Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Wednesday, November 14, 2018

- **US oil benchmark WTI dropped yesterday to its biggest 1-day loss in 3 years (link)**
- **Global investor survey flags trade tensions as biggest risk for markets (link)**
- **PM May and EU reach Brexit agreement, but still requires cabinet and parliamentary approval (link)**
- **Italian bond spreads continue to widen as government stands firm over budget plans (link)**
- **China's mixed economic reports suggest more room for supportive measures (link)**
- **S&P cuts Argentina's sovereign rating one notch to B (link)**

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

Oil, Brexit and Italian budget headlines keep markets under pressure

European bourses traded lower this morning and S&P futures were flat as markets remained cautious on various fronts. Oil prices recovered some ground today after US oil benchmark WTI saw its biggest one-day loss in three years (-7.1%) yesterday on President Trump criticism of a possible OPEC output cut. In the UK, news broke that negotiators have reached a draft Brexit agreement but this still requires cabinet and parliamentary approval. Sterling appreciated yesterday on news of the agreement but gave up some of these gains once criticism of the deal started to emerge and traded marginally weaker this morning. Meanwhile, Italian sovereign bond spreads continued to widen as the government stood firm on its budget proposals. Elsewhere, a raft of mixed economic data in China may indicate more stimulus ahead while S&P cut Argentina's sovereign rating one notch to B. Equities traded moderately lower across Asia and EMEA while EM currencies were mixed this morning.

Key Global Financial Indicators

Last updated: 11/14/18 8:28 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		2722	-0.1	-1	-2	6	2
Eurostoxx 50		3222	-0.1	-1	1	-9	-8
Nikkei 225		21846	0.2	-1	-4	-2	-4
MSCI EM		40	-0.2	-3	-1	-13	-16
Yields and Spreads				bps			
US 10y Yield		3.15	-4.2	-9	-1	78	74
Germany 10y Yield		0.41	0.0	-4	-9	1	-2
EMBIG Sovereign Spread		373	4	8	21	73	88
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		61.7	0.2	-1	-1	-9	-11
Dollar index, (+) = $ appreciation		97.1	-0.2	1	2	5	5
Brent Crude Oil ($/barrel)		66.2	1.1	-8	-18	6	-1
VIX Index (%, change in pp)		20.2	0.2	0	-1	9	9

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

United States

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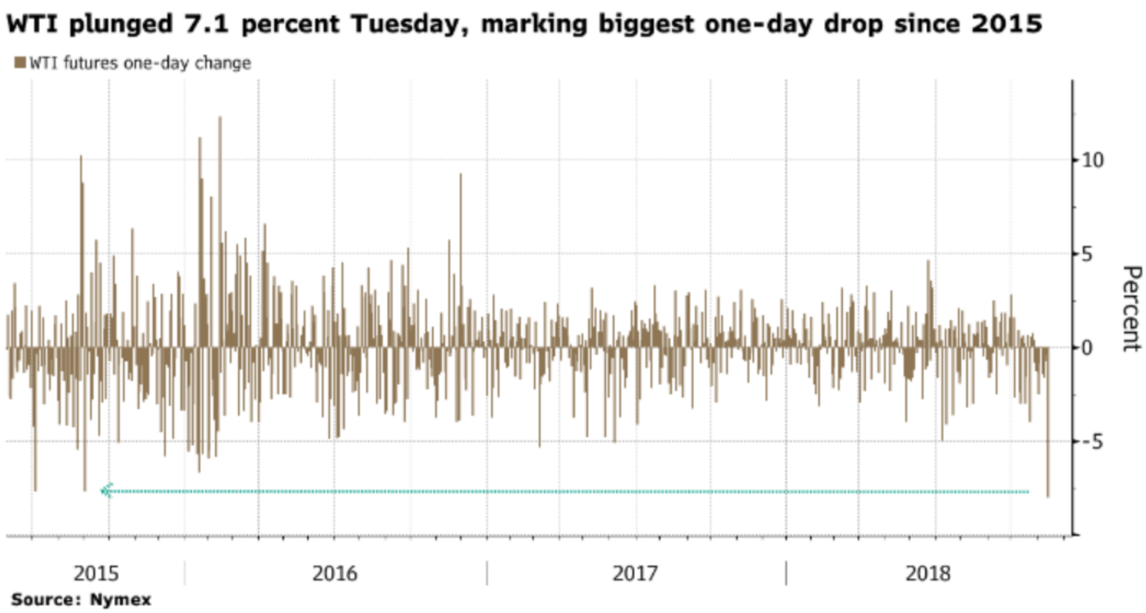
Oil prices recovered some ground this morning after the US oil benchmark WTI saw its biggest one-day loss in three years (-7.1%) and extended its losing streak to 12 consecutive days, itself a record. The selloff accelerated after President Trump criticized OPEC for high oil prices on Monday, but there have other bearish circumstances in play. OPEC's latest forecasts predict a significant decline in global oil demand in 2019 relative to its current production levels, even as production from non-OPEC countries such as the US and Canada is expected to ramp up. Some analysts also expect China's oil demand to weaken as its economy slows. Also, some investors miscalculated the impact of the Iran sanctions as the US issued waivers to major customers such as China and India, resulting in higher supply to the market. As of the Tuesday close, WTI was down nearly 28% since the 2018 high set on October 3rd and Brent was down nearly 24%. Industrial metals also hit a new low for the year, another sign of pessimism regarding China.



