GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor
TUESDAY, NOVEMBER 26, 2019

- **The Fed's first 42-day repo operations is oversubscribed ahead of year end** (link)
- **ECB estimates its QE lowered sovereign rates by about 100 bps** (link)
- **A large Chinese state-owned conglomerate signals it may default on offshore bonds** (link)
- **The Hungarian forint weakens to a record low against the euro** (link)
- **Kenya's central bank cuts rates by 50 bps to 8.5%, the first cut in 16 months** (link)

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

Markets tread water ahead of US holiday

Price action was limited once again in holiday trading conditions. With global growth data showing signs of stabilization and no new developments in US-China trade negotiations, there has been discussion that some market participants could close their books early and hold off on significant asset reallocations until next year. However, given September's volatility in repo markets, year-end funding remains a concern in the US. Demand was very strong for the first of the Fed's three planned operations to extend term funding over year end. That said, overnight repo rates remain within expected ranges and price action in other US asset markets remains sleepy in the sessions ahead of Thanksgiving.

Key Global Financial Indicators

Last updated: 11/26/19 8:04 AM	Level		Change from Market Close				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		3134	0.8	0	4	17	25
Eurostoxx 50		3703	-0.1	0	2	17	23
Nikkei 225		23373	0.3	0	3	7	17
MSCI EM		43	-0.3	1	1	8	11
Yields and Spreads			bps				
US 10y Yield		1.74	-1.5	-4	-5	-131	-94
Germany 10y Yield		-0.36	-1.4	-2	0	-72	-61
EMBIG Sovereign Spread		336	1	-2	8	-59	-78
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		59.9	-0.1	0	-2	-4	-4
Dollar index, (+) = $ appreciation		98.3	0.0	0	0	1	2
Brent Crude Oil ($/barrel)		63.7	0.1	5	3	5	18
VIX Index (%, change in pp)		11.9	0.0	-1	-1	-7	-14

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

United States

Risk asset prices ticked modestly higher on Monday as China said it would take more stringent actions on intellectual property (IP) violations. China said it is aiming to reduce frequent IP violations by 2022 and plans to make it easier for victims of transgressions to receive compensation. The S&P 500 closed up 0.7%, and Treasury yields were relatively unchanged. Fed chair Powell iterated that the Fed remains firmly committed to the 2% inflation goal as part of a prepared speech, which was taken as a signal that interest rates are unlikely to rise anytime soon.

Implied volatility in the US equities continued to ebb, with the VIX declining by 0.5 pts to 11.9. The decline may be partially attributable to a resumption of VIX shorting strategies, with the volume of speculative contracts at record short levels. Analysts highlight that this level of volatility is particularly low considering the current relatively weak levels of macro indicators. Historically, with US growth between 1% and 2%, the likelihood of the VIX spiking above 20 in the following 3 months is above 60%.

VIX and futures positioning

VIX Index (LHS)
CFTC CBOE VIX Futures (RHS)
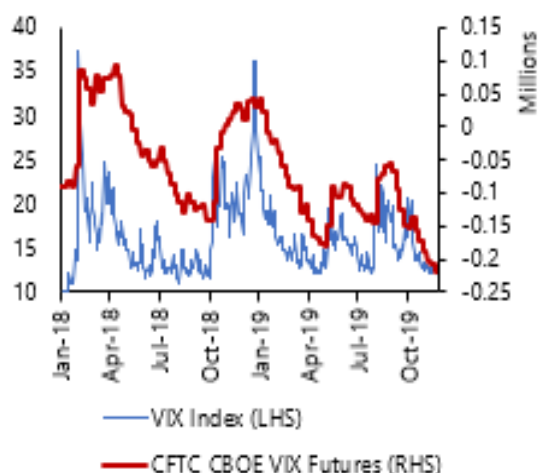
Source: Bloomberg

S&P 500 1m realised vol distribution based on different level of US growth (measured by US Current Activity Inidcator - CAI, data since 1990)

