



Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Thursday, October 11, 2018

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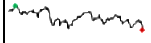








- **US equity markets drop sharply and the VIX spikes on greater risk aversion ([link](#))**
- **High yield bond funds experience large outflows ([link](#))**
- **US financials underperform despite higher rates ([link](#))**
- **Asian equities fall sharply following the overnight sell-off in U.S. markets ([link](#))**
- **Strong demand for China's first US dollar bond issuance since Oct 2017 ([link](#))**
- **Turkish Lira outperforms on positive current account data ([link](#))**

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Equity markets sell off as market sentiment deteriorates sharply

Global bourses sold-off as risk aversion took hold of investor sentiment. The S&P 500 dropped about 3.4% yesterday - its largest daily decline since February of this year- and the VIX spiked 7 percentage points to 23. The losses spread to Asian and European markets this morning, with Chinese equities amongst the worst performers (Shanghai -5.2%, Shenzhen -6.4%) and S&P 500 futures opening 0.3% lower. Although there was no clear catalyst for the sell-off, explanations abound ranging from technical factors to trade tensions and, overall, concerns over tighter financial conditions and rising yields. In Emerging markets, currencies were largely stable due to a weaker dollar with the Turkish Lira outperforming (+1.4%) and strengthening for the fifth consecutive session as current account data came in stronger than expected.

Key Global Financial Indicators

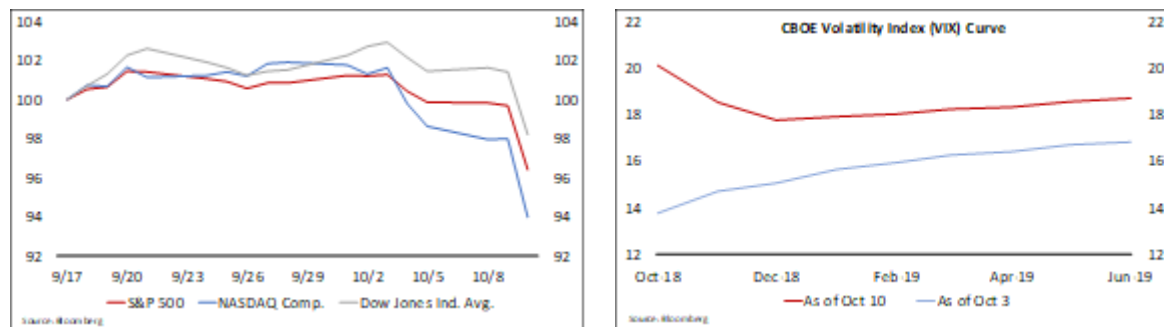
Last updated: 10/11/18 8:22 AM	Level		Change from Market Close				
	Last 12m	Index	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		2778	-0.3	-4	-4	9	4
Eurostoxx 50		3229	-1.2	-4	-3	-11	-8
Nikkei 225		22591	-3.9	-6	0	8	-1
MSCI EM		40	-3.0	-6	-4	-15	-16
Interest Rates			bps				
US 10y Yield		3.19	2.5	0	21	84	78
Germany 10y Yield		0.53	-2.1	0	10	7	10
Japan 10y Yield		0.15	-1.0	-1	3	8	10
FX / Commodities / Volatility			%				
Dollar index, (+) = \$ appreciation		95.1	-0.4	-1	0	2	3
Brent Crude Oil (\$/barrel)		81.8	-1.6	-3	3	44	22
VIX Index (% change in pp)		23.4	0.4	12	10	14	12

