Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Friday, December 21, 2018

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The Global Markets Monitor will be on holiday for the next two weeks, resuming on January 7, 2019. We wish you happy holidays and a prosperous new year!

- **Political impasse threatens partial US government shutdown (link)**
- **US financial conditions tighten as equities slump and credit spreads widen (link)**
- **Nonbank financials dominate investor demand in US leveraged loan market (link)**
- **Mexican central bank hikes policy rate and retains hawkish forward guidance (link)**
- **Chinese equities decline amid fresh US-China frictions (link)**

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

Risk aversion takes hold as global growth concerns mount

Global equity markets remain under pressure as growth pessimism continues to ripple through risky assets. Markets look to have grown increasingly worried about a US growth slowdown, recoupling it with the rest of the world, and hence the sustainability of the current FOMC hiking cycle. The S&P 500 fell 1.6% yesterday and is now down over 15% since the start of Q4, while the VIX continues to leg higher reaching 28. The looming threat of a partial US government shutdown has helped to exacerbate the risk aversion. Alongside the move lower in equity markets was a further widening in credit spreads to its widest closing level since mid-2016, a continued narrowing in US breakeven inflation rates and crude oil falling to its lowest level since September 2017. Plunging oil prices are reinforcing the gloom around growth as rising US output and US-China trade uncertainties persist as overhangs. Market sentiment remained fragile in Asia and Europe as equities pushed lower, while EM assets have outperformed more recently with relatively smaller declines than AE assets. As we approach the holidays, market participants expect thin positioning and liquidity to become ever more apparent with price action driven increasingly by flows.

Key Global Financial Indicators

Last updated: 12/21/18 8:02 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		2467	-1.6	-7	-7	-8	-8
Eurostoxx 50		2985	-0.5	-3	-5	-16	-15
Nikkei 225		20166	-1.1	-6	-6	-12	-11
MSCI EM		39	-0.3	-4	-4	-16	-18
Yields and Spreads				bps			
US 10y Yield		2.79	5.2	-10	-27	31	38
Germany 10y Yield		0.25	1.9	-1	-13	-17	-18
EMBIG Sovereign Spread		402	1	12	6	122	117
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		62.1	-0.4	0	-1	-10	-11
Dollar index, (+) = $ appreciation		96.7	0.4	-1	0	5	5
Brent Crude Oil ($/barrel)		52.9	-2.6	-12	-17	-18	-21
VIX Index (%, change in pp)		28.6	0.2	7	8	19	18

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

United States

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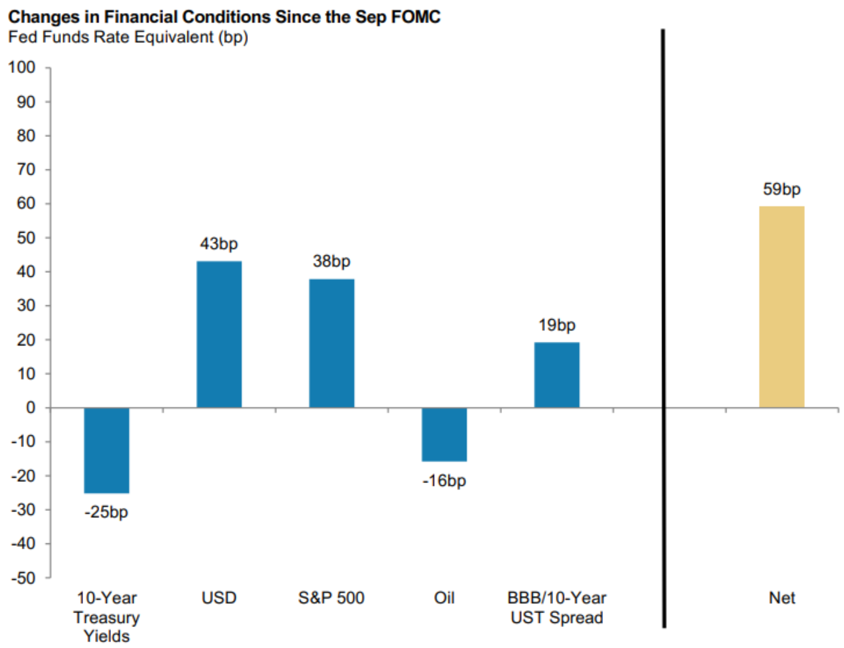
Markets saw another day of losses as the implications of the hawkish FOMC press conference continued to sink in. Sentiment was further hurt by news that President Trump refused to sign a budget measure unless it contained funding for a border wall. If unresolved, the standoff would leave 25% of the government unfunded. This came as an unpleasant surprise because of earlier talk that a deal had been reached to keep the government funded through February 8th. If a shutdown were to occur, it would have a more limited impact than previous episodes as the remaining 75% of the government has already been funded through September 2019. Markets have pulled back significantly over the past two sessions, with the S&P 500 down more than 3.1% since the Tuesday close. Treasury yields moved higher after the sharp drop following the FOMC meeting yesterday. The 10-year rose 5 bps to 2.79%, while the curve steepened slightly.

