Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Thursday, December 20, 2018

- **FOMC raises policy rate, as expected, and signals lower path for future rate hikes (link)**
- **US equities and Treasury yields fall as FOMC guidance less dovish than expected (link)**
- **BoE keeps policy stance unchanged amid rising Brexit uncertainties (link)**
- **Sweden's Riksbank hikes policy rate for first time since 2011 (link)**
- **BoJ maintains monetary policy stance but balks at boosting ETF purchases (link)**
- **Bank Indonesia pauses policy rate hikes; remains vigilant towards external risks (link)**
- **PBOC announces new targeted lending facility to support the private sector (link)**
- **FEATURE: Update on Fintech Market and Regulatory Developments (see attachment)**

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

Risk-off sentiment re-emerges as investors weigh central bank decisions

Global risk assets have traded lower following the conclusion of a number of key central bank policy meetings. In the US, the FOMC raised the policy rate 25 bps, as expected, and lowered the median expected path of the policy rate from 3 to 2 hikes next year along with the projected neutral rate to 2.75%. However, the statement and press conference were interpreted as slightly less accommodative as they indicated further gradual rate increases and viewed the risks to the outlook as balanced. US equities closed down 1.5% and Treasury yields fell at the longer end of the curve, the 10-year down 6 bps to 2.77%, driving a resumption of the curve flattening trend. Sentiment did not improve overnight as Asian and European bourses are facing losses ranging from 1 to 3%. Neither the BoE or BoJ changed their monetary policy stance, while Sweden's Riksbank hiked its policy rate for the first time since 2011. Italian sovereign spreads to Bunds continued to marginally tighten on the announced agreement with the EU over next year's budget. Oil is extending its recent slide as investors worry about underlying growth and remain skeptical about the OPEC production agreement.

Key Global Financial Indicators

Last updated: 12/20/18 8:21 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		2507	-1.5	-5	-5	-6	-6
Eurostoxx 50		3009	-1.4	-3	-3	-15	-14
Nikkei 225		20393	-2.8	-7	-6	-11	-10
MSCI EM		38	-0.5	-5	-3	-16	-18
Yields and Spreads			bps				
US 10y Yield		2.77	-6.3	-15	-30	27	36
Germany 10y Yield		0.24	-0.4	-5	-12	-17	-19
EMBIG Sovereign Spread		402	1	10	15	124	117
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		62.5	0.6	1	0	-10	-10
Dollar index, (+) = $ appreciation		96.4	-0.6	-1	0	5	5
Brent Crude Oil ($/barrel)		55.4	-3.2	-10	-11	-14	-17
VIX Index (%, change in pp)		25.0	-0.6	4	2	15	14