Distribution of S&P 500 1m realised vol
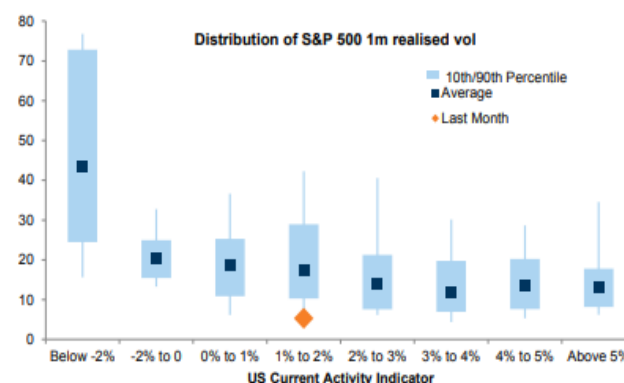
Source: Datastream, Goldman Sachs Global Investment Research

The Fed's 42-day repo operation was oversubscribed, attracting $49 bn in bids, or nearly twice the $25 bn available. This was the first of three term operations to provide funding past Dec. 31, with the Fed planning another 42-day auction on December 2 and a 28-day offering on December 9. The typical overnight repo offering received $68.5bn in bids, less than the $120 bn limit.

Investor concerns of a material increase in credit defaults persist. Although default rates have been well below long-term averages this year, there has been a slight uptick from recent lows. Barclays analysts expect 2020 full-year issuer-weighted default rates for bonds to be 3.0-4.0% and for loans to be 2.0-3.0%. On a par-weighted basis, analysts expect default rates of 2.5-3.5% for bonds and 1.5-2.5% for loans. The midpoints of these rates represent a roughly 1.0% increase from the current levels. Within sectors, energy was the largest driver of defaults this year, representing $18 bn of the $25 bn (72%) of bond defaults.

FIGURE 1
Issuer-Weighted Default Rates and 2020 Forecast
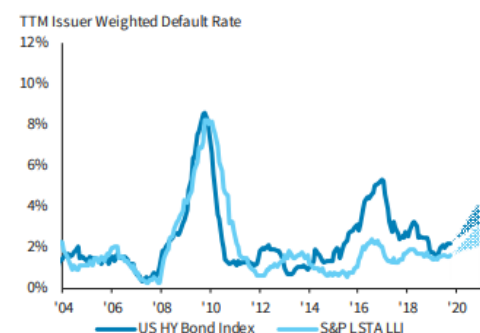
Note: PCG not included in default data because the company went from investment grade-rated to default in the same month.
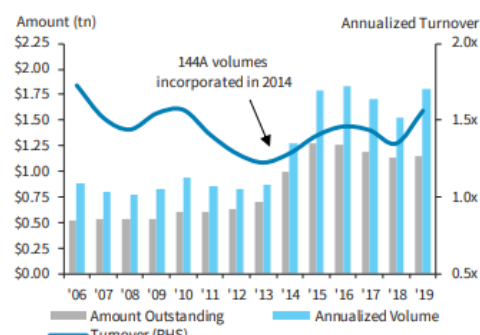Source: S&P LCD, Bloomberg Barclays Indices

FIGURE 4
2019 Bond and Loan Defaults by Sector
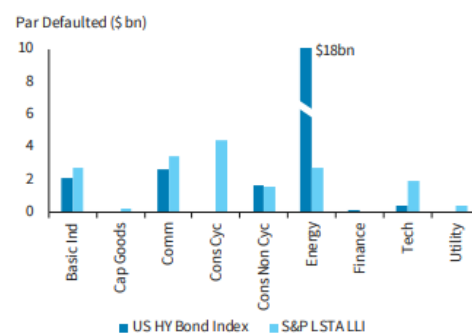
Note: Data are through October 2019. PCG not included in default data because the company went from investment grade-rated to default in the same month.
Source: S&P LCD, Moody's, Barclays Research

Market liquidity has diverged between bonds and loans in 2019. Bond trading volumes have increased significantly this year, with annualized turnover in 2019 at nearly 1.6x, the highest level since 2010. Barclays analysts highlighted that the rise has been skewed toward the more liquid portions of the market, with the largest issues having the greatest rise in turnover and bid-ask spread declining the most for the most liquid bonds. On the other hand, turnover in the loan market has declined slightly this year. The decrease this year is driven by the retail buyer base, which has shrunk by one-third. The depth of the loan market has also declined this year, per analysts, after increasing during the sell-off at the end of last year.

