GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

THURSDAY, SEPTEMBER 5, 2024
LEAD EDITOR: JOHANNES S. KRAMER

- **Bets on steeper Treasury term spread gain traction amid soft landing narrative** (link)
- **Unwinding of large VIX put position seen as driver of recent spike in implied volatility** (link)
- **Rate differentials seen as decisive driver for Euro-Dollar currency pair** (link)
- **GPIF expected to repatriate bond holdings abroad in favor of Japanese equities** (link)
- **Chilean peso and copper correlation at highest in five years** (link)
- **China ramps up trade-in schemes to boost consumer spending** (link)

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Investors Cautious Ahead of August Jobs Report

Overnight, Treasury yields softened slightly, driven by intermediate maturities, leading to a somewhat flatter curve. Flows have been quiet ahead of the August jobs report, with focus on today's ADP employment data and jobless claims. The ADP report revealed an unexpected slowdown in private hiring, aligning with the Beige Book's view of slowing business activity, which prompted a rally in Treasuries. Meanwhile, jobless claims came in lower than expected, which can be reconciled with the former in that hiring is tapering off, while businesses are not yet moving to layoffs, confirming a more gradual cooling of the labor market. Data in Europe printed with upbeat factory orders in Germany while UK construction PMI and Euro Area retail sales printed softer than expected with slightly higher benchmark yields and flat stock markets after two consecutive down sessions. Conversely, gold and crude oil remained bid, gaining on the day. In Japan, July real wage data surprised to the upside, reflecting a second consecutive month of wage growth, supporting the case of further rate hikes, which propelled the yen. In Asian emerging markets, lower energy prices pushed August inflation below expectations in the Philippines and Thailand. In the latter, the formation of a new cabinet also boosted confidence in policy continuity, which lifted Thai stock markets and the baht. In Malaysia, the central bank held its overnight policy rate, signaling no urgency for adjustments.

Key Global Financial Indicators

Last updated: 9/5/24 8:45 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		5520	-0.2	-2	6	23	15.73
Eurostoxx 50		4826	-0.5	-3	6	13	7
Nikkei 225		36657	-1.1	-4	6	10	10
MSCI EM		43	0.0	-2	5	8	6
Yields and Spreads				bps			
US 10y Yield		3.73	-2.8	-13	-6	-53	-15
Germany 10y Yield		2.20	-2.7	-8	1	-42	17
EMBIG Sovereign Spread		403	6	10	-17	-14	20
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		45.7	0.1	0	0	-3	-5
Dollar index, (+) = $ appreciation		101.1	-0.3	0	-2	-4	0
Brent Crude Oil ($/barrel)		73.4	1.0	-8	-4	-18	-5
VIX Index (%, change in pp)		21.3	0.0	4	-17	7	9

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

Mature Markets

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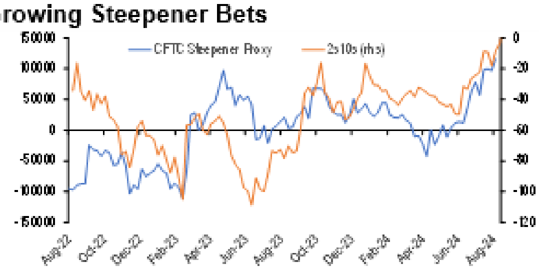
United States

Treasuries rally in reaction to today's ADP report release. The ADP report revealed an unexpected slowdown in private hiring, aligning with the Beige Book's view of slowing business activity, which prompted Treasuries to rally by -6bps to 3.72% at the 2y point, paired with a weaker dollar that approached $1.112/€ and a -0.4% weaker S&P500 in Futures markets. Meanwhile, jobless claims came in lower than expected without notable market reaction, which market reconcile with ADP data showing hiring is tapering off, while businesses are not yet moving to layoffs, which could be the next shoe to drop in a weakening labor market.