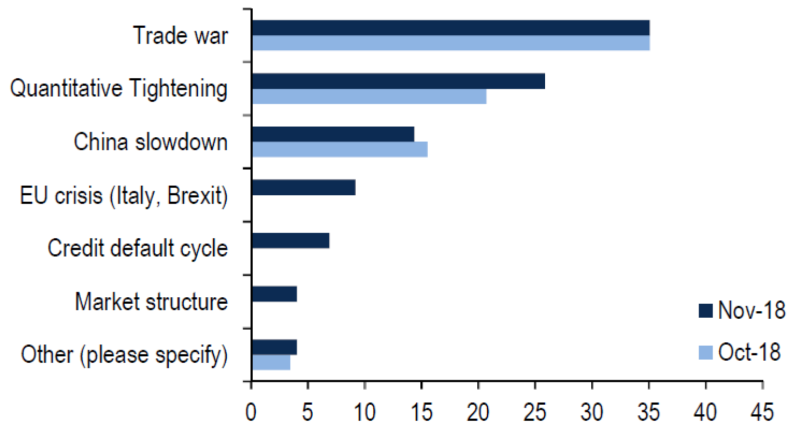
Stocks gave up early-morning gains prompted by the news of the potential deal on Brexit and hopes of lower tariff tensions. The S&P 500 posted its fourth consecutive day of losses. Reports that Boeing's aircraft sales for certain key models had fallen below forecasts also hurt sentiment, reinforcing the growing belief that Q3 2018 may be an earnings peak for US stocks and that a strong dollar could hurt US corporate earnings. Treasuries rallied again, with the 10-year yield down 10 bps from its intra-day level just a week ago. However, several analysts have commented on how relatively little Treasury rates have moved despite all the recent negative news flow and the big equity selloff in October, suggesting that interest rates could move sharply higher given the right circumstances such as an improvement in market sentiment. In other news, the latest Fed senior loans officer survey found that lending standards eased somewhat in Q3 2018.

This morning, both measures of **US CPI rose in line with expectations in October**. CPI increased 0.3% mom from +0.1% mom in September and its core measure, excluding food and energy, rose 0.2% mom from +0.1% mom the previous month. US Treasury yields were little changed immediately following the release.

Trade tensions are still the biggest risk factor for markets, according to the latest Bank of America investor survey. However, quantitative tightening is growing in importance as a potential risk, with 25%

of investors flagging it as the biggest risk compared to 20% in the previous survey. The survey also found that investors think the most crowded trades are being long technology stocks and being short US Treasuries. They do not see value in the Treasury market until the 10-year yield hits 3.70%, up 20 bps from the April survey. Investor allocation to equities is 31% overweight, which is close to the historical average. The average allocation to bonds is 58% underweight compared to the record of 69% overweight in February.

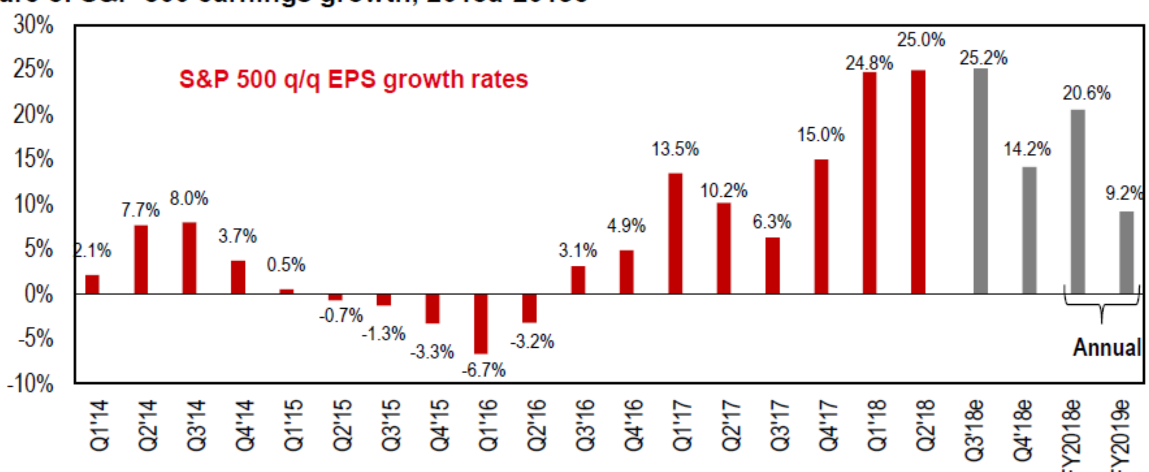
Exhibit 18: What do you consider the biggest "tail risk"?