FIGURE 3
Bond Turnover and Volume Levels Have Increased in 2019

Source: MarketAxess, Bloomberg Barclays Indices

FIGURE 7
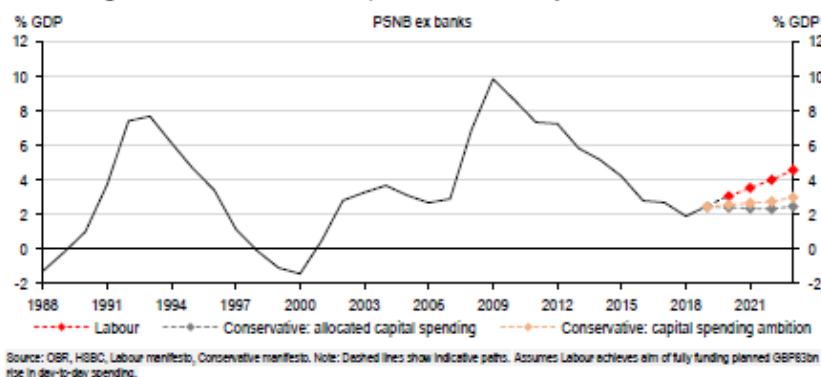**Turnover Has Declined Recently…**
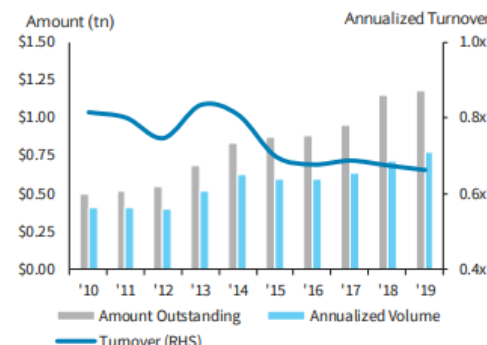
Source: LSTA

Europe   **back to top**

United Kingdom

The British pound has been tracking political news ahead of the 12 Dec elections. Yesterday, the pound gained 0.5% on a relatively moderate manifesto from the Conservative Party. Today, some of these gains were reversed on a narrowing Tory lead. A poll by Kantar estimates the lead at 11 percentage points (from 18 previously) and a Reuters poll showed a lead of 7 percentage points (from 10 previously).

HSCB calculates that U.K. **budget deficits would widen to 4.7% under a Labor government and 3.0% under a Conservative government**. The Conservatives have a cap on 3% GDP cap on investment spending compared to Labor's pledge of a £400 bn National Transformation Fund in the next decade. Conservatives are set to cut taxes somewhat compared to Labor's intention to increase taxes £80 bn/year.

1. The budget deficit looks set to widen, based on the main parties' manifestos

Source: OBR, HSBC, Labour manifesto, Conservative manifesto. Note: Dashed lines show indicative paths. Assumes Labour achieves aim of fully funding planned GBP63bn rise in day-to-day spending.

U.K. equities have gained 10% ytd in 2019, underperforming euro area equities (+22% ytd) and U.S. equities (+25% ytd).

Equities: UK versus euro area and U.S. (Jan 2015: 100)
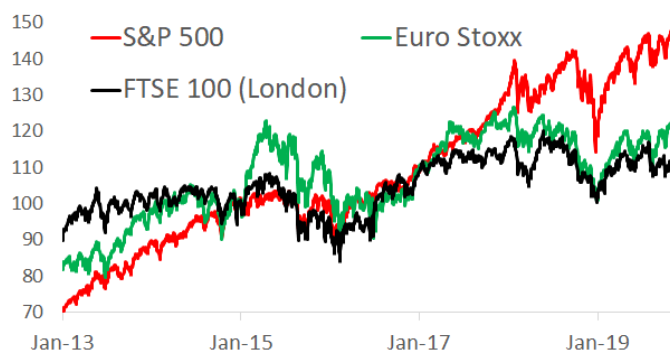
Source: Bloomberg and IMF

Euro Area

European equities and core bonds were little changed. German 10-year Bund yields fell 1 bps to -0.36%, and 10-year OAT yields to -0.05%.

Germany consumer confidence (Gfk) remains resilient, edging higher in December.

