Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Wednesday, February 6, 2019

- **US firms repatriated $557 bn of cash in first three quarters of 2018 (link)**
- **US corporate bond issuance fell in 2018 (link)**
- **2019 US bank stress test has tough assumptions but better model disclosure (link)**
- **German factory orders add to gloomy European data (link)**
- **Investor concerns about Pemex linger despite Mexico's pledge of support (link)**

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Global markets little changed in light trading

With little new information to catalyze trading, price action was limited in global markets. Asian markets remain largely closed for the lunar new year. In Europe, the negotiations to finalize a Brexit arrangement continue. Underscoring the centrality of the Irish backstop to the final agreement, Irish Prime Minister Varadkar is in Brussels for discussions, while British Prime Minister May is in Northern Ireland for a second day of talks. Tomorrow, PM May is scheduled to travel to Brussels for additional discussions with EC President Juncker.

Key Global Financial Indicators

Last updated: 2/6/19 8:06 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		2738	0.5	4	8	2	9
Eurostoxx 50		3209	-0.2	2	6	-5	7
Nikkei 225		20874	0.1	2	7	-3	4
MSCI EM		43	0.1	4	9	-11	11
Yields and Spreads					bps		
US 10y Yield		2.69	-2.5	1	2	-11	1
Germany 10y Yield		0.17	0.0	-2	-4	-52	-7
EMBIG Sovereign Spread		346	-4	-27	-62	71	-68
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		63.9	-0.3	0	1	-10	3
Dollar index, (+) = $ appreciation		96.2	0.1	1	0	7	0
Brent Crude Oil ($/barrel)		61.9	-0.1	0	8	-7	15
VIX Index (%, change in pp)		15.4	-0.1	-2	-6	-15	-10

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

United States

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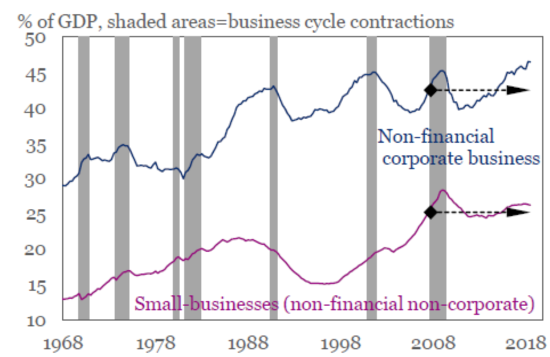
Stocks firmed again Tuesday in quiet trading, with tech stocks (+0.9%) once again outperforming. The S&P 500 has now advanced for 5 straight sessions. Service sector activity as measured by ISM continued to expand in January, but the increase was the smallest improvement in 2 years. Service sector expansion as measured by Markit also slowed. Treasury yields fell 1 to 3 bps across the maturity spectrum.

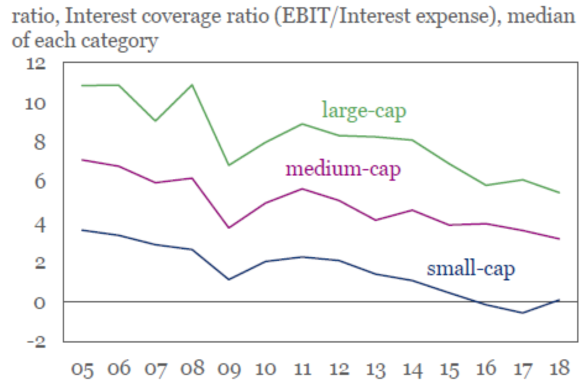
Due to softening profit margins and rising debt levels, the Institute of International Finance gauges that some parts of the **US corporate sector are becoming increasingly vulnerable**. Non-financial corporate debt has been rising and is now over 46% of GDP, which is 4 ppts higher than at the beginning of the financial crisis. Bond issuance spurred most of this growth, with the par value of debt securities now equivalent to over 30% of GDP, up from 23%. By contrast, bank lending to the sector has fallen to 16% of GDP, from 20% at the start of the financial crisis.