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

United States

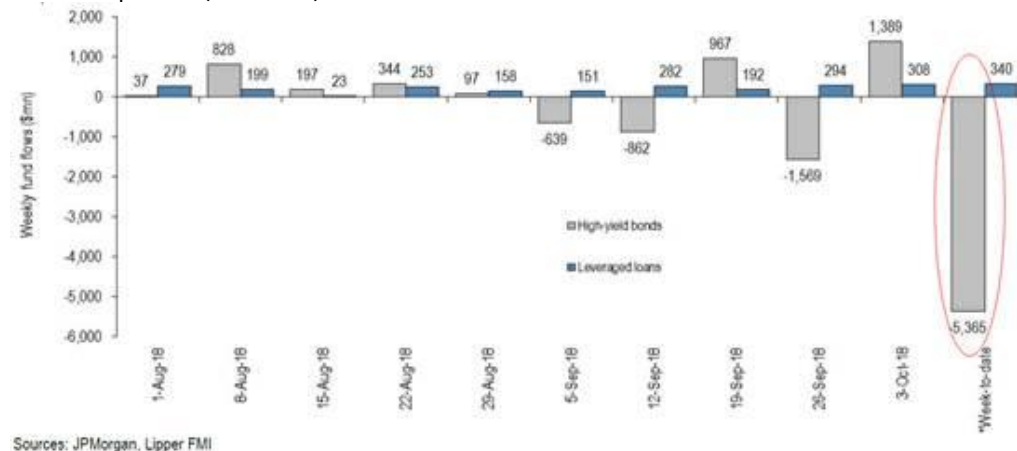
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A risk-off tone in financial markets drove US equities sharply lower on the day and increased demand for safe assets. The S&P 500 fell by about 3.4% - the largest daily decline since February of this year. Losses were broadly based, though IT (-4.7%) and Communication Services (-3.9%) suffered the worst losses. Near-term implied volatility, as indicated by the VIX, spiked 7 percentage points to 23. Moreover, the curve between the spot VIX and the second month contract was the most inverted it has been since April, a sign of potential market stress (see chart). Although there was no clear catalyst for the sell-off in equities, analysts attributed yesterday's market action to a number of factors including: (i) concerns over increased trade tensions (mainly with China); (ii) the unwind of leveraged equity positions following the recent rise in yields and increase in implied volatilities; and (iii) various technical drivers. Investors' flight to safety led to an increased demand for Treasuries and a 4 bps drop in 10-year yields. Nevertheless, the 2Y10Y treasury spread maintained its level at around 32 bps.

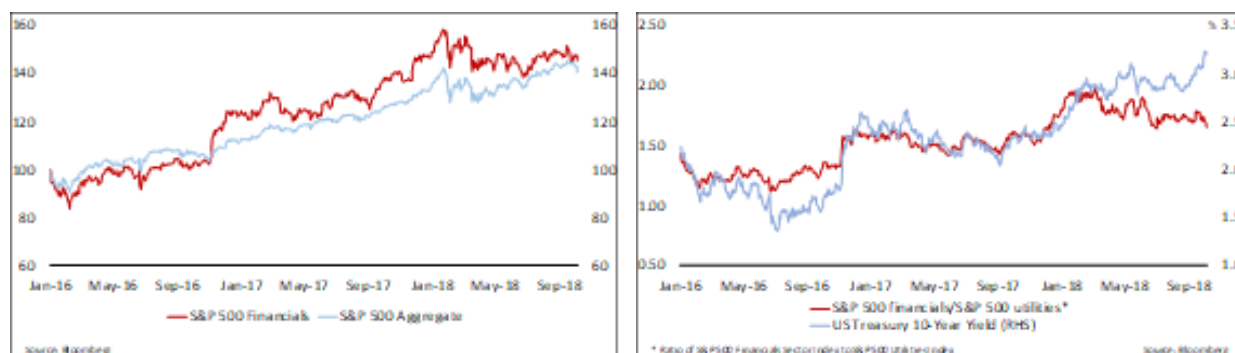


This morning, **US CPI came in weaker than expected in September as used-car prices fell and housing rents cooled**, increasing 2.3% yoy (vs. +2.4% expected) from 2.7% yoy in August. Core CPI was also weaker than expected at 2.2% yoy (vs. +2.3% expected) from 2.2% yoy in August. On a monthly basis, core CPI rose 0.1% mom (vs. +0.2% expected) from +0.1% previously. US Treasury yields were little changed and S&P 500 futures remained 0.3% lower immediately following the data release.