Source: BofA Merrill Lynch Global Fund Manager Survey

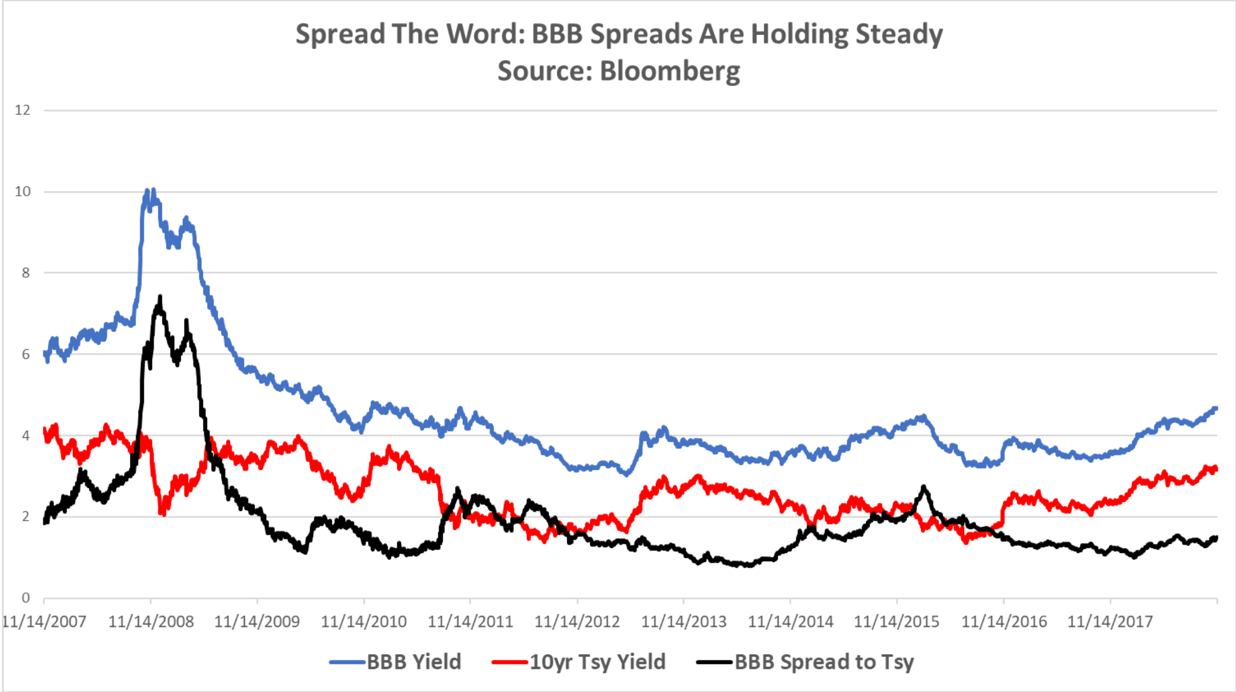
Earnings growth for S&P 500 corporations came in at a robust 20.6% in Q3 2018, but many investors think that future growth will be much more subdued. Analysts think this pessimism about future earnings is what caused the decline in equity markets despite the strong top-line revenues and bottom-line earnings, and many are themselves forecasting much slower earnings growth in 2019. Investor worries about earnings are also driving spread widening in the investment grade (IG) corporate bond market, which has seen leverage among non-financial corporates rise to very high levels. In addition, lower-rated companies have come to dominate the volume of IG issuance as BBB-rated companies now account for 50% of the market. This is the highest proportion for BBB issuers in history.

Figure 8: S&P 500 earnings growth, 2013a-2019e



Source: HSBC, Bloomberg, FactSet

Despite recent market turmoil and despite its growth in size, spreads in the BBB-rated corporate bond sector have remained very stable. Recent troubles at Ford (BBB-) and GE (BBB+) have raised fears that there is a risk of a growing number of "fallen angels," i.e. investment grade companies downgraded to junk status. Such a trend might lead to higher funding costs for these companies and downstream spillovers to the wider market and employment. However, spreads have remained steady as many analysts have pointed out that many companies are headed the other way towards higher credit ratings. By some estimates, a larger group of companies rated BBB- are on review for an upgrade than a downgrade. Although IG returns in 2018 are on schedule to be the worst since 2008, the fallout for spreads has been less than what was expected by many investors.