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

United States

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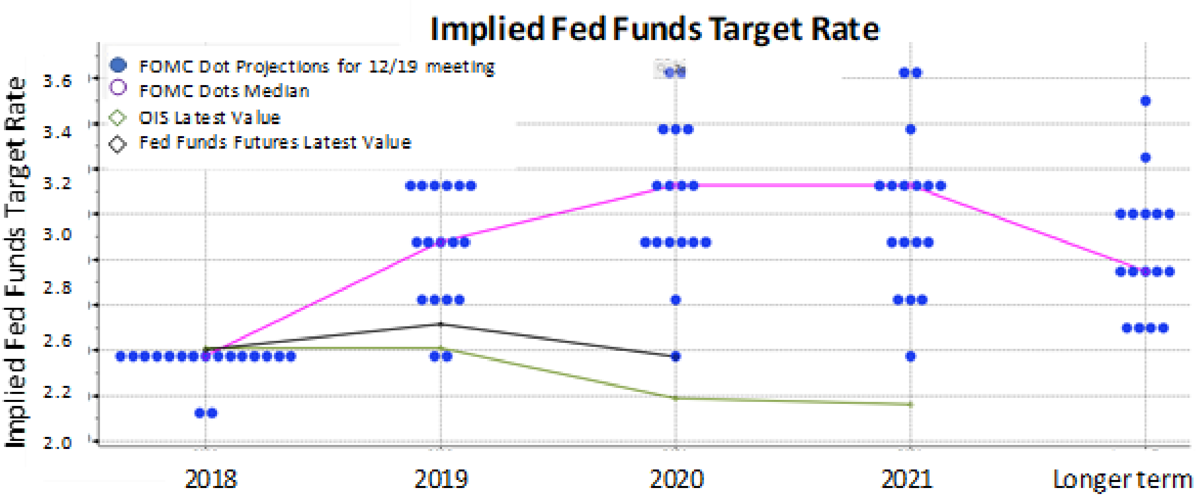
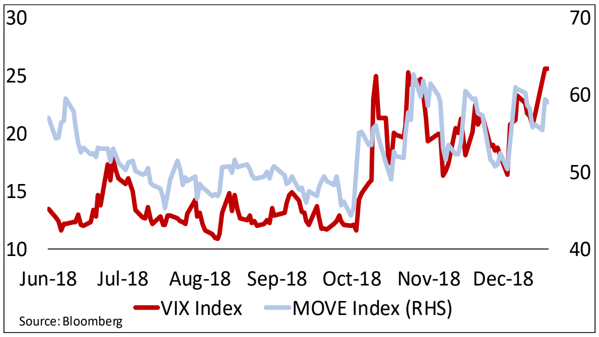
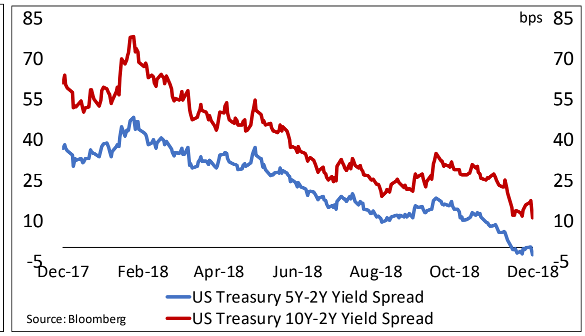
In its last meeting of the year, the FOMC voted to raise rates by 25 bps and signaled less rate hikes for 2019. The Fed raised its target Fed Funds Rate range to 2.25% – 2.5%, in line with market expectations, with Committee members projecting two more rate hikes next year, down from three previously. Although more dovish, the new rate trajectory is still higher than what is being priced into financial markets (less than one rate hike in 2019). Furthermore, the FOMC expected growth to moderate slightly in 2019 to 2.3% and labor markets to tighten further. However, inflation, at 1.9%, was projected to remain right around target next year, allowing the Fed to be patient with its rate hikes going forward. Chairman Powell also emphasized that with the policy rate now reaching the bottom edge of its "neutral range", the FOMC will let incoming data inform its decisions on the appropriate future rate path. **With respect to quantitative tightening, Chairman Powell expected the pace of the Fed's balance sheet normalization to remain steady going forward**. He also strongly ascertained the Fed's independence and strict focus on its dual mandate. Lastly, the FOMC raised the Interest on Excess Reserves by only 20 bps in order to move the effective fed funds rate closer to the center point of the policy range, in line with expectations.



