Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

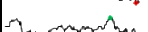**Tuesday, December 18, 2018**
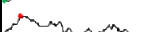
- **US equity sell-off continued on Monday ahead of this week's FOMC meeting (link)**
- **Market expectations for further Fed hikes continue to decline (link)**
- **Credit investors becoming increasingly bearish according to survey (link)**
- **UK Labour leader proposes vote of no-confidence in PM May (link)**
- **Asian equities decline amid disappointment about lack of new policy measures in China's president Xi speech (link)**
- **Mexican assets react positively to the proposed 2019 budget (link)**

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Markets cautious amid persistent worries about global growth

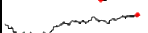**Markets took a breather this morning with European bourses and S&P futures trading flat.** Concerns about global growth persist, however, with the VIX at a 6-week high and Asian equities suffering sizeable losses overnight amid dissapointment about lack of new policy measures in China's president Xi speech. Oil prices continued their descent (Brent -2.1%, WTI -2.2%), sinking to a new fresh one-year low as losses in global equity markets worsened an already fragile investor sentiment fueled by the on-going excess supply concerns. Lower oil prices helped support some EM currencies, with the Indian rupee (+1.6%) and the Indonesian rupiah (+0.5%) appreciating against the dollar this morning. In Latam, the Mexican peso continued to appreciate following a positive reaction to the president's first budget which targets a fiscal consolidation with a primary surplus of 1% of GDP in 2019. Investors are now focusing on the FOMC meeting tomorrow where expectations for a Fed rate hike have continued to decline, with the implied probability based on Fed Futures falling to 68% (from 72% Friday).

Key Global Financial Indicators

Last updated: 12/18/18 8:11 AM	Level		Change from Market Close					YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		
Equities			%					%
S&P 500		2546	-2.1	-3	-7	-5		-5
Eurostoxx 50		3062	-0.1	0	-4	-15		-13
Nikkei 225		21115	-1.8	0	-3	-8		-7
MSCI EM		39	-0.7	0	-4	-15		-16
Yields and Spreads			bps					
US 10y Yield		2.83	-3.2	-5	-23	43		42
Germany 10y Yield		0.24	-2.1	0	-13	-7		-19
EMBIG Sovereign Spread		394	1	-2	11	111		109
FX / Commodities / Volatility			%					
EM FX vs. USD, (+) = appreciation		62.1	0.2	0	-1	-10		-11
Dollar index, (+) = $ appreciation		96.8	-0.3	-1	0	5		5
Brent Crude Oil ($/barrel)		58.3	-2.1	-3	-13	-8		-13
VIX Index (%, change in pp)		23.7	-0.9	2	6	14		13

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

United States

The US equity sell off continued Monday ahead of this week's FOMC meeting. The S&P 500 slid to its lowest level in more than a year as it declined 2.1%. All sectors finished in the red. The index has declined 8% month-to-date. The NASDAQ and Dow experienced similar declines, each falling 2.3%. Treasuries benefitted from the risk-off environment with the yield on the 10-year down 3 bps to 2.86%. The 2-year yield fell 4 bps to 2.69%, its lowest value since early September.

This morning, **US housing starts were reported better than expected for November, rising 3.2% mom compared to 0% expected.** The surprise was driven by multifamily units. The results did not have a meaningful impact on treasury yields.

Pricing for a Fed rate hike this week declined somewhat, with the implied probability based on Fed Futures falling to 68% (from 72% Friday). Analysts still largely expect a "dovish" hike, with the statement, SEP, and press conference all expected to point toward an inclination to fewer hikes and a more data dependent approach going forward. Several analysts believe that the median 2019 dot will likely move from implying three hikes next year to just two. Markets meanwhile have continued to move even lower with the difference between the January 2020 and January 2019 fed funds future (January is the first fed future to fully incorporate pricing for any December rate decisions) declining to 18 bps (chart below). Several analysts also believe that the IOER will likely be hiked by just 20 bps compared to a 25 bps hike for the fed funds rate in order to move the effective fed funds rate close to the center point of the policy range.