	Actual	Consensus	Prior	Revised
ADP Employment Change	99k	144k	122k	111k
Initial Jobless Claims	227k	230k	231k	232k
Continuing Jobless Claims	1838k	1,869k	1,868k	1,860k

Positive S&P 500 and 2-year Treasury yield correlation with a steepening 2y-10y spread underscores belief in a soft landing, alongside with a shift in fiscal expectations. Yesterday, the 2y-10y Treasury spread briefly turned positive, reaching 0.75 bps, continuing its sharp steepening from the trough of -20bps seen on August 19th. Market contacts suggest this may accelerate steepener trades, which have been popular since May (left chart), as a positive spread offers better carry, while an inverted curve imposed higher costs. Meanwhile, Bloomberg analysts note that a weakly positive 30-day correlation between the S&P 500 and 2-year Treasury yields has persisted for a month (right chart). This could suggest that investors still see a soft landing as the most likely outcome, which could prove supportive for US equities. Other market participants suggest that a steeper Treasury term structure appears consistent with a repricing of fiscal expectations as investors demand higher term premiums to bear the risk of holding longer-term bonds over shorter-term instruments, as outlined in the spring GFSR.

The 2y-10y Term Structure Dis-Inverts on Growing Steepener Bets

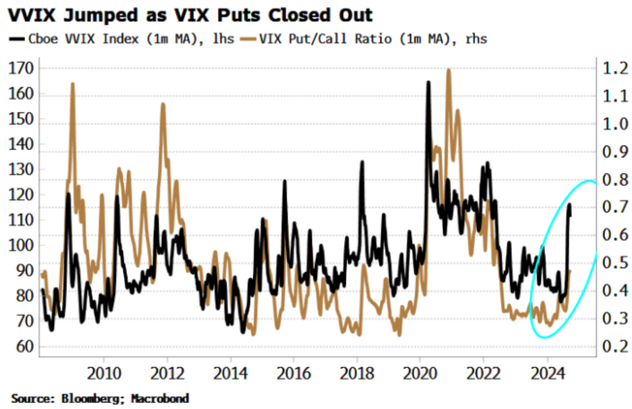


Source: Bloomberg, IMF staff calculations.

30d Correlation of S&P 500 and 2y Treasury yields positive for a month

Source: Bloomberg.

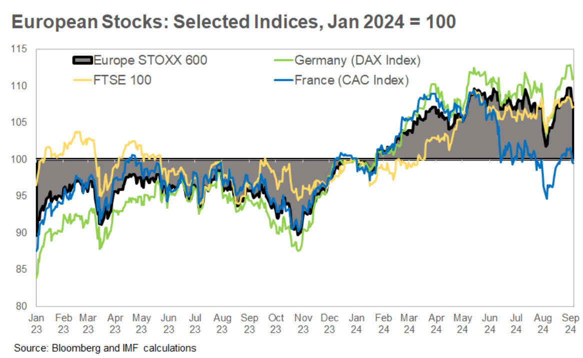
The unwinding of a large VIX put position is seen as the driver for the recent rise in implied volatility. Weak ISM data surprised investors with large short positions in the VIX. The swift recovery from the August turmoil brought about increased optimism that the equity market would reach new highs and that the VIX would return to extreme lows. VIX puts were bought in large amounts, leading to rise in Put/Call ratio – historically a sign that the volatility in the VIX (VVIX) will jump. The exit of these VIX shorts on the back of weaker ISM data on Tuesday forced dealers to exit their long S&P calls, amplifying the decline in the S&P500. Once again, small macro datapoints are leading to large reactions in markets on the back of the unwinding of leveraged positions, pointing to a fragile technical positioning setup.



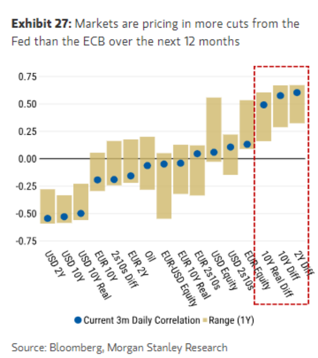
Euro Area

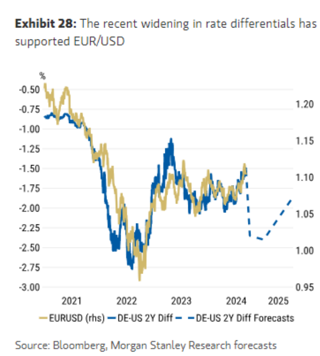
This morning, equity markets remained flat while sovereign bond yields inched higher with a stronger euro. The Stoxx 600 index was marginally lower (-0.2%), with mixed performances across sectors. Bund yields flatlined at 2.23% at the 10y maturity point, -11bps lower than at the start of the week. The euro slightly appreciated (+0.1%) to $1.1096/€. On the data front, Germany's July factory orders data surprised on the upside, while July euro area retail sales disappointed.