In a speech yesterday, **ECB chief economist Lane said that the synethetic euro area sovereign 10-year rate would have been more than 100 basis higher in a hypothetical scenario without ECB QE** (APP). In the Q&A, Mr Lane pointed to the September package ("a little bit of everything") as the best guide to what the ECB would do in case inflation disappoints again.

APP impact on ten-year euro area sovereign yield over time

(basis points)
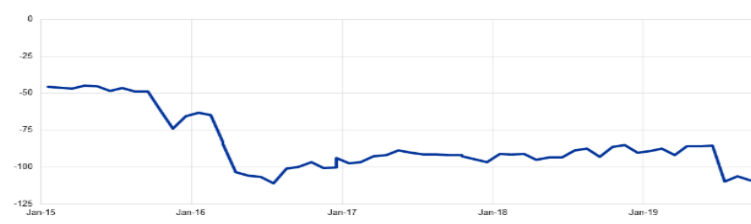
Sources: ECB, based on Eser et al. (2019).
Notes: Evolution of the APP impact on the ten-year synthetic sovereign yield (weighted average of Germany, France, Italy, Spain). The impact is derived on the basis of an arbitrage-free affine model of the term structure with a quantity factor (see Eser et al. 2019).
Latest observation: September 2019.

Banque de France governor Villeroy reiterated that low rates will continue to support the economy, and that Germany and the Netherlands must use fiscal space. Italian spreads over 10-year Bunds are up 2 at 153 bps as Italy is selling inflation-bonds. Spanish 10-year spreads over Bunds trade at 75 bps.

Greece concluded the early repayment of €2.7 billion of its loans from the IMF.

Other Mature Markets   back to top

Japan

The yen held steady while equities edged higher (+0.2%) amid a dearth of significant news. Meanwhile, yields on longer-dated JGBs fell following robust demand for the 40-year bond at its auction. The sale of the 40-year long bond saw a bid-to-cover ratio of 3.50x, up from 2.69x previously. The 40-year yield fell 3 bps to 0.44%, the 10-year note fell 1 bp to -0.11% while the 2-year note held steady at -0.20%.

Emerging Markets   back to top

Asian equities were mixed while currencies mostly weakened against the dollar as the oft-discussed US-China phase-one trade deal has yet to materialize. Hong Kong's Hang Seng Index slipped (-0.3%) following comments from the city's Chief Executive Carrie Lam. In her first weekly briefing since Sunday's local council election, which handed the pro-democracy camp overwhelming control of the district councils, the Chief Executive offered no new policy proposals or concessions, stoking concerns that dissatisfied voters could take to the streets in protests once again. Meanwhile, Alibaba shares rose 6% in its Hong Kong debut, following oversubscribed retail demand for its IPO, which raised $11 bn in Hong Kong's biggest listing since 2010. In currencies, the Indian rupee paced gains (+0.2%) while the Philippine peso underperformed (-0.3%). Most main equity indices in **EMEA** dropped today on worries about the stalling trade deal between the US and China. Losses were the largest in Egypt (-1.2%), Qatar (-1.2%), and Saudi Arabia (-1.1%). Bourses in central and eastern Europe also declined: Hungary (-0.7%), the Czech Republic (-0.5%), and Russia (-0.5%). Currencies across the region were mostly stable against the dollar, except the South African rand (-0.3%). **In Latin America,** the Chilean Peso (+0.5% stronger against the dollar) outperformed the rest of EM. Analysts highlight that local pension funds might start increasing again their allocation in local bonds. Ecuador bond prices bounced back for a second day in a row, increasing by 2 to 3 points across the curve, as optimism grows that congress will approve revised tax reform legislation submitted by President Moreno.