Spread between January 2019 and 2020 fed funds future (bps)


Source: Bloomberg

Investors have become increasingly bearish on credit markets. According to a Citi investor survey, investment grade bond positioning is near a multi-year low, while high yield bond positions are at their lowest since 2008. In some cases, such extreme short indicators are taken as a signal that the market may be oversold and that there is a buying opportunity. Analysts however are more skeptical this time considering the challenging global environment. Also, according to the survey, 60% of respondents believe that US investment grade spreads will widen by at least 10 bps next year, while only 26% believe that spreads will tighten by at least 10 bps.

Figure 20. High Grade Overall, All Respondents

Source: Citi Research

Figure 21. High Yield Overall, All Respondents
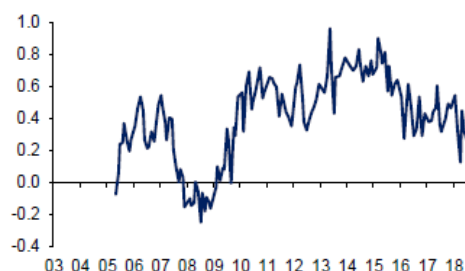
Source: Citi Research

Several high yield oil producers have significantly hedged their oil production against further declines in oil markets, according to analysis by Barclays. The mean amount of expected 2019 production which is hedged is 52%, among the 14 companies analyzed. The mean price of oil for the hedge is $54.97. With the greater than 30% sell-off in oil prices since October, the spread for the energy sub-index of the Bloomberg Barclays high yield index has risen by over 200 bps from 360 bps to 572 bps, still far below its highs during the 2014-2016 oil sell-off.

FIGURE 2. High Yield Oil-Biased Producers: 2019E Production Hedged and Floor/Swap Price
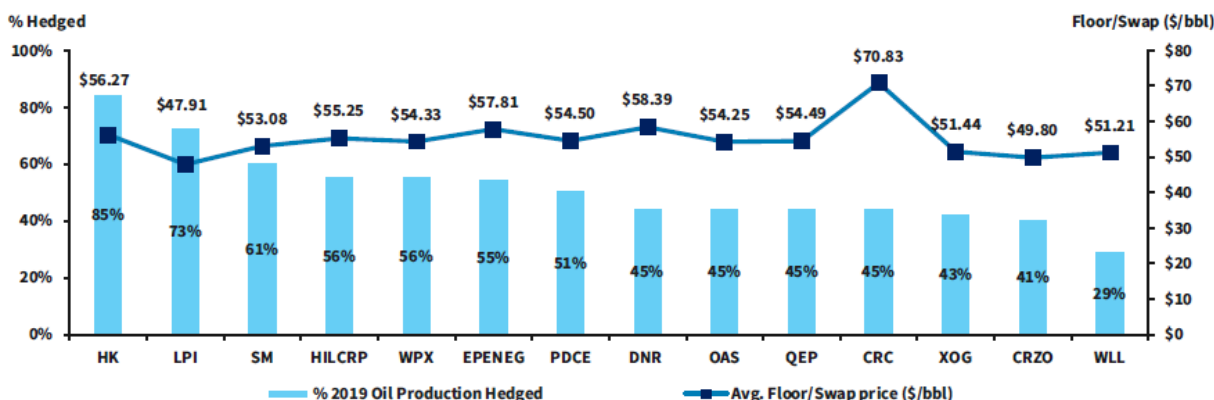
Note: Barclays high yield credit estimates reflect 2019 volumes hedged against downside risk as disclosed in issuers' latest investor presentations (post-3Q18), while companies not under coverage reflect Bloomberg estimates as of 3Q18.
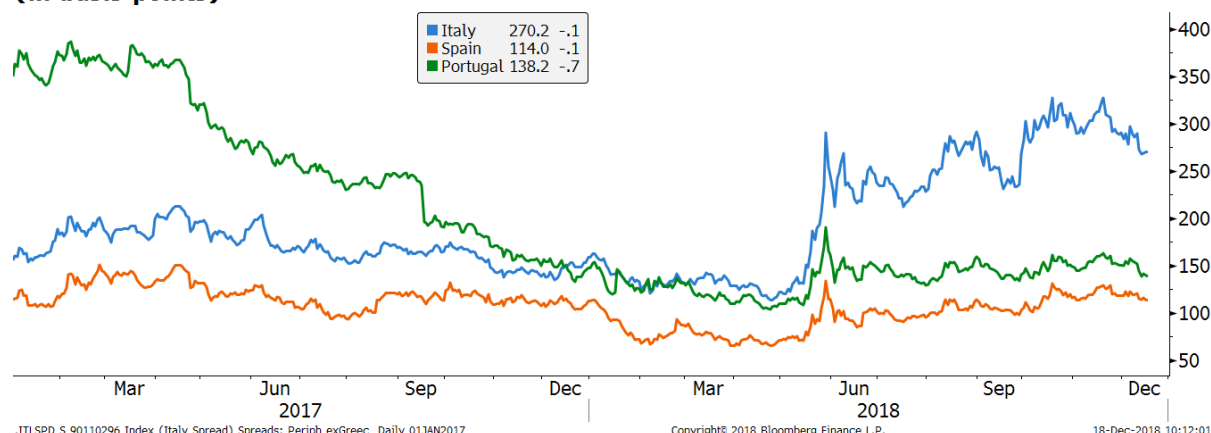Source: Company reports, Bloomberg, Barclays Research

