



Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Monday, December 17, 2018

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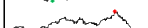

- **Slowdown concerns continue to weigh on US rate and credit markets** ([link](#))
- **Italian coalition cabinet reportedly agrees to 2.04% deficit for 2019** ([link](#))
- **Chinese corporate bond defaults continue to rise** ([link](#))
- **Malaysia files criminal charges against Goldman Sachs over 1MDB involvement** ([link](#))
- **Mexico's budget proposal targets a primary surplus** ([link](#))

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Central banks headline key events as markets wind down activity into the year end

Global markets were little changed overnight, with traders reporting moderating volumes as the holiday season draws near. The ongoing themes of political risk, trade tensions and slowing global growth look likely to carry into trading in 2019. This week, the Fed is expected to deliver a 25 bp rate hike, while the BoE and BoJ will likely stay put as inflation data is released through the week. In EMs, Banco de México and Bank of Thailand are also anticipated to tighten policy; the central banks in Colombia, Hungary, and Indonesia will likely leave rates unchanged. The Italian government is reportedly aiming for a 2.04% deficit in 2019 to avoid EU fines; French leaders reiterate their forecast of a 3.0-3.2% deficit after concessions to the "yellow vest" movement.

Key Global Financial Indicators

Last updated: 12/17/18 8:10 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		2599	-1.9	-1	-5	-3	-3
Eurostoxx 50		3073	-0.6	2	-3	-14	-12
Nikkei 225		21507	0.6	1	-1	-5	-6
MSCI EM		40	-0.7	0	-3	-14	-15
Yields and Spreads			bps				
US 10y Yield		2.88	-2.4	2	-18	53	47
Germany 10y Yield		0.26	0.4	1	-11	-5	-17
EMBIG Sovereign Spread		390	0.0	-13	7	102	105
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		62.0	0.2	0	-1	-10	-11
Dollar index, (+) = \$ appreciation		97.2	-0.2	0	1	6	6
Brent Crude Oil (\$/barrel)		61.0	1.1	2	-9	-4	-9
VIX Index (% change in pp)		22.6	1.0	0	4	13	12

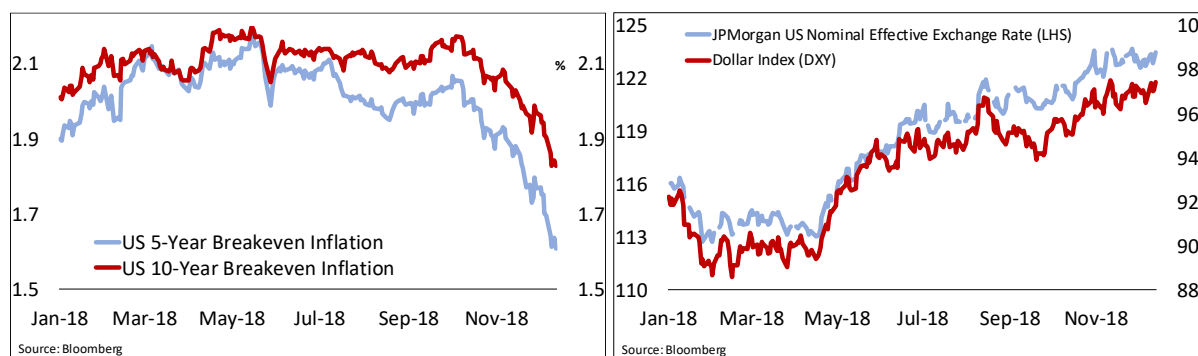
Colors denote **tightening**/**easing** financial conditions for observations greater than ± 1.5 standard deviations. Data source: Bloomberg.

The budget showdown in Washington, as well as political uncertainties in Europe, will be the focus of many investors. The US President has threatened to shut down parts of the federal government should Congress not approve funding of a border wall with Mexico. Without an agreement, the funding would expire for some key government institutions by December 21. Separately, the Federal Reserve is expected to raise policy rates by 25 bps on Wednesday. In Europe, financial markets will continue to focus on current developments with respect to Brexit, particularly in light of growing momentum for a potential second referendum. In the Euro area, markets will continue to digest the potential impact on the budget of the recently announced spending measures in France; a matter that could test the strength of the Security and Growth Pact, with potential implications for Italy. Elsewhere, investors will likely keep a close eye on the evolving tension between China and Canada on the back of the recent arrest of Huawei's CFO, while also closely watching developments at the Reserve Bank of India following the appointment of a new Governor. On the data front, inflation figures will be in focus this week, with data announcements expected in the Eurozone (Monday), Canada and the UK (Wednesday), Japan (Thursday), and the US (Friday). Q3 GDP data will also be released in Canada, France, the UK and the US (Friday).

