GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, OCTOBER 1, 2019

- **Fed measures ease stress in US funding markets** (link)
- **Eurozone manufacturing and inflation data on the weaker side** (link)
- **Japanese Government Bonds sell-off on weak auction** (link)
- **Reserve Bank of Australia lowers interest rates to a record low** (link)
- **Brazil's debt rises to a record high** (link)

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A Quiet End to An Eventful Quarter

Packed with political and economic events, Q3 came to a relatively quiet close yesterday. Higher uncertainty and weaker investor confidence dragged down the performance of risk assets during Q3, with global equities declining by close to 1% during the quarter and emerging market equities dropping by 5%. Safe havens on the other hand were well bid, resulting in a 3.5% rise in the USD against major currencies and a 5% appreciation against EM currencies. US Treasuries also posted a total return of about 3% on the quarter. Euro area manufacturing and inflation data out today were generally in line with investor expectations, but further underlined the area's weak economic conditions. European equity markets have traded on the weaker side as a result. In Japan, a very weak auction of 10-year JGBs led to a sharp increase in yields, as investors pondered the effects of changes to Bank of Japan's sovereign bond purchases. Developments in Japan's bond markets seemed to reverberate across to European markets, with German and French 10-year sovereign yields also rising. Separately, the long-planned sales tax increase in Japan—from 8 to 10 percent—became effective today, though the news was largely priced into markets.

Key Global Financial Indicators

Last updated: 10/1/19 8:56 AM	Level: Last 12m	Level: Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		2977	0.5	-1	2	2	19
Eurostoxx 50		3564	-0.1	1	4	4	19
Nikkei 225		21885	0.6	-1	6	-10	9
MSCI EM		41	-0.9	-2	2	-5	5
Yields and Spreads					bps		
US 10y Yield		1.75	-1.5	10	25	-134	-94
Germany 10y Yield		-0.52	5.6	9	19	-99	-76
EMBIG Sovereign Spread		333	-5	-14	-21	-3	-81
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		60.0	-0.4	-1	0	-4	-4
Dollar index, (+) = $ appreciation		99.6	0.2	1	1	4	4
Brent Crude Oil ($/barrel)		59.9	1.0	-5	-1	-30	11
VIX Index (%, change in pp)		16.2	-0.1	-1	-3	4	-9

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

United States

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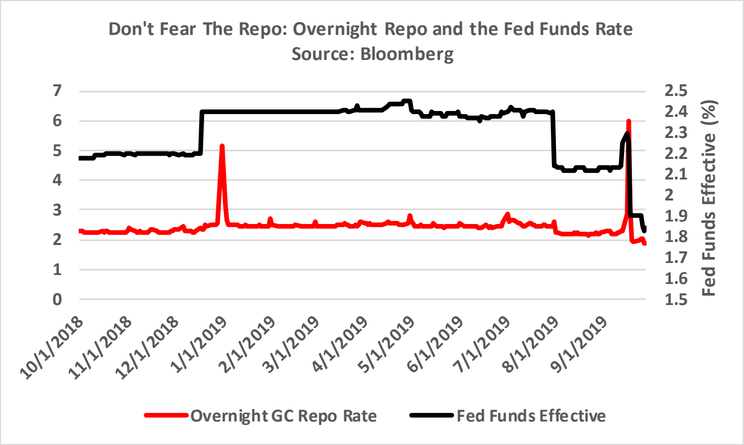
The third quarter came to a quiet end as Fed action kept money markets in check and the latest news on the US-China dispute gave a modest boost to equities. The White House appeared to walk back some of the possible measures that were mentioned last week. The VIX remained quiet at 16.24. Attention now turns to the jobs report on Friday, the upcoming US-China talks scheduled to be held on October 11-12 and the start of the Q3 earnings season with reports from the big US banks starting October 14.