Financial conditions tightened by nearly 60 bps in Fed Funds equivalent terms between the September and December, according to estimates. The strengthening of the dollar and the selloff in stocks have played the largest role. Fed Chair Powell's commitment to the policy of balance sheet runoff and the projected decline in US economic data expected in the next few weeks are likely to maintain the tightness in financial conditions and keep interest rates low early into the first weeks of the new year, some analysts believe.

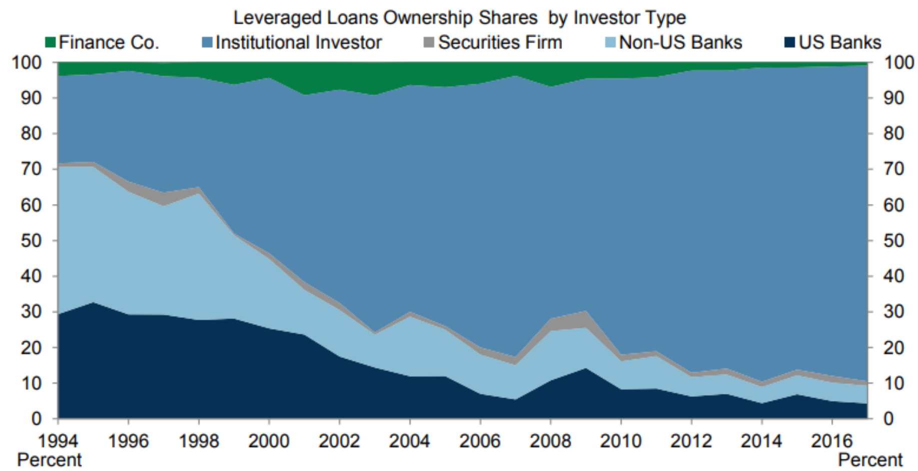


Source: Morgan Stanley Research

The final reading on US Q3 2018 GDP was revised lower to a 3.4% annualized rate versus the previous read and forecast of 3.5%. However, the print still confirms strong growth in the quarter driven by personal consumption expenditure and changes in private inventories. Consumer spending continued to boost the economy as personal consumption rose 3.5%, while core PCE beat consensus, up 1.6% qoq compared to the 1.5% forecast. **Durable goods orders rebounded less strongly than expected**, advancing 0.8% mom in November (consensus: +1.6%) after October's deep 4.3% contraction. The ex-transportation measure also came in below expectations, declining 0.3% mom compared to expectations of a 0.3% increase, although October's gain was revised up to 0.4%. Capital goods orders were also weaker, with the non-def ex-air measure posting a slight decline of 0.6% mom. On the whole, these data suggest domestic demand still remained robust in November and over Q3. Following the data release, Treasury yields and the US dollar were little changed, while S&P 500 futures point to a marginal 0.1% decline at the open.