United States

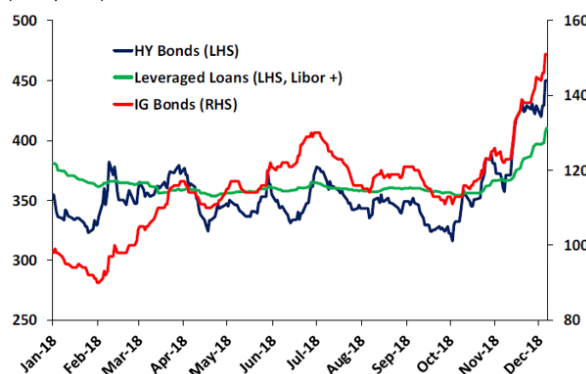
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Markets ended the week on a negative note on growing investor concerns over the global economic outlook. US equity markets closed down by about 2% on Friday as they seemed to brush off better-than-expected November retail sales figures, choosing to focus instead on the weaker economic data coming out of China and its rising trade tensions with the US. This came on top of weak Q3 growth figures out of Germany and Japan a few weeks earlier, which seemed to further deepen concerns about a deteriorating global economic outlook heading into 2019. US 10-year Treasury yields were slightly lower on the day (2 bps) as market attention has now mainly turned to the short-end of the curve ahead of the FOMC's last meeting of the year on Wednesday. Markets are currently placing a 72% probability on a rate hike following the meeting and are pricing in only around one rate hike during 2019. The less hawkish market outlook on rates is partly a reflection of weaker investor expectations on US inflation which continue to weaken (see chart). Equally important to the rate decision will be the Fed's Summary of Economic Projections, also known as the 'dots'. Meanwhile, in the face of higher political and economic uncertainty in Europe and Asia, the US dollar continues to strengthen, with the Dollar Index up by about 1% last week (see chart).

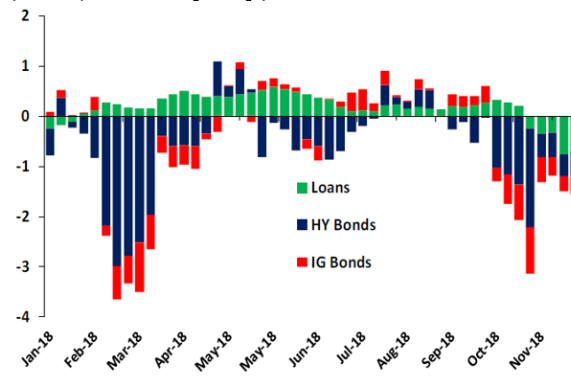


A broader retreat in risk appetite continues to put pressure on US credit markets, while recent credit fund outflows have impacted pricing, slowed issuance, and tightened terms. Although high yield (HY) and investment grade (IG) spreads tightened marginally last week, the trend in the credit space continues to be significantly negative (see charts below). And in the leveraged loan space, spreads have widened further as investor demand for floating-rate investments has waned following somewhat more cautious comments from Fed officials on the path of future policy rates. Weaker investor demand has impacted issuances in the credit space. According to market reports, not one company has tapped the \$1.2 tn US HY corporate bond market so far this month.

