Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Friday, November 16, 2018

- **Fed announces comprehensive review of its strategies, tools and communication practices (link)**
- **Vote of no confidence in the UK gains traction after further resignations (link)**
- **Brazil's central bank to be headed by Campos Neto from Banco Santander (link)**
- **Mexican central bank hikes policy rate by 25 bps to 8% (link)**
- **China's easing of rules on equity financing may increase stock market risks (link)**

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Markets under Pressure as Focus Remains on Trade and Brexit

Global equity markets are under pressure this morning against a backdrop of heightened political strains in the UK and simmering trade tensions between the US and China. In the UK, PM May could face a no-confidence vote, with at least 20 members of her conservative party reportedly demanding such a vote. On trade, investors continue to gauge the chances of progress at the upcoming Trump-Xi meeting at the G-20 summit in late November. US stock futures suggest that equity markets will open 0.6% lower this morning, after similar declines on European and Japanese bourses. Credit spreads across the major markets have continued to drift up, led by the US high yield sector (+50 bps over the past week). The Brent oil price is up 1.7% today at $67.8 per barrel, boosted by expectations that OPEC will cut production to reduce supply. In EMs, most currencies are little changed while bond yields and spreads have generally edged down today.

Key Global Financial Indicators

Last updated: 11/16/18 7:45 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		2730	1.1	-3	-3	6	2
Eurostoxx 50		3178	-0.4	-2	-2	-11	-9
Nikkei 225		21680	-0.6	-3	-4	-3	-5
MSCI EM		41	-0.5	1	0	-12	-13
Yields and Spreads					bps		
US 10y Yield		3.10	-1.5	-8	-6	73	70
Germany 10y Yield		0.36	0.2	-5	-13	-1	-7
EMBIG Sovereign Spread		380	2	18	32	83	95
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		62.3	-0.1	0	-1	-9	-11
Dollar index, (+) = $ appreciation		97.0	0.0	0	2	5	5
Brent Crude Oil ($/barrel)		67.6	1.5	-4	-17	10	1
VIX Index (%, change in pp)		20.8	0.8	4	3	9	10

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

United States

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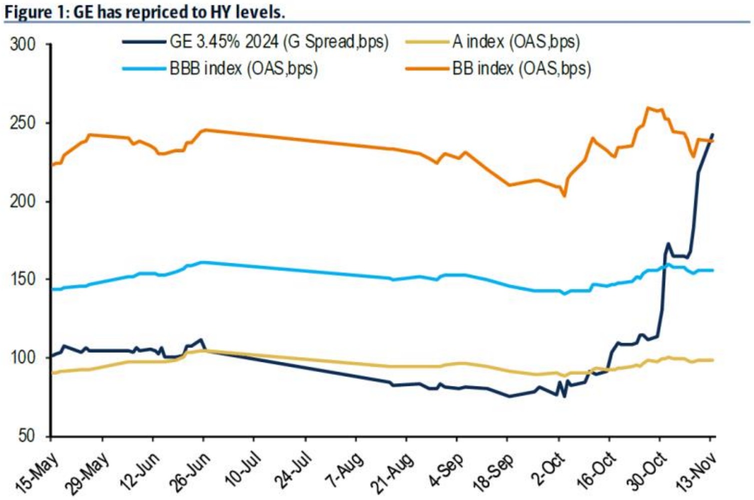
In an unexpected move, Fed Chair Powell announced a comprehensive public review of the Fed's practices to be held in 2019. According to the Fed's press release, the review will cover tools, strategies and communication practices and will involve significant outreach efforts. The effort will assess how the Fed should "formulate, conduct, and communicate monetary policy," with the findings to be reported after the "year of review." As part of the review, a research conference is to be held in Chicago on June 4-5, 2019.

The US equity market snapped a five-day losing streak as stocks finally enjoyed a positive session, with the S&P 500 gaining 1.1%. However, sentiment remained cautious and Treasury yields ended 2-3 bps lower on safe haven trading. Buffeted by conflicting rumors about the US-China trade dispute, the equity benchmark fluctuated widely before closing higher.

