles due to rising hedging costs and change their allocations to higher yielding investments and equities. Japanese exposure has risen sharply in the current cycle because other markets such as Europe have offered much less attractive yields and equity returns. US assets remain more attractive despite the higher hedging costs.

Exhibit 2: Japan's US Treasury holdings declined in 2005 and 2015 as the Fed tightened or prepared to tighten



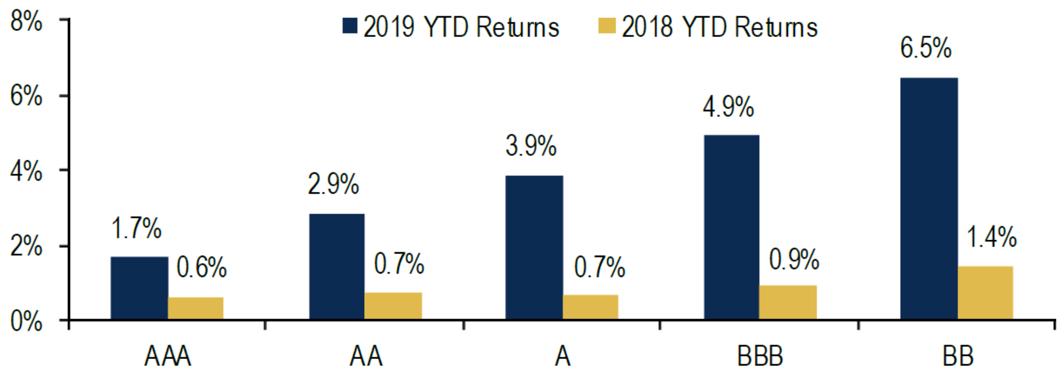
Source: Macrobond, Morgan Stanley Research

Exhibit 3: Japanese investors have increased risk exposure in their US asset holdings

Source: Macrobond, Morgan Stanley Research

The CLO market has delivered strong results so far in 2019, well ahead of its performance in 2018. Many analysts expected CLOs to underperform if the Fed stopped hiking rates, as most CLO tranches are floating rate. However, CLOs have benefited from the strong risk-on sentiment in the overall financial markets. In addition, their relative value was more attractive than usual given the very low level of rates. That said, senior CLO tranches did underperform relative to high yield bonds and leveraged loans, which did especially well because investors sought out assets with higher credit risk profiles to earn increased returns during the strong market rally. Some think the CLO market is likely to be propped up by scarcity value through the rest of the year, as a slowdown in the origination of the underlying leveraged loans is expected to lead to a drop off in CLO production.

Chart 1: 2019 YTD returns running well ahead of 2018



Source: BofA Merrill Lynch Global Research

Core CPI came in weaker than expected at 0.1% versus the 0.2% consensus forecast. The headline number was 0.3% (vs. 0.4%). The equivalent annualized numbers were 2.1% (vs. 2.1%) and 2% (vs. 2.1%). Treasury yields were slightly lower immediately following the report but the overall market response was muted.

Europe

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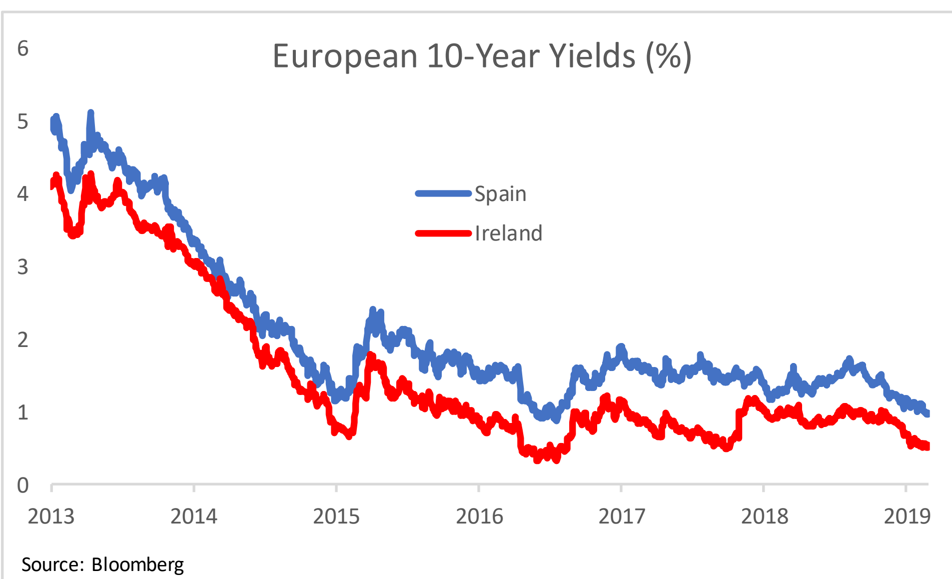
Equities rebounded despite the rise in US-China tariffs. The Euro Stoxx 600 was up 0.7%, partially erasing yesterday's losses of 1.7%. Almost all sectors were in the green with materials and financials, yesterday's underperformers, the strongest performers. Banks saw a gain of 1% but are still down by 5% this week.