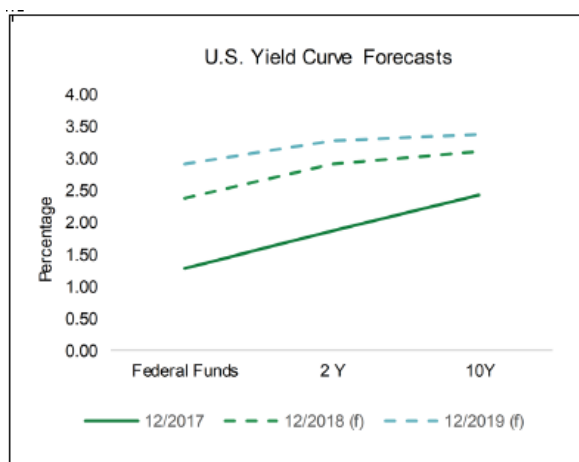
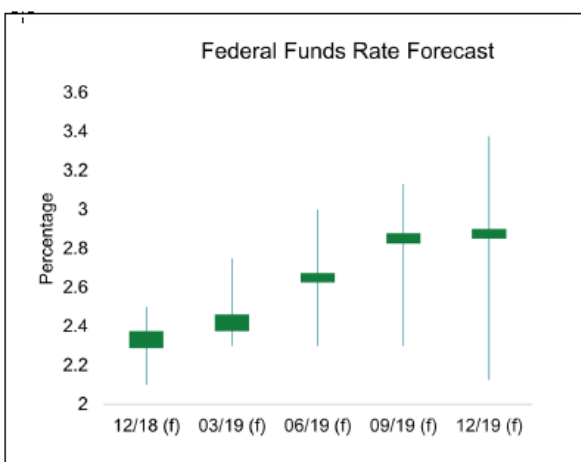
US Corporate Bond and Leveraged Loan Spreads
(Basis points)



US Bond and Loan Fund Flows
(\$ billions, 4-week moving average)



A survey by a large broker-dealer trade association reveals a mostly benign US economic outlook, though downside risks from growing trade tensions remain a concern. SIMFA's membership saw US growth declining slightly from about 2.9% in 2018 to 2.6% in 2019, but believed labor markets will remain tight with unemployment dropping by a further 0.2 ppts next year, to 3.5%. US inflation, both headline and core, was also expected to remain around the policy target of 2%. Nevertheless, respondents seemed to be somewhat more hawkish when it came to monetary policy, with close to half of them expecting two rate hikes in 2019 versus one hike currently priced into Fed Funds Futures (see chart). Moreover, more than two-thirds of participants expected a further flattening of the Treasury yield curve in 2019, but not to the point of inversion (see chart).

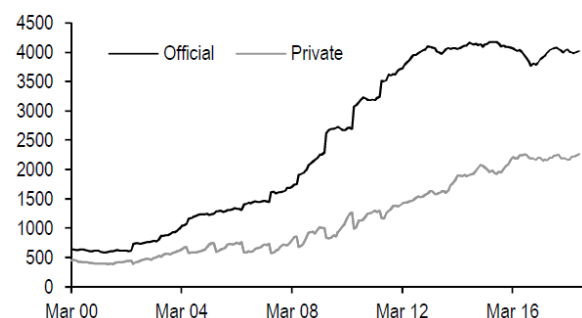


Source: SIFMA Economic Outlook End-Year 2018

Analysts expect foreign demand for US Treasuries to remain fairly muted in the medium-term, which could put further pressure on yields. As of 2017, foreign investors were the largest single owner of US Treasuries, with about 43% of total outstanding paper – followed by the Fed (17%) and US pension funds (8%). Among foreign investors, official institutions (e.g., central banks and sovereign wealth funds) accounted for about two-thirds of Treasury holdings, with the rest owned by private investors whose share has been growing over time (see chart). When it comes to investing in US Treasuries, analysts argue that these two types of investors are motivated by different incentives. "Official foreign investors" are mainly driven by a need to diversify their FX reserves, about 62% of which are currently denominated in US dollars globally (see chart). But since analysts expect the pace of global reserve accumulation to decline, mainly due to expectations of rising trade tensions and reduced capital flows to EM countries, they foresee a

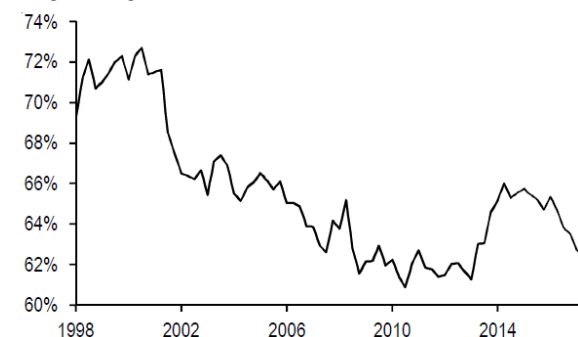
softer demand for US dollars (and US Treasuries) from the official foreign sector in the medium-term. "Private foreign investors" on the other hand, are arguably motivated by the search for yield and positive risk-adjusted carry. But with US rates rising (and falling Treasury prices) and with hedged US returns declining (an issue covered in last Friday's GMM) the appeal of Treasuries to private foreign investors is also waning. Based on historical data, JPMorgan estimates that a USD 200 bn decline in foreign Treasury holdings would raise US 10-year yields by about 7-8 bps, although they do not anticipate such a large-scale of selling.