The outperformance of the Germany stock index (DAX) against regional peers is seen as unlikely to persist. The Stoxx 600 index contracted -1% yesterday, posting its third consecutive daily decline, but remaining +7% higher year-to-date. While several European stock indices have now fallen somewhat from record highs, Bloomberg strategists are cautious on the performance of the DAX in the second half of the year, citing the slowdown in earnings momentum, exposure to China as well as sector specific risk. The DAX erased nearly all its year-to-date gains during the sell-off in August, while the index has since then staged a remarkable recovery rally, now up +11% year-to-date despite economic data pointing at economic contraction in Germany during Q2.



Analysts see rate differentials as a key driver for the Euro-Dollar exchange rate. Amid US yields having declined more rapidly than German yields, Morgan Stanley analysts point out that the narrowing in front-end yield differentials has been an important driver that supported the euro. However, the analysts perceive that markets will eventually adjust to the euro area's weaker growth outlook and also more downside risks on inflation compared to the US. With a -25bps rate cut being a base case for the September ECB meeting, Morgan Stanley analysts look further ahead and expect the euro to weaken on a mean-reversion in front-end yield differentials. Meanwhile, an ING survey reveals that a majority of respondents expect the EUR/USD to remain relatively stable in the 1.10–1.13 range while a quarter of survey participants expect the EUR/USD to trade at 1.13 by end-2024.



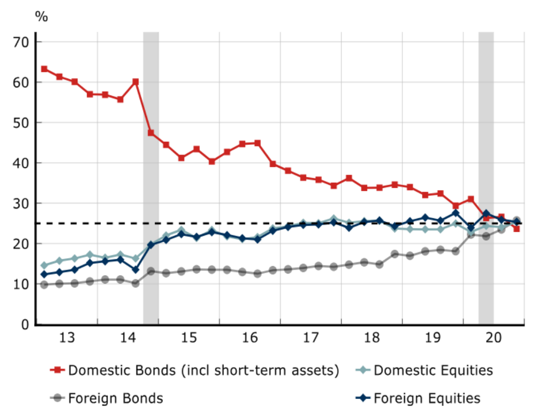


Japan

Upbeat July real wage data prompted yen appreciation while equities continued to sell-off. Today's July real wage data surprised to the upside, printing at +0.4% y/y (exp. -0.2% from +1.1%). This reflects a second consecutive month of wage growth, supporting further rate hikes. Following the release, the yen appreciated (+0.1%) to up to ¥143.05/$. Stock markets declined with the Nikkei 225 falling -1.1%. In terms of sectors, exporters underperformed domestic demand-related stocks.

Anticipation looms that the Government Pension Investment Fund (GPIF) will repatriate bond holdings abroad in favor of domestic equities. Market contacts are closely monitoring the pension flow data, given that even a 5 ppt. change in the equity investment of the GPIF could result in an additional net purchase of more than ¥10 trn ($69 bn). Bloomberg's recent survey reveals that nearly half of the surveyed analysts expect an increase in domestic equities to achieve higher returns amid rising inflation. For foreign bonds, nearly half anticipate a reduction, with only 5% of survey participants expecting an increase. Nomura strategists interpret this as reflective of concerns over the potential impact of a weakening yen as most of the GPIF's holdings abroad are not currency-hedged. Nomura analysts further perceive that the split survey results reflects doubts whether JGBs can yield higher returns relative to other assets.