General Electric's bonds saw their spreads rise sharply this month. The downgrades and other problems faced by GE has increased scrutiny of other parts of the US investment grade (IG) corporate bond market. GE bonds are now trading at BB-rated junk levels and credit spreads in the sector have widened sharply. The Bloomberg Barclays US Corporate Aggregate benchmark spread is close to its highest level of the year. On a total return basis, the sector is set to deliver its worst performance since 2008. Investors are worried that other highly indebted companies could come under pressure and some prominent investors have identified the GE episode as a potential trigger for more stress in the US corporate IG market. The California utility company PG&E became the latest US investment grade company to see its bonds come under pressure due to credit concerns. Investors are worried about the impact of the California fires on the company.

Figure 1: GE has repriced to HY levels.

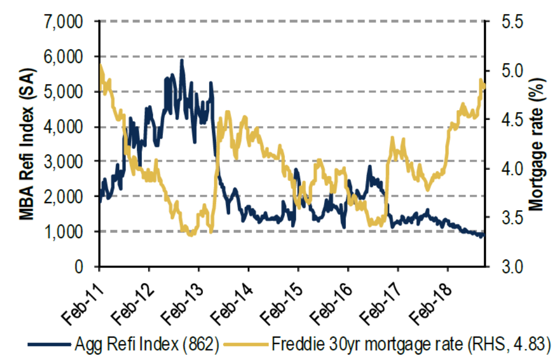


Source: ICE Data Indices, LLC, Bloomberg, BofA Merrill Lynch Global Research

The largest US banks have significantly reduced their involvement in the leveraged loan market and the high yield market more broadly. Leveraged loans are typically arranged by a syndicate of banks and made to companies that are heavily indebted or have weak credit ratings. They are called "leveraged" because the ratio of the borrower's debt to assets or earnings significantly exceeds industry norms. The share of large US banks in leveraged loan and high yield issuance has fallen from a majority position 10-12 years ago to just 35.7% and 32.8%, respectively. Other players such as Canadian banks, US regional banks, banks from the Asia-Pacific region and non-bank financial companies have stepped in to take their place. Regulators have flagged weak credit standards in the leveraged loan market as an area for concern and some investors take comfort from the fact that the G-SIBs have lower exposure to the sector. However, others worry that pushing the bulk of the activity into less closely regulated segments of the market could itself have negative consequences.

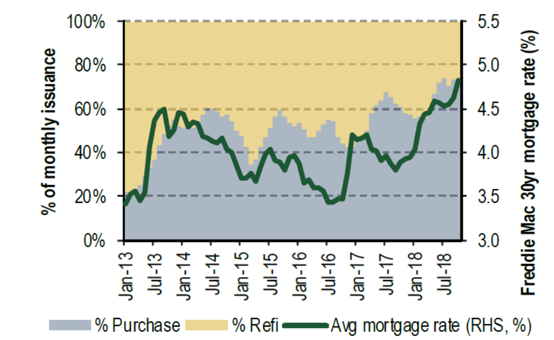
Benchmark US mortgage rates are nearly 100 bps higher than at the start of the year, with far-reaching consequences for the mortgage sector and the mortgage-backed securities (MBS) market. Mortgage refinancing rates have fallen to historic lows as borrowers remain in their lower-rate mortgages. New supply to the MBS market is coming mainly from new purchase flows. As interest rates continue to move higher, the MBS market will underperform as its option-adjusted duration moves higher than the rest of the bond market. This could be a concern given that the Fed is shrinking its MBS portfolio. If rates increase faster than investors currently expect, they could destabilize the MBS market or even the broader bond market.

Chart 1: Rising rates have led to refi index declining to a historical low



Source: MBA, Freddie Mac

Chart 2: Purchase issuance is now above 70%, heading towards 80%



Source: BofA Merrill Lynch Global Research, Freddie Mac

Europe

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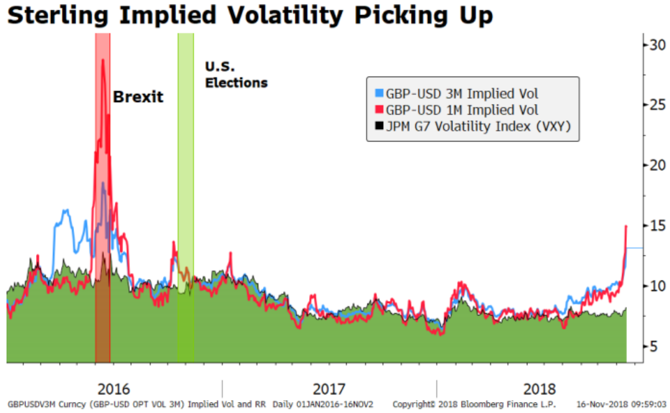
United Kingdom