Chart 2: Debt in the U.S. Non-Financial Business Sector



Source: IIF, Fed

Chart 6: Interest Coverage Ratios, by market cap



Source: IIF, Bloomberg

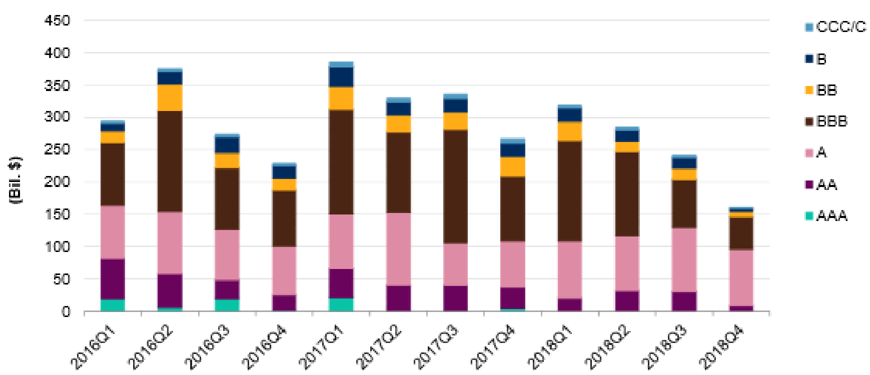
Corporate cash repatriation has been somewhat disappointing, despite being quite sizeable. The current administration pushed through a one-time 15.5% tax on bringing back overseas money. Some $557.1 bn was repatriated in the first three quarters of 2018. Estimates vary, but Bloomberg gauges there was an overseas cash pile of around $1.4 tn at the end of 2017, while MarketWatch put the figure at $3 tn. Bloomberg points out that foreign subsidiaries also need cash and retaining cash in particular international jurisdictions can sometimes be more attractive to firms. Moreover, some firms have encountered difficulties getting refunds from the US government on repatriation taxes they overpaid.

US Corporate Cash Repatriation

Source: Bloomberg

The rush of repatriation last year contributed to a **fall in bond issuance**, as did corporate tax cuts. Corporate bond issuance in 2018 totaled $1.1 tn, falling from $1.4 tn in 2017, and the lowest annual amount since 2012. Among non-financial corporations, speculative-grade issuance dropped 46%. Going forward, S&P expects issuance to further decline this year, with many of the risks prevailing in 2018 to continue this year, "as economic growth slows, fiscal stimulus fades, interest rates remain moderately elevated, and equity markets face continued headwinds."

Quarterly U.S. Corporate Rated Bond Issuance



Sources: Thomson Financial and S&P Global Fixed Income Research.

The market for the Fed-inspired successor to Libor, known as SOFR (secured overnight financing rate), has been growing. Over $40 bn of SOFR-linked securities have been issued in the marketplace since Fannie Mae's inaugural offering last July, but issuance is still mainly the purview of government-sponsored enterprises. JPMorgan notes that the derivatives market associated with SOFR continues to expand gradually. However, Barclays advises that a competing product recently rolled about the ICE "looks very similar to Libor" and could work to slow SOFR's adoption.

Exhibit 5: The number of SOFR-linked floating rate note deals has more than doubled since November, with issuance beginning to increase in maturity

Count, amount issued (in $bn) and balance-weighted spread (in bp) to the benchmark for SOFR-linked FRNs by issuer type

	Financials			GSEs			SSAs		
Term	Cnt	Amt	Sprd	Cnt	Amt	Sprd	Cnt	Amt	Sprd
6M	9	$6.1	42	13	$20.2	4	-	-	-
1Y	4	$.8	46	5	$7.5	8	1	$.0	27
18M	1	$1.0	48	5	$8.1	10	-	-	-
2Y	5	$3.3	61	-	-	-	3	$2.1	27
Total	19	$11.3	49	23	$35.7	7	4	$2.1	27

Note: Data from Bloomberg through 1/31/19. GSEs include FHLMC, FNMA and FHLB.

Source: J.P. Morgan, Bloomberg

2019 CCAR features tougher stress scenario assumptions but more transparent model disclosure. The Federal Reserve's 2019 Comprehensive Capital Analysis and Review (CCAR) process, applied to banks with more than $100 bn in assets, will be calibrated on the harshest economic scenario ever formulated –

with GDP contracting by nearly 10% and unemployment jumping to 10% -- though asset price decline assumptions are largely in line with previous years. Harsh scenarios may somewhat reduce banks' assessed capacity to return capital to shareholders. A key positive, however, is that the Federal Reserve will improve the transparency of its review process by disclosing more information about the mechanics of their loan-loss estimation models, information that could allow banks to engineer more capital-efficient submissions. Also, the Fed will allow banks with less than $250 bn of assets to defer their filings until 2020.