Source: Bloomberg

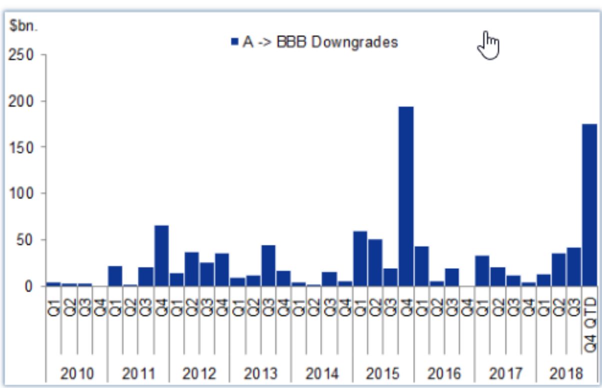
Market reaction to the FOMC decision and the Chairman's statement was generally negative, as the Fed was seen as less "dovish" than expected. Although the rate hike was in line with expectations, investors seem to have been underwhelmed by Chairman Powell's weak emphasis on recent market volatility, and by the FOMC's apparent lack of willingness to adjust the pace of balance sheet normalization in response to that. There was a view that strong emphasis was being placed on the ongoing strength of the economy and not enough on the tightening of financial conditions. **Equity markets sold-off sharply**, with the S&P 500 down 2.6% following the announcement, ending the day in negative territory. Market volatility also spiked, with the VIX up by about 3 points, following an equal slide earlier in the day. **Investors' disappointment was also reflected in rates, with Treasuries rallying on the news and 10-year yields dropping by about 6 bps to 2.77% – their lowest level since April this year.** The yield curve flattened further on the announcement with the 2-10 year spread dipping below 11 bps. Lastly, the USD was well bid on the news, with the Dollar Index rising by about 0.5% and ending the day slightly up.





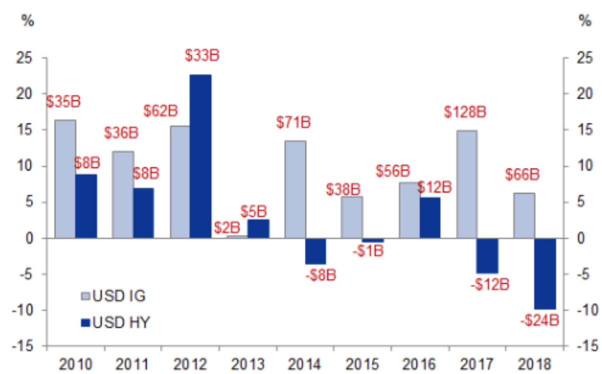
With the rapid increase in non-financial sector debt since the global financial crisis, there is increasing evidence of a worrisome drop in credit quality. In the Investment Grade (IG) space, Goldman Sachs estimates that over $176 bn of debt has been downgraded to BBB from the A bucket during the 2018Q4, the highest since 2015Q4 (see chart). Of particular concern has been the apparent willingness of many IG companies to access easy debt financing in order to boost shareholder returns, including through share buybacks. Furthermore, investor concerns have not been limited to IG issuers. This year, High Yield (HY) funds have also experienced some of the largest outflows since the financial crisis (see chart). It is notable that HY spreads have widened by about 160 bps so far this quarter, as investors have turned away in mass from the asset class.

Notional amount of bonds downgraded from A into BBB, by quarter



Source: Bloomberg, Goldman Sachs Global Investment Research

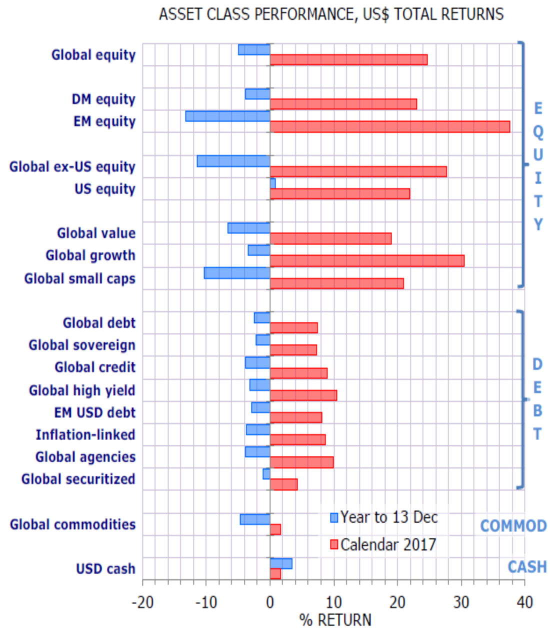
Annual cumulative flows as a percentage of AUM