Month-To-Date Performance, Selected Assets
Source: Bloomberg

	MTD	YTD
S&P 500	+1.2%	+18.7%
Stoxx 600	+3.6%	+16.4%
MSCI Emerging Markets	+1.7%	+3.7%
10-year Treasury	+17 bps	-102 bps
2-year Treasury	+12 bps	-87 bps
Euro-Dollar	Nearly unchanged	Dollar 3.9% stronger
Dollar-Yen	Dollar 1.7% stronger	Dollar 1.5% weaker
Dollar- Renminbi	Nearly unchanged	Dollar 4.2% stronger
Brent	+0.6%	+13%
Gold	-3.1%	+14.2%

The Fed's actions to curb volatility in US markets over the quarter end turned out to be very effective as funding pressures were relatively contained and there was no spike in money market rates in yesterday's trading. The surge in volatility which began on September 17 was eventually quelled through the use of a package of overnight and term repo operations which succeeded in driving down key short term funding rates such as the overnight general collateral (GC) repo rate and also the Fed's benchmark Fed Funds effective rate. Just $63.5 bn of the $100 bn overnight term repo offer was taken up market participants. The mid-month volatility explosion was highly unusual; such large increases in funding costs usually occur at year-end as market participants with last-minute funding needs bid up funding rates.



Contacts and analysts have expressed concern that there are not enough reserves in the banking system and that the Fed will have to resume its purchases of Treasuries to improve liquidity.

Regulatory constraints, heavy issuance of new Treasuries due to the rising budget deficit and an increased reliance on money market funds to fill the gap has led to a situation where the supply of reserves is too low to deal with unexpected funding squeezes. Temporary solutions such as the recent open market operations were effective but a more permanent solution is needed. There is a growing consensus that the Fed will need to reinstate its purchases of Treasuries to inject more reserves into the system, with some predicting an announcement might come as early as the October 30 meeting. This would not represent a return to QE, as the scale and duration of the purchases is likely to be much more modest. Estimates of the size of purchases needed tend to fall in the $200-400 bn/year range. JP Morgan estimates the buying need at $220 bn and expects it to begin in November and end by April. This will introduce much less duration into the market, with a much smaller impact on interest rates more broadly due to the fact that interest rates are already so low.

Exhibit 5: If our projections are correct, the Fed's upsized purchases of Treasuries to "top up" reserve balances should prove to be smaller in notional and duration terms, and shorter in length than any of the Fed's QE programs

Statistics on previous Fed Treasury purchase programs and projections for upcoming purchases; units as indicated

		Avg. monthly purchase pace			
Period	Dates	Nominal terms, $bn	% of UST market	10y equiv., $bn	Term premium** over 6m prior; %
Pre-crisis*	-	3	0.07%	1.4	0.19
Upsized QE 1	Mar '09 - Oct '09	43	0.65%	21.7	1.92
QE 2	Nov '10 - Jun '11	97	1.08%	66.4	1.56
Twist 1+2	Oct '11 - Dec '12	0	0.00%	53.9	1.52
QE 3.5	Jan '13 - Oct '14	37	0.31%	40.4	0.00
Upcoming	Nov '19 - Apr '20	37	0.22%	20.8	-0.90

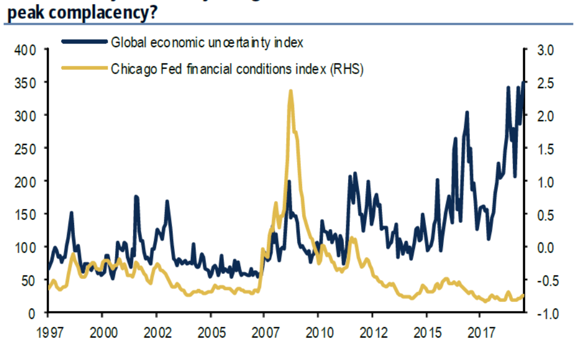
* Computed using data from 8/25/05 to 5/3/07 due to limited availability.

** The average of 10-year ACM term premium over the 6 months prior to onset of a purchase program.

Source: J.P. Morgan, Federal Reserve Bank of New York

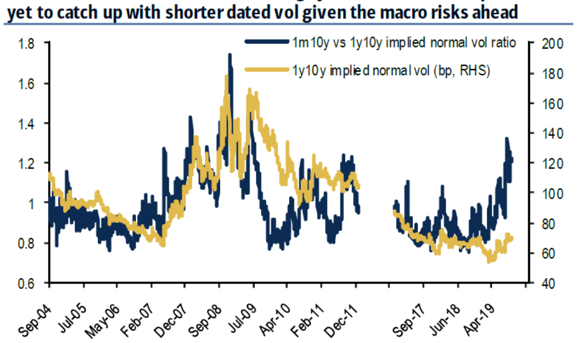
Rising political and economic uncertainty has yet to be reflected in financial markets, risking a potential destabilizing reversal if sentiment were to abruptly change. Financial conditions remain very easy despite a multitude of growing problems arising from the global economic slowdown, the US-China trade dispute, future ECB policy, Brexit, and other geopolitical risks. Volatility remains very low in the equity market as the VIX remains contained, and FX volatility is also relatively low. Short term interest rate volatility has risen with the intensification of shocks from news headlines, but intermediate and long term volatility have yet to catch up.