### Key Emerging Market Financial Indicators

Last updated:	Level		Change				YTD
11/26/19 8:05 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks				%			%
MSCI EM Equities		43.30	-0.3	1	1	8	11
MSCI Frontier Equities		28.85	0.3	1	1	6	10
EMBIG Sovereign Spread (in bps)		336	1	-2	8	-59	-78
EM FX vs. USD		59.93	-0.1	0	-2	-4	-4
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		7.04	-0.1	0	0	-1	-2
Indonesian Rupiah		14088	0.0	0	0	3	2
Indian Rupee		71.50	0.3	0	-1	-1	-2
Argentine Peso		59.75	-0.1	0	0	-35	-37
Brazil Real		4.25	-0.5	-1	-6	-7	-9
Mexican Peso		19.46	-0.1	-1	-2	6	1
Russian Ruble		63.99	-0.1	0	0	5	8
South African Rand		14.81	-0.2	0	-2	-6	-3
Turkish Lira		5.74	0.1	-1	0	-9	-8
EM FX volatility		7.02	0.0	-0.2	-0.1	-3.2	-2.8

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

EM issuance

Citigroup expects global EM sovereign hard-currency issuance to decline to $130 bn in 2020 from $154 bn in 2019. The decline is largely driven by increased prefunding (e.g. in Angola, Morocco, Brazil, Panama) over the past month. In 2019, African issuance exceeded expectations, with slightly larger-than-anticipated issuance from Ghana and Ivory Coast. Turkey and UAE, two of the largest gross suppliers, also surprised to the upside. In Latin America, upside surprises from Panama ($4.3 bn) and Chile ($1.7 bn) helped replace Argentine bond supply. Mexican and Brazilian issuance was also higher than expected by $2.4 bn and $2.0 bn, respectively. In 2020, Citigroup expects large issuers such as the GCC countries and Turkey to lead the market.

Figure 4. Gross supply: GCC, Turkey, have led 2019YTD supply….
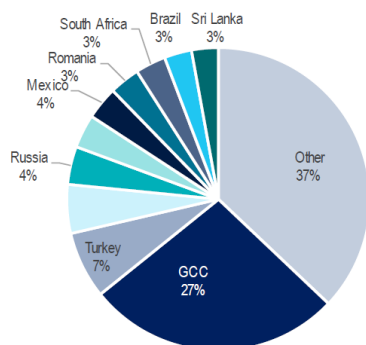
Source: Citi Research, Bloomberg

Figure 5. … and may continue to lead the 2020 gross supply
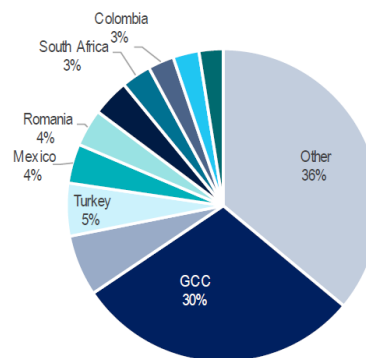
Source: Citi Research, Bloomberg

China

A large state-owned enterprise (SOE) is poised to miss coupon payments in the offshore dollar bond market, underscoring weakening official support. Tewoo Group, based in Tianjin, is owned by the local government and operates in a number of industries including infrastructure, logistics, mining, autos and ports. It is ranked 132 in 2018's Fortune Global 500 list, higher than other conglomerates including China Telecom and Citic Group. Tewoo proposed that investors either lose up to 64% of principal or accept delayed repayment with sharply reduced coupons on $1.25 bn of dollar bonds outstanding. Any default could have wider implications on investors' assessment of SOE bonds in the future as Tewoo's financial troubles underscore local governments' weakened fiscal positions in a slowing economy. By NBS' estimate, Tianjin's local economy grew 1.4%, y/y, in 2018, the slowest in China. Meanwhile, its debt outstanding totaled RMB 408 bn last year, or about 22% of its economy.