Source: EPFR, Goldman Sachs Global Investment Research

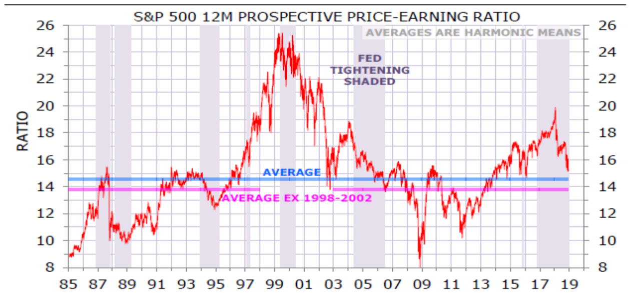
2018 has shaped up to be a bad year for almost all asset classes, with equities arguably fairing the worst. After a record year in 2017, most asset classes have done poorly so far this year (see charts below by Minack Advisors). Rising trade tensions, greater corporate leverage and higher political uncertainties have certainly contributed to the poor performance of riskier assets. But rising yields on safe assets have also been a main contributor. In fact, cash has arguably been one of the best performing asset classes so far this year. It is interesting to note that following a significant derating in 2018, US equity valuations are now back to where they were when the current tightening cycle began.

2017: everything up; 2018: everything down

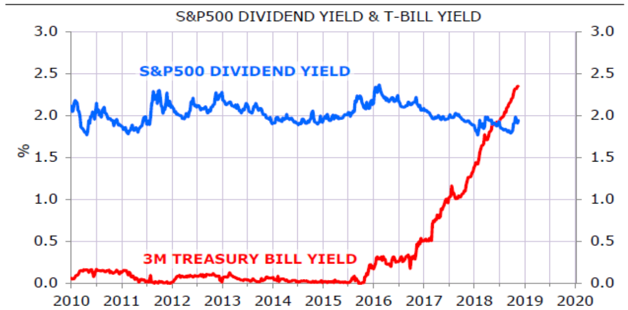


Source: Bloomberg, MSCI, Bloomberg-Barclays; Minack Advisors

Fed tightening finally bites valuation



Source: IBES/DataStream, Bloomberg; Minack Advisors



Source: Bloomberg, Standard & Poor's; Minack Advisors

Europe

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European bourses followed US and Asian peers lower as central bank decisions disappointed. EuroStoxx 600 (-1.0%), DAX (-1.0%), and CAC 40 (-1.3%). Bank stocks are 1.6% lower, underperforming main indices. **Equities in the UK are faring slightly better**, however, with the FTSE 100 and FTSE 250 down 0.4% and 0.8%, respectively.

Euro area sovereign bond markets traded sideways again today: German 10-year bunds at 0.23% (-1 bp) and French at 0.68% (-2 bps). Italian yields are also stable at 2.74% (-3 bps), after the confirmation yesterday of the agreement between the EC and the Italian government on the budget.

The Bank of England kept its policy stance unchanged as Brexit uncertainties have risen. In a unanimous agreement, the MPC voted to hold the benchmark rate at 0.75%. The minutes of the meeting stated the broader economic outlook will continue to depend on the nature of the EU withdrawal, and that the monetary policy response to Brexit will not be automatic and could be in either direction. The MPC also noted that they now see inflation slowing below the 2% target as early as January 2019, as the fall in oil prices has added downward pressure. **UK assets were little changed following the announcement** with the pound reversing some of its earlier gains, but still up 0.5% this morning.

The European Commission has announced the implementation of contingency measures ahead of a "no-deal" Brexit. The announced package includes 14 measures in those areas where a "no-deal" scenario would create major disruption for citizens and businesses in the EU27. These areas include financial services, air transport, customs, and climate policy, amongst others. On financial services, the EC has adopted:

- A temporary and conditional equivalence decision for a fixed, limited period of 12 months to ensure that there will be no immediate disruption in the central clearing of derivatives.
- A temporary and conditional equivalence decision for a fixed, limited period of 24 months to ensure that there will be no disruption in central depositaries services for EU operators currently using UK operators.
- Two Delegated Regulations facilitating novation, for a fixed period of 12 months, of certain over-the-counter derivatives contracts, where a contract is transferred from a UK to an EU27 counterparty.