Chart 9: Policy uncertainty at highs vs. US financial conditions at lows= peak complacency?



Source: BofA Merrill Lynch Global Research, Bloomberg, Ahir, Bloom and Furceri

Chart 10: In contrast to the last easing cycle, intermediate expiries have yet to catch up with shorter dated vol given the macro risks ahead



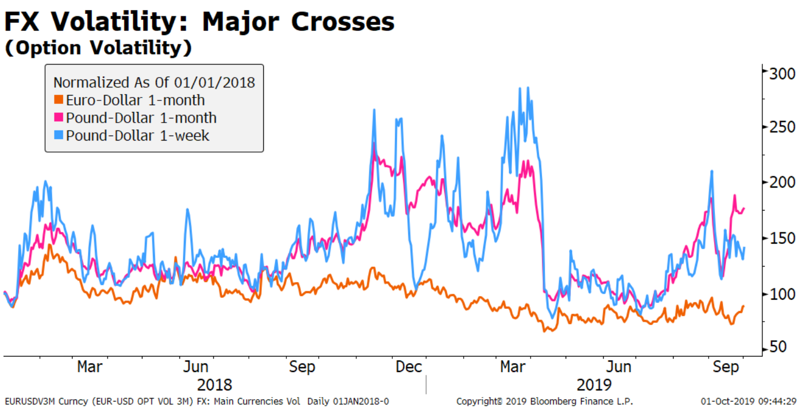
Source: BofA Merrill Lynch Global Research

Europe [back to top]

European equity indices drifted downwards following the release of weak inflation data in the Eurozone: DAX (-0.2%), CAC 40 (-0.3%), EuroStoxx 600 (-0.3%). Bank stocks (+0.8%) outperformed.

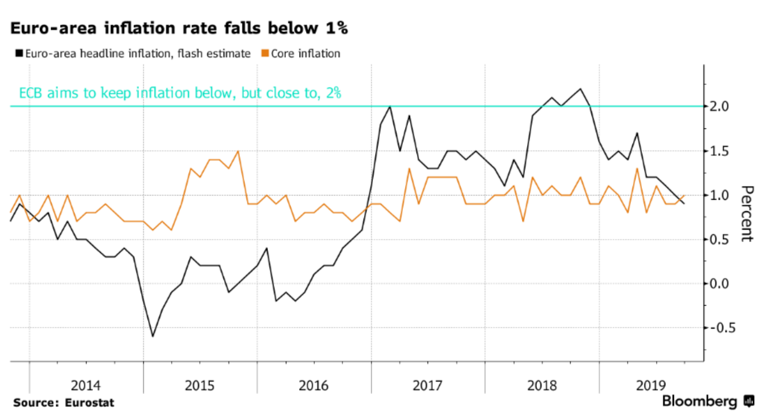
Core sovereign debt markets saw relatively large moves, with gains of 5 bps in German and French 10-year yields (at -0.52% and -0.22%, respectively). Italian yields gained 3 bps to 0.85%; Spanish at 0.18% (+4 bps). Gilt yields also gained: 10-year at 0.55% (+7 bps). The moves have been attributed to spillover form the weak JGB auction in Japan earlier today (see below), which is pushing global bond investors to reassess their bond holdings.

In FX markets, **sterling traded at $1.23 (+0.1%)** and the **euro at $1.09** (unch.). One-month pound-dollar volatility has shot up to levels similar to late March 2019, right before the previous Brexit date.



The UK's Financial Conduct Authority (FCA) has confirmed new rules for funds investing in "inherently illiquid assets." The new normative aims to guarantee that investors are provided timely information on the liquidity conditions of their investments. The rules will come into force in Sept. 2020 and will apply to non-UCITS open-ended funds that invest in illiquid assets, such as property. The rules call for additional disclosure requirements of liquidity management by the funds (including regular publication of liquidity risk contingency plans), as well as the suspension of trading when the valuation of over 20% of the fund's assets becomes uncertain.