Hungary

The Hungarian forint has weakened to a new record against the euro. The forint (-0.1%) traded at 336/euro today, the weakest recorded level. The National Bank of Hungary has kept its base rate unchanged since early 2016, while it resumed injecting HUF liquidity in August 2019, according to Credit Suisse research. Various analysts expect depreciating pressures on the forint to continue unless the macro environment improves.
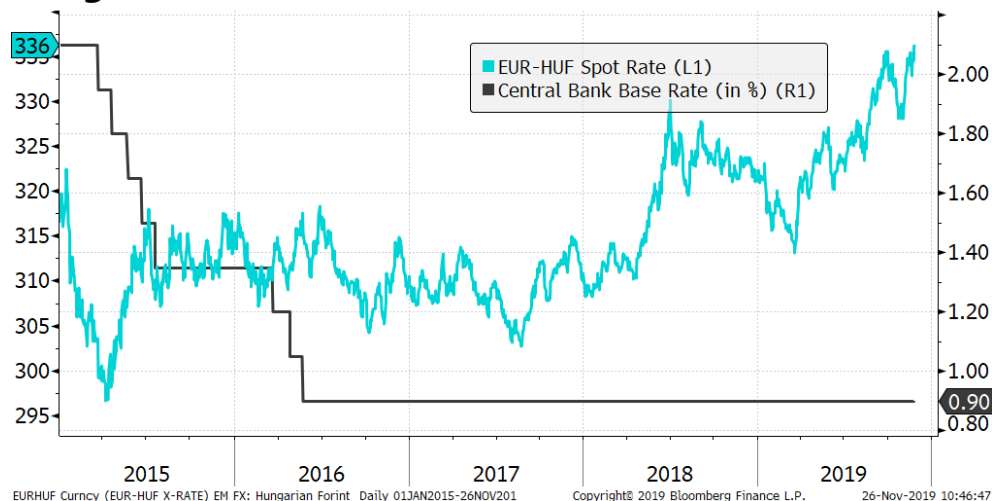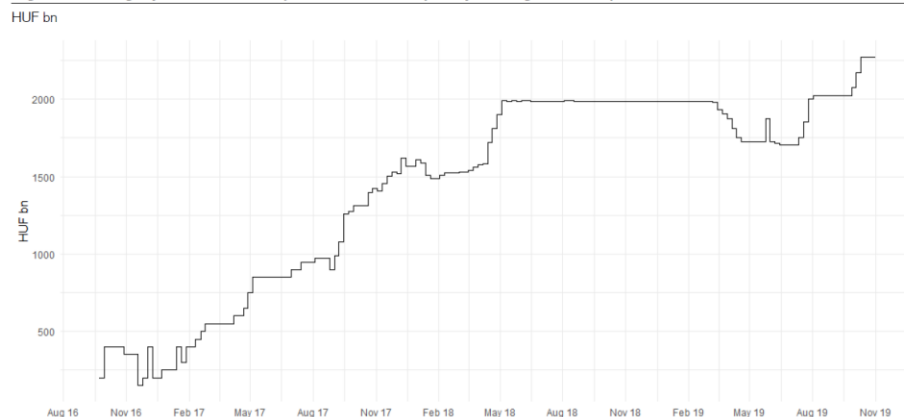
Hungarian Forint Per Euro

EURHUF Curncy (EUR-HUF X-RATE) EM FX: Hungarian Forint Daily 01JAN2015-26NOV201   Copyright© 2019 Bloomberg Finance L.P.   26-Nov-2019 10:46:47

Figure 1. Hungary: Cumulative injection of HUF liquidity through FX swap tenders

Source: MNB, the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Kenya

The Kenyan central bank cut the policy rate for the first time in 16 months. The CBK reduced its key rate to 8.5% from 9.0%. Governor Patrick Njoroge justified the cut as the Kenyan economy is operating below its potential at the same time that the fiscal stance is tightening; inflation is forecasted to remain within the bank's 2.5%-7.5% target band. The shilling weakened about 0.5% to the dollar.

Kenya's central bank cut its key rate to support the economy

Source: Central Bank of Kenya
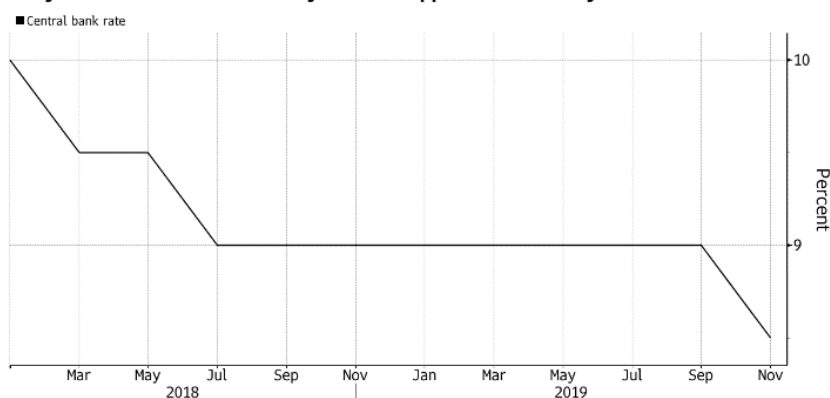
Chile

The Chilean Peso (+0.5% stronger against the dollar) outperformed the rest of EMFX. After Friday's close, a local advisory firm, Felices y Forrados (FyF), recommended that pensioners switch from a 100% allocation of foreign stocks to an allocation of 50% foreign stocks and 50% local bonds. This is opposite to their previous recommendations on October 16 and November 11, which likely caused some of the recent volatility in the FX markets. The size of the outflows that followed these recommendations (see charts) were quite large compared to the liquidity of the peso.