Fig. 1: GPIF's asset allocation from 2013-2020
Allocation of pension reserve from 2013-2020



Source: GPIF, Nomura

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EMEA equities were mostly lower, while currencies were mostly trading higher. CEE currencies were little changed against the euro, with the Polish zloty steady against the euro to trade at 4.27/€ after the National Bank of Poland kept rates unchanged at 5.75% yesterday, in line with expectations. Contacts are now looking to this afternoon's press conference and comments from Governor Glapinski on the future path for rates. Elsewhere, on the monetary policy front, expectations are for the Central Bank of Egypt to keep policy rates on hold at 27.25% later today. Separately, Bloomberg reports that Hungary raised $276m (¥39.6bn) in a Samurai bond sale. The sale involved ¥38.3bn in three-year and ¥1.3bn in 10-year green bonds and was the country's first yen-denominated issuance since 2022.

Asian equities lack directionality, while most currencies appreciated on rising bets for Fed rate cuts. EM Asian stock markets rose by 0.3%, with Thai equities (+2.7%) and the baht (+1.1%) leading the way as the formation of a new cabinet boosted confidence in policy continuity. Long-term government bond yields continued to fall, tracking the decline in U.S. Treasury yields. In Malaysia, the central bank held its overnight policy rate at 3.00%, as expected, citing inflation unlikely to exceed 3% this year and signaling no urgency for rate adjustments. Lower energy prices pushed August inflation below expectations in the Philippines and Thailand. Philippine CPI came in at +3.3% y/y (vs. exp. +3.6%, prev. +4.4%), and Thailand's CPI was +0.35% (vs. exp. +0.40%, prev. +0.83%).

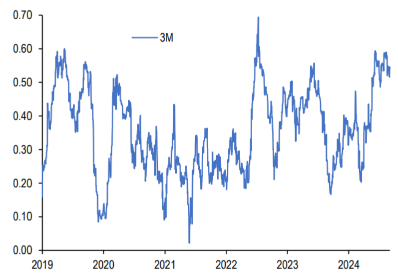
Yesterday, Latin American currencies traded on country-specific factors while stock markets broadly gained. The Chilean peso (-1.5%) emerged as the worst performing currency as copper prices fell (-2.5%). Meanwhile, the Mexican peso (-0.7%) fell after a judicial reform bill passed their lower chamber. Among other currencies, the Brazilian real and Colombian peso rose. In equity markets, Brazil's index rose (+1.3%) with 90% of stocks advancing. Equities also rose in Mexico and Chile while declining in Colombia (-0.9%).

Chile

Copper emerges as the key driver of the Chilean peso, consistent with yesterday's market reaction. JP Morgan analysts point out that unlike the interest rate differentials for Mexico and Brazil, interest rates in the US and Chile have reached parity, which has recently shielded the peso from the Yen carry trade unwinding that has hit the Mexican peso and Brazilian real. However, the Chilean peso's rising correlation with copper introduces hew risks (left chart). This was exemplified with yesterday's market reaction when the peso fell (-1.5%) as copper prices fell (-2.5%) below $9,000 per ton with Goldman Sachs analysts predicting $5,000 by year-end due to China's slowdown. Furthermore, non-resident short positions have rebounded recently (right chart).

Figure 5: CLP correlation to copper has increased in recent months to the highs of the last 5 years

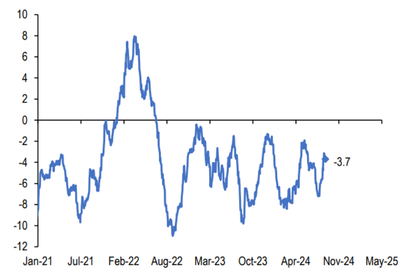
3m rolling correlation between daily USDCLP spot returns and daily change in copper prices



Source: J.P. Morgan, Bloomberg Finance L.P.

Figure 6: Short CLP positioning was cleaned out in the last month

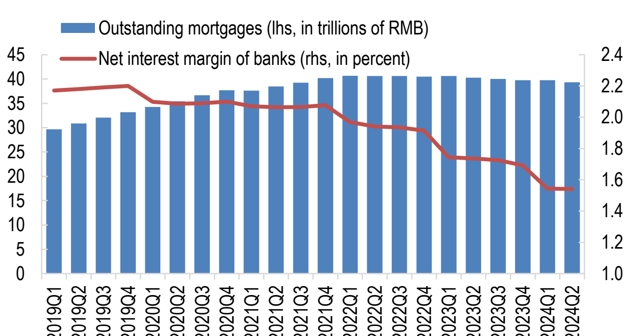
Foreigners FX derivatives positions; USDbn (negative means short CLP); in USDbn



Source: J.P. Morgan, BCCh

China

China is considering cutting mortgage rates by -80bps in two phases, with an imminent first reduction and a second one seen likely early next year. This move follows a reported RMB 325.5bn (US$45.8bn) drop in outstanding mortgages at China's six largest state-owned banks in the first half of the year. The staggered cuts reportedly aim to support the struggling property market and economy without putting too much pressure on banks, which are already facing low profit margins. Chinese equities edged down (CSI 300: +0.2%), while the RMB appreciated (+0.2%).

