



Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Friday, May 31, 2019

- Trade tensions escalate as US imposes tariffs on Mexico ([link](#))
- China readies retaliatory actions against US restrictions on Huawei ([link](#))
- US administration announces it could more than double tariffs on China ([link](#))
- Sovereign yields continue to fall as Italy bucks the trend ([link](#))
- **SPECIAL FEATURE: Fintech Update** ([see attachment](#))








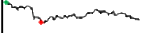


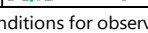
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Trade tensions flare up as investors run for safety

President Trump threatened the imposition of tariffs on Mexico, citing illegal immigration concerns.

According to communication from the White House, a 5% tariff will be imposed on all imports from Mexico starting June 10. Tariff duties will also continue to rise by 5% a month, to a ceiling of 25% in October, should pending immigration issues not be resolved. The immediate response by the Mexican authorities was to call for "prudence and responsibility" as the country's top diplomat was dispatched to Washington for negotiations. **Meanwhile, the Chinese government is planning to take retaliatory measures to the US blacklisting of tech giant Huawei** and has reportedly established of a list of "unreliable entities" aimed at targeting foreign companies that cut supply ties to China. Moreover, it has readied plans to restrict rare earth exports to the US. These announcement exacerbated the global risk-off sentiment and led to a sell-off in risk assets globally, with European stocks down by about 1.25% this morning and US equity futures declining by about 1.2%. Conversely, safe haven assets have been strongly bid with the 10Y Treasury yield dropping to 2.14% and the 10Y Bund yield dipping below -0.2%, its lowest level on record. The Japanese yen was also bid, appreciating by about 0.8%, while the US dollar slightly weakened against major currencies this morning.

Key Global Financial Indicators

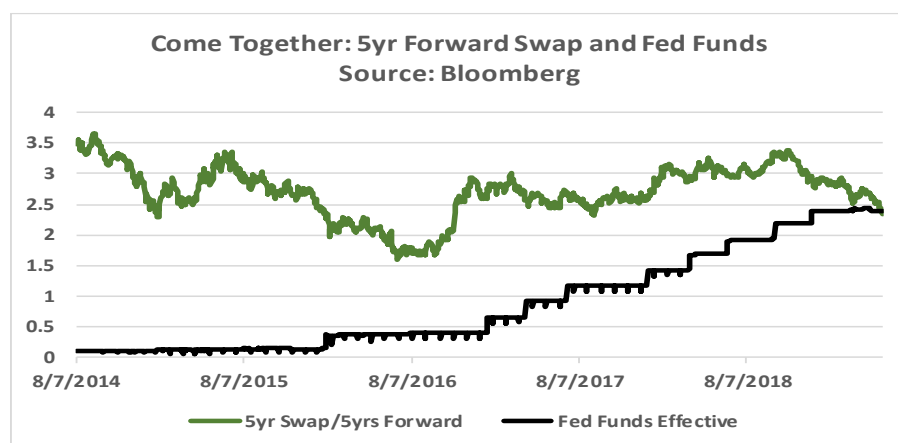
Last updated: 5/31/19 8:59 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		2789	0.2	-2	-5	3	11
Eurostoxx 50		3270	-1.5	-2	-7	-4	9
Nikkei 225		20601	-1.6	-2	-7	-7	3
MSCI EM		41	-0.8	0	-8	-11	4
Yields and Spreads			bps				
US 10y Yield		2.18	-4.7	-14	-32	-68	-50
Germany 10y Yield		-0.19	-1.7	-8	-21	-53	-43
EMBIG Sovereign Spread		376	2	12	31	34	-38
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		61.3	0.1	0	-2	-7	-2
Dollar index, (+) = \$ appreciation		98.0	-0.2	0	0	4	2
Brent Crude Oil (\$/barrel)		65.0	-2.8	-5	-11	-16	21
VIX Index (% change in pp)		19.2	1.9	2	6	4	-6