In macro data, the **Eurozone's Manufacturing PMI for September came in at 45.7**, from 45.6 the month prior. Similar gauges for Germany, France, and Italy printed at 41.7, 50.1, and 47.8, respectively. Values below 50 point to a contraction in economic activity. **Eurozone inflation for September were slightly below expectations**, with the headline gauge printing at 0.9% y-o-y (vs. 1.0% expected) and core at 1.0% y-o-y (vs. 1.0% expected). With this print, European inflation remains stubbornly below the ECB's desired rate of under 2%.



Other Mature Markets

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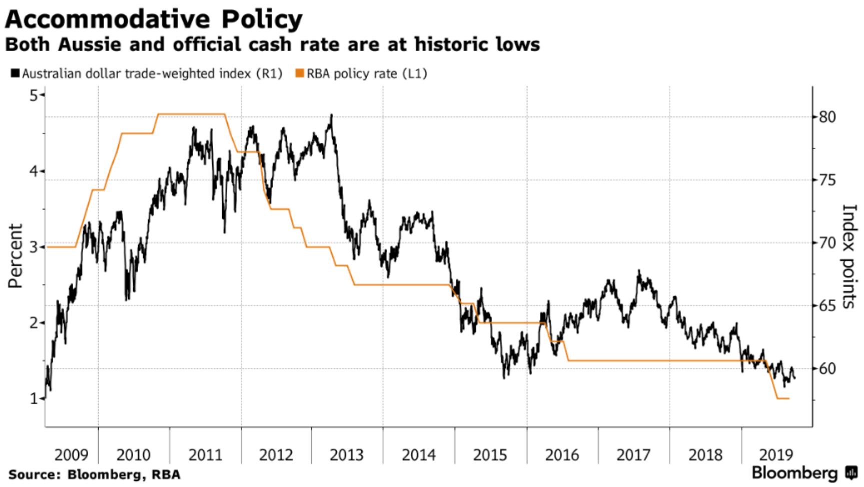
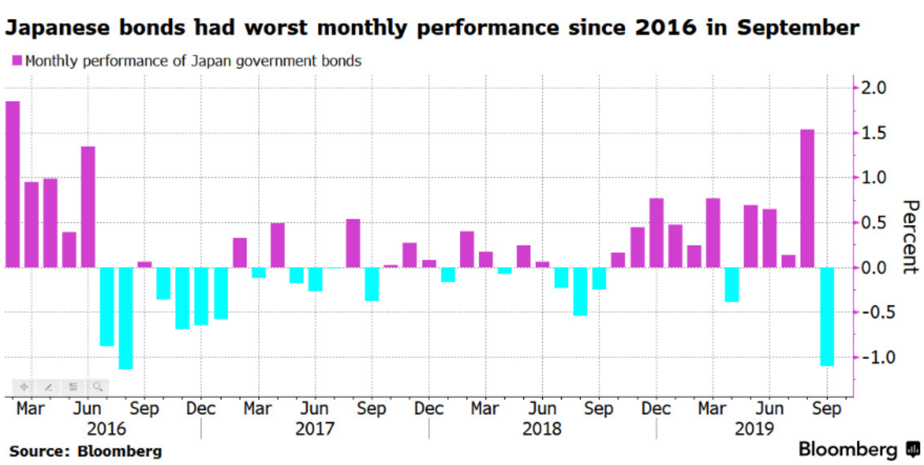
Australia

The Reserve Bank of Australia (RBA) cut its cash rate by 25bps to a record low of 0.75%, as expected. This was the third reduction for the year following cuts in June and July. In its statement, the RBA left the door open for further monetary accommodation, mentioning that it 'is prepared to ease monetary policy further if needed to support sustainable growth in the economy, full employment and the achievement of the inflation target over time.' **The Australian dollar weakened -0.8% while equities rose 0.8%. 10-year bond yields fell 4.5bps to 0.97%.**



Japan

10-year JGB yields rose 6.1bps to -0.17% following the worst 10-year debt auction in three years. Yields across the JGB yield curve increased amid the heavy sell-off. The auction of 10-year debt registered a bid-to-cover ratio of 3.4, the lowest since 2016. According to analysts, the Bank of Japan (BoJ)'s reduction in its bond purchases across four major maturities, an indicated that it may stop buying maturities above 25 years entirely, and an announcement by the Government Pension Fund that it is pivoting toward buying more foreign debt spooked investors. Meanwhile, the BoJ's quarterly Tankan survey showed that business confidence for large manufacturers beat expectations in Q3, even though it fell to the lowest level since 2013. **The yen weakened -0.3% while equities (+1.0%) rose, led by electronics and chemicals.** Separately, the long-planned **sales tax increase** from 8 to 10 percent became effective today.