Foreign official and private ownership of US Treasuries; \$bn



Source: J.P.Morgan, TIC, IMF COFER

Foreign exchange reserves in US dollars as a share of total allocated reserves; %



Europe

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European bourses are slightly down: EuroStoxx 600 (-0.3%), CAC 40 (-0.3%), Titans 30 (-0.1%). Bank equities also inched down: about 0.2% for the sector, with some exceptions: **Bankia (+0.8%)** and **BBVA (+0.5%)** are outperforming following news that both lenders are close to completing sales of NPLs and repossessed collateral. Bankia would sell about €3 bn of underperforming debt to US investor Lone Star, while BBVA's deal would amount to €1 to €2.5 bn with Canadian CPPIB.

Euro area sovereign bond yields are steady amid news flow regarding the Italian and French fiscal deficits. French FM Le Maire has reiterated that the budget target for 2019 is 3%, while PM Philippe forecasts a deficit of about 3.2%. Ten-year OATs are stable at 0.71% (+1 bp); German bunds at 0.25% (flat).

Italian 10-year bond yields inched up 2 bps to 2.95% following reports that members of the governing coalition had agreed to a new draft budget. In the new plan, the 2019 deficit would be confirmed at 2.04% from 2.4% before, while new social welfare payments previously estimated at €9 bn would come down to €7.1 bn.

Italy-Germany Sovereign Spreads (in bps)

Source: Bloomberg
CFRTR1US Curncy (FRANCE CDS USD SR 5Y D14) FI: Ita-Germ Spreads Daily 29DEC2017

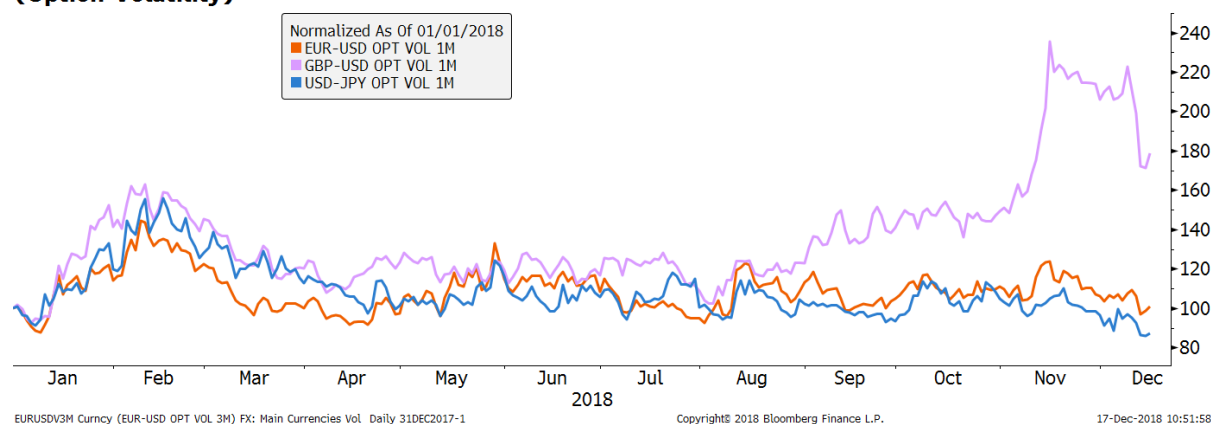
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Speculation over a possible second Brexit referendum has been rampant over the weekend after [press outlets](#) reported that the government was considering such scenario and that a [growing number of MPs would welcome the idea](#). Downing Street promptly denied the reports while PM May and other senior government figures have decried a second vote as a 'breach of trust between voters and politicians'. Some analysts point out, however, that the threat of a second referendum could play in May's favor as it would push hard-core Brexiteers to rally behind her existing deal with the EU.