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

United States

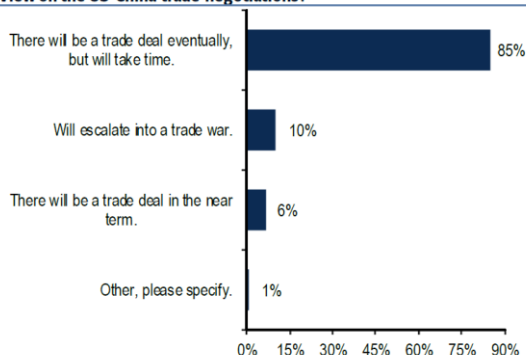
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Vice President Pence's remarks at a press conference in Canada that the US could "more than double" tariffs on China sparked a late day surge in the Treasury market and a selloff in US stocks, although the S&P 500 did recover to end with a small gain. It was a disappointing result after many other markets managed to post decent returns and Treasury yields ticked higher in the morning as risk aversion abated. Instead, the US yield curve inversion in the three-month/ten-year sector became more pronounced (it went as low as -15.9 bps, the most since 2007) and risk aversion was back with a vengeance. Treasury yields set new multi-year lows intra-day. Contacts pointed to the US five-year forward five-year interest rate swap, a key bond market benchmark which is now trading below Fed Funds Effective (2.34% vs. 2.39%) for the first time since December 2006 as another flashing red light for the market. In other news, pending home sales were much weaker than expected at -1.5% in April versus the forecast of a 0.5% gain, another downside economic surprise following last week's weak PMI and retail sales data.



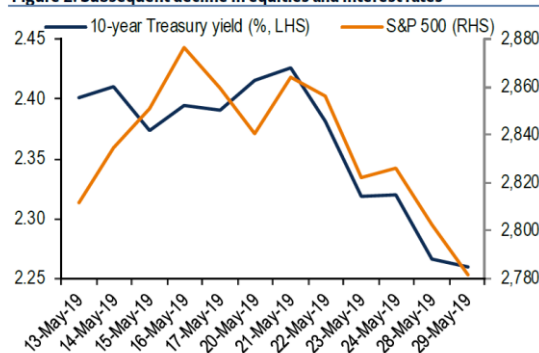
The flareup in trade tensions during the month of May has taken the markets completely by surprise. Survey data from earlier in the month showed that investors were confident that a trade deal would be reached although it might take time. Just 10% predicted a trade war. The escalation in the conflict was a shock that sparked a steep decline in both stocks and bond yields. Some analysts believe that credible evidence of de-escalation will result in a strong market recovery, but others are more pessimistic in light of mixed US economic data and the fear that the US administration is unpredictable with regard to its rhetoric and tactics.

Figure 1: Credit investors: Which of the following best describes your view on the US-China trade negotiations?



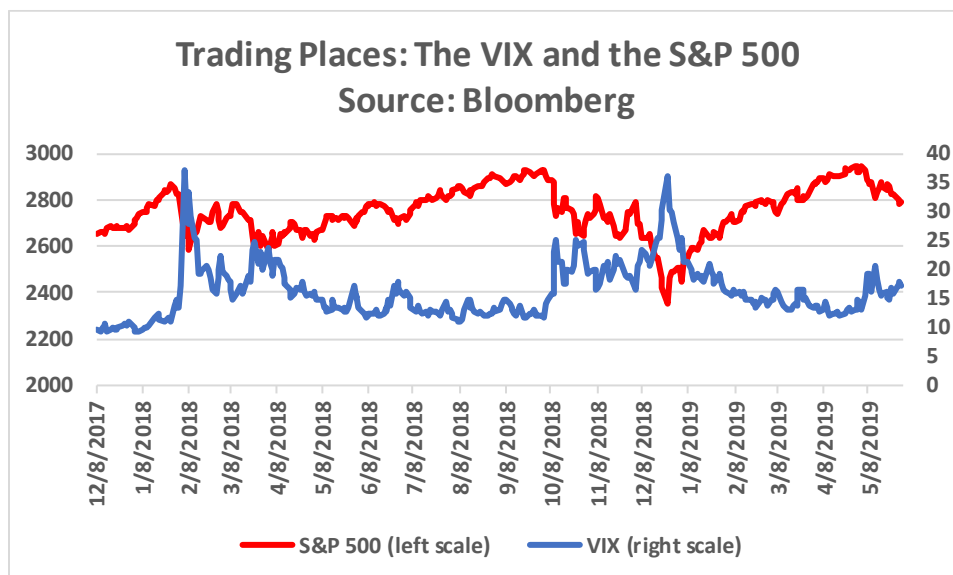
Source: BofA Merrill Lynch Global Research US Credit Investor Survey (May 13-17, 2019)