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European equities are mixed within a narrow corridor: DAX (+0.3%), EuroStoxx 600 (-0.2%), CAC 40 (-0.1%), FTSE 100 (-0.3%), and Titans 30 (+0.5%). Bank stocks are slightly outperforming with gains of 0.6%.

Euro area sovereign bond yields inched lower. Ten-year yields are at: Germany: 0.23% (-2 bps); France: 0.69% (-4 bps); Italy: 2.93% (-2 bps); Spain: 1.37% (-3 bps). UK gilt yields are also slightly down at 1.23% (-3 bps).

Selected European Sovereign Spreads to 10yr Bunds
(in basis points)

.ITLSPD S 90110296 Index (Italy Spread) Spreads: Periph exGreec Daily 01JAN2017   Copyright© 2018 Bloomberg Finance L.P.   18-Dec-2018 10:12:01

UK's Labour leader Jeremy Corbyn proposed yesterday a no-confidence motion in PM Theresa May. The motion is addressed to PM May alone, rather than at her entire cabinet, and it is unclear when such a vote would take place. PM May's office has added that the government would only allow for a no-confidence vote on the entire cabinet, which would in turn lead to general elections if successful. Separately, PM May announced yesterday that the 'meaningful vote' of the Withdrawal Agreement – postponed last week – is set for the third week of January 2019. The British premier also noted today that preparations for a no-deal Brexit – a scenario reportedly dubbed as operation Cobra within Downing Street – will be stepped up, and that she is not considering seeking an extension to Art. 50. The pound, however, appreciated 0.4% to the dollar this morning while the FTSE 100 traded 0.4% lower.

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Japan
Equities declined to an 18-month low (Nikkei -1.8%, Topix -2%) on heavy trading volumes. Tech and healthcare stocks underperformed, but declines were broad based with all major sectors in the red. **The yen appreciated 0.3% against the dollar. 10-year JGB yields fell 0.5 bps to 0.013%.**

Fresh Low
Japan's Topix index falls to lowest since May 2017

■ Topix

Source: TSE

Emerging Markets   back to top

Key Emerging Market Financial Indicators

| Last updated:	Level		Change				
12/18/18 8:13 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		39.46	-0.7	0	-4	-15	-16
MSCI Frontier Equities		27.03	-0.9	-1	-1	-18	-18
EMBIG Sovereign Spread (in bps)		394	1	-2	11	111	109
EM FX vs. USD		62.14	0.2	0	-1	-10	-11
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.90	0.0	0	1	-4	-6
Indonesian Rupiah		14501	0.5	1	1	-6	-7
Indian Rupee		70.45	1.6	2	2	-9	-9
Argentine Peso		38.27	-0.1	-1	-6	-54	-51
Brazil Real		3.90	0.1	0	-4	-16	-15
Mexican Peso		20.06	0.1	1	2	-5	-2
Russian Ruble		66.94	-0.3	-1	-2	-12	-14
South African Rand		14.33	0.4	0	-2	-11	-14
Turkish Lira		5.35	0.5	0	-1	-28	-29
EM FX volatility		9.74	0.0	-0.4	-0.3	2.3	1.9