CCAR Stress Test Assumptions: 2019 and Previous Years

	2019 test	2018 test	2015-17 average
Real GDP	-9.4%	-8.9%	-7.0%
Rise in unemployment	6.2	5.9	4.9
Change in DJ industrial	-50.0	-65.0	-50.1
Housing prices	-26.3	-29.9	-24.0
Commercial real esate	-34.8	-40.1	-29.8

Source: Bloomberg

The US trade deficit narrowed by more than expected in November. The balance on trade in goods and services came in at a $49 bn deficit, below the consensus forecast for a $54 bn, and down from $58 bn in the previous month. This was driven by a 2.9% fall in imports; exports also fell, but by 0.6%. There was little market reaction to the data release.

Europe

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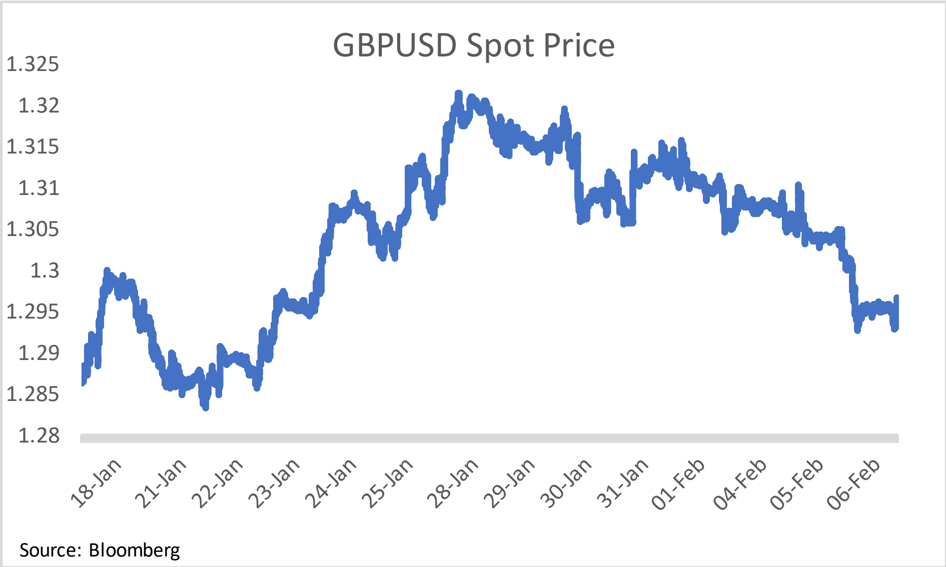
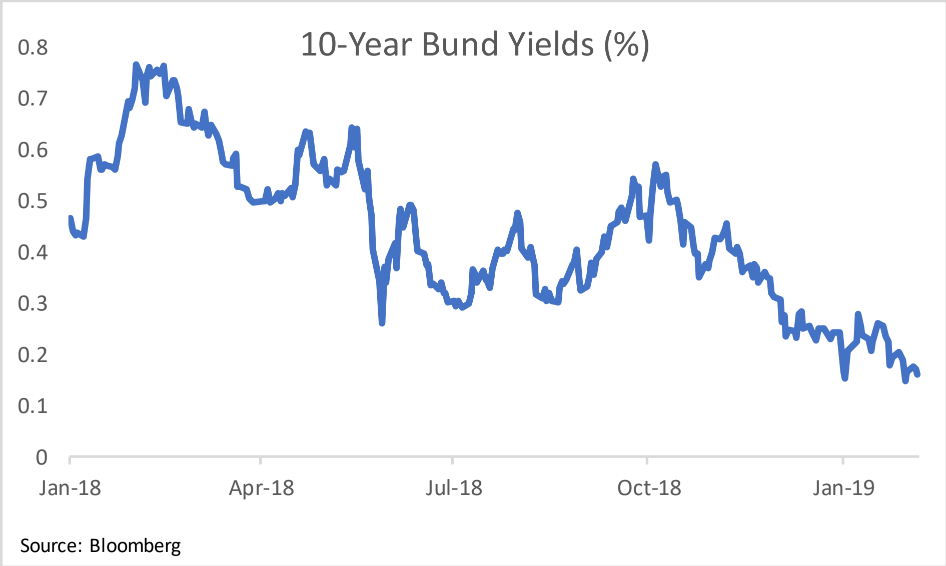
Equities were flat, pausing after 7 straight sessions of gains, as German data disappointed (see below). The Euro Stoxx 50 was unchanged while banks outperformed with a 0.7% gain. Sovereign yields were mostly flat, with BTPs (+1 bps across the curve) seeing the biggest move.