Figure 2: Subsequent decline in equities and interest rates



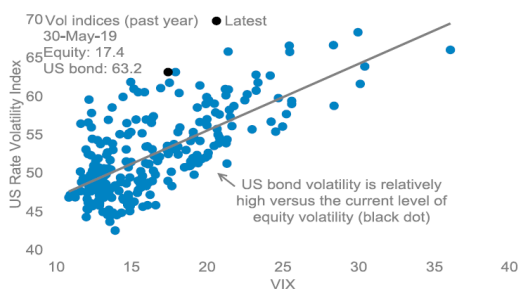
Source: Bloomberg

Equity market volatility has remained relatively contained, limiting the fallout from the stock market decline. This is particularly notable in view of the fact that the flareup in trade tensions was so unexpected. Previous major selloffs in 2018 saw much larger spikes in the VIX and much more disordered trading conditions, while the current episode appears to be more contained and conditions have been calmer. The VIX hit 37 during the February 2018 volatility episode and 36 at the height of the December selloff, but during the recent selloff it has not gone beyond 21. Some think that the VIX has been more restrained because the market still believes that a trade deal will eventually be worked out.



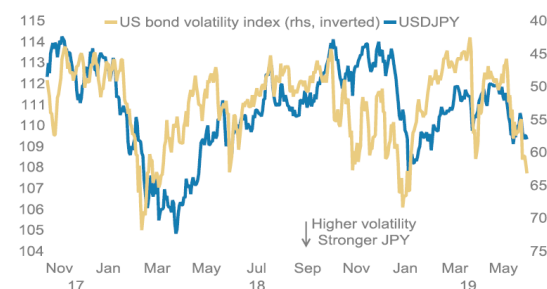
However, the widespread uncertainty has led to a noticeable uptick in US interest rate volatility and has favored safe haven currencies such as the yen and Swiss franc versus the dollar. For example, higher interest rate volatility tends to be associated with a stronger yen although the relationship appears to be weakening. The US currency has appreciated against other major peers as the market has sold off, with the euro, Sterling and many emerging market currencies weakening into the market decline.

Exhibit 9: US bond volatility has picked up faster than equity volatility



Source: Macrobond, Bloomberg, Morgan Stanley Research

Exhibit 10: USDJPY still falls with higher US bond volatility but the sensitivity may be reducing



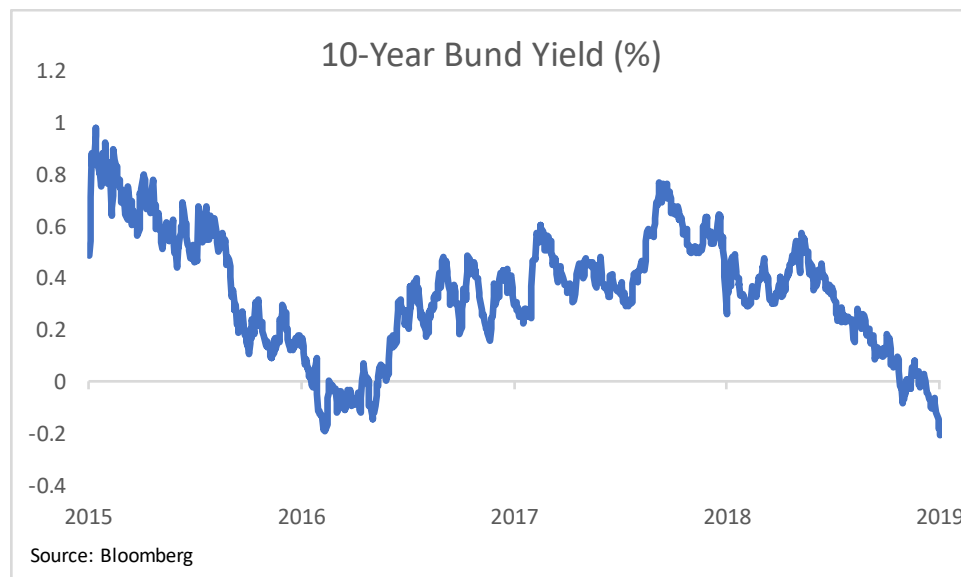
Source: Macrobond, Bloomberg, Morgan Stanley Research

The core PCE deflator, the Fed's preferred measure of inflation, came in on target at the consensus forecast of 1.6% annualized. The monthly number was also on target at 0.2%. The headline PCE numbers were 1.5% (vs. 1.6%) and on target at 0.3%. Personal spending was stronger than expected (0.9% vs. 0.3%). The market response was fairly muted.