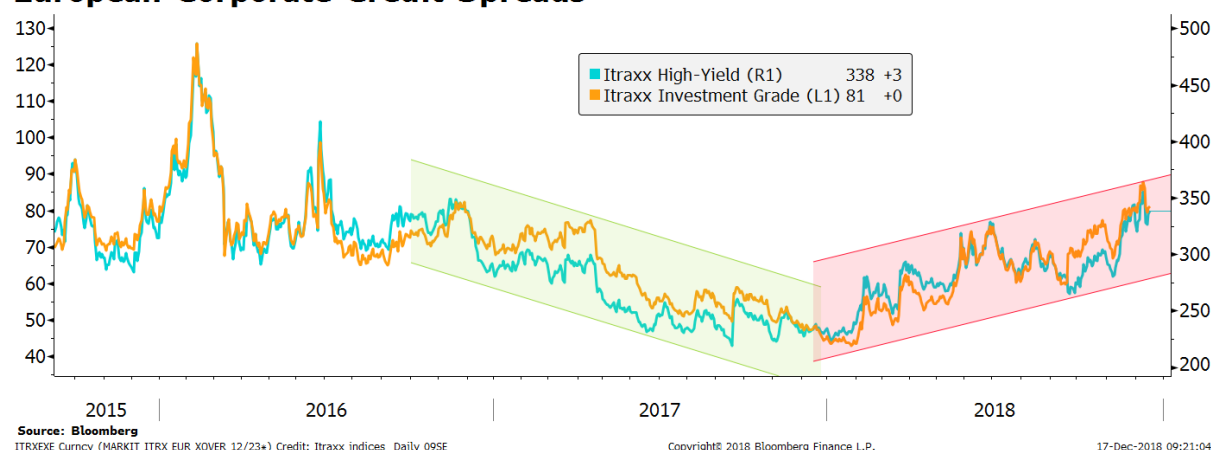
UK financial assets have remained steady through today's session, with the **pound (\$1.26)** gaining 0.1% to the dollar and **gilt yields unchanged** at 1.25% for the 10-year and 0.73% for the 2-year note. **UK equities are 0.4% down**, in line with European peers.

FX Volatility: Major Crosses (Option Volatility)



In the **corporate debt space**, credit spreads appear poised to close the year on an upward trend. Both the high-yield and the investment grade Itraxx indices are hovering at their highest levels for 2017-2018.

European Corporate Credit Spreads



Other Mature Markets [back to top](#)

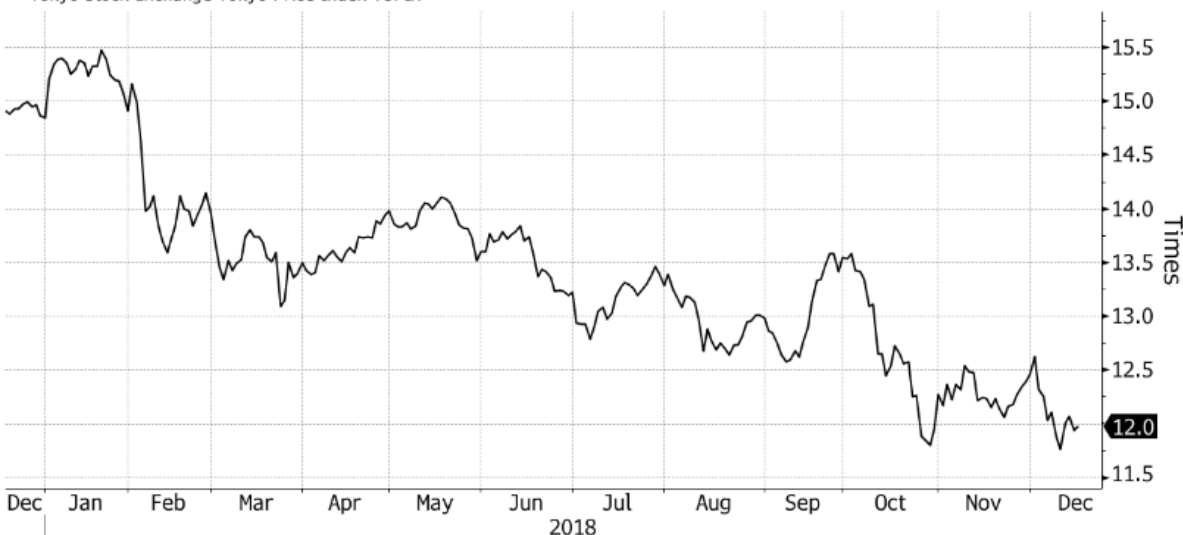
Japan

Equities advanced (Nikkei +0.6%, Topix +0.1%) on heavy trading volumes. Financials outperformed alongside strong gains in utilities and real estate. **The yen and JGB yields were little changed on the day.**