General risk aversion has also been weighing on some riskier fixed income assets. Outflows from high yield (HY) bond ETFs and mutual funds totaled close to \$5.4 bn in the week from October 4 through Tuesday, according to analysts from JP Morgan. That was the largest outflow recorded since February (\$6.3 bn), which in turn was the second largest on record. The impact on the asset class was necessarily negative, with US corporate HY yield spreads over 10-year treasuries rising by 19 bps since Oct 2 (to 329 bps). Interestingly, leverage loans funds did not seem to be similarly affected and continued to register inflows over this period (see chart).



US Financials seem to have become less sensitive to rising rates, showing potential investor concerns about their profitability going forward. Given the nature of their business models, financial institutions are usually expected to perform better in a rising rate environment. Indeed, US financials had outperformed the general market early on during the current rate-hiking cycle. But their performance has lagged since Q1 2018. Especially when compared to the performance of sectors such as utilities, which usually struggle in a rising rate environment. Analysts attribute this weaker trend to expectations of lower banks earnings due to slower loan and mortgage growth. Friday's US bank earnings reports should help shed some light on these conjectures.



One reason given for the recent sell-off in Treasuries is lower international demand for US bonds, but the evidence is not clear cut. Higher currency hedging costs have reduced the attractiveness of US fixed income assets to foreign investors. To see this, one could consider the hedged returns to Japanese investors from owning US 10-year treasuries (see chart). These are currently no greater than those on domestic Japanese bonds, which reduces the incentive of Japanese investors to own Treasuries. However, as some analysts point out, the fact that Japanese investors have been net sellers of Treasuries is not a recent phenomenon (see chart). It is therefore unlikely to be a significant driver of the current rise in US yields.

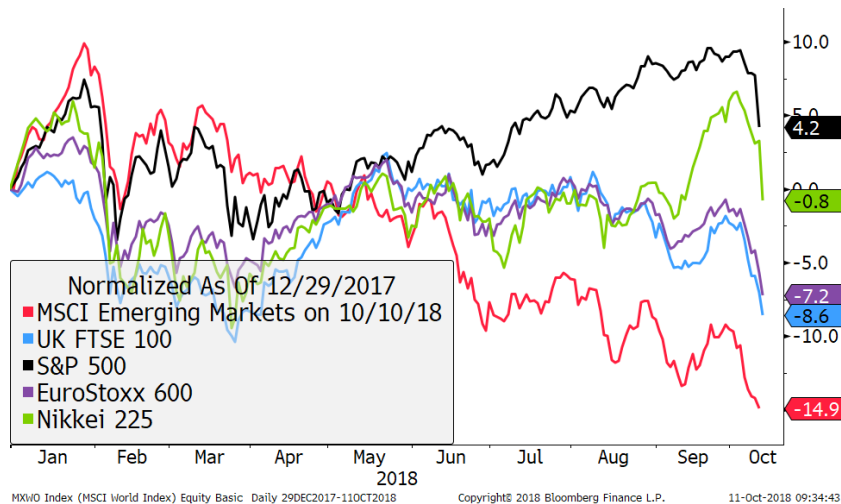


Europe

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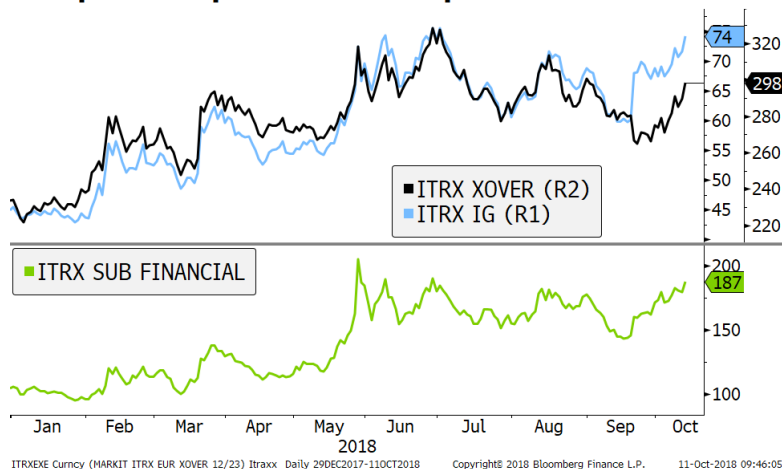
Equities followed the sharp declines in the US yesterday with the EuroStoxx 50 index -1.4% lower. Losses were relatively well distributed amongst countries. The EuroStoxx is down over 5% this month and 8% since the start of the year. EU and UK indices are vastly underperforming the US and Japan this year.