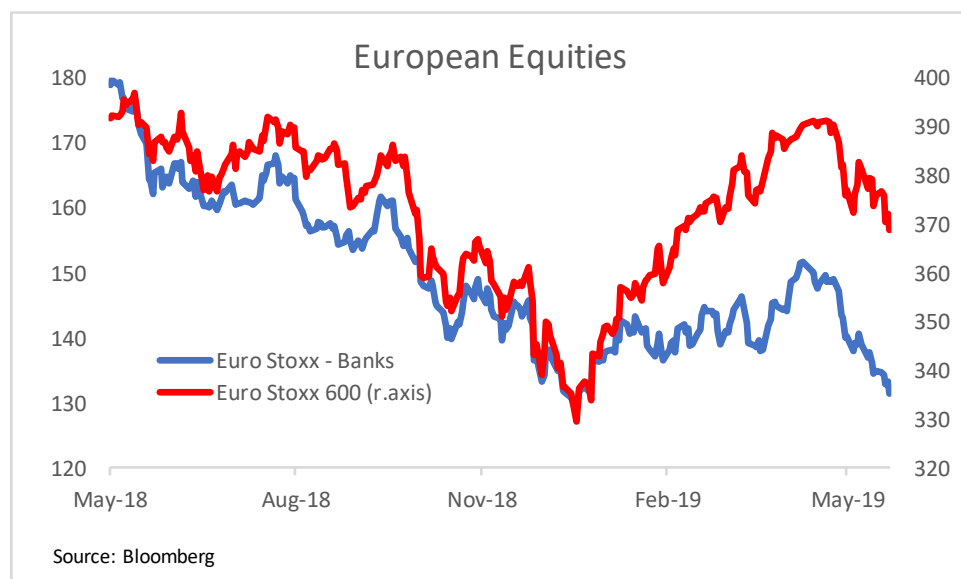
Europe

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Sovereign yields continued to fall this morning as global trade worries were reignited. Bunds saw some of the biggest moves with the 10-year down 3 bps. The move took the benchmark below -0.2%, surpassing the all-time low of 2016. Italy proved the exception to this morning's moves again, seeing a 5-7 bps rise across the curve. Continued risks regarding the coalition government's viability and the disagreement with the European Commission were the main culprits with deputy PM Salvini reportedly ready to end the coalition if he is unable to push through his policy priorities.



Equities were firmly in the red after president Trump's tariff threat to Mexico. The Euro Stoxx 600 was down by 0.9% as consumer stocks (-1.5%) led the declines. Banks also suffered and were 1.4% lower. Having seen smaller increases than other sectors in Q1, lenders have now nonetheless experienced larger losses than the overall index. Banks have now reached negative territory for the year while the broader index is still up by 9%.