'Very Cheap'

Topix trading near 2018 low earnings valuation

■ Tokyo Stock Exchange Tokyo Price Index TOPIX



Source: Bloomberg, Tokyo Stock Exchange

Emerging Markets [back to top](#)

Equities gained modestly across **Asia Pacific** (+0.2%), led by the advanced economies in the region. Outside of Singapore, south east Asian markets underperformed with Vietnam (-1.9%), Indonesia (-1.3%), and Malaysia (-1.2%) posting notable losses. Currencies and bond yields were little changed against the dollar. **EMEA** equities are mixed, with notable losses in Hungary (-0.6%). Russia (+0.5%) and Saudi Arabia (+0.8%) posted the largest gains in the region, as crude prices advanced 1% to about \$61/barrel for Brent. EMEA currencies are stronger to the dollar by about 0.2-0.3%.

Key Emerging Market Financial Indicators

Last updated: 12/17/18 8:12 AM	Level		Change				YTD
	Last 12m	index	1 Day	7 Days	30 Days	12 M	
Major EM Benchmarks			%				%
MSCI EM Equities		39.83	-0.2	0	-3	-14	-15
MSCI Frontier Equities		27.28	-0.4	-1	0	-18	-18
EMBIG Sovereign Spread (in bps)		390	0.0	-13	7	102	105
EM FX vs. USD		61.96	0.2	0	-1	-10	-11
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.90	0.1	0	1	-4	-6
Indonesian Rupiah		14580	0.0	0	0	-7	-7
Indian Rupee		71.55	0.5	0	0	-10	-11
Argentine Peso		38.14	0.0	-1	-6	-54	-51
Brazil Real		3.91	0.0	0	-4	-16	-15
Mexican Peso		20.12	0.6	1	1	-5	-2
Russian Ruble		66.57	0.4	0	-1	-12	-13
South African Rand		14.35	0.3	0	-2	-11	-14
Turkish Lira		5.37	-0.2	-1	-1	-29	-29
EM FX volatility		10.06	1.0	-0.1	0.0	2.5	2.2

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

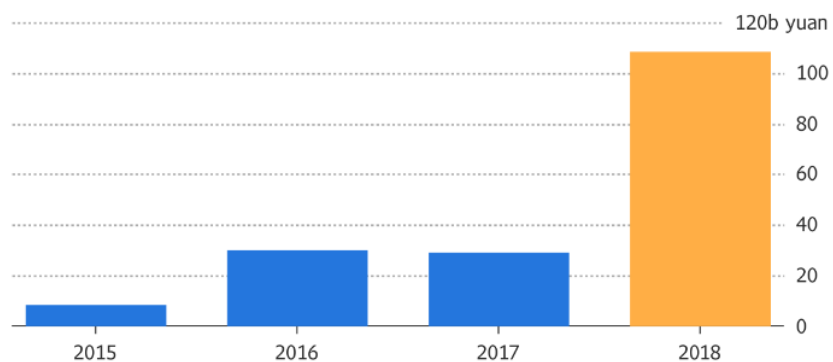
China

Missed bond payments on RMB bonds have been on the rise in 2018 from very low levels. Missed payments in China's gigantic local currency corporate bond market (estimated at about \$5.5 tn) reached a record RMB 103 bn (\$15.7 bn) this year, more than in the previous three years combined. At the same time, bankruptcy applications from firms that defaulted on publicly issued bonds have been on the rise recently, with five such applications in November, as many as in the previous four years combined. Analysts suggest that the rise in bankruptcy applications follows calls from Beijing on local governments to address unviable firms. Equities and the RMB were little changed on the day. 10-year bond yields rose 4 bps to 3.4%.