PM May has vowed to "see this through" after several of her government members resigned yesterday. Brexit secretary Raab's resignation was followed by a handful of more junior colleagues who felt they couldn't support the deal agreed by EU and UK negotiators. **Speculation regarding a "no confidence" vote in May has increased further over the last 24 hours with some reports suggesting that the 48 required requests from Conservative MPs have almost been reached.** If a vote is called, a majority of the party's MPs would be required to vote against May to oust her. Meanwhile, Chancellor Merkel said that the deal on the table was final and that there was "no question" of renegotiating the terms of the deal. However, EC President Tusk hinted that the EU would allow the UK to stay in the EU if it decided to do so.

On markets, sterling is up 0.3% against the dollar but remains near its recent lows. Unsurprisingly, implied volatility has risen sharply this week. At the three-month tenor, for example, implied volatility increased 2.5 ppts to 13%. For comparison, this figure was 18.6% at the height of the Brexit fallout in mid-2016. Risk reversals for sterling have also moved sharply. Gilt yields have stabilized after falling 8-13 bps across the curve. Equities are little changed overall, helped in part by the weaker pound.

Sterling Implied Volatility Picking Up

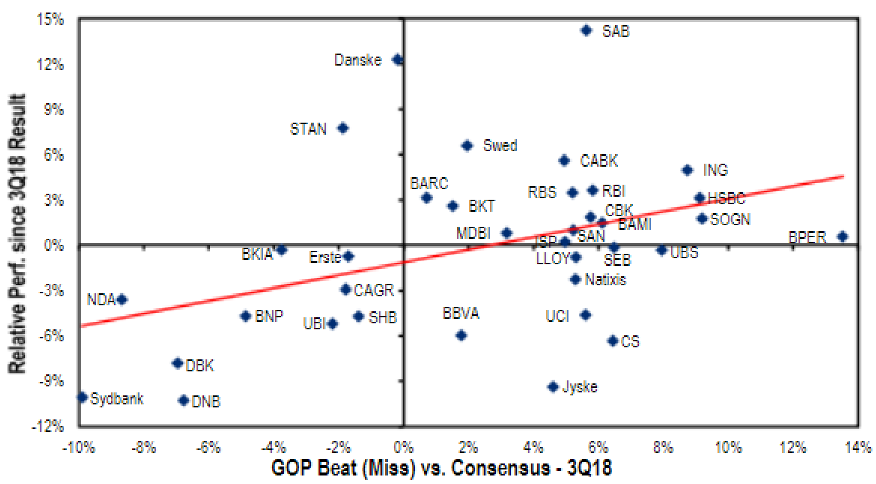


Banks have fallen further this morning, though the moves are smaller than yesterday. RBS is again underperforming, down 2.1% today after yesterday's 9.6% dive.

Euro Area

The EuroStoxx 500 is up 0.4%, only partially recovering from yesterday's -1.0% close. The index is down 1.6% on the week. The banking sub-sector was down 1.3% on the week. Of note, aggregate 2018Q3 banking sector earnings have beaten consensus for a third consecutive quarter. Analysts at Citi note positive underlying trends such as operating profits (+6%) driven by higher revenues (especially in Benelux Spain and Italy), lower operating expenses and impairments.

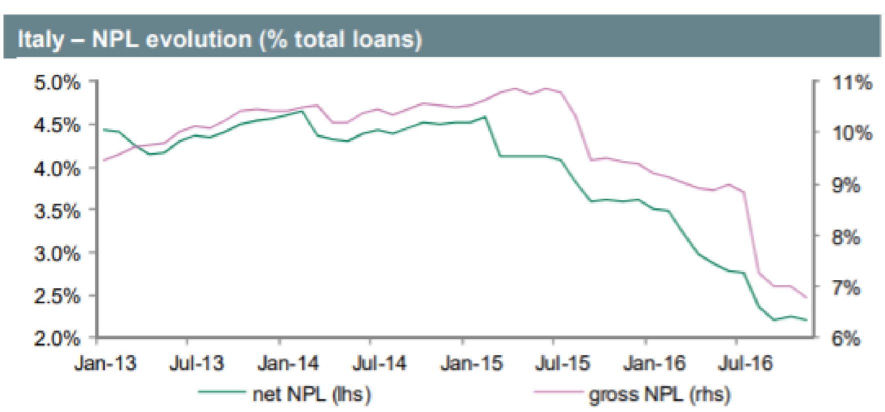
Figure 1. GOP Beat (Miss) vs. Relative Performance Since 3Q18 Results



Yields are little changed across the region, except for Italy where yields are down 5-7 bps. The moves in Italy don't seem to be driven by any particular development, but on continued headlines of efforts by the government to avoid initiating the Excessive Deficit Procedure. Two-year yields in Italy are up 8 bps on the week and 10-year up 3 bps.