Emerging Markets

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Asian equities were little changed on net, but dispersion was wide across markets. Taiwan Province of China (+1.3%) and Singapore (+0.8%) led gains. India (-1.3%) and Thailand (-0.7%) underperformed. Chinese markets are closed for a week-long National Day holiday. Regional currencies depreciated slightly, with the Singapore dollar, the Thai baht and the Indian rupee underperforming (all -0.3%). **EMEA** stocks faltered, with losses of about 0.2%-0.5% across markets: Poland (-0.5%), Czech Republic (-0.4%), Morocco (-0.4%), and Turkey (-0.3%). Currencies traded within a narrow ±0.1% corridor, except the South African rand (-1.1%). **Latin American** markets mostly weakened yesterday on continued concerns about US-China developments. Regional stocks lost 0.3%, but Mexican equities rose 0.6%--in tandem with the US. The Latin American currencies edged lower on a stronger US dollar and lower oil and copper prices, with the Colombian peso and the Chilean peso down 0.6% and 0.4%, respectively. During the turbulent third quarter, the Argentine peso depreciated by almost a third, while the October general elections are expected to be another source of volatility. The Brazilian real and the Colombian peso weakened 7% each in Q3, and the Mexican peso edged 2.5% lower.

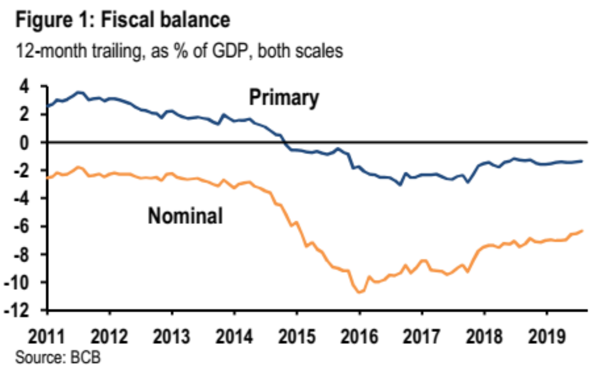
Key Emerging Market Financial Indicators

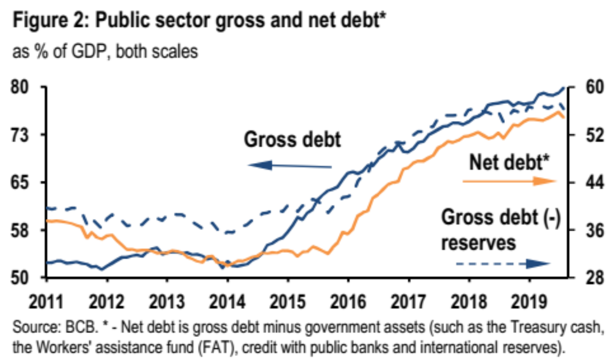
Last updated:	Level		Change				
10/1/19 8:57 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		40.87	-0.9	-2	2	-5	5
MSCI Frontier Equities		28.14	0.5	-1	-2	-1	8
EMBIG Sovereign Spread (in bps)		333	-5	-14	-21	-3	-81
EM FX vs. USD		60.04	-0.4	-1	0	-4	-4
Major EM FX vs. USD				%, (+) = EM currency appreciation			
China Renminbi		7.15	-0.4	0	0	-4	-4
Indonesian Rupiah		14216	-0.1	-1	0	5	1
Indian Rupee		71.08	-0.3	0	0	3	-2
Argentine Peso		57.59	-0.5	-1	-3	-31	-35
Brazil Real		4.17	-0.3	0	0	-4	-7
Mexican Peso		19.80	-0.3	-2	2	-5	-1
Russian Ruble		65.25	-0.6	-2	2	0	7
South African Rand		15.31	-1.1	-3	0	-7	-6
Turkish Lira		5.70	-0.8	0	2	4	-7
EM FX volatility		8.15	0.0	0.0	-0.7	-1.9	-1.6