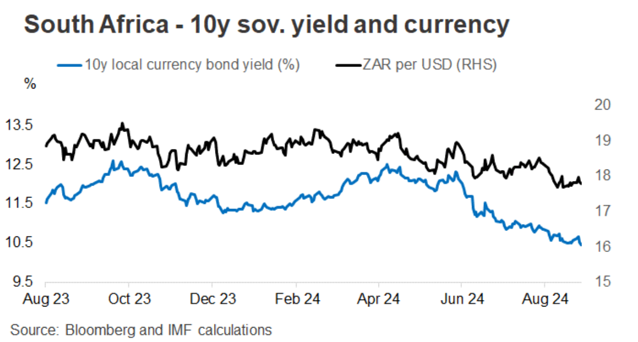


Source: CEIC

Furthermore, China is ramping up trade-in programs to boost consumer spending. Shanghai is offering a record RMB 4 bn (US$562mn) in subsidies for trading in consumer goods, funded mostly through the issuance of ultra-long special treasury bonds. Buyers replacing old cars with new energy vehicles can receive up to RMB 15,000, while those trading in home appliances or furniture can get subsidies of up to RMB 2,000. Similar programs are being rolled out across the country, including green and smart appliance subsidies in Chongqing and increased car trade-in incentives in Hubei. These measures follow the State Council's plan to upgrade consumer goods and drive economic recovery.

South Africa

Continued investor optimism and expectations of US rate cuts support South African assets. As the rand price of exports increased more than imports, data released this morning shows that the current account deficit narrowed to -0.9% of GDP versus estimates of -1.0% in Q2. Following the data release, the South African rand was stronger against the dollar (+0.4%) at 17.79/$ with the currency one of the best performing EMEA currencies, strengthening by around +3.3% against the dollar year-to-date. According to Bloomberg, the rand and local risk assets have performed well recently, buoyed by investor optimism that the National Government of Unity will accelerate reforms to boost growth, as well as growing expectations that the US Federal Reserve will cut interest rates later this month. Yesterday, yields on local currency South African government bonds were lower by between 12-16bps across the curve, according to Bloomberg data, mirroring expectations for Fed rate cuts that extended following the recent US job market data releases.



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Global Financial Indicators

9/5/24 8:45 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		5512	-0.2	-1	6	23	16
Europe		4826	-0.5	-3	6	13	7
Japan		36657	-1.1	-4	6	10	10
China		3258	0.2	-1	-3	-15	-5
Asia Ex Japan		71	-0.1	-2	5	8	7
Emerging Markets		43	0.0	-2	5	8	6
Interest Rates					basis points		
US 10y Yield		3.73	-2.8	-13	-6	-53	-15
Germany 10y Yield		2.20	-2.7	-8	1	-42	17
Japan 10y Yield		0.88	-0.4	-2	9	22	27
UK 10y Yield		3.90	-3.2	-12	3	-62	37
Credit Spreads					basis points		
US Investment Grade		137	-0.7	3	-8	-11	3
US High Yield		384	2.4	19	-34	-29	-1
Exchange Rates					%		
USD/Majors		101.06	-0.3	0	-2	-4	0
EUR/USD		1.11	0.2	0	1	4	1
USD/JPY		143.1	-0.5	-1	-1	-3	1
EM/USD		45.7	0.1	0	0	-3	-5
Commodities					%		
Brent Crude Oil ($/barrel)		73.4	1.0	-7	-3	-11	-2
Industrials Metals (index)		140	-0.4	-4	3	-3	-2
Agriculture (index)		55	-0.4	2	2	-18	-12
Implied Volatility					%		
VIX Index (%, change in pp)		21.3	0.0	4.2	-17.3	7.3	8.9
Global FX Volatility		8.6	0.0	-0.1	-0.7	0.4	0.5
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		104	1.2	0	-12	-28	0
Italy		144	0.1	6	-6	-29	-24
Portugal		61	0.6	1	-9	-13	-2
Spain		82	0.2	0	-8	-23	-15