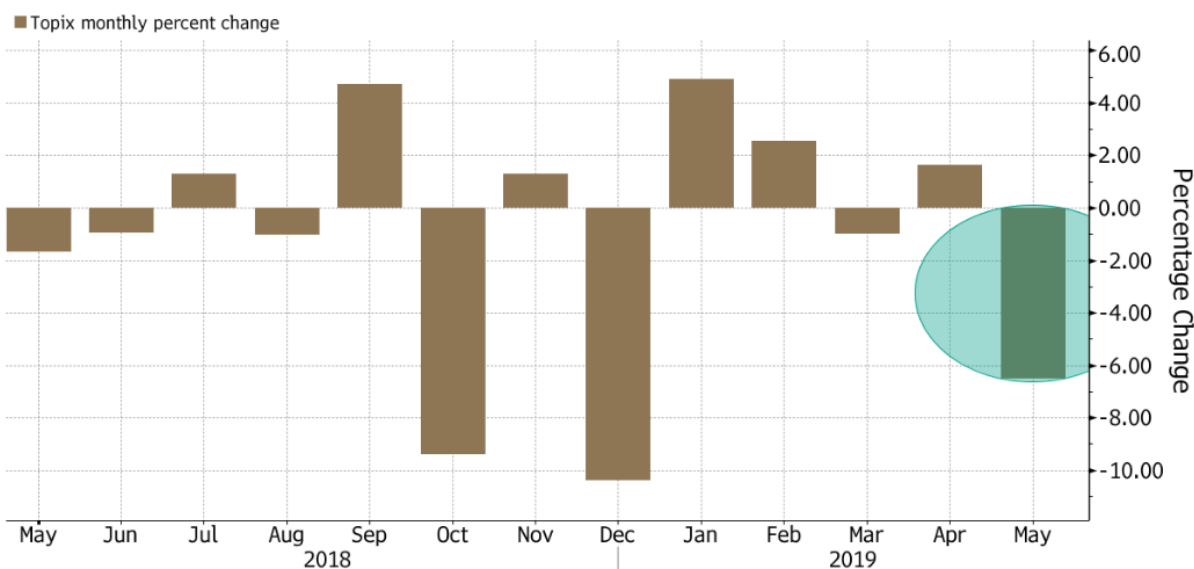
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Japan

Equities (Nikkei -1.6%; Topix -1.3%) fell despite positive industrial production data. Automakers were the biggest drag after US President Trump's tweet that he will impose 5% tariffs on Mexican goods. Toyota, Honda and Nissan dropped 2.9%, 4.3% and 5.3%, respectively. Many car manufacturers and their suppliers have plants in Mexico from which finished products are exported to the U.S. Financial stocks also underperformed as bond yields bull-flattened. **The risk aversion also saw the yen appreciating 0.7% while 10-year JGB yield fell 1.7 bps to -0.1%.**

Back in the Red

Topix posts the biggest monthly drop this year



Emerging Markets [back to top](#)

Asian equities (+0.2%) rose slightly on net despite negative Chinese manufacturing data and trade news. The Philippines (+1.7%) and Indonesia (+1.7%) led gains in the region, while Singapore (-0.9%) and Hong Kong (-0.8%) lagged. Indonesian stocks were boosted by the upgrading of the sovereign long-term credit rating by S&P by one level to BBB on strong growth prospects and prudent fiscal policy. **The Indonesian rupiah (+1.0%) also outperformed on the upgrade, while most other regional currencies were flat on the day.** In EMEA, equity indices are broadly lower driven by the global risk-off mood. Turkey and South Africa are underperforming, down around 0.5%. In the FX space, the South African rand and the Russia ruble depreciated near 0.5% against the dollar, while other currencies were flat. There was no reaction to today's data out of Turkey showing that GDP came in at -2.6% in Q1, slightly better than expected. **In Latin America,** the Mexican peso depreciated over 2% after President Trump imposed tariffs on the country's exports to the US. The Argentine peso ended four sessions of positive performance by depreciating marginally against the dollar (0.2%). The Colombian peso was the main underperformer (-0.5% against the dollar) driven by the weakness in oil prices. The currency is heading for its sixth consecutive week of depreciation and it's the worst performing EM currency quarter to date.

Key Emerging Market Financial Indicators

Last updated: 5/31/19 9:01 AM	Level		Change				YTD
	Last 12m	index	1 Day	7 Days	30 Days	12 M	
Major EM Benchmarks			%				%
MSCI EM Equities		40.57	-0.8	0	-8	-11	4
MSCI Frontier Equities		28.71	-0.3	1	1	-5	10
EMBIG Sovereign Spread (in bps)		376	2	12	31	34	-38
EM FX vs. USD		61.30	0.1	0	-2	-7	-2
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.91	-0.1	0	-3	-7	0
Indonesian Rupiah		14273	1.0	1	0	-3	1
Indian Rupee		69.70	0.3	0	0	-3	0
Argentine Peso		44.60	-0.1	1	-1	-44	-16
Brazil Real		3.99	-0.1	1	-2	-7	-3
Mexican Peso		19.73	-3.0	-3	-4	1	0
Russian Ruble		65.38	-0.3	-1	-1	-5	7
South African Rand		14.70	0.2	-2	-3	-14	-2
Turkish Lira		5.84	0.6	4	2	-23	-9
EM FX volatility		8.34	0.0	-0.2	0.3	-0.9	-1.4