Leveraged loans may pose less of a systemic risk than many fear, with banks accounting for less than 5% of the new issue demand. Although the market has grown rapidly in size to $1.13 tn, the majority of the debt is held by non-bank financial institutions. Of these, Collateralized Loan Obligations (CLOs) account for 50% of the market and most CLO managers may not be large enough to pose a threat to the wider financial system. Some of them have credit lines from banks but are estimated to be relatively limited. In terms of the distribution of risk, the mezzanine and junior tranches as well as the equity pieces of CLOs are typically held by hedge funds and asset managers, as well as longer term investors such as pension funds and private equity firms who have longer time horizons and more long-term funding than banks. However, there is evidence of late cycle behavior in the leveraged loan markets, with deteriorating underwriting standards, new and less experienced CLO managers entering the market and less experienced servicers and deal originators involved in the deal flow.

Exhibit 4: US Banks Now Own less than 5% of Leveraged Loans



Source: S&P, Goldman Sachs Global Investment Research

Europe

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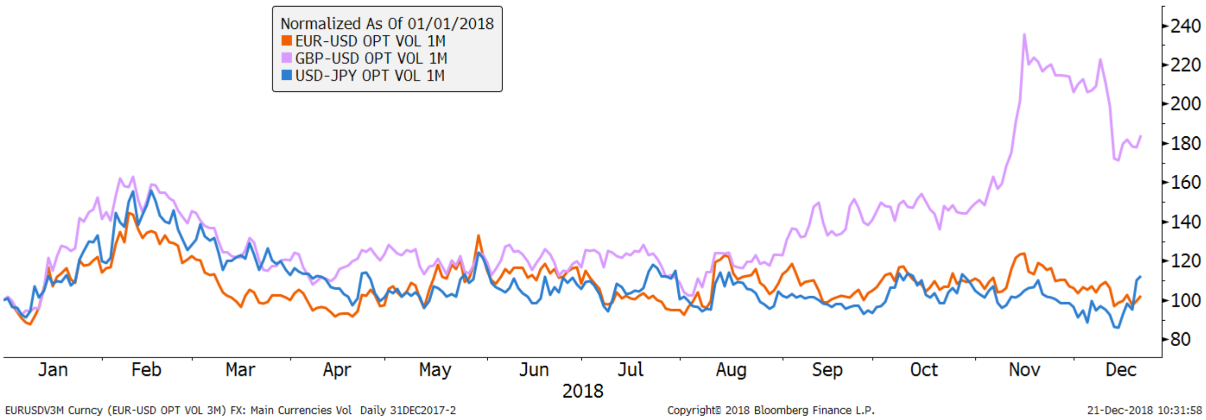
European bourses mirrored US and Asian losses this morning: EuroStoxx 600 (-1.0%), DAX (-0.8%), and CAC 40 (-1.3%). Bank stocks (-1.3%) are down also, in line with broad indices.

Euro area sovereign bond markets were steady. The main moves this morning were on the Italian 2-year yield – at 0.49 (+7 bps) – and the 10-year – at 2.78% (+5 bps).

UK 2018Q3 GDP growth was released at 1.5% yoy today – the fasted pace since 2016. Sterling is flat at $1.27, but pound implied volatility remains elevated.

FX Volatility: Major Crosses
(Option Volatility)



Other Mature Markets

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Japan

Equities extended their losses as concerns over global growth continues to mount. The Topix lost another 1.9%, pushing its monthly loss to nearly 12%. A potential U.S. government shutdown combined with new tension in the US-China relations added to investor concerns. By contrast, **the yen was little changed (-0.1%).**

As a result of increased tax revenues, the **Ministry of Finance will reduce the size of its bond issuance for a sixth year in 2019**, lowering its offering amounts across the two- to 20-year maturities. The Ministry of Finance will offer ¥129.4 tn ($1.16 tn) of government securities starting next April, down from ¥134.2 tn planned initially. Analysts noted that a reduction in supply could place further downward pressure on JGB yields and could force the BoJ to further scale back its bond purchases. Amid recent market volatility, safe-haven flows have boosted demand for JGBs, pushing the 10-year yield close to zero. **JGB yields edged higher on the day**, with the 2-year yield up 0.5 bps to -0.15% and the 10-year up 2 bps to 0.04%.