Global Indices YTD Performance



In fixed income markets, yields are down in core countries and rising in Southern Europe. German yields are down 1-4 bps across the curve, but up as much as 13 bps in Italy and 6 bps in Portugal. **Corporate credit spreads continue to widen.** The Itraxx IG index increased to 74 bps, near heights of the year, while the HY index is trading at just under 300 bps. The sub-financial index is up 44 bps since the September lows, now at 187 bps.

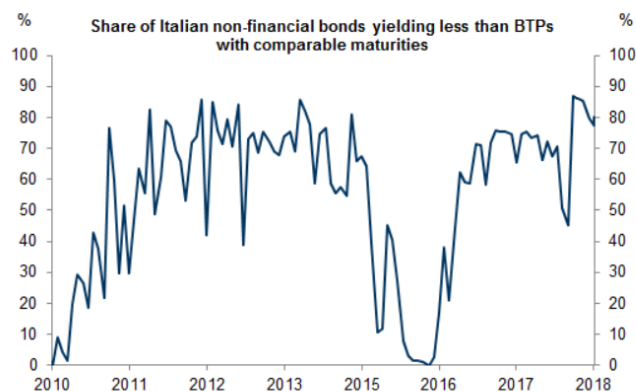
European Corporate Credit Spreads



Italy

The increased political pressure has revived discussions about redenomination risks in Italy and how to quantify them. Analysts at Goldman, for example, noted the resilience of Italian corporate bonds relative to the sovereign (BTPs). To be clear, Italian corporates have underperformed the broader euro credit market, but nearly 80% of its IG-rated corporate bonds still yield less than BTPs with comparable maturities—in some cases by as much as 180bp. The difference comes down to redenomination risk: most corporate bonds are written under English law, whereas BTPs fall under Italian law. This is a similar phenomenon to the ISDA spread, where different CDS contracts are priced differently depending on contract specifications and the jurisdiction.

Exhibit 1: Close to 80% of Italian non-financial corporate bonds still yield less than BTPs with comparable maturities



Source: iBoxx, Goldman Sachs Global Investment Research

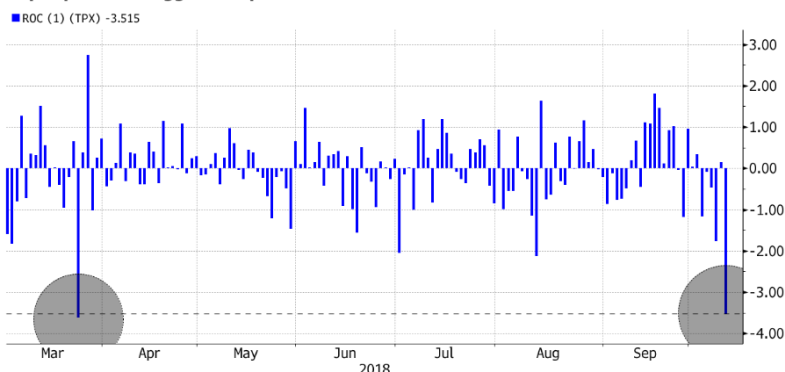
Other Mature Markets [back to top](#)

Japan

Equities fell sharply on very heavy volumes, while the yen was little changed. The Topix dropped 3.5%, and the Nikkei closed 3.9% lower. Energy and technology stocks underperformed. Meanwhile, producer prices rose more than expected in September at 3% y/y (consensus: 2.9%) boosted by a weaker yen and higher oil prices. **Ten-year bond yields fell 0.6 bps.** In an auction held today, Japan's issuance of 30-year bonds saw mediocre results, with a bid-to-cover ratio sliding to 3.92, its lowest this year.