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

EM corporate issuance

EM hard currency corporate bond issuance was recorded at $4.0bn last week as compared with $4.3bn the week before, extending the YTD corporate supply to $342bn (vs $459bn in 2017). Within regions, the issuance continued to be concentrated in Asia though has reduced significantly in both Asia
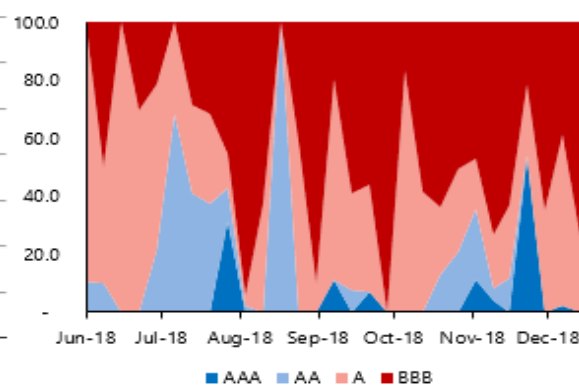
and Latam vs last year. Furthermore, credit quality continues with worsen with 74% of the new IG issuance being focused in the BBB segment.
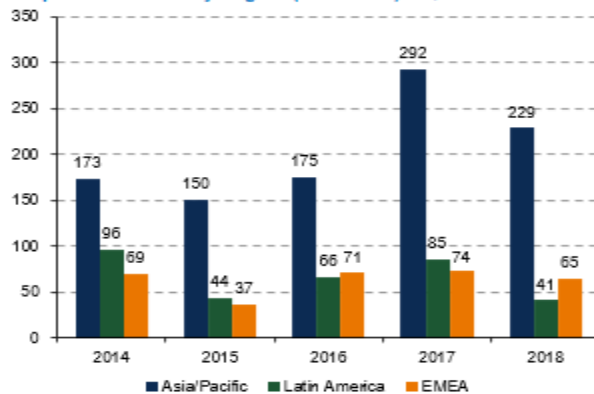

Source: BAML, Bloomberg

Source: BAML, Bloomberg

EM FX Flows

Citi analysis highlighted that investor flows into EM currencies turned cautious last week, impacted by continued concerns over the health of the global economy hurting overall risk sentiment. The flows remained weak from real money as well as leveraged investors. Within Asia, investor outflows were seen across most currencies except the Chinese renminbi and the Taiwanese dollar. Within CEEMEA, hedge funds trimmed their exposure. Within Latin America, investors were most bearish about the Brazilian real and the Argentine peso.

Figure 1. Weekly indexed investor flows show signs of caution
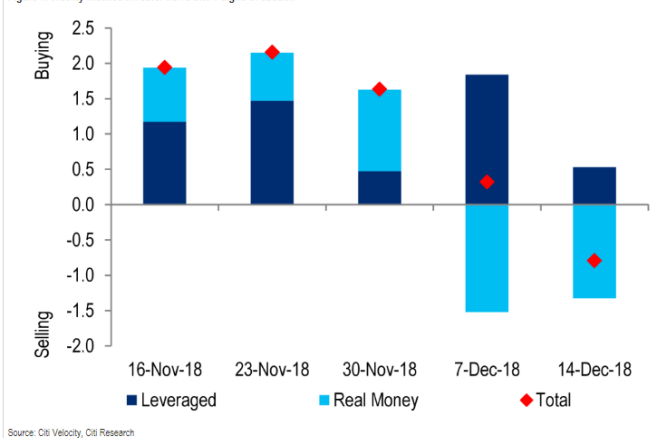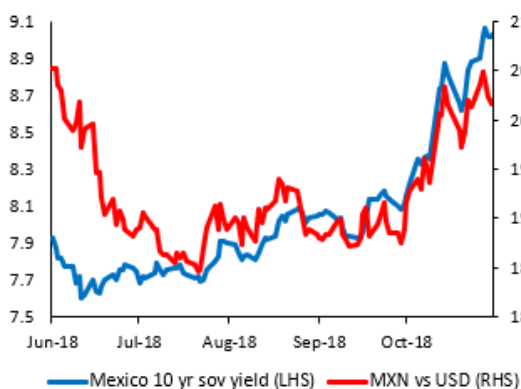
Source: Citi Velocity, Citi Research