Banca Monte dei Paschi is said to be close to completing a deal to sell €2.1 bn of NPLs. The buyers include Banca Ifis and Credito Fondiario, who will acquire a portfolio of mostly unsecured loans, according to unconfirmed sources. Monte dei Paschi stocks are 1.3% lower today, in line with peers.

Sweden's Riksbank raised its policy rate by 25 bps, its first rate hike since 2011, which lifts the repo rate to minus 25 bp. Market participants were split in the lead-up to the decision, as some expected no change following some weaker than expected inflation prints. However, the Riksbank Executive Board claimed that with inflation and inflation expectations anchored, the need for extreme accommodation was no longer needed. That said, the Board signaled more stimulus would not be removed until H2 2019. Following the meeting, the krona strengthened against both the dollar (+1.8%) and euro (1.1%) on the news.

Other Mature Markets back to top

Japan

The BoJ kept its stimulus program unchanged. Following the Fed’s latest rate hike, the BoJ kept its yield curve-control program and asset purchases unchanged, disappointing those that had hoped for an increase in ETF purchases. In its policy statement, the BoJ repeated its previous assessment that the economy is likely to continue expanding moderately, supported by growth in exports and an uptrend in domestic demand. **The yen gained (+0.5%) while equities suffered sizable losses.** The Topix shed 2.5% and the Nikkei lost 2.8%, dragged lower by dashed expectations that the BoJ could increase its ETF purchases. On a year-to-date basis, the Topix has lost nearly 17% and the Nikkei 11%.

Emerging Markets

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Key Emerging Market Financial Indicators

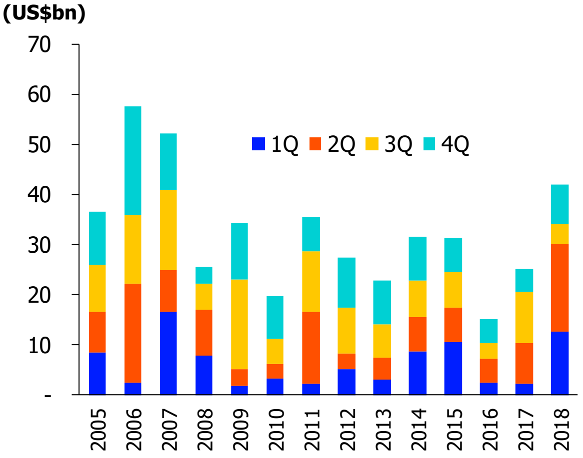
Last updated: 12/20/18 8:25 AM	Level: Last 12m	Level: index	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		38.49	-0.6	-5	-3	-16	-18
MSCI Frontier Equities		26.10	-3.1	-5	-4	-21	-21
EMBIG Sovereign Spread (in bps)		401	0	9	14	123	116
EM FX vs. USD		62.50	0.7	1	0	-10	-10
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.89	0.1	0	1	-4	-6
Indonesian Rupiah		14473	-0.2	0	1	-6	-6
Indian Rupee		69.71	1.0	3	3	-8	-8
Argentine Peso		38.08	0.8	-1	-5	-53	-51
Brazil Real		3.85	1.2	1	-2	-14	-14
Mexican Peso		19.89	1.2	2	2	-3	-1
Russian Ruble		67.69	-0.3	-2	-2	-13	-15
South African Rand		14.19	1.4	0	-1	-10	-13
Turkish Lira		5.26	0.4	1	2	-27	-28
EM FX volatility		9.63	0.0	-0.4	-0.5	1.9	1.8