British PM May will travel to Brussels tomorrow for talks with EU leaders. May is expected to seek changes to the Irish backstop despite repeated confirmations from the EU that the withdrawal agreement is final. Yesterday, PM May visited Northern Ireland where she suggested that some form of backstop would have to be included in any final deal. In markets, sterling dipped below $1.30 for the first time in two weeks yesterday on weak PMI data. The broad slowdown poses downside risks to growth in Q1, according to analysts.



German factory orders unexpectedly declined in December, adding to concerns over the slowing economy. The year-over-year decline of 1.6% was the steepest in 6 months, with weak demand for investment goods outside the euro area the main culprit. Some analysts are suggesting that the economy was drifting towards recession as the raft of weakening data points continues. The slowdown has prompted investors to dial back expectations of an interest rate hike at the ECB while 10-year Bund yields are back to their recent lows of 0.16%.



Other Mature Markets

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Japan

Equities closed flat today. Despite losses in automaker stocks, the main the Topix was unchanged while the Nikkei inched up 0.1%. Yields on 10-year JGBs were also unchanged at -0.013%. The yen strengthened 0.3% to the dollar, reaching ¥109.7.

Emerging Markets

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Various **Asian** bourses remain closed today. Stocks in India (+1.0%) advanced while equities in the Philippines (-0.1%) were slightly down. Regional currencies were largely unchanged. In **EMEA**, stocks were mixed, as South Africa (+0.5%) and Poland (+0.3%) posted gains while Russia (-0.4%) and Turkey (-0.4%) saw the largest loses in the region. Currencies were weaker to the dollar, with the largest drop seen in the Hungarian forint (-0.5%) and the Turkish lira (-0.4%). **Latin American** equities were broadly higher, led by gains in Mexico (+1.4%) which benefitted from improved investor optimism about the state-owned oil company, Pemex. Regional currencies were broadly stable. Local government bond yields declined in most countries. **The Polish and Brazilian central banks are expected to keep rates on hold later today.**

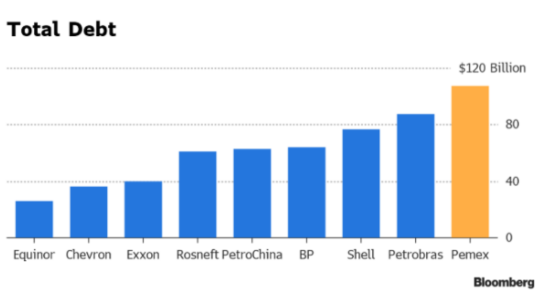
Key Emerging Market Financial Indicators

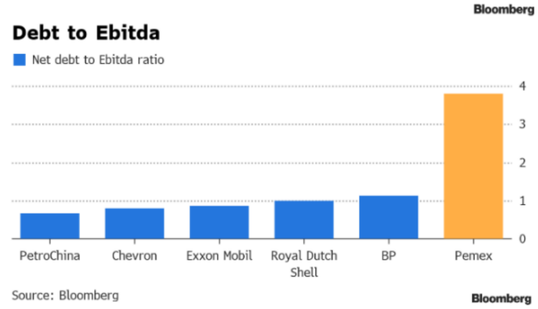
Last updated:	Level		Change				
2/6/19 8:08 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		43.42	0.1	4	9	-11	11
MSCI Frontier Equities		28.57	2.1	1	6	-15	9
EMBIG Sovereign Spread (in bps)		346	-4	-27	-62	71	-68
EM FX vs. USD		63.94	-0.3	0	1	-10	3
Major EM FX vs. USD					%, (+) = EM currency appreciation		
China Renminbi		6.74	-0.7	0	2	-7	2
Indonesian Rupiah		13920	0.3	2	1	-3	3
Indian Rupee		71.56	0.0	-1	-3	-10	-3
Argentine Peso		37.20	0.0	1	0	-47	1
Brazil Real		3.69	-0.7	0	1	-12	5
Mexican Peso		19.11	-0.4	0	1	-3	3
Russian Ruble		65.74	-0.2	-1	1	-14	5
South African Rand		13.46	-0.6	-1	3	-11	7
Turkish Lira		5.21	-0.3	0	3	-28	1
EM FX volatility		8.78	0.0	-0.2	-0.8	0.0	-1.0