Figure 30. Cumulative fund switches since the first recommendation from *Felices y Forrados*
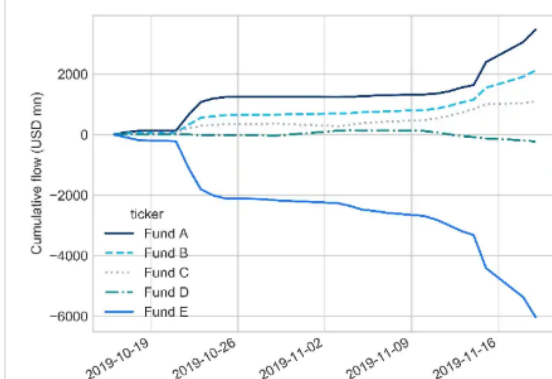
Source: *Superintendencia de Pensiones*, Bloomberg, Citi Research

Figure 31. Pension funds had another bout of massive switches after the second recommendation from *Felices y Forrados* on Nov 11
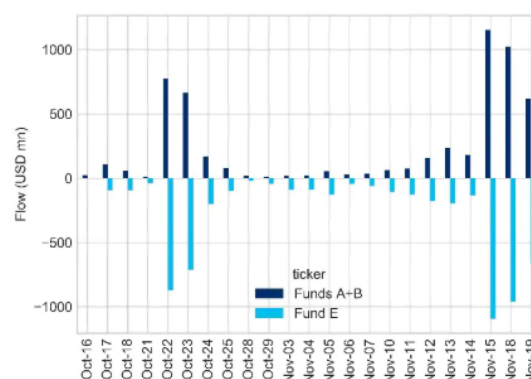
Source: *Superintendencia de Pensiones*, Bloomberg, Citi Research

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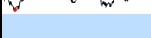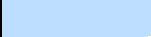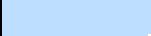
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Global Financial Indicators

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China		2907	0.0	-1	-2	13	17
Asia Ex Japan		71	1.4	1	2	8	11
Emerging Markets		43	-0.3	1	1	8	11
Interest Rates			basis points				
US 10y Yield		1.74	-1.5	-4	-5	-131	-94
Germany 10y Yield		-0.36	-1.4	-2	0	-72	-61
Japan 10y Yield		-0.09	-1.1	-1	5	-18	-9
UK 10y Yield		0.65	-4.3	-8	-3	-76	-62
Credit Spreads			basis points				
US Investment Grade		118	-0.5	-2	-1	-2	-29
US High Yield		473	1.3	2	25	51	-48
Europe IG		48	-0.4	-2	-2	-31	-40
Europe HY		227	-0.6	-6	-1	-102	-125
EMBIG Sovereign Spread		336	1.0	-2	8	-59	-78
Exchange Rates			%				
USD/Majors		98.30	0.0	0	0	1	2
EUR/USD		1.10	0.1	-1	-1	-3	-4
USD/JPY		109.0	-0.1	0	0	4	1
EM/USD		59.9	-0.1	0	-2	-4	-4
Commodities			%				
Brent Crude Oil ($/barrel)		64	0.1	5	3	5	18
Industrials Metals (index)		112	-0.1	-1	-5	-2	2
Agriculture (index)		39	-0.4	1	0	-6	-6
Implied Volatility			%				
VIX Index (%, change in pp)		11.9	0.0	-1.0	-0.8	-7.0	-13.5
10y Treasury Volatility Index		4.1	0.0	-0.2	-0.5	0.2	-0.5
Global FX Volatility		6.1	0.0	-0.2	-0.2	-2.5	-2.9
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		174	2.6	-4	17	-229	-241
Italy		153	2.0	-5	22	-138	-97
Portugal		72	-0.7	1	14	-80	-76
Spain		76	-0.7	-1	12	-45	-42