Sovereign bond yields were little changed. Most 10-year yields were unchanged but Italian yields were slightly lower. Ireland and Spain saw strong demand in primary markets. Ireland issued €4 bn from a syndicated sale of a 2050 bond yesterday, with coverage at 4.5x the amount raised. Yesterday, the country's 10-year benchmark yield reached its lowest level since 2017 of 0.49%. Spanish yields are also near multi-year lows, having dipped below the 1%-mark last week for the first time since 2016.



Italian lender Carige will not be nationalized, according to PM Conte. The comments come after BlackRock decided not to proceed with a rescue plan that would have seen the asset manager provide capital to the bank as a part of a broader restructuring strategy. Conte added that a market solution to the lender's problems needed to be found, echoing a statement by the bank's administrators that they are working on a "private solution". The ECB said that it had been informed of the developments and that they had been "in contact with the temporary administrators".

EU officials are said to be worried about Greece's fiscal plans. The country has over-performed on its targets recently and seen a steady decline in borrowing costs. However, PM Tsipras announced tax cuts and increases in welfare spending earlier this week which could breach the country's fiscal targets according to unnamed officials. Greece has committed to a primary budget surplus of 3.5% up to 2022. Yields on the country's bonds has risen this week with the 10-year up by 20 bps this week, having reached a post-crisis low of 3.28% last month.

Other Mature Markets back to top

Japan

Japanese assets seesawed to end the day little changed. The yen held steady at 109.77/dollar, reversing its initial appreciation, following U.S. tariff increases on more than $200 bn in goods from China. Meanwhile, the Topix was unchanged, having swung between a 0.9% gain to a loss of as much as 0.7% on the day. Contacts noted that beyond a tariff increase, whether U.S. and China would engage further and the progress of future trade talks matter more for market reaction going forward. The Topix lost 4.2% this week, its biggest decline since last December. Meanwhile, meetings minutes from the BoJ's April deliberation revealed growing concerns among BoJ board members over the side effects of the central bank's policy easing.

Australia

The RBA noted in its quarterly Statement on Monetary Policy that it has lowered its outlook for consumption and investment while incorporating expectations for two rate cuts in its forecasts. The Australian dollar was little changed at AUD 0.6998/dollar. In equities, most Asian bourses rose moderately, suggesting cautious optimism that a trade deal could still materialize.

Emerging Markets back to top

Asian stocks swung in a volatile session as investor reacted to headlines from the latest US tariff increases on Chinese goods. Despite increased volatility and heightened tension, most currencies ended the day stronger against the US dollar. The Thai baht paced gains (+0.7%) while the Malaysian ringgit underperformed, losing 0.12% on the day. The baht has strengthened in four consecutive sessions to THB 31.54/dollar, its strongest level since late February. Chinese shares, by contrast, surged, with the large cap CSI 300 rising 3.6% and the Shanghai Composite rising 3.1% on the day. **In EMEA,** Turkey and South Africa are outperforming. For the latter, early elections results suggest that the ruling ANC has around 57% support, an improvement from the 54.5% won in the 2016 municipal elections. The rand has appreciated 0.9% against the dollar and the JSE index is up 1.5%. Turkish assets are benefiting from yesterday's monetary tightening by the central bank, leading the lira to appreciate 1.1% against the dollar though the BIST index is little changed. Other regional markets are mixed with Polish equities (+0.9%) outperforming and Russian (-0.6%) underperforming, while currencies are little changed. **Latin American** assets mostly saw losses yesterday amid the uncertainties around US-China trade war. Among equities, Argentina (+1%) saw the biggest gains, while Brazil (-0.8%), Mexico (-0.5%) and Chile (-0.3%) saw some losses. Among regional currencies, Brazilian real (-0.5%) weakened the most against dollar, followed by Mexican peso (-0.8%) and Argentine peso (-0.4%).