Emerging Markets

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Key Emerging Market Financial Indicators

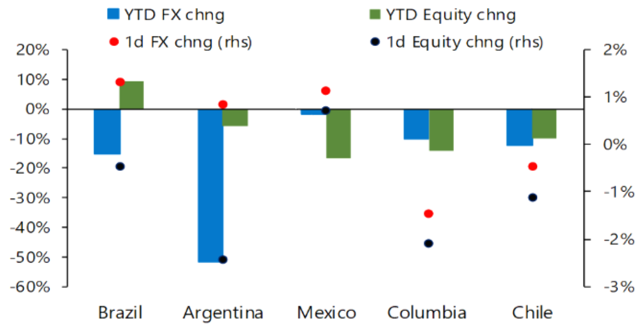
Last updated:	Level		Change				
12/21/18 8:08 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		38.79	-0.3	-4	-4	-16	-18
MSCI Frontier Equities		26.16	0.2	-5	-4	-21	-21
EMBIG Sovereign Spread (in bps)		402	1	12	6	122	117
EM FX vs. USD		62.13	-0.4	0	-1	-10	-11
Major EM FX vs. USD				%, (+) = EM currency appreciation			
China Renminbi		6.91	-0.3	0	0	-5	-6
Indonesian Rupiah		14553	-0.5	0	0	-7	-7
Indian Rupee		70.17	-0.7	2	2	-9	-9
Argentine Peso		38.03	0.0	0	-5	-53	-51
Brazil Real		3.86	-0.4	1	-2	-14	-14
Mexican Peso		19.95	-0.3	1	2	-2	-1
Russian Ruble		68.54	-0.3	-3	-4	-15	-16
South African Rand		14.44	-0.2	0	-4	-12	-14
Turkish Lira		5.30	-0.7	1	0	-28	-28
EM FX volatility		9.53	0.0	-0.4	-0.6	1.6	1.7

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

Asian equities suffered broad-based declines this morning following losses in the US yesterday. Chinese shares (-1.1%) underperformed on renewed U.S.-China frictions and concern about a potential government shutdown in the US. Regional currencies were mixed, with the Korean won pacing gains (+0.5%) and the Indian rupee (-0.7%) underperforming. In **EMEA**, equities were also down but by smaller amounts: Czech Republic (-0.8%), Turkey (-0.8%), and Russia (-0.7%). Currencies were mixed within a narrow corridor, while **Latin American** currencies, despite trading softer this morning, mostly saw gains against the dollar yesterday. The Brazilian real (+1.4%) strengthened the most, followed by the Mexican peso (+1%) and the Argentine peso (+0.8%). Argentine equities (-2.4%) led losses in the region while Mexican assets bucked the trend and gained slightly even as the central bank hiked rates.

Latin America

Latin American assets mostly underperformed this year as currency depreciation took a toll on emerging markets, most notably in Argentina (-52%), causing higher inflation and leading the central bank to increase interest rates. On the other hand, **Brazilian equities (+9%) outperformed** on the optimism that the right-wing president will succeed in pursuing reforms and curbing the debt load of Latin America's biggest economy. A Bloomberg survey reports that among EMs, Brazil will remain the most favored economy in 2019.