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

Emerging Market Financial Indicators

Last updated: 9/5/2024 8:48 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		7.09	0.3	0.1	1	3	0		1.9	0.5	-7	-8	-79	-61
Indonesia		15398	0.5	0.1	5	-1	0		6.6	-3.1	1	-17	20	16
India		84	0.0	-0.1	0	-1	-1		7.0	-3.1	-3	14	(64.9)	-23
Philippines		56	0.6	0.1	3	1	-1		5.1	-0.3	-5	-16	-85	-55
Thailand		34	1.7	0.8	5	5	1		2.4	-1.8	-2	4	-60	-30
Malaysia		4.34	0.4	-0.6	2	8	6		3.7	-1.9	-1	6	-10	1
Argentina		953	0.0	-0.5	-2	-63	-15		41.4	31.3	60	-317	-7721	-4501
Brazil		5.62	0.4	0.1	2	-12	-14		11.9	0.8	9	10	41	147
Chile		942	0.2	-3.2	1	-7	-7		4.9	-1.5	-7	-12	-55	-6
Colombia		4173	0.3	-1.8	0	-3	-8		7.9	0.0	16	17	-47	27
Mexico		20.12	-0.9	-1.3	-4	-13	-16		9.0	0.0	-16	-3	2	53
Peru		3.8	-0.2	-1.5	-2	-3	-2		6.5	0.0	-2	-19	-36	-14
Uruguay		40	-0.1	-0.2	0	-6	-4		9.6	1.4	3	6	37	6
Hungary		354	0.3	0.2	2	2	-2		5.7	-17.0	-23	7	-124	-5
Poland		3.85	0.3	0.5	2	9	2		4.5	-1.4	-12	17	-18	7
Romania		4.5	0.1	0.3	1	3	1		6.5	-0.9	3	11	-8	30
Russia		89.4	-2.2	2.9	-5	9	0							
South Africa		17.8	0.6	-0.1	4	8	3		8.5	-6.0	-16	-26	-101	-59
Türkiye		33.98	0.1	0.3	-2	-21	-13		28.7	-9.0	21	51	607	198
US (DXY; 5y UST)		101	-0.3	0.0	-2	-4	0		3.52	-2.6	-14	-12	-85	-32

	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	7 Days	30 Days	12 M	YTD
									basis points				
China		3258	0.2	-1	-3	-15	-5		126	-26	-25	-59	-32
Indonesia		7681	0.1	1	8	10	6		116	14	-13	-8	20
India		82201	-0.2	0	5	25	14		112	1	1	-29	-4
Philippines		6908	0.4	0	7	11	7		100	9	-14	2	20
Thailand		1404	2.8	3	10	-9	-1		0	0	0	0	0
Malaysia		1665	-0.3	1	6	14	14		86	-4	-8	-12	1
Argentina		1796920	3.6	11	26	200	93		1468	-20	-145	-628	-445
Brazil		136111	1.3	-1	9	16	1		235	14	-11	6	20
Chile		6389	0.0	-1	5	8	3		129	8	-10	8	4
Colombia		1336	-0.9	0	3	27	12		329	12	-6	6	58
Mexico		51811	0.4	-1	0	-2	-10		334	11	-3	-25	0
Peru		28026	-0.2	-1	0	22	8		151	9	-14	7	7
Hungary		72298	0.1	-1	3	30	19		162	8	-12	-30	13
Poland		84448	-0.1	0	7	25	8		115	9	-8	-2	18
Romania		17761	-1.4	-3	0	34	16		214	14	5	10	13
South Africa		82030	0.1	-3	3	9	7		311	15	-24	-68	3
Türkiye		9926	-0.6	2	0	21	33		316	17	-21	-75	2
EM total		43	-0.3	-2	5	8	6		415	7	-22	41	70

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

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