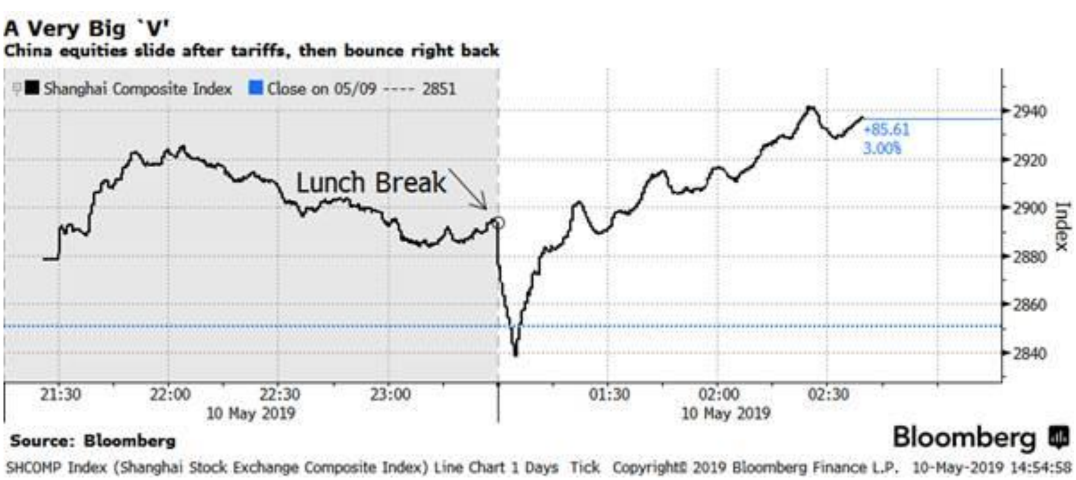
Key Emerging Market Financial Indicators

Last updated:	Level		Change				
5/10/19 8:14 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		41.73	2.1	-5	-6	-12	7
MSCI Frontier Equities		28.79	-0.4	1	0	-11	10
EMBIG Sovereign Spread (in bps)		354	3	13	11	24	-60
EM FX vs. USD		61.89	0.0	-1	-2	-9	-1
Major EM FX vs. USD			**%, (+) = EM currency appreciation**				
China Renminbi		6.82	0.1	-1	-2	-7	1
Indonesian Rupiah		14327	0.2	0	-1	-2	0
Indian Rupee		69.91	0.1	-1	-1	-4	0
Argentine Peso		45.25	-0.4	-1	-4	-50	-17
Brazil Real		3.95	-0.2	0	-3	-10	-2
Mexican Peso		19.20	0.2	-1	-2	0	2
Russian Ruble		65.32	-0.1	0	-2	-5	6
South African Rand		14.23	0.8	1	-2	-14	1
Turkish Lira		6.13	1.0	-3	-7	-31	-14
EM FX volatility		9.29	0.0	1.4	1.2	0.7	-0.5

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

China

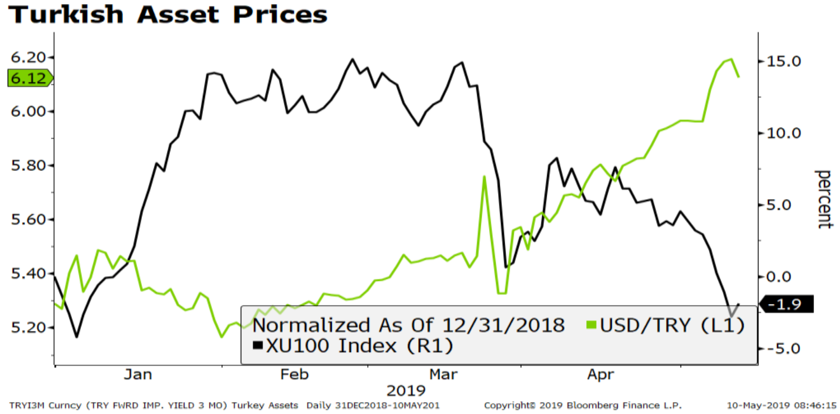
Chinese assets ended the day with gains, following a volatile session buffeted by headlines related to the latest US tariff increase. The offshore CNH ended the day unchanged at CNH 6.84/dollar while the onshore CNY appreciated 0.2% to CNY 6.815/dollar. Still, despite gains for the day, the onshore CNY has lost about 1% of its value this week while the offshore CNH lost 1.5%. Meanwhile, China's stocks erased initial gains before swiftly climbing again. The Shanghai Composite Index fell as much as 0.4% before rising 3.1%. Gains were broad-based; the large cap CSI 300 index rose 3.63% and the tech-heavy Shenzhen Composite rose 3.8% on the day. Market observers noted that state-backed funds were active buying equities, contributing to the sharp rebound in equity bourses. Still, even after today's gains, the Shanghai composite has lost almost 5%. Although market contacts generally expect the Chinese authorities to ramp up policy support to the economy to offset the impact of trade tensions, they are becoming less optimistic over the outcome of the latest trade negotiation. Many see a détente on Friday as increasingly elusive and expect trade negotiations to drag on for some time.