China

President Xi's speech to mark the 40th anniversary of China's reforms opened up emphasizing the continuation of established policies. President Xi confirmed the importance of the state in the Chinese economy and made clear that China's policies would not be influenced by the West. Market contacts were disappointed as they had expected specific announcements on reforms and stimulus measures. **Equity indices in Shanghai and Shenzhen declined 0.8% on the day.** The offshore and onshore renminbi were little changed.
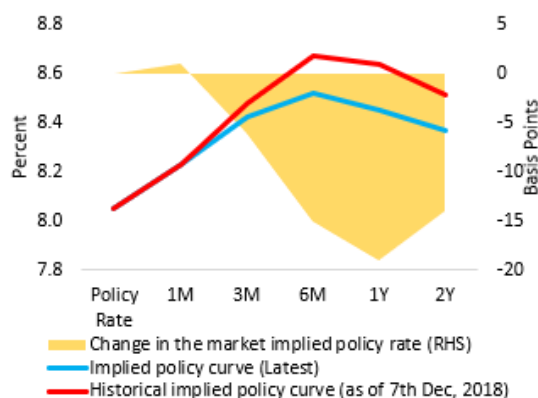
Mexico

Mexican assets reacted positively to the budget presented over the weekend with the Mexican peso appreciating 0.8% to the dollar, and 10-year domestic sovereign yields declining by 8 bps. Equity markets declined by 2.4% however inline with the broader weakness in the region. The 2019 budget considers a fiscal consolidation with a primary surplus of 1% of GDP in 2019 and plans to keep public debt constant as a percentage of GDP. Market analysts expect the budget to be approved without any major modifications and highlighted that the support for quasi-sovereign firms like PEMEX and CFE was a positive. Amid broader market optimism, implied policy rates have dropped and the policy rate curve has flattened over the past 10 days (Figure 2 below).

Mexico: Currency (vs USD) and 10-yr sovereign yield

Mexico 10 yr sov yield (LHS) — MXN vs USD (RHS)

Source: Bloomberg

Mexico: Market implied policy rate curve

Change in the market implied policy rate (RHS)
Implied policy curve (Latest)
Historical implied policy curve (as of 7th Dec, 2018)
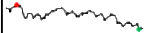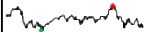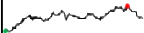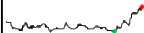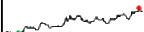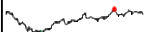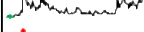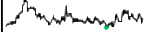
Source: Bloomberg