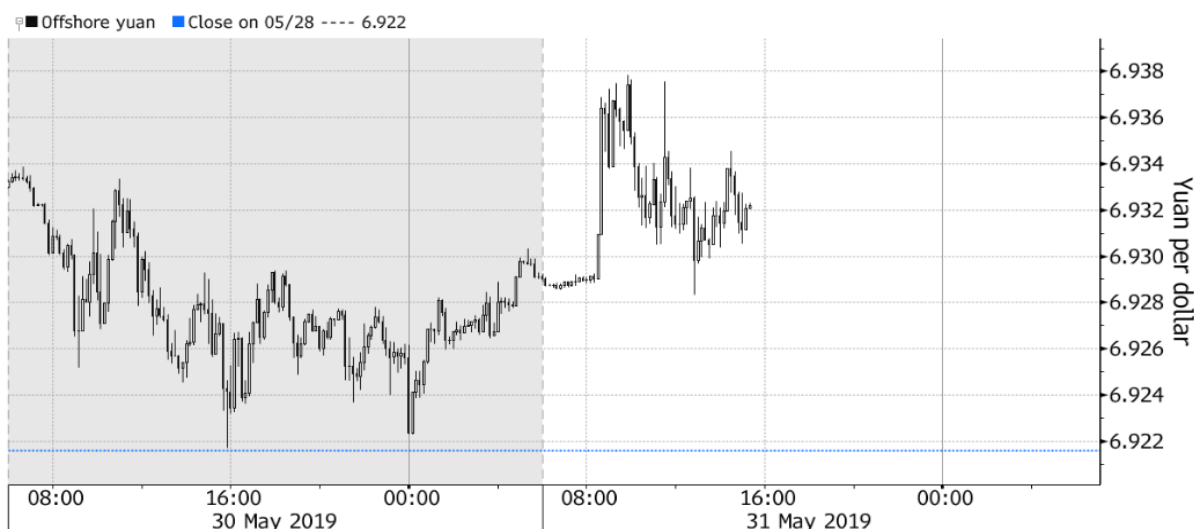
Colors denote **tightening/easing** financial conditions for observations greater than ± 1.5 standard deviations. Data source: Bloomberg.

China

Equities (Shanghai -0.2%, Shenzhen 0.0%) closed flat, giving away earlier gains on poor manufacturing data. The official manufacturing purchasing managers index dipped back into contraction of 49.4 in May, from 50.1 in April and also missed expectations. The new export orders sub-index also shrank further, pointing to weak trade activity going forward. Although presidents Trump and Xi are likely to meet during the G20 summit in Japan next month, Beijing is not optimistic about achieving a breakthrough in negotiations, according to the South China Morning Post. **The onshore and offshore RMB were however stable.**

Stimulus Hope

Offshore yuan pared a drop on increased speculation of further government stimulus



Additionally, China has readied its plan to restrict rare earth exports to the US should the trade war deepen. According to Bloomberg, the plan can be implemented as soon as the government decides to go ahead. Beijing will focus on heavy rare earths, in which the US is notably reliant on China. **Furthermore, the dispute between Huawei and the US continues to escalate.** According to the FT, Huawei has repatriated American research and development workers from its Shenzhen headquarters after the US blacklisted the tech firm and its 68 affiliates. Huawei also ordered employees to cancel technical meetings with US contacts. The government has also announced the establishment of a list of “unreliable entities” aimed at targeting foreign companies that cut supplies ties to China, according to Bloomberg.