Record Defaults

Missed bond payments in 2018 have almost quadrupled the tally last year

■ Defaulted bonds in China



NOTE: 2018 is YTD
Source: Bloomberg

Bloomberg

Malaysia

The government has filed criminal charges against Goldman Sachs units in relation to the bank's involvement in bond sales for state fund 1MDB. Malaysia will seek fines well in excess of the \$2.7, the

attorney general said in a statement. The charges accuse Goldman bankers of bribing Malaysian officials to secure involvement in the placement of \$6.5 bn in bonds for 1MDB in 2012 and 2013. According to the attorney general, Goldman received \$600 mn in fees for its role, a total that was "several times higher than the prevailing market rates and industry norms".

Mexico

The new administration's budget proposal is expected to target a primary surplus of 1% of GDP.

President Lopez Obrador is expected to submit his budget plans for 2019 to Congress on Saturday. The budget proposal will likely include increased spending on pensions, education, and infrastructure. Earlier, new finance minister Urzua pledged to improve the primary balance from a surplus of 0.7% of GDP this year to a surplus of 1% of GDP in 2019. The increased expenditures are expected to be ameliorated by the consolidation of social programs and gains from an anti-corruption initiative. Analysts will examine the credibility of the economic assumption underpinning the proposed budget and of the cost-cutting measures. Government bond yields declined 8 to 9 bps last week, signaling investor confidence in the outlook for the fiscal sector. Some analysts noted that a weakening in the primary balance would add to the recent market jitters. Separately, the central bank's survey of economists' forecasts showed that the expected GDP growth for 2019 was revised down to 1.89% from 1.97% a month ago.

List of GMM Contributors (Global Markets Analysis Division, MCM Department)

Anna Ilyina

Division Chief

Peter Breuer

Deputy Division Chief

Will Kerry

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

Rebecca McCaughrin

Senior Financial Sector Expert

Juan Solé

Senior Economist

Jeffrey Williams

Senior Financial Sector Expert

Akihiko Yokoyama

Senior Financial Sector Expert

Dimitrios Drakopoulos

Financial Sector Expert

Tryggvi Gudmundsson

Economist

Henry Hoyle

Financial Sector Expert

Robin Koepke

Economist

Thomas Piontek

Financial Sector Expert

Jochen Schmittmann

Economist

Ilan Solot

Financial Sector Expert

Nour Tawk

Economist

Martin Edmonds

Senior Data Mgt Officer

Yingyuan Chen

Senior Research Officer

Rohit Goel

Research Officer

Piyusha Khot

Research Assistant

Xingmi Zheng

Research Assistant

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Global Financial Indicators

Last updated: 12/17/18 8:12 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		2599	-1.9	-1	-5	-3	-3
Europe		3073	-0.6	2	-3	-14	-12
Japan		21507	0.6	1	-1	-5	-6
China		2598	0.2	1	-3	-20	-21
Asia Ex Japan		65	-1.2	0	-2	-14	-15
Emerging Markets		40	-0.7	0	-3	-14	-15
Interest Rates			basis points				
US 10y Yield		2.88	-2.4	2	-18	53	47
Germany 10y Yield		0.26	0.4	1	-11	-5	-17
Japan 10y Yield		0.04	0.6	0	-6	-1	-1
UK 10y Yield		1.28	4.1	8	-13	13	9
Credit Spreads			basis points				
US Investment Grade		135	0.1	-3	23	40	43
US High Yield		440	0.0	-7	26	60	65
Europe IG		81	0.4	-7	1	34	36
Europe HY		338	1.9	-18	10	103	104
EMBIG Sovereign Spread		390	0.0	-13	7	102	105
Exchange Rates			%				
Dollar Index (DXY)		97.23	-0.2	0	1	4	6
USDEUR		1.13	0.3	0	-1	-4	-6
USDJPY		113.3	0.1	0	-1	-1	0
EM FX vs. USD		62.0	0.2	0	-1	-10	-11
Commodities			%				
Brent Crude Oil (\$/barrel)		61	1.1	2	-9	-4	-9
Industrials Metals (index)		113	-0.5	0	-2	-12	-18
Agriculture (index)		43	0.3	0	1	-8	-9
Implied Volatility			%				
VIX Index (% change in pp)		22.6	1.0	-0.1	4.4	13.2	11.5
10y Treasury Volatility Index		3.7	-0.2	-0.7	-0.6	0.5	0.1
Global FX Volatility		8.5	0.1	-0.3	-0.2	1.3	1.1
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		406	7.1	6	-14	38	38
Italy		270	0.9	-16	-43	111	111
Portugal		139	-2.2	-15	-22	-13	-13
Spain		114	-1.7	-5	-13	0	0