Turkey

The central bank implemented tightening measures yesterday to help stem the lira's depreciation. Officials suspended the one-week repo auctions, meaning that lira liquidity will probably be available through the overnight lending facility (25.5%). It is unclear for how long the repo auctions will be suspended. Separately, the central bank increased reserve requirements for FX liabilities by 100 bps and lowered the upper limit for the FX maintenance facility with the reserve option mechanism (ROM). The ROM was cut to 30% from 40%. The bank estimates that the RRR cut will shore up some $3 bn worth of FX liquidity, while the ROM adjustment will partially offset this by adding $2.8 bn of FX liquidity but draining TRY7.2 bn (press release here). Turkish assets rebounded with the lira appreciating 1.1% against the dollar since the measures were announced, but the currency pair remains above the key TRY6.0 level.

Turkish Asset Prices

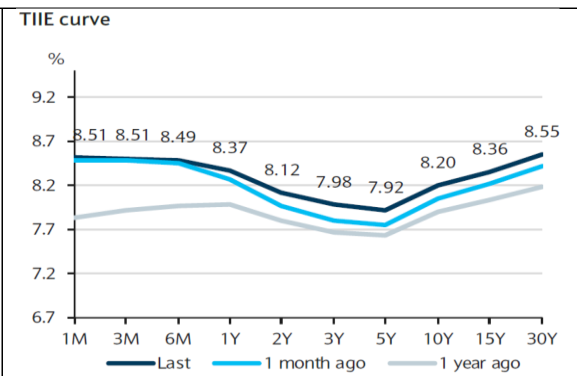


Mexico

Analysts report that though the global growth environment has remained mildly supportive for EM and Mexican assets in the past month, the recent renewal of trade tensions and uncertainty on the USMCA ratification could cloud the current environment. Mexico's local rate yields have slightly increased and the curves have remained inverted in the past month. Some analysts think that Banxico will remain on hold during 2019, contrary to market pricing of almost two cuts in the one-year horizon, as inflation is not converging to target.

President Obrador said that Pemex, the state oil company, will run a new $8 bn oil refinery project as the international companies invited to bid on the construction did not meet requirements for cost and time. Mexican assets saw losses yesterday following the news with equities down 0.5% and the peso weakened by 0.7% against dollar. One-month implied volatility jumped to 10.7%, the highest in more than a month.

Source: Bloomberg



Source: Barclays

Chile

The central bank of Chile decided to hold the benchmark interest rates at 3% as weaker-than-expected activity and subdued inflation tempered pressure to lift borrowing costs. The board reiterated its willingness to act with flexibility to reach an inflation target rate of 3% in two years. Policymakers said the current level of inflation was consistent of relatively accommodative monetary policy for the time being.

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Global Financial Indicators

Last updated: 5/10/19 8:13 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities				%			%
United States		2871	-0.3	-2	-1	5	15
Europe		3366	0.4	-4	-2	-6	12
Japan		21345	-0.3	-4	-2	-5	7
China		2939	3.1	-5	-9	-7	18
Asia Ex Japan		68	-1.6	-5	-6	-12	8
Emerging Markets		42	2.0	-5	-6	-12	7
Interest Rates				basis points			
US 10y Yield		2.44	-4.1	-8	-2	-52	-24
Germany 10y Yield		-0.04	0.5	-7	-2	-60	-28
Japan 10y Yield		-0.05	-0.1	-1	0	-10	-5
UK 10y Yield		1.12	-0.4	-10	2	-31	-16
Credit Spreads				basis points			
US Investment Grade		117	2.3	6	1	16	-30
US High Yield		418	0.8	26	12	80	-103
Europe IG		66	-0.7	7	6	11	-22
Europe HY		278	-2.4	26	23	11	-75
EMBIG Sovereign Spread		354	3.0	13	11	24	-60
Exchange Rates				%			
USD/Majors		97.37	0.0	0	0	5	1
EUR/USD		1.12	0.2	0	0	-6	-2
USD/JPY		109.7	0.0	1	1	0	0
EM/USD		61.9	0.0	-1	-2	-9	-1
Commodities				%			
Brent Crude Oil ($/barrel)		71	0.7	0	-1	-8	32
Industrials Metals (index)		114	0.1	-2	-7	-16	4
Agriculture (index)		37	0.0	-3	-8	-24	-10
Implied Volatility				%			
VIX Index (%, change in pp)		19.5	0.4	6.6	6.2	6.3	-5.9
10y Treasury Volatility Index		4.3	0.1	0.6	0.7	0.7	-0.3
Global FX Volatility		7.2	0.0	0.9	0.7	-0.4	-1.7
EA Sovereign Spreads				10-Year spread vs. Germany (bps)			
Greece		354	-4.3	22	9	1	-62
Italy		272	-0.5	19	29	135	22
Portugal		115	-1.6	5	-4	-2	-33
Spain		101	-3.1	5	-6	25	-17