Europe

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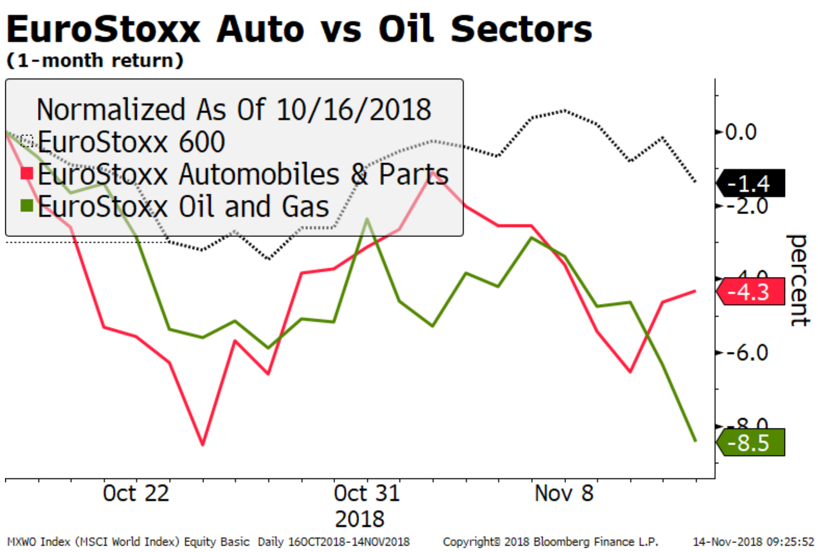
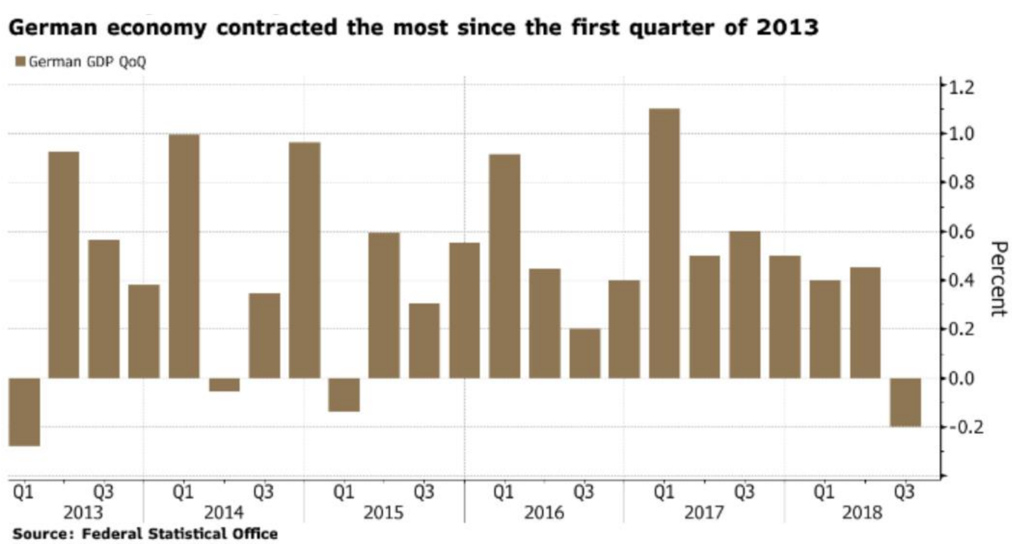
Equity markets are broadly lower with the energy sector still underperforming. The EuroStoxx 600 index is -0.5% but the oil and gas sub-index is -1% today (and -2.8% over the last two sessions). In contrast, Europe's automobile sub index is up 3.5% over the last two sessions after Trump signaled a softening of the administration's stance towards car imports. Italian stocks are underperforming (-1.0%) on lack of progress regarding the budget dispute, while UK stocks (-0.2%) are outperforming on hopes for a Brexit deal.