Korea

The Bank of Korea (BoK) held its policy rate at 1.75% as expected, but the decision was not unanimous. One member voted to lower interest rates, with analysts viewing the dissenting vote as a potential sign of a rate cut over the coming months. Even though the BoK left its economic assessment unchanged, in its official statement and the press conference, it emphasized heightened external uncertainty and risks, especially the escalation of the US-China trade dispute. **The Korean won weakened -0.2% making it Asia’s worst performer on the day.**

Bank of Korea Policy Rate, South Korea Bond Yields



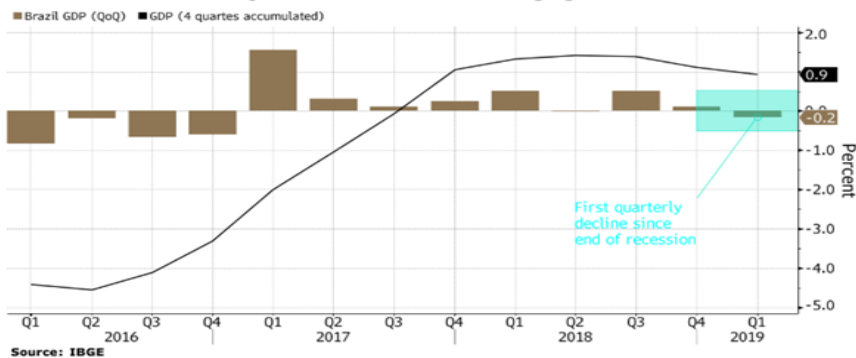
Source: Bloomberg

Brazil

Brazil’s activity declined for the first time since 2016 driven by investment and exports. GDP declined 0.2% q-o-q in Q1, compared with a 0.1% in Q4. The result was in line with the median estimate from economists surveyed by Bloomberg. Analysts highlighted that first-quarter results were marred by a bad crop that caused agriculture to decline, deadly collapse of a mining dam in the town of Brumadinho that affected iron ore shipments, and a prolonged recession in neighboring Argentina that is reducing demand for Brazilian exports. JP Morgan revised their growth forecast for 2019 from 1.5% to 0.9%. The 2019 GDP growth expectation in BCB’s analyst survey declined to 1.23% this week, from 2.5% in February.

Sleepwalking Giant

Contraction in the first quarter sends annual GDP edging further down





























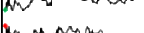


Source: IBGE

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***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***Martin Edmonds***Senior Data Mgt Officer***Yingyuan Chen***Senior Research Officer***Piyusha Khot***Research Assistant***Xingmi Zheng***Research Assistant*

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Global Financial Indicators

Last updated: 5/31/19 9:00 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		2789	0.2	-2	-5	3	11
Europe		3270	-1.5	-2	-7	-4	9
Japan		20601	-1.6	-2	-7	-7	3
China		2899	-0.2	2	-6	-6	16
Asia Ex Japan		66	0.2	-1	-9	-13	4
Emerging Markets		41	-0.8	0	-8	-11	4
Interest Rates			basis points				
US 10y Yield		2.18	-4.7	-14	-32	-68	-50
Germany 10y Yield		-0.19	-1.7	-8	-21	-53	-43
Japan 10y Yield		-0.09	-1.5	-2	-5	-13	-10
UK 10y Yield		0.88	-2.1	-8	-31	-35	-40
Credit Spreads			basis points				
US Investment Grade		131	1.7	5	21	27	-16
US High Yield		472	9.3	27	74	111	-49
Europe IG		72	2.3	4	14	2	-16
Europe HY		312	9.8	17	63	6	-41
EMBIG Sovereign Spread		376	2.0	12	31	34	-38
Exchange Rates			%				
USD/Majors		97.95	-0.2	0	0	4	2
EUR/USD		1.12	0.3	0	-1	-5	-3
USD/JPY		108.8	0.7	0	2	0	1
EM/USD		61.3	0.1	0	-2	-7	-2
Commodities			%				
Brent Crude Oil (\$/barrel)		65	-2.8	-5	-11	-16	21
Industrials Metals (index)		111	-0.6	0	-6	-19	1
Agriculture (index)		41	-1.4	7	7	-17	-1
Implied Volatility			%				
VIX Index (% change in pp)		19.2	1.9	2.3	6.1	3.8	-6.2
10y Treasury Volatility Index		5.0	0.3	0.6	1.0	0.4	0.4
Global FX Volatility		6.6	0.0	-0.2	0.1	-1.4	-2.4
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		311	-11.7	-37	-24	-113	-104
Italy		287	3.8	20	33	42	37
Portugal		101	-2.6	-8	-9	-63	-47
Spain		92	-1.9	-2	-7	-24	-25