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

Asian currencies were mixed while equities suffered broad-based losses as investors had expected a more dovish sentiment from Fed Chair Powell. The Korean won (-0.4%) underperformed while the Indian rupee paced gains. Equities, by contrast, fell in nearly all the major bourses. In India, the RBI released the minutes of its December MPC meeting and reaffirmed that the Committee is on hold, though several members flagged upside risks to inflation. The prospect of possible rate hikes boosted the rupee (+0.3%). **EMEA** equities also suffered losses, led by Hungary (-1.2%), Russia (-1.1%), and Poland (-1.0%). Currencies in the region strengthened as the dollar weakened globally. **Latin American** stocks were mixed yesterday, but some markets were closed before the FOMC news broke. The Argentine unemployment rate fell to 9.0% in Q3 from 9.6%. The Brazilian congress approved the 2019 budget while the Colombian congress approved tax legislation to address the 2019 budget gap. The Chilean central bank published its December meeting minutes where policymakers signaled it could hike rates as much as 50 bps at the next meeting if economic data continues to strengthen.

Latin American syndicated loan issuance hit a new post-crisis high in 2018. There has been issuance of over $40 bn so far in 2018, with another $5.3 bn in the pipeline according to (Thomson Reuter's) Refinitiv. This is up 56% from the 2017 level. Brazil has the highest volume ($18.0 bn) followed by Mexico ($15.7 bn), Chile ($1.8 bn), and Colombia ($1.4 bn). Project finance lending accounts for 11% of the regional total

Latin America Syndicated Loan Issuance (US$bn)



China

The PBOC introduced a new program for direct lending to smaller companies while keeping its borrowing costs in the open market unchanged. The PBOC will supply lower-cost liquidity for as long as 3 years to banks looking to lend to SMEs and POEs. The cost of the funds will be 3.15%, compared to 3.30% for a 1-year MLF at the PBOC. The terms of loan qualification as well as the types of collateral accepted are not yet clear. Analysts noted that the latest PBOC funding program, in addition to the 4 reserve requirement reductions this year, underscored the authorities' concerns regarding the economy. That said, few expect an outright reserve requirement reduction or changes in the benchmark interest rates in the near term as such reductions could weaken the RMB at a time when the US-China trade negotiations are still fraught with tension. **The central government bond yield curve flattened,** with the yield on the 2-year note up 1 bp to 2.65% while the 3-year note was little changed at 2.81%. Meanwhile, the onshore CNY lost 0.1% while the offshore CNH held steady.

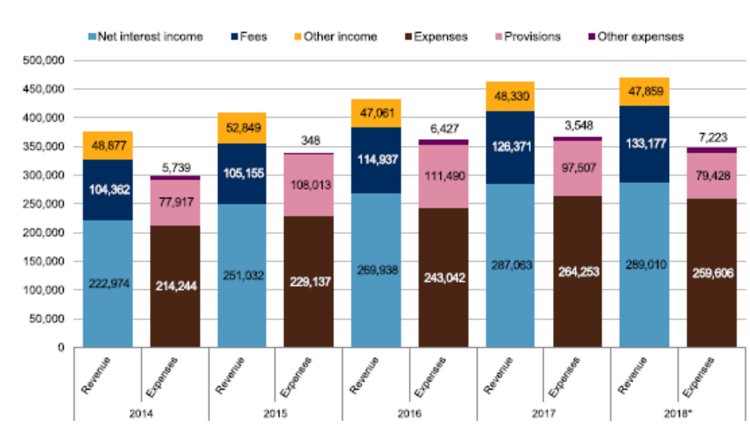
Indonesia

In line with expectations, **Bank of Indonesia kept its 7-day repo rate unchanged at 6%,** after a 25-bps rate hike in November. The bank maintained its relatively hawkish policy stance and reiterated that it will continue to guard the rupiah in line with fundamentals. The central bank's cumulative rate hikes to stem rupiah depreciation this year totaled 175 bps. On the day, the rupiah lost 0.25%.