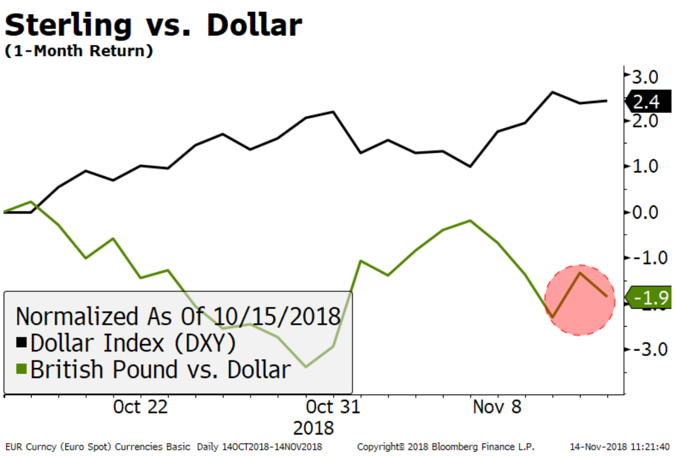


German yields are a couple of basis points lower today but remain well within recent ranges. The German economy contracted for the first time since Q1 2015 and by the most since Q1 2013. Q1 GDP came in at -0.2% qoq (-0.1% expected) and 1.1% yoy, but some analysts played down the data, attributing it to temporary negative impact of the emissions tests disrupting car production. Preliminary euro area Q3 GDP came in at 1.7% yoy, as expected. **Yields are up 7 bps across the Italian sovereign curve (see below).** The 10-year rising for the fifth consecutive session to 3.5%, 18 bps below high for the year in mid-October.



United Kingdom

Sterling appreciated yesterday on news of an agreement between the EU and the UK on the Brexit withdrawal text but gave up some of these gains once criticism of the deal started to emerge. Still, the currency is up 1% against the dollar since yesterday's open. Negotiators have agreed on a text that includes a backstop for the UK as well as a "deeper" backstop for Northern Ireland, which would entail greater regulatory alignment. The cabinet will meet at 14:00 GMT to discuss the terms. If they agree, PM May will try to secure an EU summit later this month to finalize the deal before taking it to parliament. It's unclear whether she will have enough votes in her cabinet or parliament. Indeed, **Labour members and Brexit-supporting Conservative MPs have already come out against the deal, complaining about the reported backstop and the nature of the proposed links to the EU**. EU27 ambassadors are meeting today.



Italy

Contrary to media speculation, the government did not alter its growth and deficit targets embedded in the budget. The only change was a marginal increase in the privatization revenue goal to 1% of GDP for 2019, up from a prior 0.3% annually for the 2019-2021 period. But this will only reduce the debt-to-GDP ratio from 126.7% to 126.0% in 2021. Several analysts consider the Excessive Deficit Procedure (EDP) almost inevitable now. The EC is expected to issue its assessment of the budget next week, then EU's Economic and Financial Committee has until December 8 to issue an opinion, then the EC can formally recommend initiating a EDP.

Other Mature Markets

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Japan

Equities bucked the overall trend in the region and were moderately higher. The Nikkei and Topix both rose 0.2% as communication and IT stocks recovered some of the recent losses. Bonds also rose, giving rise to speculation that the BoJ may reduce further its purchases. Elsewhere, GDP data for Q3 came in more or less as expected. The seasonally adjusted q-o-q number was -0.3%, in line with expectations, while the annualized number was slightly worse than expected at -1.2%. The quarter was negatively affected by natural disasters with analysts broadly expecting a rebound in Q4.

Emerging Markets

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Key Emerging Market Financial Indicators

Last updated:	Level		Change				
11/14/18 8:30 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		39.69	-0.2	-3	-1	-13	-16
MSCI Frontier Equities		26.85	-0.9	-2	-3	-14	-19
EMBIG Sovereign Spread (in bps)		372	3	7	20	72	87
EM FX vs. USD		61.73	0.3	-1	-1	-9	-11
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.95	0.1	0	-1	-5	-6
Indonesian Rupiah		14787	0.1	-1	3	-8	-8
Indian Rupee		72.31	0.5	1	2	-10	-12
Argentine Peso		36.07	-0.1	-1	2	-52	-48
Brazil Real		3.80	0.3	-2	-2	-13	-13
Mexican Peso		20.44	0.3	-3	-8	-6	-4
Russian Ruble		67.40	1.0	-2	-3	-10	-14
South African Rand		14.36	0.7	-3	0	0	-14
Turkish Lira		5.47	0.2	-2	6	-29	-31
EM FX volatility		10.15	0.0	0.3	-0.3	2.0	2.3