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

Brazil

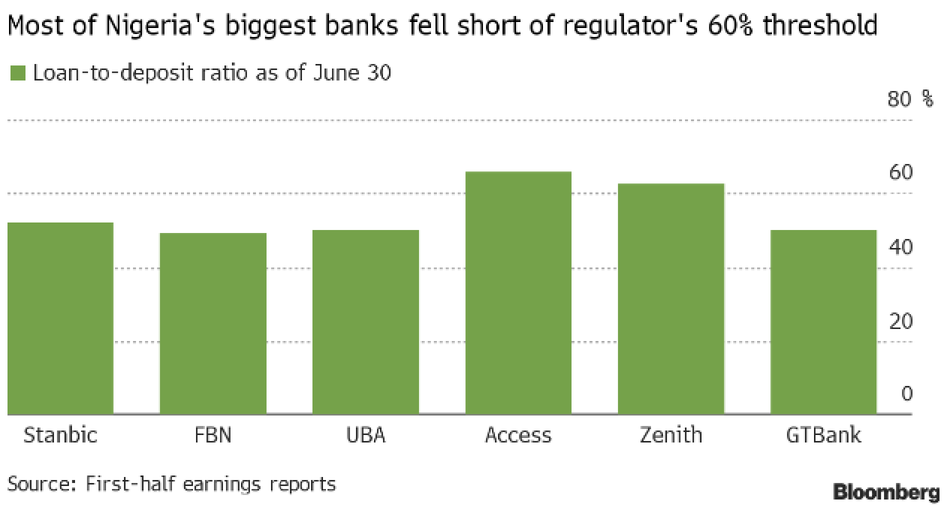
Gross government debt has reached a record high of 79.8% of GDP. The central bank said that the country's primary deficit stood at BRL13.4 bn in August, or BRL95.5 bn on a 12-month basis, which is below the target of BRL132 bn (figure). JPMorgan analysts expect that the 2019 primary deficit will be even lower because of one-offs. Net debt declined to 54.8% of GDP driven by a weaker currency but gross debt rose unexpectedly to a new record high of 79.8% (figure).





Nigeria

The Nigerian Central Bank raised the minimum loan-to-deposit ratio from 60% to 65%. The measure is intended to promote lending, as financial authorities seek to boost growth. Credit expanded at 5.3% between end-May and end-September this year, a rate considered insufficient by the central bank. The CBN announced that banks have until end-2019 to comply with the new minimum LTD ratio, or risk facing additional reserve requirements equal to 50% of their lending shortfall.



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Global Financial Indicators

Last updated: 10/1/19 8:58 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
United States		2977	0.5	-1	2	2	19
Europe		3564	-0.2	1	4	4	19
Japan		21885	0.6	-1	6	-10	9
China		2905	-0.9	-2	1	3	16
Asia Ex Japan		66	0.7	-2	2	-6	4
Emerging Markets		41	-0.9	-2	2	-5	5
Interest Rates			basis points				
US 10y Yield		1.75	-1.5	10	25	-134	-94
Germany 10y Yield		-0.52	5.5	9	19	-99	-76
Japan 10y Yield		-0.15	6.4	9	12	-29	-15
UK 10y Yield		0.56	7.0	3	8	-103	-72
Credit Spreads			basis points				
US Investment Grade		127	-1.0	-4	-7	30	-20
US High Yield		457	-5.6	0	-25	134	-64
Europe IG		54	-1.6	-2	4	-14	-34
Europe HY		228	-3.5	3	-24	-45	-125
EMBIG Sovereign Spread		333	-5.0	-14	-21	-3	-81
Exchange Rates			%				
USD/Majors		99.57	0.2	1	1	4	4
EUR/USD		1.09	0.0	-1	-1	-6	-5
USD/JPY		108.4	-0.3	-1	-2	5	1
EM/USD		60.0	-0.4	-1	0	-4	-4
Commodities			%				
Brent Crude Oil ($/barrel)		60	1.0	-5	-1	-30	11
Industrials Metals (index)		115	-0.6	-1	0	-5	5
Agriculture (index)		39	0.0	2	4	-8	-7
Implied Volatility			%				
VIX Index (%, change in pp)		16.2	-0.1	-0.9	-2.8	4.2	-9.3
10y Treasury Volatility Index		5.5	0.2	-0.2	0.2	2.0	0.9
Global FX Volatility		7.2	0.0	0.0	-1.0	-0.9	-1.8
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		188	-4.2	-6	-45	-187	-228
Italy		137	-1.9	-6	-32	-145	-113
Portugal		73	-0.5	-2	-10	-70	-75
Spain		71	-0.7	-1	-10	-35	-47