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: 12/17/2018 8:13 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		6.90	0.1	0.2	1	-4	-6		3.2	1.8	1	-16	-76	-73
Indonesia		14580	0.0	-0.2	0	-7	-7		8.3	4.4	10	1	152	167
India		72	0.5	-0.3	0	-10	-11		7.5	1.9	-1	-27	21	5
Philippines		53	0.1	-0.5	-1	-5	-6		6.3	0.0	1	-45	146	143
Thailand		33	0.1	0.3	0	0	-1		2.8	-0.3	4	-17	39	44
Malaysia		4.18	0.2	-0.2	0	-2	-3		4.1	0.1	0	-5	19	22
Argentina		38	0.0	-1.2	-6	-54	-51		23.4	2.0	19	-67	737	734
Brazil		3.91	0.0	0.2	-4	-16	-15		8.2	-11.3	-30	-49	-73	-78
Chile		684	0.2	-0.5	-2	-9	-10		4.6	-1.1	2	-17	-35	-19
Colombia		3188	0.2	0.1	0	-7	-6		6.6	2.7	-1	-21	32	36
Mexico		20.13	0.5	0.9	1	-5	-2		9.0	-3.5	-11	-4	158	136
Peru		3.3	0.1	0.6	1	-3	-3		5.9	0.9	4	1	59	66
Uruguay		32	0.1	-0.1	1	-11	-11		10.9	0.1	-9	14		235
Hungary		285	0.4	-0.1	-2	-7	-9		2.4	0.7	5	-33	103	111
Poland		3.78	0.5	0.1	0	-5	-8		2.4	-2.7		-11	-24	-30
Romania		4.1	0.3	-0.2	-1	-5	-5		4.0	-2.0		-14	-39	21
Russia		66.6	0.4	0.2	-1	-12	-13		8.5	3.5	5	1	108	117
South Africa		14.4	0.3	0.2	-2	-11	-14		9.9	8.1		24	17	11
Turkey		5.38	-0.2	-0.9	-1	-29	-29		18.4	0.3	87	130	601	650
US (DXY; 5y UST)		97	-0.3	0.0	1	3	5		2.72	-1.2	0	-16	57	51

	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		2598	0.2	1	-3	-20	-21		190	-1	-2	3	44	38
Indonesia		6089	-1.3	0	1	0	-4		219	0	-14	-6	44	53
India		36270	0.9	4	2	8	6		188	2	5	16	77	78
Philippines		7520	-0.1	2	6	-10	-12		109	0	-8	-6	8	14
Malaysia		1642	-1.2	-1	-4	-6	-9		151	1	-1	8	40	41
Argentina		31109	0.3	-1	0	15	3		763	1	10	105	402	413
Brazil		87189	-0.3	1	-1	20	14		258	1	-14	-3	21	24
Chile		5166	0.0	3	0	-1	-7		157	1	-8	6	35	38
Colombia		1359	0.0	-1	-5	-7	-10		199	1	-9	-9	23	25
Mexico		41312	-0.5	-2	-2	-14	-16		323	-1	-24	-6	75	78
Peru		19073	-0.7	-2	-2	3	-5		156	1	-16	-9	11	19
Hungary		39860	-0.7	2	1	3	1		135	-5	-17	-7	45	47
Poland		58222	-1.0	1	5	-7	-9		74	0	-4	4	28	27
Romania		8523	-0.6	0	-1	12	10		209	-4	-18	10	87	95
Russia		2378	0.5	-1	0	11	13		241	1	-9	3	57	63
South Africa		51560	-0.4	1	-1	-10	-13		352	2	-15	6	81	98
Turkey		90301	-0.3	-2	-4	-17	-22		449	1	-30	9	147	160
Ukraine		567	1.4	-1	-3	85	80		721	3	-19	83	260	266
EM total		24	-1.1	1	-2	-10	-10		390	0	-13	7	102	105

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