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

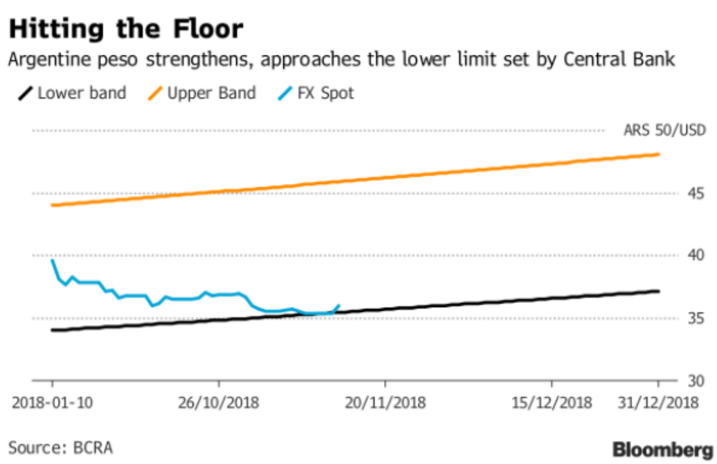
China

China's mixed economic reports suggest more room for supportive measures. The October economic data showed that fixed asset investment growth picked up to 5.7% year to date, up from 5.4% in the previous release. The increase was partly driven by the rebound in infrastructure spending by the government, mainly in projects related to environmental protection and road transportation, while some hydro power and energy projects also accelerated. This helped offset the slowdown in property investment. Meanwhile, industrial production growth edged up to 5.9% yoy in October from 5.8% in September, thanks to expansion in cement and steel production. However, the output of export-oriented items, such as integrated circuits, saw a sharp decline as higher US tariffs started to bite. There were also signs of moderation of consumer spending, with growth in retail sales slowing from 9.2% to 8.6% in October, partly due to slump in auto sales. With these mixed economic readings, analysts are generally expecting the Chinese government to roll out more stimulus measures to prevent a sharper deceleration in economic activities.

Chinese stock market fell on worries over slowdown in global growth amid the sharp fall in oil prices. The Shanghai A-share index slid 0.9%, mainly dragged by energy-related stocks that fell by 2.8%. The decline in Shenzhen small-cap ChiNext was less prominent, slipping by 0.5%. In the currency market, the renminbi was little changed against US dollar, trading at 6.9509 in the onshore market versus 6.9493 in the offshore market.

Argentina

S&P cut the country's rating by one notch to B on a weakening economy. The S&P rating is now five notches below investment grade and is in line with the ratings by Moody's and Fitch. The outlook is stable, with expectations that the government will implement measures to anchor the economy over the next 18 months. S&P cited the country's weak fiscal and external positions, limited flexibility of monetary policy, growing debt, and reliance on foreign borrowing as key factors behind the downgrade. The peso dropped 1.1% yesterday and equities weakened 3.0%, underperforming their regional peers. Some analysts indicated that the downgrade will have a limited lasting effect on the market, given that the country is already deeply into non-investment grade. Some commentators noted that the pressure on the central bank to decide on FX intervention has been alleviated for now, as the peso had been approaching the lower bound of the non-intervention zone (figure).

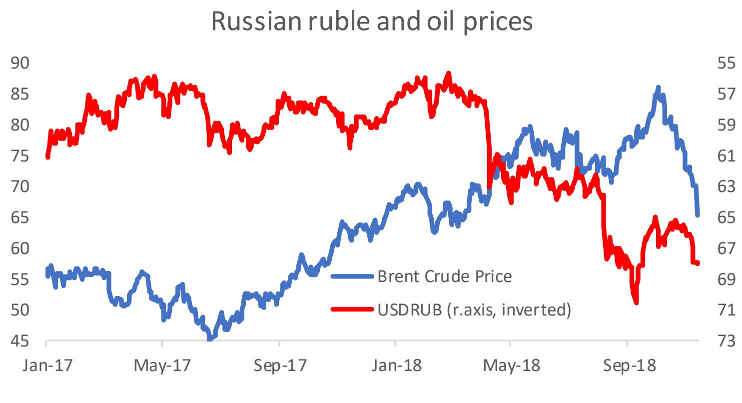


Thailand

The central bank kept interest rates on hold in a tight vote. Four of seven committee members voted to keep rates at 1.5%, with the remaining three opting for a 25-bps hike. The benchmark rate has remained unchanged since 2015 with subdued inflation and a softening of data preventing a rise in rates recently. In its statement, the committee said it felt that "monetary policy should remain accommodative, although the need for currently accommodative monetary policy would be gradually reduced". Inflation is currently at 1.2%, within the bank's target range of 1 to 4 percent but close to the lower bound.

Russia

There was little market reaction as GDP disappointed in Q3. Annual growth slowed from 1.9% in Q2 to 1.3% in Q3, slightly slower than the consensus expectations. Little detail was provided on the composition but analysts pointed to monthly data showing a decelerating industrial output and retail spending as well as declines in construction and agriculture. The ruble was 0.2% weaker on the day but has erased those losses this morning. After large losses towards the end of last week, the currency has been resilient this week to the rapid fall in oil prices, although it remains 2.6% weaker month-to-date, underperforming all other major EM currencies. Fading expectations of further sanctions from the US may have helped support the ruble this week.