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

Mexico

Investor optimism about Pemex, the state-owned oil company, rose yesterday after the government pledged additional support. Pemex's troubles include a large debt of $107 bn (first chart) and high leverage (second chart), which have been compounded by several years of production cuts. The previous support measure announced by the government last month—$3.5 bn of tax cuts over 6 years—was perceived as insufficient and resulted in a downgrade by Fitch and a slump in Pemex bond prices. President Lopez Obrador promised yesterday to announce extraordinary measures. As a result, Pemex 2027 bond prices rose 1.3 cents to a 3-month high of 99.372. Pemex is widely expected to access capital markets soon to make $5.3 bn in debt payments by end-May. Investors are now hoping for a large support package from the government which would tighten Pemex's spread over the sovereign. However, some market commentators noted the lack of details in the

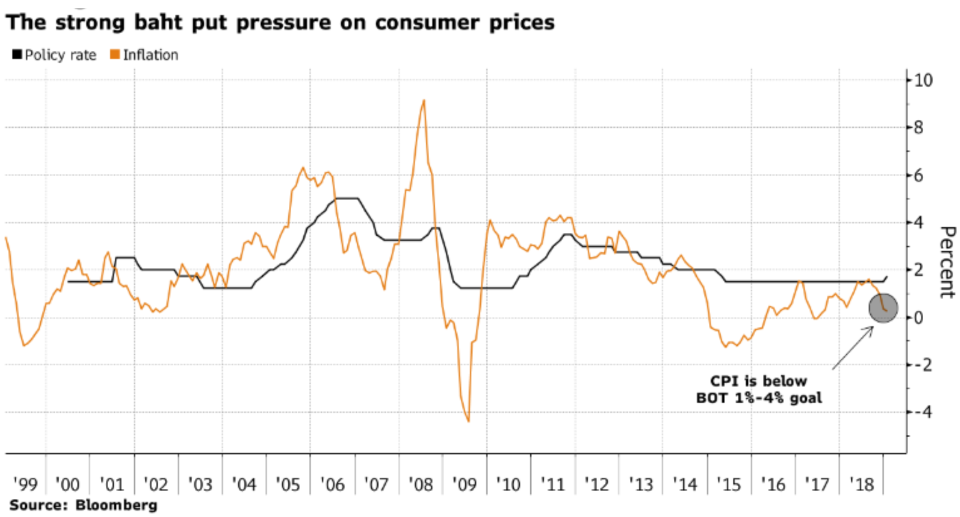




government's announcement and a worrisome outlook for the company. Pemex is the largest borrower in the Bloomberg Barclays USD EM aggregate index.

Thailand

The Bank of Thailand (BoT) left its policy rate unchanged at 1.75%, as expected. The Bank cited a slowdown in inflation and a strong baht as the main reasons for its decision. The baht has strengthened more than 4% year-to-date against the dollar, while inflation continues to undershoot the BoT's target range of 1% to 4%. Analysts expect the BoT to remain on hold for the rest of 2019 as the US Fed pauses its tightening cycle. The BoT's statement also highlighted financial stability risks in the real estate and mortgage markets, where debt levels continue to rise.



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Global Financial Indicators

Last updated: 2/6/19 8:07 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		2738	0.5	4	8	2	9
Europe		3209	-0.2	2	6	-5	7
Japan		20874	0.1	2	7	-3	4
China		2618	1.3	1	4	-24	5
Asia Ex Japan		70	1.4	4	10	-11	10
Emerging Markets		43	0.1	4	9	-11	11
Interest Rates					basis points		
US 10y Yield		2.69	-2.5	1	2	-11	1
Germany 10y Yield		0.17	0.0	-2	-4	-52	-7
Japan 10y Yield		-0.01	-0.4	-2	3	-9	-2
UK 10y Yield		1.23	-0.7	-3	-5	-30	-5
Credit Spreads					basis points		
US Investment Grade		119	-1.8	-6	-30	35	-28
US High Yield		421	-5.6	-22	-76	69	-100
Europe IG		69	-0.2	-4	-17	20	-18
Europe HY		303	-0.3	-17	-42	48	-50
EMBIG Sovereign Spread		346	-4.0	-27	-62	71	-68
Exchange Rates					%		
Dollar Index (DXY)		96.17	0.1	1	0	7	0
USDEUR		1.14	-0.1	-1	-1	-8	-1
USDJPY		109.7	0.2	-1	-1	0	0
EM FX vs. USD		63.9	-0.3	0	1	-10	3
Commodities					%		
Brent Crude Oil ($/barrel)		62	-0.1	0	8	-7	15
Industrials Metals (index)		119	-0.1	2	8	-13	9
Agriculture (index)		43	-0.1	1	1	-11	3
Implied Volatility					%		
VIX Index (%, change in pp)		15.4	-0.1	-2.2	-5.9	-14.6	-10.0
10y Treasury Volatility Index		3.6	-0.1	-0.3	-1.0	-1.5	-0.9
Global FX Volatility		7.7	0.0	-0.1	-1.3	-1.1	-1.2
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		373	0.6	0	-46	69	-42
Italy		264	1.8	23	-5	135	14
Portugal		148	-1.7	0	-12	11	0
Spain		108	-0.6	1	-19	35	-9