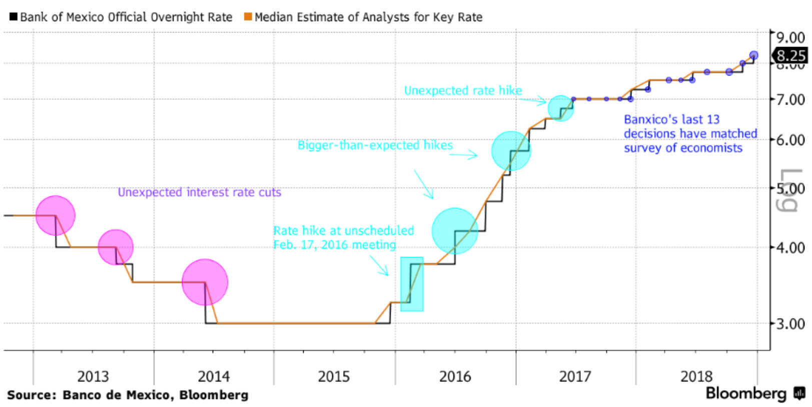
Source: Bloomberg

Mexico

Banxico unanimously decided to hike its policy rate by 25 bps to 8.25%, as widely expected, reaching the highest level since 2008 as inflation remains above the official target rate. The central bank mentioned that the size of the recent increase in minimum wages in addition to its possible direct impact, might fuel salary revisions that outpace productivity gains and generate cost pressures that could affect formal jobs and prices. Analysts interpreted the board's statement to be hawkish and signaled further potential hikes for 2019. The Mexican peso strengthened 1% against the dollar following the rate hike and news that the MEXCAT bondholders would accept the revised offer on the $1.8 bn buyback with a 70% participation rate. All tranches were approved without any additional changes from the second offer.

As Expected

Following a run of surprises, Banxico's moves have aligned with expectations



Source: Banco de Mexico, Bloomberg

EM Asia

Asian equities suffered broad-based declines following losses in the US. The Korean Kospi and the Indonesian Jakarta Composite both held steady, outperforming others. Elsewhere, losses continued to mount with Chinese shares underperforming (Shanghai Composite: -1.1%). **Renewed US-China friction** and concern about a potential government shutdown in the US weighed on investor sentiment. Overnight, the US accused Chinese officials of coordinating efforts to steal intellectual property and other data from US companies; China denied these charges. In other news, **Chinese reports suggest tax cuts and fee reductions could be rolled out in the coming months** in signs of further policy easing. **Currencies were mixed**, with the Korean won pacing gains (+0.5%) and the Indian rupee (-0.5%) underperforming its peers. Year-end dollar sales by Korean exporters likely supported the won while ongoing equity market weakness reportedly sapped sentiment regarding the rupee after its recent gains. The RMB softened a touch (onshore CNY: -0.15%; offshore CNH: -0.10%) as it continued to hover around the 6.90/USD level for the week. On net, trading activity was limited as trading activities slowed heading into year end.