Bad Day

Topix posts its biggest drop since March













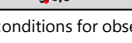



Source: Bloomberg, Tokyo Stock Exchange

Emerging Markets

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Key Emerging Market Financial Indicators

Last updated: 10/11/18 8:26 AM	Level		Change				YTD
	Last 12m	index	1 Day	7 Days	30 Days	12 M	
Prices/Returns of Major EM Benchmarks			%				%
MSCI EM Equities		39.54	-3.0	-6	-4	-15	-16
MSCI Frontier Equities		27.50	-1.6	-4	0	-13	-17
Hard Currency Sovereign Debt		819.31	0.0	-1	1	-4	-5
Local Currency Sovereign Debt		16.13	-0.7	-1	2	-15	-15
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.91	0.2	-1	-1	-5	-6
Indonesian Rupiah		15235	-0.2	0	-2	-11	-11
Indian Rupee		74.13	0.1	-1	-2	-12	-14
Argentine Peso		37.21	-0.2	1	0	-53	-50
Brazil Real		3.74	0.4	4	11	-15	-11
Mexican Peso		19.10	0.3	0	0	-2	3
Russian Ruble		66.45	0.6	1	4	-13	-13
South African Rand		14.60	1.1	2	3	-7	-15
Turkish Lira		5.99	1.4	3	7	-39	-37
Dollar vs. Mature FX (DXY index)		95.16	-0.4	-1	0	2	3

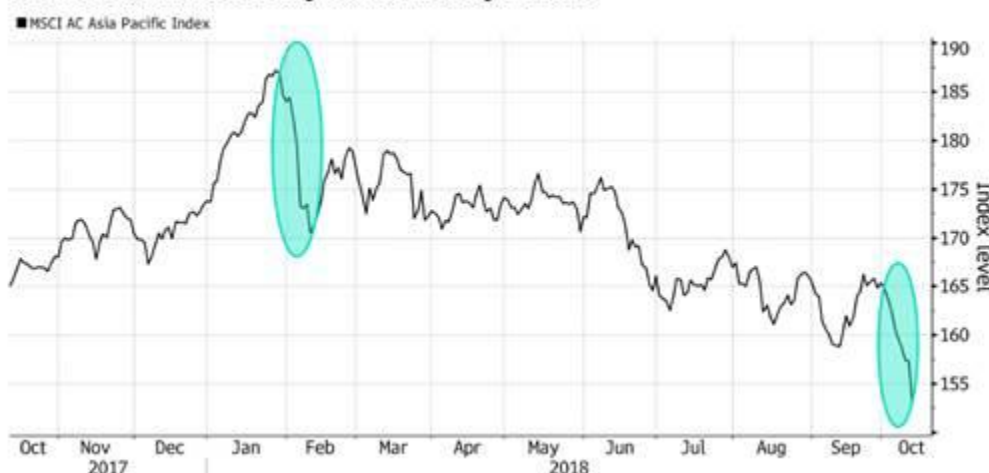
Colors denote **tightening**/**easing** financial conditions for observations greater than ± 1.5 standard deviations. Data source: Bloomberg.

Asia

Regional equities sold off sharply following the slide in U.S. markets overnight. Benchmark indices in China (Shanghai -5.2%, Shenzhen -6.4%), Vietnam (-4.8%) and Korea (-4.4%) led losses. The rout in equities followed the dramatic sell-off in U.S. markets overnight as US Treasury yields rose to their highest in seven years. **Selling pressures in regional currencies and sovereign bond markets were contained.** The Korean won depreciated the most (-0.9%), followed by the Indonesia rupiah (-0.2%). Sovereign yields mostly declined, except for Indonesia (+9 bps).

Stocks Slump

Asian stocks see worst day since February's selloff



China

Equities sold off sharply (Shanghai -5.2%, Shenzhen -6.4%) on heavy trading volumes, while the CNY tested fresh ytd lows after another weak yuan fix. Technology stocks (-8%) led losses. Close to a quarter of stocks declined by 10%, the daily limit. Analysts point to US equity weakness overnight as the immediate cause of the dramatic decline, but negative news flow over the last weeks with broadening US-China tensions is at the heart of negative sentiment. The onshore yuan depreciated 0.1% to 6.927, while the offshore yuan depreciated 0.2% to 6.934. According to analysts, the yuan's decline past 6.9 in recent days is fueling speculation that the authorities agree with comments in the Securities Journal yesterday that they should not intervene even if the currency weakens through the 7.0 level.