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Global Financial Indicators

Last updated: 12/18/18 8:12 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
United States		2546	-2.1	-3	-7	-5	-5
Europe		3062	-0.1	0	-4	-15	-13
Japan		21115	-1.8	0	-3	-8	-7
China		2577	-0.8	-1	-4	-21	-22
Asia Ex Japan		64	-1.0	0	-3	-15	-15
Emerging Markets		39	-0.7	0	-4	-15	-16
Interest Rates			basis points				
US 10y Yield		2.83	-3.2	-5	-23	43	42
Germany 10y Yield		0.24	-2.1	0	-13	-7	-19
Japan 10y Yield		0.03	-1.5	-2	-8	-2	-2
UK 10y Yield		1.26	-0.4	7	-15	11	7
Credit Spreads			basis points				
US Investment Grade		136	1.2	-5	19	41	44
US High Yield		455	3.5	13	41	76	79
Europe IG		82	-0.2	-5	2	34	37
Europe HY		340	-2.8	-8	12	105	106
EMBIG Sovereign Spread		394	1.0	-2	11	111	109
Exchange Rates			%				
Dollar Index (DXY)		96.84	-0.3	-1	0	3	5
USDEUR		1.14	0.3	1	-1	-3	-5
USDJPY		112.4	0.4	1	0	0	0
EM FX vs. USD		62.1	0.2	0	-1	-10	-11
Commodities			%				
Brent Crude Oil ($/barrel)		58	-2.1	-3	-13	-8	-13
Industrials Metals (index)		113	-0.7	-1	-3	-13	-18
Agriculture (index)		43	0.0	-1	0	-9	-10
Implied Volatility			%				
VIX Index (%, change in pp)		23.7	-0.9	1.9	5.5	14.1	12.6
10y Treasury Volatility Index		4.0	0.4	-0.3	-0.2	0.7	0.5
Global FX Volatility		8.3	0.0	-0.4	-0.4	1.2	0.9
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		415	5.8	11	-6	49	46
Italy		273	2.3	-16	-40	123	114
Portugal		139	-0.2	-13	-22	-8	-12
Spain		114	0.0	-6	-13	2	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: 12/18/2018 8:14 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	0.0	0.1	1	-4	-6		3.3	2.1	5	-8	-73	-70
Indonesia		14501	0.5	0.7	1	-6	-7		8.3	1.7	-5	7	155	169
India		70	1.6	2.0	2	-9	-9		7.5	0.3	-10	-31	21	6
Philippines		53	0.0	-0.5	-1	-5	-6		6.3	5.7	7	-29	152	149
Thailand		33	0.1	0.2	1	0	-1		2.8	0.2	4	-14	41	45
Malaysia		4.17	0.1	0.3	0	-2	-3		4.1	0.0	1	-5	19	22
Argentina		38	-0.1	-1.2	-6	-54	-51		23.3	-7.2	5	-65	732	726
Brazil		3.90	0.1	0.0	-4	-16	-15		8.3	9.7	-28	-20	-62	-68
Chile		687	0.0	-0.6	-3	-9	-10		4.6	-0.7	0	-17	-34	-19
Colombia		3190	-0.3	-0.1	0	-7	-6		6.6	-1.4	-1	-16	39	35
Mexico		20.06	0.1	0.7	2	-5	-2		8.9	-10.2	-24	-11	137	126
Peru		3.3	0.3	0.9	1	-2	-3		5.8	-4.4	-5	6	36	61
Uruguay		32	0.1	0.0	1	-11	-11		10.9	-3.4	-13	8		232
Hungary		284	0.4	0.7	-1	-6	-9		2.4	2.0	6	-28	110	113
Poland		3.77	0.2	0.9	0	-5	-7		2.4	-0.4	-9	-28	-30	-34
Romania		4.1	0.3	0.7	0	-4	-5		4.0	1.0	-12	-34	21	21
Russia		66.9	-0.3	-0.7	-2	-12	-14		8.5	1.7	6	7	114	119
South Africa		14.3	0.4	0.1	-2	-11	-14		9.9	0.0	7	24	28	61
Turkey		5.35	0.5	0.4	-1	-28	-29		18.3	-17.2	54	143	571	633
US (DXY; 5y UST)		97	-0.3	-0.6	0	3	5		2.66	-3.2	-8	-22	49	45

	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		2577	0.3	-1	-4	-21	-22		194	1	9	7	51	42
Indonesia		6082	0.1	0	1	-1	-4		222	0	-7	-3	53	56
India		36347	3.4	3	3	8	7		191	3	11	17	82	81
Philippines		7420	-0.4	0	5	-12	-13		113	1	0	-2	17	18
Malaysia		1635	-1	-1	-4	-7	-9		155	1	11	12	49	45
Argentina		29888	0.6	-3	-4	10	-1		779	-3	25	121	424	429
Brazil		86901	0.6	1	-2	19	14		258	1	-7	-3	27	24
Chile		5107	0.7	1	-2	-9	-8		158	-1	-2	7	43	39
Colombia		1336	-0.3	-3	-7	-9	-12		202	2	3	-6	31	28
Mexico		40341	-1.1	-4	-5	-17	-18		325	2	-9	-4	84	80
Peru		19128	0	0	-2	1	-4		155	1	-10	-10	16	18
Hungary		39501	-0.9	-1	0	2	0		141	3	-5	-1	55	53
Poland		58536	2.8	3	6	-8	-8		78	0	16	8	35	31
Romania		8420	-1.9	-2	-2	10	9		209	0	-19	5	88	95
Russia		2344	-2.1	-2	-1	10	11		243	-1	1	5	65	65
South Africa		51114	-0.1	1	-2	-11	-14		357	2	0	11	103	103
Turkey		90423	-1.5	-2	-3	-18	-22		452	0	-10	12	158	163
Ukraine		565	-1.5	-1	-3	83	79		737	13	-2	99	280	282
EM total		23	-0.9	0	-3	-11	-11		394	1	-2	11	111	109

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