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Global Financial Indicators

Last updated: 12/21/18 8:03 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		2467	-1.6	-7	-7	-8	-8
Europe		2985	-0.5	-3	-5	-16	-15
Japan		20166	-1.1	-6	-6	-12	-11
China		2516	-0.8	-3	-5	-24	-24
Asia Ex Japan		63	0.5	-4	-3	-16	-17
Emerging Markets		39	-0.3	-4	-4	-16	-18
Interest Rates					basis points		
US 10y Yield		2.79	5.2	-10	-27	31	38
Germany 10y Yield		0.25	1.9	-1	-13	-17	-18
Japan 10y Yield		0.05	2.0	1	-5	-1	0
UK 10y Yield		1.31	4.2	7	-9	5	12
Credit Spreads					basis points		
US Investment Grade		139	0.9	5	18	45	48
US High Yield		500	19.7	67	75	125	125
Europe IG		89	1.7	8	11	43	44
Europe HY		357	4.7	21	37	126	124
EMBIG Sovereign Spread		402	1.0	12	6	122	117
Exchange Rates					%		
Dollar Index (DXY)		96.67	0.4	-1	0	4	5
USDEUR		1.14	-0.3	1	0	-4	-5
USDJPY		111.2	0.1	2	2	2	1
EM FX vs. USD		62.1	-0.4	0	-1	-10	-11
Commodities					%		
Brent Crude Oil ($/barrel)		53	-2.6	-12	-17	-18	-21
Industrials Metals (index)		112	-0.1	-2	-3	-16	-19
Agriculture (index)		42	-0.4	-2	-1	-11	-11
Implied Volatility					%		
VIX Index (%, change in pp)		28.6	0.2	6.9	7.8	19.0	17.5
10y Treasury Volatility Index		4.3	0.5	0.5	0.0	0.8	0.8
Global FX Volatility		8.5	0.0	0.1	-0.2	1.2	1.1
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		412	5.1	12	-17	44	43
Italy		254	3.2	-14	-55	105	95
Portugal		141	-1.5	0	-18	6	-10
Spain		113	-1.3	-3	-13	8	-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: 12/21/2018 8:08 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		6.91	-0.3	0.0	0	-5	-6		3.3	-1.5	2	-8	-74	-72
Indonesia		14553	-0.5	0.2	0	-7	-7		8.2	-2.6	-9	-7	141	153
India		70	-0.7	2.5	2	-9	-9		7.4	0.9	-11	-43	4	-8
Philippines		53	0.5	0.1	-1	-5	-6		6.3	0.6	6	-19	152	149
Thailand		33	0.1	0.4	1	0	0		2.7	-1.7	-7	-16	33	38
Malaysia		4.18	0.0	0.2	0	-2	-3		4.1	0.3	-2	-7	19	20
Argentina		38	0.0	0.3	-5	-53	-51		23.1	0.6	-26	-86	713	705
Brazil		3.86	-0.4	1.3	-2	-14	-14		8.2	-8.5	-13	-34	-89	-80
Chile		693	-0.3	-1.2	-4	-10	-11		4.5	-4.8	-12	-21	-35	-29
Colombia		3282	-0.4	-2.6	-3	-10	-9		6.5	-4.0	-7	-29	29	27
Mexico		19.95	-0.3	1.5	2	-2	-1		8.7	-6.4	-38	-44	105	101
Peru		3.3	0.1	0.1	1	-2	-3		5.8	-6.5	-11	0	46	54
Uruguay		32	0.1	0.2	1	-11	-11		10.8	-5.8	-10	-9		225
Hungary		282	-0.4	1.4	0	-7	-8		2.3	-7.5	-8	-31	101	102
Poland		3.75	-0.2	1.2	1	-6	-7		2.3	-3.2	-8	-27	-45	-39
Romania		4.1	-0.3	1.3	1	-4	-4		4.2	0.0	19	-13	37	41
Russia		68.5	-0.3	-2.6	-4	-15	-16		8.5	-3.8	5	1	119	118
South Africa		14.4	-0.2	-0.3	-4	-12	-14		9.7	-3.8	-16	-3	41	37
Turkey		5.30	-0.7	1.1	0	-28	-28		17.3	-27.9	-118	-21	488	532
US (DXY; 5y UST)		97	0.4	-0.8	0	4	5		2.65	-1.9	-8	-24	40	44

	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		2516	-0.8	-3	-5	-24	-24		191	0	0	5	45	39
Indonesia		6164	0.3	0	4	0	-3		225	1	6	-6	64	59
India		35742	-1.9	-1	2	6	5		186	-7	0	14	77	76
Philippines		7480	-1.1	-1	3	-11	-13		114	1	5	-1	27	19
Malaysia		1670	1	1	-1	-5	-7		153	-1	3	9	46	43
Argentina		29243	-2.4	-6	-3	3	-3		812	6	50	130	464	462
Brazil		85429	-0.5	-2	-2	14	12		269	2	12	1	42	35
Chile		5053	-1.1	-2	-1	-7	-9		158	2	2	5	44	39
Colombia		1298	-2.6	-4	-7	-13	-14		220	2	22	7	53	46
Mexico		41683	0.7	0	0	-14	-16		348	2	24	5	110	103
Peru		19085	0	-1	0	-1	-4		164	2	9	-1	30	27
Hungary		39272	-0.8	-2	0	0	0		139	1	-1	-4	58	51
Poland		57809	-0.9	-2	2	-9	-9		73	0	-1	4	34	26
Romania		7114	-3.0	-17	-17	-9	-8		212	-6	-1	3	102	98
Russia		2336	-0.7	-1	-1	12	11		242	-3	2	1	67	64
South Africa		51663	0.6	0	1	-12	-13		353	0	3	-14	101	99
Turkey		91291	-0.6	1	-2	-18	-21		415	-10	-33	-54	125	126
Ukraine		558	-0.9	0	-2	80	77		764	16	46	85	312	309
EM total		23	0.0	-3	-2	-12	-12		402	1	12	6	122	117

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