China's issuance of USD-denominated sovereign securities today was reportedly oversubscribed.

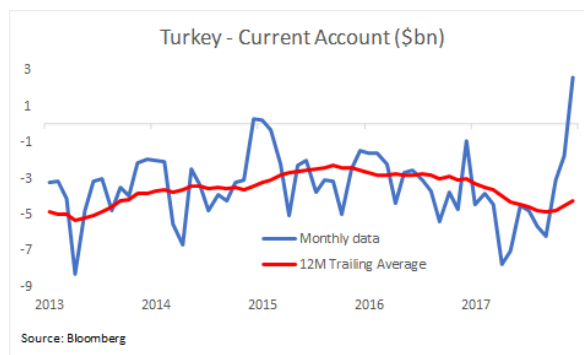
China offered 3 bn worth of bonds in three tranches in its first US dollar issuance since October 2017. The issue drew more than \$10bn of orders, according to Bloomberg sources. Spreads over US treasuries were 50 bps for the 5-year notes, 65 bps for the 10-year notes, and 90 bps for the debut 30-year bonds.

China is suspending approvals for an overseas investment product known as the Qualified Domestic Limited Partnership program, according to Reuters. New applicants for the businesses were said to have been told to wait. Such guidance possibly signals concerns over capital outflows amid US-China trade disputes.

Turkey

The lira strengthened for the fifth consecutive session as current account data came in stronger than expected. The highly anticipated data release showed a continuation of the recent turnaround with the current account in surplus of \$2.6bn for August (\$2.5bn expected). This means that the trailing 12-month current account deficit is 5.8% of GDP, down from a peak of 6.6% in May. The monthly data has shown a sharp upturn following the dramatic weakening of the lira, although it has mostly been caused by import compression as opposed to export gains. The lira strengthened following the release, breaching the 6-handle against the dollar. It appreciated 1.4% on the day and is 2.8% stronger since last Thursday.

No Support Shanghai stocks drop to lowest since 2014

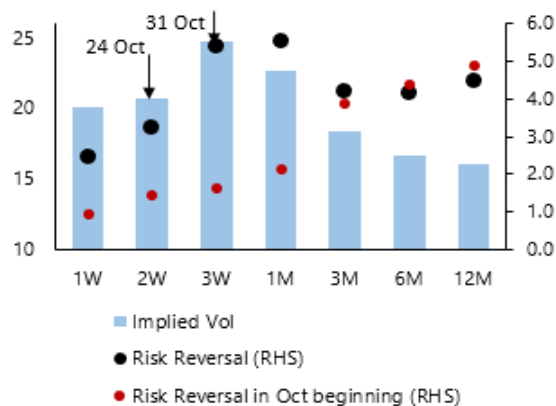


Brazil

Brazilian assets gave up gains yesterday with the currency depreciating 1.1% against USD, and equity markets declining by 2.8%. The headwinds included a global risk-off sentiment, market concerns over Bolsonaro's appetite for reforms and probing of Bolsonaro's advisor Guedes. With investors focusing on the second round of elections (scheduled on 28th October), hedges are building up ahead of the event. This is also reflected in the market implied volatilities using option pricing data (chart 1). Furthermore, shorter dated risk reversals have also increased sharply in the last 2 weeks, while there is

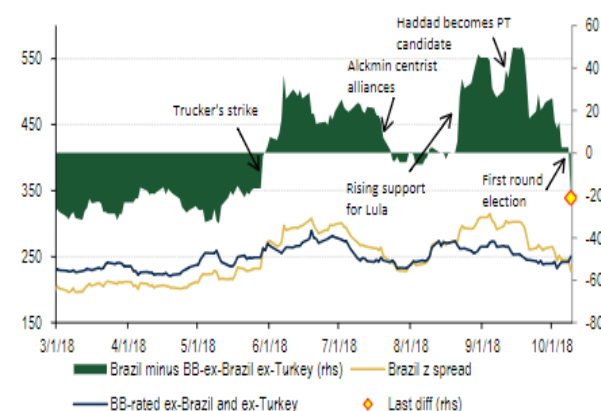
no meaningful change in the longer dated risk reversals. Market analysts also highlighted that the large risk premium embedded in Brazilian external bonds, has mostly eroded following the first round of elections.