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: 11/26/2019 8:05 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		7.04	-0.1	-0.2	0	-1	-2		3.2	0.8	-4	-3	-13	3
Indonesia		14088	0.0	0.0	0	3	2		7.2	-0.2	5	-3	-98	-100
India		71	0.3	0.3	-1	-1	-2		6.8	-1.4	-2	-3	-99	-65
Philippines		51	-0.2	-0.1	0	3	3		4.3	-0.8	-1	-1	-208	-199
Thailand		30	0.1	-0.1	0	9	7		1.7	-0.4	0	18	-105	-89
Malaysia		4.18	-0.1	-0.6	0	0	-1		3.4	-0.1	-2	-6	-78	-71
Argentina		60	-0.1	-0.1	0	-35	-37		92.4	-491.4	2628	3559	6842	6935
Brazil		4.25	-0.5	-1.2	-6	-7	-9		6.3	8.2	13	43	-214	-188
Chile		791	0.6	-0.4	-8	-14	-12		3.4	-6.6	-1	29	-130	-108
Colombia		3450	-0.4	-0.3	-2	-6	-6		6.1	8.5	13	42	-62	-39
Mexico		19.46	-0.1	-0.6	-2	6	1		7.1	4.1	13	19	-200	-160
Peru		3.4	0.1	-0.4	-2	0	-1		4.5	-4.9	-5	9	-127	-127
Uruguay		38	-0.1	-0.4	-1	-14	-14		11.2	1.2	24	6	42	51
Hungary		305	-0.1	-1.5	-3	-6	-8		1.1	-0.9	-13	0	-143	-115
Poland		3.90	0.0	-0.9	-1	-3	-4		1.8	-0.4	-4	5	-72	-44
Romania		4.3	0.0	-0.5	-1	-5	-6		4.0	1.0	-7	13	-40	-28
Russia		64.0	-0.1	-0.2	0	5	8		6.2	1.7	-6	-4	-227	-219
South Africa		14.8	-0.2	-0.3	-2	-6	-3		9.7	6.3	12	41	14	9
Turkey		5.74	0.1	-0.7	0	-9	-8		12.0	5.5	18	-83	-517	-493
US (DXY; 5y UST)		98	0.0	0.5	0	1	2		1.61	-0.5	-1	-1	-128	-91

	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		2907	0.0	-1	-2	13	17		176	1	0	-10	-10	-18
Indonesia		6026	-0.7	-2	-4	0	-3		181	0	-2	7	-46	-55
India		40821	-0.2	1	5	15	13		129	2	-4	-1	-44	-67
Philippines		7708	-0.8	-3	-3	4	3		87	0	-2	11	-26	-34
Malaysia		1584	-0.5	-1	1	-7	-6		120	0	0	-1	-26	-42
Argentina		33495	-0.3	5	-3	8	11		2325	19	-40	155	1635	1510
Brazil		108424	-0.2	2	1	27	23		237	2	-3	12	-35	-36
Chile		4669	-1.7	-3	-6	-9	-9		151	1	-2	18	-2	-15
Colombia		1601	-0.8	0	-2	15	21		187	2	-6	17	-31	-41
Mexico		43535	0.0	0	0	10	5		323	2	-6	27	-22	-31
Peru		19972	0.4	1	2	5	3		132	3	-2	9	-34	-36
Hungary		43847	-1.1	1	4	11	12		102	1	-2	10	-40	-46
Poland		57964	-0.3	-1	1	3	0		28	0	-3	1	-43	-57
Romania		9811	0.4	1	1	15	33		197	0	-2	15	-11	-24
Russia		2939	-0.6	0	2	27	24		165	1	-7	-14	-72	-87
South Africa		56247	-0.9	-2	2	9	7		352	4	9	45	-8	-13
Turkey		105490	0.1	-2	5	12	16		434	2	11	-13	-34	5
Ukraine		519	0.0	0	-1	-10	-7		491	4	17	41	-182	-296
EM total		43	-0.3	1	1	8	11		336	1	-2	8	-59	-78

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

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