Italy

Although political pressure continues to weigh on local banks, NPLs are still trending lower. According to the latest data by the Bank of Italy, gross NPLs fell 22.7% yoy in September and stand just above 6% of total loans. This compares with a peak of 11% in mid-2015. The report also showed a pickup in corporate (+2.9% yoy) and household (+2.8%) lending. Deposits rose 4.6% yoy. Italian banking sector stocks are down 35% this year compared with a 13% decline for the broad FTSE MIB.



Source: Bank of Italy

Other Mature Markets

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Japan

For the second day in a row, equities edged lower despite a generally positive session across Asia. The Topix and Nikkei were both down 0.6% as energy stocks continued to slide. IT firms (-2.2%) also suffered as chipmakers in the region slid on expectations of weakening demand. In comments to media in Australia, PM Abe said that he will order a second extra budget on his return to Japan. Abe also expressed concerns about downside risks in the global economy. Yields continued to drift down with the 10-year going below 10 bps for the first time since August.

Emerging Markets

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EM assets were broadly mixed, but mostly trading in narrow ranges. In Latin America, Banxico's rate hike lifted the peso but drove equities down 2.1%. Chilean and Colombian markets gained on stronger commodity prices. Brazilian markets were closed for a holiday. Major bourses are mostly higher in EMEA, except for Poland (-1.2%) weighed down by the financial sector after a bribing scandal hit a local bank. In FX markets, the lira appreciated 2% yesterday on further positive diplomatic headings between the US and Turkey (see below). Asian currencies were mixed in narrow ranges, but the Indonesian rupia (+0.4%) is appreciating for the fourth consecutive session, and the third consecutive week (+4% month to date).

Key Emerging Market Financial Indicators

Last updated:	Level		Change				
11/16/18 7:49 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		40.82	-0.6	1	0	-12	-13
MSCI Frontier Equities		27.26	0.9	-1	-1	-14	-18
EMBIG Sovereign Spread (in bps)		380	2	18	32	83	95
EM FX vs. USD		62.29	-0.1	1	-1	-9	-11
Major EM FX vs. USD				%, (+) = EM currency appreciation			
China Renminbi		6.95	-0.2	0	-1	-5	-6
Indonesian Rupiah		14612	0.4	0	4	-7	-7
Indian Rupee		71.93	0.1	1	2	-9	-11
Argentine Peso		36.06	-0.4	-2	2	-51	-48
Brazil Real		3.77	0.4	-1	-1	-13	-12
Mexican Peso		20.36	-0.6	-1	-8	-6	-3
Russian Ruble		66.06	-0.3	3	-1	-10	-13
South African Rand		14.23	-0.4	1	0	0	-13
Turkish Lira		5.35	-0.1	2	6	-28	-29
EM FX volatility		10.06	0.0	0.1	0.4	2.0	2.2

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

Brazil

Incoming President Bolsonaro nominated Santander's Roberto Campos Neto to succeed Ilan Goldfajn as head of the central bank. Goldfajn is leaving for personal reasons. Campos Neto is currently Treasury director for the Americas at banco Santander, and his appointment needs to be approved by Congress. Market participants welcomed the nomination which has reportedly further boosted pro-market sentiment with respect to the new government. Analysts said that the new chief would be unlikely to change the country's monetary policy framework. Campos Neto would head the central bank at a time when the policy rate is at a record low level and inflation is close to target. Commentators expect that monetary policy will tighten gradually over the next 12 months. Brazilian markets were closed yesterday for a holiday, but the iShares MSCI Brazil ETF jumped 3.3%.