USDBRL: Market Implied Currency FX and Risk Reversals



Source: Bloomberg

Chart 1: Brazil election risk premium has eroded

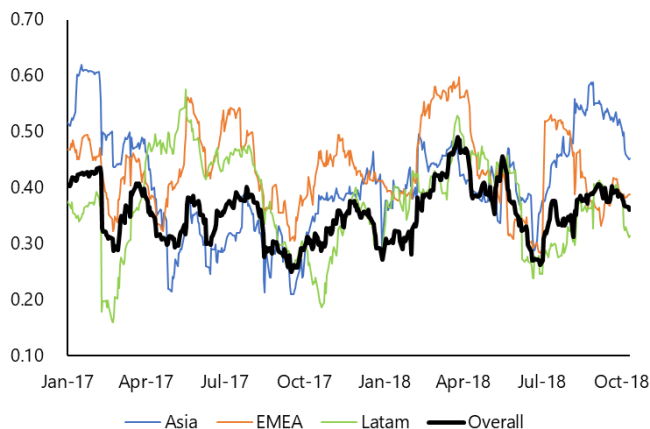


Source: BofA Merrill Lynch Global Research, Bloomberg

EM FX Correlation

Median EM currency correlation has declined over the last few days after increasing sharply since mid-July. In terms of regional trends, median FX correlation has moderated across all the three key EM regions in the last few days. However, it remains quite high within EM Asia (both vs its own time history as well as vs other regions), potentially reflecting the continued market concerns on trade tensions in China and the spillover effects.

60-day median pairwise correlation between FX returns




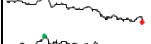
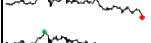


























Source: Bloomberg

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Global Financial Indicators

Last updated: 10/11/18 8:24 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		2778	-0.3	-4	-4	9	4
Europe		3229	-1.2	-4	-3	-11	-8
Japan		22591	-3.9	-6	0	8	-1
China		2583	-5.2	-7	-3	-24	-22
Asia Ex Japan		64	-2.8	-7	-6	-14	-16
Emerging Markets		40	-3.0	-6	-4	-15	-16
Interest Rates			basis points				
US 10y Yield		3.19	2.5	0	21	84	78
Germany 10y Yield		0.53	-2.1	0	10	7	10
Japan 10y Yield		0.15	-1.0	-1	3	8	10
UK 10y Yield		1.70	-2.4	4	20	32	51
Credit Spreads			basis points				
US Investment Grade		101	-0.3	3	-2	3	9
US High Yield		352	-0.5	28	14	-16	-23
Europe IG		74	2.0	5	13	18	29
Europe HY		296	6.7	19	16	54	63
EMBIG Sovereign Spread		352	-2.0	13	-20	68	67
Exchange Rates			%				
Dollar Index (DXY)		95.13	-0.4	-1	0	2	3
USDEUR		1.16	0.5	1	0	-2	-4
USDJPY		112.3	0.0	1	-1	0	0
EM FX vs. USD		61.8	0.5	1	2	-11	-11
Commodities			%				
Brent Crude Oil (\$/barrel)		82	-1.6	-3	3	44	22
Industrials Metals (index)		119	-0.7	-2	5	-8	-14
Agriculture (index)		43	-0.3	0	1	-11	-10
Implied Volatility			%				
VIX Index (% change in pp)		23.4	0.4	11.8	10.1	13.5	12.3
10y Treasury Volatility Index		4.4	-0.1	0.5	0.8	0.2	0.8
Global FX Volatility		8.3	0.0	-0.1	-0.8	0.3	1.0
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		398	6.0	1	32	29	29
Italy		304	8.9	24	53	145	145
Portugal		146	4.6	7	-1	-6	-6
Spain		110	3.9	7	6	-4	-4