Brazil

The country's five largest banks posted record profits in 2018. Profits totaled 62.1 bn reals in the first nine months of 2018, 27% bigger than 12 months earlier. S&P gauges that these results were largely due to lower credit provisioning, and that higher profits and bettter asset quality have sustained or improved capitalization levels. S&P notes that the banks have changed their portfolio mix by boosting consumer loans, coupled with a contraction in commercial loans for corporates and small- to medium-sized enterprises. However, the agency expects provisioning adjustments to temper going forward and banks will need to increase portfolio growth to keep increasing profitability.

Brazil Banks Income Breakdown

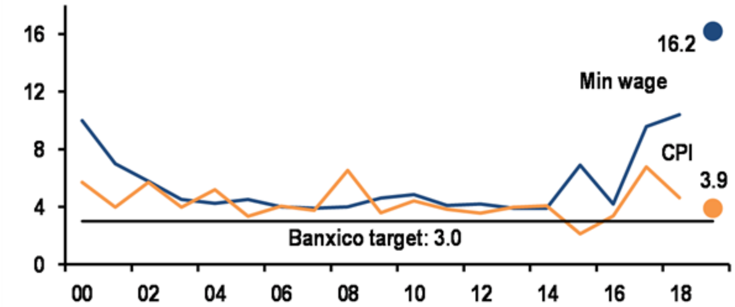


*2018 numbers were annualized.

Mexico

The government will increase the minimum wage by 16.2% beginning January 1. The increase will be higher along the US border region, and the finance ministry expects the loss in tax revenues to be 0.2% of GDP. Mexican equities were up over 1% on the day, but Mexican sovereign CDS spreads widened about 10 bps following the announcement. The market expects the central bank to raise the policy rate 25 bps to 8.25% today.

Ex-ante min wage negotations and observed inflation
%oya



Source: J.P.Morgan with data from STPS and Conasami. J.P. Morgan forecasts for CPI.

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Global Financial Indicators

Last updated: 12/20/18 8:23 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		2507	-1.5	-5	-5	-6	-6
Europe		3009	-1.4	-3	-3	-15	-14
Japan		20393	-2.8	-7	-6	-11	-10
China		2536	-0.5	-4	-4	-23	-23
Asia Ex Japan		63	-1.6	-4	-2	-16	-18
Emerging Markets		38	-0.5	-5	-3	-16	-18
Interest Rates					basis points		
US 10y Yield		2.77	-6.3	-15	-30	27	36
Germany 10y Yield		0.24	-0.4	-5	-12	-17	-19
Japan 10y Yield		0.03	-0.8	-3	-8	-3	-2
UK 10y Yield		1.26	-1.3	-3	-12	1	7
Credit Spreads					basis points		
US Investment Grade		138	0.9	3	19	44	47
US High Yield		480	-0.8	46	55	105	104
Europe IG		85	3.1	5	4	38	40
Europe HY		346	8.7	20	16	112	112
EMBIG Sovereign Spread		402	1.0	10	15	124	117
Exchange Rates					%		
Dollar Index (DXY)		96.43	-0.6	-1	0	3	5
USDEUR		1.15	0.7	1	1	-4	-5
USDJPY		111.7	0.7	2	1	2	1
EM FX vs. USD		62.5	0.6	1	0	-10	-10
Commodities					%		
Brent Crude Oil ($/barrel)		55	-3.2	-10	-11	-14	-17
Industrials Metals (index)		113	-0.3	-1	-2	-15	-19
Agriculture (index)		43	0.3	-1	1	-9	-10
Implied Volatility					%		
VIX Index (%, change in pp)		25.0	-0.6	4.3	2.5	15.3	13.9
10y Treasury Volatility Index		3.8	0.0	0.0	-0.5	0.3	0.3
Global FX Volatility		8.4	0.0	0.1	-0.2	1.1	1.0
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		405	-0.6	10	-29	32	36
Italy		250	-2.9	-17	-76	97	92
Portugal		142	1.3	3	-21	4	-9
Spain		115	0.6	1	-15	7	1