Mexico

Banxico hiked the policy rate by 25 bps to counter political risks. The central bank raised the policy rate to 8% yesterday, as was expected by most analysts. The MPC said the political and policy uncertainty associated with the new government had weakened the currency and worsened the inflation outlook. The central bank added that it would continue to anchor the currency through an orderly adjustment in the face of future economic shocks, if needed. **Breakeven inflation expectations have surged to multi-year highs** and the peso has been volatile in recent weeks. Analysts interpreted the statement as very hawkish, and some expect a further tightening of 50 bps over the next six months. The peso gained 0.9% yesterday, while equities dropped 2.1%.

China

Easing rules on equity financing may increase risks in the stock market. While the supportive measures introduced by the Mainland authorities help improve investor sentiment, they may also increase speculative activities in the A-share market. In October, the China Securities Regulatory Commission (CSRC) said it would speed up approvals for M&A deals and support listings of companies whose IPOs had been rejected in the past. Recently, the regulator encourages listed firms to raise funds by issuing additional shares. With expectations of more supportive measures in the pipeline, there have been some signs of increased buying of the shares of small firms or even loss-making firms which are likely to be the targets of acquisition. One possible indication is the recent stronger rebound of small-cap stocks relative to blue-chip stocks. During the first half of November, the small-cap CSI 1000 index picked up by some 9%, much more than the 1.1% increase in Shanghai A-share index. Some analysts argue that such speculative activities are not healthy for the long-term developments of the equity market.

The Chinese equity market gained for the second consecutive day, as investors are hoping that the upcoming Trump-Xi meeting will ease the trade tensions between the US and China. Meanwhile, the rebound in tech stocks also helped buoy market sentiment. The Shanghai A-share index picked up 0.4% while the Shenzhen small-cap ChiNext was little changed. In the currency market, the renminbi weakened by 0.2% to close at 6.95. In the offshore market, the CNH was little changed, trading at 6.94 against the dollar.

India

The RBI's board is reportedly set to discuss rules regarding the bank's transfer of reserves to the government. A first meeting will take place on Monday, after a public debate between governor Patel and politicians over the extent to which the central bank should hand reserves over to the government. Separately, markets have pared back expectations of interest rate increases on easing inflation. Fitch today affirmed the country's sovereign rating at BBB- with a stable outlook, citing a strong medium-term growth outlook and relatively favorable external balances. The agency warned of significant risks to the outlook, however, and described the financial sector as fragile.

Turkey

The lira rallied 2% since yesterday's open on headlines that the US is considering extradition of cleric Gulen from the US. The move would reportedly be part of efforts by the Trump administration to ease pressure on the Saudi government after the death of journalist Khashoggi. This would be yet another step towards improving the relationship with the US administration. Turkish CDS prices were down slightly on the news, now at around 370 bps compared with 575 bps in September.

Turkish Lira and CDS

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Global Financial Indicators

Last updated: 11/16/18 7:45 AM	Level Last 12m	Level Latest	Change 1 Day	Change 7 Days	Change 30 Days	Change 12 M	YTD
Equities					%		%
United States		2730	1.1	-3	-3	6	2
Europe		3178	-0.4	-2	-2	-11	-9
Japan		21680	-0.6	-3	-4	-3	-5
China		2679	0.4	3	5	-21	-19
Asia Ex Japan		66	2.3	1	1	-14	-13
Emerging Markets		41	-0.5	1	0	-12	-13
Interest Rates					basis points		
US 10y Yield		3.10	-1.5	-8	-6	73	70
Germany 10y Yield		0.36	0.2	-5	-13	-1	-7
Japan 10y Yield		0.10	-0.5	-2	-4	5	6
UK 10y Yield		1.40	2.8	-9	-21	9	21
Credit Spreads					basis points		
US Investment Grade		114	2.5	9	13	12	23
US High Yield		402	9.0	49	53	-5	27
Europe IG		79	2.7	9	6	27	34
Europe HY		314	0.0	26	25	72	81
EMBIG Sovereign Spread		380	2.0	18	32	83	95
Exchange Rates					%		
Dollar Index (DXY)		96.96	0.0	0	2	3	5
USDEUR		1.13	0.1	0	-2	-4	-6
USDJPY		113.2	0.4	1	-1	0	0
EM FX vs. USD		62.3	-0.1	0	-1	-9	-11
Commodities					%		
Brent Crude Oil ($/barrel)		68	1.5	-4	-17	10	1
Industrials Metals (index)		115	0.1	1	-4	-11	-17
Agriculture (index)		43	0.0	0	-4	-11	-10
Implied Volatility					%		
VIX Index (%, change in pp)		20.8	0.8	4.1	3.2	9.0	9.7
10y Treasury Volatility Index		4.1	-0.1	0.1	0.4	0.2	0.6
Global FX Volatility		8.6	0.0	0.4	0.6	1.1	1.3
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		422	-0.5	24	43	-61	53
Italy		309	-4.3	9	13	163	150
Portugal		160	-0.7	6	15	0	9
Spain		127	-0.6	7	11	10	13