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: 5/31/2019 9:02 AM	Exchange Rates						YTD	Local Currency Bond Yields (GBI EM)						
	Level		Change (in %)					Level		Change (in basis points)				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
	vs. USD		(+) = EM appreciation					% p.a.						
China		6.91	-0.1	-0.1	-3	-7	0		3.3	-2.2	-3	-10	-31	10
Indonesia		14273	1.0	0.8	0	-3	1		8.1	0.0	2	21	67	-2
India		70	0.3	-0.2	0	-3	0		7.2	0.3	-11	-30	-71	-21
Philippines		52	0.0	0.0	0	1	1		5.1	-0.9	0	-12	-40	-122
Thailand		32	0.5	0.7	1	1	3		2.5	1.4	-3	-8	-13	-10
Malaysia		4.19	0.0	0.0	-1	-5	-1		3.8	-0.3	-3	-3	-50	-29
Argentina		45	-0.1	0.6	-1	-44	-16		33.1	-54.3	40	648	1368	1006
Brazil		3.99	-0.1	0.9	-2	-7	-3		7.7	-2.6	-31	-53	-178	-45
Chile		715	-0.8	-2.8	-5	-12	-3		3.9	3.1	-16	-25	-99	-62
Colombia		3390	-0.8	-0.9	-5	-15	-4		6.2	-1.5	-14	-16	-14	-33
Mexico		19.73	-3.0	-3.4	-4	1	0		8.0	2.3	-9	-15	23	-68
Peru		3.4	-0.3	-0.5	-2	-3	0		5.2	2.2	-6	-12	-51	-55
Uruguay		35	0.0	0.0	0	-12	-8		11.2	-1.8	7	32		49
Hungary		291	0.3	-0.1	-1	-6	-4		1.9	-1.2	-8	-22	-10	-31
Poland		3.84	0.4	-0.3	-1	-4	-3		2.2	-0.6	-6	-19	-35	-4
Romania		4.3	0.4	-0.1	0	-6	-5		4.2	-2.0	-11	-3	-16	-4
Russia		65.4	-0.3	-1.4	-1	-5	7		7.7	-5.6	-5	-23	56	-72
South Africa		14.7	0.2	-2.0	-3	-14	-2		9.4	1.6	14	5	33	-15
Turkey		5.84	0.6	4.1	2	-23	-9		20.6	-38.7	-78	-60	592	369
US (DXY; 5y UST)		97.9	-0.2	0.3	0	4	2		1.97	-4.6	-15	-30	-72	-54

	Equity Markets							Bond Spreads on USD Debt (EMBIG)						
	Level		Change (in %)				YTD	Level		Change (in basis points)				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
								basis points						
China		2899	-0.2	2	-6	-6	16		181	-1	3	7	-1	-13
Indonesia		6209	1.7	3	-4	3	0		208	-3	8	27	12	-28
India		39714	-0.3	1	2	12	10		156	3	-2	2	-6	-40
Philippines		7970	1.7	3	0	6	7		94	-2	8	16	-26	-27
Malaysia		1651	0.9	3	1	-5	-2		131	-1	4	7	-12	-31
Argentina		34239	0.8	0	16	20	13		974	17	69	22	455	159
Brazil		97457	0.9	4	1	27	11		269	4	11	23	-27	-4
Chile		4934	1.2	1	-5	-10	-3		144	0	9	18	5	-22
Colombia		1487	0.4	0	-6	-4	12		209	2	11	34	6	-19
Mexico		43346	1.1	1	-3	-3	4		330	9	16	36	42	-24
Peru		19812	0.8	1	-5	-5	2		144	0	4	17	-23	-24
Hungary		40747	-0.8	2	-4	15	4		118	4	13	14	-21	-30
Poland		57563	0.0	1	-4	0	0		65	4	15	18	-21	-20
Romania		8489	1.0	4	1	5	15		212	4	6	22	46	-9
Russia		2648	-0.4	1	3	15	12		224	4	15	26	5	-28
South Africa		55384	-0.5	2	-5	-1	5		324	6	15	16	52	-41
Turkey		90087	0.1	5	-6	-10	-1		548	3	-6	43	156	119
Ukraine		568	0.0	-1	1	26	2		658	13	11	17	157	-129
EM total		41	-0.8	0	-8	-11	4		376	2	12	31	34	-38

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