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: 2/6/2019 8:09 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		6.74	-0.7	0.1	2	-7	2		3.1	0.0	-3	-4	-93	-13
Indonesia		13920	0.3	1.5	1	-3	3		8.0	0.0	-33	-23	136	-19
India		72	0.0	-0.6	-3	-10	-3		7.6	-0.8	8	11	-18	17
Philippines		52	0.0	0.0	0	-2	0		5.7	0.0	-6	-59	100	-58
Thailand		31	0.1	0.1	2	1	4		2.6	-0.2	-1	1	23	-5
Malaysia		4.09	0.1	0.5	1	-5	1		4.0	0.0	-2	-4	2	-7
Argentina		37	0.0	0.8	0	-47	1		20.5	-39.9	-84	-171	500	-252
Brazil		3.69	-0.7	-0.3	1	-12	5		7.7	3.5	-13	-26	-112	-41
Chile		655	-0.4	2.0	4	-8	6		4.4	-1.3	-8	-2	-47	-8
Colombia		3116	-0.3	1.6	2	-9	4		6.4	0.3	-12	-16	7	-11
Mexico		19.11	-0.4	0.1	1	-3	3		8.4	-5.0	0	-5	79	-29
Peru		3.3	0.2	1.0	1	-3	1		5.6	-1.3	-15	-14	79	-15
Uruguay		32	0.0	0.2	0	-12	0		10.2	0.1	-11	-45		-47
Hungary		280	-0.4	-1.7	0	-10	0		2.0	-1.0	-12	-12	26	-20
Poland		3.77	-0.2	-0.9	-1	-11	-1		2.2	-2.5	0	-6	-52	-4
Romania		4.2	-0.1	-0.6	-2	-10	-2		4.3	2.0	-11	23	34	9
Russia		65.7	-0.2	-0.5	1	-14	5		7.9	-2.9	-18	-49	94	-48
South Africa		13.5	-0.6	-1.0	3	-11	7		9.3	-3.8	-16	-10	15	-27
Turkey		5.21	-0.3	0.3	3	-28	1		15.1	7.7	-72	-205	338	-178
US (DXY; 5y UST)		96	0.1	0.9	0	7	0		2.50	-0.8	2	0	-4	-1

	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		2618	0.0	1	4	-24	5		184	0	1	-1	25	-10
Indonesia		6548	1.0	2	4	-1	6		188	0	-15	-44	31	-48
India		36975	1.0	4	4	8	3		174	0	-8	-20	56	-22
Philippines		8058	-0.1	0	4	-6	8		87	0	-15	-25	-4	-34
Malaysia		1684	0	-1	1	-9	0		134	1	-7	-24	27	-28
Argentina		37472	0.9	6	16	18	24		642	6	-47	-89	246	-173
Brazil		96582	-0.3	0	5	15	10		235	4	-3	-28	5	-38
Chile		5465	-0.1	1	5	-4	7		137	-2	-9	-21	23	-29
Colombia		1493	1.3	3	10	-2	13		188	3	-8	-26	21	-40
Mexico		44337	1.4	2	4	-10	6		308	-1	-20	-35	81	-46
Peru		20518	0	2	5	0	6		137	1	-11	-28	14	-31
Hungary		40403	-0.2	-1	1	4	3		110	-8	-25	-31	22	-38
Poland		61165	0.0	2	6	-2	6		52	0	-16	-22	-2	-33
Romania		7423	0.2	5	-3	-7	1		194	-6	-23	-21	77	-27
Russia		2546	-0.1	1	6	14	7		217	-5	-6	-26	61	-35
South Africa		54732	1.0	1	5	-3	4		281	-6	-34	-72	49	-84
Turkey		102248	-0.2	-2	15	-11	12		382	-15	-36	-63	96	-47
Ukraine		557	0.0	1	1	66	0		666	-14	-21	-152	267	-121
EM total		43	0.1	4	9	-11	11		346	-4	-27	-62	71	-68

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