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: 12/20/2018 8:26 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		6.89	0.1	-0.1	1	-4	-6		3.3	-0.8	6	-7	-72	-70
Indonesia		14473	-0.2	0.2	1	-6	-6		8.2	-5.5	-13	-5	143	156
India		70	1.0	2.8	3	-8	-8		7.4	-9.9	-15	-44	5	-8
Philippines		53	-0.1	-0.9	-1	-5	-6		6.3	0.0	5	-23	152	149
Thailand		33	0.0	0.1	1	0	0		2.7	-2.9	-4	-15	35	39
Malaysia		4.18	0.0	0.0	0	-2	-3		4.1	-0.9	-2	-7	18	20
Argentina		38	0.8	-0.7	-5	-53	-51		23.1	-19.1	-21	-86	713	705
Brazil		3.85	1.2	1.1	-2	-14	-14		8.3	-8.9	-20	-28	-92	-71
Chile		687	0.1	-0.7	-2	-10	-10		4.5	-2.4	-5	-20	-33	-24
Colombia		3224	-0.1	-1.4	-1	-8	-7		6.6	-4.5	-5	-23	34	31
Mexico		19.89	1.2	2.2	2	-3	-1		8.7	-7.4	-37	-29	116	108
Peru		3.4	-0.1	0.2	1	-2	-3		5.8	-0.1	-2	5	49	61
Uruguay		32	0.0	0.1	1	-11	-11		10.9	-0.5	-7	3		231
Hungary		281	1.0	1.3	1	-6	-8		2.4	-5.3	1	-30	111	110
Poland		3.74	0.7	1.0	1	-5	-7		2.3	0.8	-4	-26	-39	-35
Romania		4.1	0.7	0.7	1	-4	-4		4.2	20.0	16	-13	37	41
Russia		67.7	-0.3	-2.2	-2	-13	-15		8.5	0.6	9	10	119	122
South Africa		14.2	1.4	-0.1	-1	-10	-13		9.7	-9.1	-10	3	44	41
Turkey		5.26	0.4	1.4	2	-27	-28		17.5	-62.2	-83	69	513	560
US (DXY; 5y UST)		96	-0.6	-0.7	0	3	5		2.64	2.0	-12	-25	40	43

	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		2536	-0.5	-4	-4	-23	-23		193	0	2	8	51	41
Indonesia		6148	-0.5	0	2	1	-3		228	2	3	3	69	62
India		36432	-0.1	1	3	8	7		193	4	5	21	87	83
Philippines		7563	-0.2	1	4	-10	-12		117	6	5	6	32	22
Malaysia		1651	0	-2	-4	-6	-8		157	1	7	16	55	47
Argentina		29968	0.6	-4	1	7	0		790	0	41	118	442	440
Brazil		86201	-1.1	-2	-2	17	13		266	1	11	-2	40	32
Chile		5091	-0.1	-1	0	-8	-9		159	-2	2	6	44	40
Colombia		1332	-0.3	-2	-4	-10	-12		212	0	16	-5	47	38
Mexico		41388	1.2	1	-1	-14	-16		341	2	19	2	105	96
Peru		19119	0	-1	0	-1	-4		162	1	2	-6	29	25
Hungary		39471	-1.2	-1	1	2	0		141	-2	1	-1	60	53
Poland		58630	-1.0	-1	6	-7	-8		75	-3	3	10	36	28
Romania		7341	-1.8	-15	-14	-6	-5		217	7	1	13	105	104
Russia		2342	-0.7	-2	0	11	11		249	1	9	12	77	71
South Africa		51398	-0.3	0	1	-11	-14		356	-4	5	3	108	102
Turkey		91621	-1.0	0	0	-17	-21		428	-22	-29	-20	140	139
Ukraine		565	0.1	0	-1	82	79		750	5	19	100	296	295
EM total		23	0.0	-3	-1	-12	-12		401	0	9	14	123	116

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