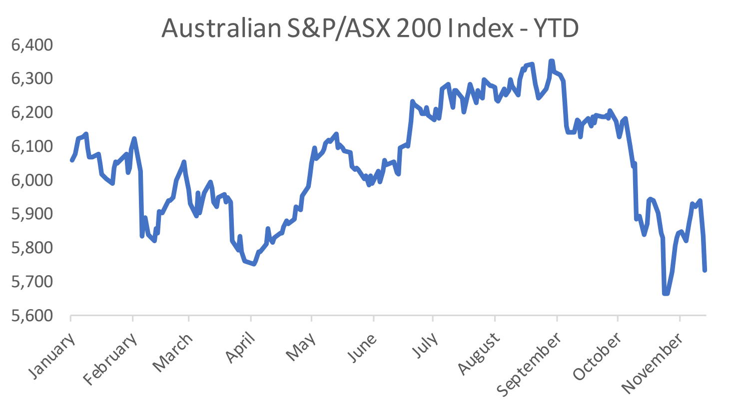
Source: Bloomberg

Poland

The director of the Financial Supervision Authority resigned yesterday after bribery allegations surfaced. The director, Marek Chrzanowski, was said to have requested significant bribes from Getin Noble Bank, a troubled lender, in exchange for protection during the bank's potential restructuring process. The bank officials are said to have recorded the exchange but Chrzanowski denies the claims and said he was stepping down to "for the good of the state". PM Morawiecki has asked prosecutors as well as the security services to look into the claims.

Australia

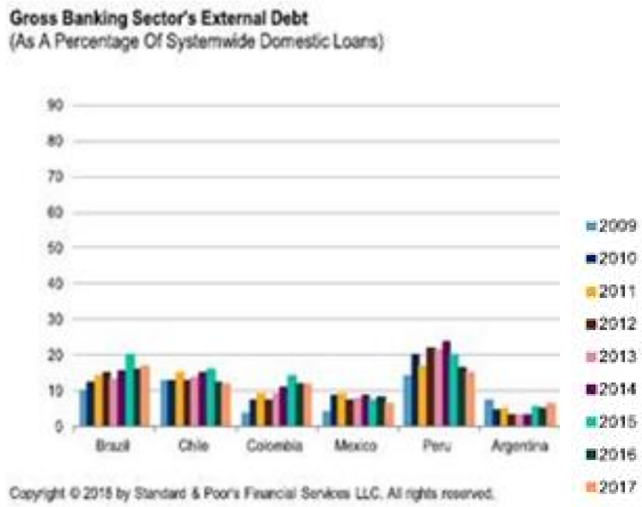
Stocks were firmly in the red on falling energy prices and concerns over Chinese growth. The S&P/ASX 200 was 1.7% lower as energy, health care, and bank stocks all saw losses of more than 2%. The two-day loss of 3.5% is the heaviest since February as yesterday's 7%-drop in oil prices weighs on the index. Global trade concerns and a worrying outlook for the big banks has added to the negative momentum in equities. On the data front, wage growth accelerated to its fastest since 2015.



Source: Bloomberg

Regional banks (Latam)

Latin American financials have outperformed their EM peers by around 8 ppts this year. Within the region, Brazilian and Peruvian banks have outperformed, while those in Mexico and Colombia have remained under pressure. S&P analysis highlighted that Latin American banks are now well positioned to withstand political risk and market volatility in 2019. This is against the backdrop of the still-high political uncertainty in the region, investors' risk aversion to EMs, and a modest extent of economic rebound in the region. Analysts highlighted that key regional banks have conservative growth strategies, maintain and a low reliance on external funding, and preserve sound reserve coverage and healthy margins.



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Global Financial Indicators

Last updated: 11/14/18 8:29 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		2722	-0.1	-1	-2	6	2
Europe		3222	-0.1	-1	1	-9	-8
Japan		21846	0.2	-1	-4	-2	-4
China		2632	-0.9	0	1	-23	-20
Asia Ex Japan		64	1.9	-2	-1	-15	-16
Emerging Markets		40	-0.2	-3	-1	-13	-16
Interest Rates					basis points		
US 10y Yield		3.15	-4.2	-9	-1	78	74
Germany 10y Yield		0.41	0.0	-4	-9	1	-2
Japan 10y Yield		0.11	-0.3	-1	-4	6	6
UK 10y Yield		1.50	-1.9	-3	-13	18	31
Credit Spreads					basis points		
US Investment Grade		109	0.0	5	8	8	18
US High Yield		382	-0.5	29	34	-15	7
Europe IG		72	1.0	5	-3	19	27
Europe HY		297	2.9	16	2	47	63
EMBIG Sovereign Spread		373	4.0	8	21	73	88
Exchange Rates					%		
Dollar Index (DXY)		97.15	-0.2	1	2	4	5
USDEUR		1.13	0.1	-1	-2	-4	-6
USDJPY		113.9	-0.1	0	-2	0	-1
EM FX vs. USD		61.7	0.2	-1	-1	-9	-11
Commodities					%		
Brent Crude Oil ($/barrel)		66	1.1	-8	-18	6	-1
Industrials Metals (index)		113	0.0	-2	-6	-12	-18
Agriculture (index)		43	0.3	-2	-3	-11	-10
Implied Volatility					%		
VIX Index (%, change in pp)		20.2	0.2	0.3	-1.1	8.6	9.1
10y Treasury Volatility Index		4.1	0.0	-0.6	0.1	0.2	0.6
Global FX Volatility		8.5	0.0	0.4	0.2	0.9	1.1
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		411	6.4	25	20	-57	42
Italy		306	2.6	17	-2	163	147
Portugal		155	1.0	7	0	-2	3
Spain		121	0.9	5	3	7	7