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: 5/10/2019 8:15 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		6.82	0.1	-1.3	-2	-7	1		3.3	-1.6	-6	9	-27	15
Indonesia		14327	0.2	-0.4	-1	-2	0		8.2	2.9	18	40	62	1
India		70	0.1	-1.0	-1	-4	0		7.5	-0.6	-5	-3	-38	3
Philippines		52	0.0	-0.7	-1	0	1		5.1	-1.9	-7	-16	-34	-118
Thailand		32	0.6	1.0	1	1	2		2.6	0.2	-2	2	6	-4
Malaysia		4.16	-0.1	-0.4	-1	-5	-1		3.8	1.6	-3	1	-39	-27
Argentina		45	-0.4	-1.1	-4	-50	-17		27.7	58.2	112	417	780	470
Brazil		3.95	-0.2	-0.4	-3	-10	-2		8.1	-3.4	-18	-17	-64	-10
Chile		685	-0.1	-0.4	-3	-8	1		4.1	-1.1	0	2	-65	-36
Colombia		3277	0.5	-0.6	-5	-13	-1		6.3	-7.5	-12	14	2	-25
Mexico		19.20	0.2	-1.5	-2	0	2		8.2	-0.8	0	12	51	-49
Peru		3.3	0.1	-0.1	-1	-1	2		5.4	0.6	3	5	-9	-36
Uruguay		35	-0.1	0.0	-3	-13	-8		10.9	0.8	-1	41		20
Hungary		288	0.3	0.2	-1	-8	-3		2.1	-5.2	-1	14	44	-6
Poland		3.83	0.2	-0.2	-1	-7	-2		2.4	-2.4	-8	4	-25	9
Romania		4.2	0.1	0.1	0	-8	-4		4.2	1.0	1	1	-5	0
Russia		65.3	-0.1	-0.4	-2	-5	6		7.9	0.0	1	-8	78	-49
South Africa		14.2	0.8	0.8	-2	-14	1		9.4	-3.4	-5	13	35	-18
Turkey		6.13	1.0	-2.7	-7	-31	-14		22.9	63.1	168	387	874	601
US (DXY; 5y UST)		97.3	0.0	-0.2	0	5	1		2.24	-0.5	-8	-3	-59	-27

	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		2939	3.1	-5	-9	-7	18		175	3	3	0	-10	-19
Indonesia		6209	0.2	-2	-4	5	0		190	4	9	0	-7	-46
India		37463	-0.3	-4	-3	6	4		149	3	2	-10	-3	-47
Philippines		7742	-0.2	-3	-3	2	4		84	3	5	-6	-25	-37
Malaysia		1610	-0.5	-2	-2	-13	-5		124	6	4	-3	-57	-38
Argentina		34119	1.0	11	6	15	13		900	1	-26	82	427	85
Brazil		94808	-0.8	-1	-1	10	8		248	5	6	-1	2	-25
Chile		5046	-0.3	-2	-4	-12	-1		129	8	8	-1	4	-37
Colombia		1543	0.2	-1	-5	-1	16		189	7	14	8	8	-39
Mexico		43193	-0.5	-3	-4	-7	4		308	6	11	14	45	-46
Peru		20213	-1.1	-3	-5	-5	4		134	6	8	9	-20	-34
Hungary		41362	0.4	-1	-2	13	6		100	5	4	-7	-24	-48
Poland		56796	0.3	-5	-8	-5	-2		43	1	3	-7	-33	-42
Romania		8298	0.0	-2	0	-6	12		190	6	8	-13	30	-31
Russia		2527	-0.7	-2	-2	10	7		211	3	10	-3	-4	-41
South Africa		57109	1.1	-3	-2	-2	8		307	1	3	13	35	-58
Turkey		88631	-0.1	-6	-9	-13	-3		531	-2	44	48	163	102
Ukraine		572	0.4	2	3	21	2		651	-9	29	63	142	-136
EM total		42	2.1	-5	-6	-12	7		354	3	13	11	24	-60

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