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:	Exchange Rates							Local Currency Bond Yields (GBI EM)						
10/1/2019	Level		Change (in %)					Level		Change (in basis points)				
8:58 AM	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		7.15	-0.4	-0.4	0	-4	-4		3.2	4.3	6	10	-44	0
Indonesia		14216	-0.1	-0.8	0	5	1		7.4	-0.6	1	-8	-80	-78
India		71	-0.3	-0.1	0	3	-2		6.9	-1.8	-3	15	-130	-58
Philippines		52	-0.2	0.5	0	4	1		4.4	-0.8	-2	-3	-208	-195
Thailand		31	-0.2	-0.3	0	5	6		1.5	-0.9	-1	1	-133	-111
Malaysia		4.19	-0.1	-0.3	0	-1	-1		3.4	-1.3	-9	6	-67	-69
Argentina		58	-0.5	-1.2	-3	-31	-35		66.2	100.7	-218	762	4235	4315
Brazil		4.17	-0.3	-0.1	0	-4	-7		6.4	-0.6	-7	-46	-372	-180
Chile		731	-0.3	-0.9	-1	-10	-5		2.8	-1.1	7	12	-198	-163
Colombia		3477	-0.5	-1.2	-1	-14	-7		5.7	1.1	3	-7	-93	-85
Mexico		19.80	-0.3	-1.8	2	-5	-1		7.0	-0.6	-1	-13	-94	-172
Peru		3.4	0.4	-0.4	1	-2	0		4.4	-4.5	0	0	-129	-134
Uruguay		37	-0.3	-0.6	0	-10	-12		10.6	-3.7	-2	-58		-9
Hungary		307	0.0	-1.5	-2	-9	-9		1.1	1.4	10	5	-154	-112
Poland		4.02	-0.2	-1.1	-1	-8	-7		1.8	-0.3	-3	11	-82	-47
Romania		4.4	-0.2	-1.1	-1	-8	-7		3.8	7.0	1	8	-59	-49
Russia		65.3	-0.6	-1.9	2	0	7		6.9	0.2	0	-8	-140	-156
South Africa		15.3	-1.1	-2.9	0	-7	-6		9.4	0.2	6	3	-19	-18
Turkey		5.70	-0.8	0.0	2	4	-7		13.2	-13.4	-107	-258	-681	-365
US (DXY; 5y UST)		100	0.2	1.2	1	4	4		1.61	6.9	9	23	-135	-90

	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		2905	0.0	-2	1	3	16		185	-1	1	-2	7	-9
Indonesia		6138	-0.5	0	-3	3	-1		182	-5	5	-4	4	-54
India		38305	-0.9	-2	3	5	6		131	-3	3	-8	-30	-65
Philippines		7740	-0.5	-2	-3	7	4		75	-5	-1	-8	-15	-46
Malaysia		1589	0.3	0	-1	-11	-6		124	1	3	0	-3	-38
Argentina		29067	0.7	0	18	-11	-4		2142	11	-83	-391	1512	1327
Brazil		104745	-0.3	0	4	33	19		238	-4	1	-4	-54	-35
Chile		5062	-0.8	1	5	-4	-1		138	-2	-1	4	18	-28
Colombia		1578	-0.4	-1	1	4	19		181	-5	-4	1	13	-47
Mexico		43011	0.4	-1	1	-14	3		314	-4	-10	-19	57	-40
Peru		19603	-0.7	1	3	0	1		140	5	16	17	9	-28
Hungary		40388	-0.5	-1	1	10	3		93	-6	-3	-16	-15	-55
Poland		57001	-0.6	-1	0	-3	-1		28	-5	-3	-12	-17	-57
Romania		9545	-0.3	1	3	13	29		194	0	8	-18	25	-27
Russia		2774	1.0	1	1	12	17		190	-3	1	-19	-18	-62
South Africa		55049	0.4	-1	0	-1	4		327	-3	-4	7	32	-38
Turkey		103980	-1.0	2	8	6	14		462	-4	-19	-68	29	33
Ukraine		525	0.0	0	0	-2	-6		503	-8	-5	-4	-50	-284
EM total		41	-0.9	-2	2	-5	5		334	-4	-13	-20	-2	-80

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

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