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: 11/16/2018 7:50 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	-0.2	0.1	-1	-5	-6		3.4	-3.2	-9	-20	-64	-60
Indonesia		14612	0.4	0.5	4	-7	-7		8.3	-1.7	8	-61	134	165
India		72	0.1	0.8	2	-9	-11		7.8	0.6	-7	-29	55	33
Philippines		53	0.2	0.5	2	-3	-5		6.7	-4.9	-3	10	182	183
Thailand		33	0.0	0.1	-1	0	-1		2.9	-2.4	0	-4	59	59
Malaysia		4.19	0.0	-0.3	-1	0	-3		4.2	0.1	3	8	10	27
Argentina		36	-0.4	-1.6	2	-51	-48		24.1	8.2	35	152	780	809
Brazil		3.77	0.4	-1.0	-1	-13	-12		8.7	0.1	-6	-32	-42	-29
Chile		675	0.2	1.5	-1	-7	-9		4.8	-1.4	-5	-13	8	-3
Colombia		3190	0.4	-1.5	-3	-5	-6		6.8	-2.1	1	4	27	55
Mexico		20.36	-0.6	-1.1	-8	-6	-3		9.1	-1.2	22	94	164	139
Peru		3.4	0.1	-0.5	-1	-4	-4		5.9	-2.9	2	3	44	62
Uruguay		33	0.4	0.2	1	-9	-12		10.8	2.0	22	33		223
Hungary		284	0.2	0.0	-2	-7	-9		2.7	-0.9	-2	-20	136	144
Poland		3.80	-0.4	-0.4	-3	-5	-8		2.6	-0.2	-1	0	-16	-9
Romania		4.1	0.0	-0.1	-2	-4	-5		4.4	-3.0	3	-25	44	56
Russia		66.1	-0.3	3.1	-1	-10	-13		8.4	-3.6	-13	3	86	112
South Africa		14.2	-0.4	0.9	0	0	-13		9.8	0.2	2	-6	-22	44
Turkey		5.35	-0.1	1.9	6	-28	-29		16.8	-38.7	-101	-329	426	481
US (DXY; 5y UST)		97	0.0	0.1	2	3	5		2.93	-0.7	-10	-9	86	72

	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		2679	0.4	3	5	-21	-19		183	-1	-1	-1	40	31
Indonesia		6012	1.0	2	4	0	-5		220	-2	9	19	45	54
India		35457	0.6	1	1	7	4		169	-3	2	5	51	59
Philippines		7083	1.9	2	1	-14	-17		110	-1	7	2	13	15
Malaysia		1706	1	0	-2	-1	-5		138	-2	2	14	28	28
Argentina		30474	3.7	-1	4	12	1		650	1	35	18	277	300
Brazil		86187	0.0	1	3	22	13		258	0	8	7	14	24
Chile		5183	0.8	0	1	-2	-7		147	2	7	19	16	28
Colombia		1427	1.8	0	-4	-1	-6		208	1	16	31	20	34
Mexico		41451	-2.1	-6	-14	-13	-16		334	1	29	80	86	89
Peru		19184	1	0	-1	-1	-4		162	1	8	19	22	25
Hungary		39111	0.1	1	4	0	-1		137	3	15	20	43	49
Poland		55096	-2.2	-4	-4	-12	-14		64	-1	8	-1	18	17
Romania		8568	-0.1	-1	0	11	10		199	1	16	18	59	85
Russia		2377	-0.2	-1	-2	11	13		234	-2	4	16	49	56
South Africa		52006	-0.3	-2	-2	-13	-13		341	1	14	15	51	87
Turkey		93225	-0.1	0	-5	-13	-19		435	1	11	-10	115	146
Ukraine		592	-2.6	-1	7	95	88		633	9	20	68	161	178
EM total		24	0.0	1	0	-10	-9		380	2	18	32	83	95

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