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: 10/11/2018 8:26 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	0.2	-0.6	-1	-5	-6		3.6	-0.4	-2	-1	-14	-37
Indonesia		15235	-0.2	-0.4	-2	-11	-11		8.6	-2.9	28	-9	173	197
India		74	0.1	-0.7	-2	-12	-14		8.1	-2.2	-7	-14	104	67
Philippines		54	0.0	0.3	0	-5	-8		6.6	5.4	19	44	179	178
Thailand		33	0.7	-0.1	0	1	-1		2.9	-1.4	9	11	74	64
Malaysia		4.16	-0.1	-0.3	0	2	-3		4.1	-0.5	1	-3	20	19
Argentina		37	-0.2	1.3	0	-53	-50		23.1	-17.2	19	-173	811	705
Brazil		3.74	0.4	3.6	11	-15	-11		9.2	8.7	-58	-127	56	18
Chile		687	-0.2	-1.7	1	-9	-10		4.9	4.1	5	6	30	8
Colombia		3094	-1.1	-2.5	0	-4	-3		6.7	3.0	4	-1	41	43
Mexico		19.10	0.3	0.1	0	-2	3		8.1	1.4	19	8	93	48
Peru		3.3	-0.1	-0.2	0	-2	-3		5.8	4.4	6	18	52	55
Uruguay		33	0.4	0.1	0	-11	-13		10.5	1.1	7	-119		191
Hungary		281	0.7	0.3	0	-7	-8		2.9	7.9	27	36	135	164
Poland		3.73	0.4	0.4	-1	-3	-7		2.7	2.3	6	3	-16	-2
Romania		4.0	0.4	0.6	-1	-4	-4		4.6	0.0	30	30	136	78
Russia		66.5	0.6	0.7	4	-13	-13		8.5	-1.1	29	-36	106	123
South Africa		14.6	1.1	1.8	3	-7	-15		9.8	3.6	9	1	49	51
Turkey		5.99	1.4	2.9	7	-39	-37		21.5	-39.6	77	-97	1021	959
US (DXY; 5y UST)		95	-0.4	-0.6	0	2	3		3.03	2.7	-1	16	107	82

	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		2583	-5.2	-7	-3	-24	-22		186	-2	7	1	46	34
Indonesia		5703	-2.0	-1	-2	-3	-10		196	-2	8	-13	34	30
India		34001	-2.2	-3	-9	7	0		165	0	9	-5	45	55
Philippines		6884	-1.7	-3	-8	-18	-20		106	-1	9	-1	17	11
Malaysia		1708	-1.5	-5	-5	-3	-5		128	-1	7	-6	9	18
Argentina		28550	-3.6	-11	-2	6	-5		699	-2	41	-43	333	349
Brazil		83679	-2.8	0	12	9	10		270	-1	-5	-59	32	36
Chile		5233	0.0	-2	0	-4	-6		125	1	7	-13	-1	6
Colombia		1480	0.0	-2	0	0	-2		180	-1	11	-5	-7	6
Mexico		48136	-0.8	-2	-2	-4	-2		264	-1	6	-17	22	19
Peru		19211	-0.9	-3	2	-1	-4		141	-2	11	-5	0	4
Hungary		36223	-1.7	-3	0	-6	-8		114	-3	13	1	25	26
Poland		55818	-1.8	-5	-3	-15	-12		59	-4	17	7	11	12
Romania		8373	-1.4	-2	1	5	8		175	0	14	-11	46	61
Russia		2356	-2.5	-4	1	12	12		221	-3	8	-27	37	43
South Africa		51761	-2.0	-6	-8	-10	-13		329	-1	17	-23	67	75
Turkey		94562	0.1	0	2	-9	-18		467	-11	-3	-79	178	178
Ukraine		550	0.1	1	4	85	75		558	-4	-1	-37	105	103
EM total		24	-2.5	-5	-4	-11	-11		352	-2	13	-20	68	67

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