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: 11/14/2018 8:31 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		6.95	0.1	-0.5	-1	-5	-6		3.4	-1.2	-7	-14	-56	-54
Indonesia		14787	0.1	-1.3	3	-8	-8		8.3	-4.4	-2	-46	139	170
India		72	0.5	1.0	2	-10	-12		7.8	-2.5	-4	-27	62	36
Philippines		53	-0.1	-0.6	2	-4	-6		6.7	1.9	8	15	186	187
Thailand		33	0.0	-0.4	-1	0	-1		2.9	0.2	2	-3	61	60
Malaysia		4.20	-0.1	-0.8	-1	0	-4		4.2	1.8	1	7	8	27
Argentina		36	-0.1	-1.1	2	-52	-48		23.9	15.0	34	128	750	785
Brazil		3.80	0.3	-1.6	-2	-13	-13		8.8	1.5	14	-46	-24	-21
Chile		688	0.6	-1.7	-2	-8	-11		4.8	-2.2	0	-10	10	0
Colombia		3199	-0.2	-2.2	-3	-6	-7		6.8	2.0	1	7	32	58
Mexico		20.44	0.3	-2.8	-8	-6	-4		9.0	13.7	42	90	170	136
Peru		3.4	-0.2	-0.3	-1	-4	-4		5.9	2.9	0	6	55	65
Uruguay		33	-0.3	0.0	1	-10	-12		10.7	1.0	3	19		209
Hungary		286	0.1	-1.5	-2	-7	-9		2.8	2.6	11	-15	141	151
Poland		3.80	0.1	-1.2	-2	-5	-8		2.6	-0.2	4	-2	-19	-11
Romania		4.1	0.0	-1.1	-2	-5	-6		4.4	2.0	-1	-26	60	53
Russia		67.4	1.0	-1.7	-3	-10	-14		8.7	1.5	34	22	115	141
South Africa		14.4	0.7	-3.2	0	0	-14		9.8	0.2	8	-5	-20	50
Turkey		5.47	0.2	-1.9	6	-29	-31		17.3	6.8	-7	-341	481	533
US (DXY; 5y UST)		97	-0.2	1.2	2	4	5		2.99	0.9	-9	-2	93	79

	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		2632	-0.2	0	1	-23	-20		182	-3	-1	-2	40	30
Indonesia		5858	-1.4	-1	2	-2	-8		217	2	-6	15	42	51
India		35142	-0.3	0	1	7	3		169	0	1	3	52	59
Philippines		6923	-1.6	-2	-1	-17	-19		108	1	-5	-1	8	13
Malaysia		1688	-2	-2	-2	-3	-6		139	1	-4	12	27	29
Argentina		28543	1.4	-9	-4	11	-5		637	0	33	-19	255	287
Brazil		84507	-1.1	-4	2	19	11		256	-2	1	-5	8	22
Chile		5129	0.0	-2	0	-3	-8		141	-1	-11	17	15	22
Colombia		1387	1.5	-1	-5	-3	-8		200	1	1	21	9	26
Mexico		42421	1.3	-8	-11	-11	-14		324	-1	14	64	73	79
Peru		18976	0	-2	-1	-3	-5		158	1	-8	15	19	21
Hungary		38721	1.4	1	7	-1	-2		131	4	7	17	34	43
Poland		57041	-1.3	0	1	-10	-11		60	5	8	-1	11	13
Romania		8557	-1.3	-1	2	10	10		196	9	8	13	64	82
Russia		2373	-3.0	-3	-1	9	12		237	0	5	12	49	59
South Africa		51708	-5.5	-5	-3	-13	-13		337	2	-2	3	22	83
Turkey		93227	-2.4	-2	-4	-15	-19		431	1	4	-33	101	142
Ukraine		608	3.7	4	10	101	93		635	8	35	64	163	180
EM total		24	-3.6	-2	-1	-11	-11		372	3	7	20	72	87