



Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Monday, October 15, 2018

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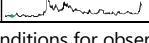
- **JP Morgan and Citi reported strong earnings last Friday** ([link](#))
- **Brexit discussions achieve little progress ahead of this week's key EC summit** ([link](#))
- **German coalition party loses support in regional election** ([link](#))
- **Japanese government approves ¥936 bn supplemental budget** ([link](#))
- **Saudi assets under pressure as diplomatic tensions rise** ([link](#))
- **Asian equities suffered new losses as sentiment continues to sour** ([link](#))

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Global markets remain skittish heading into week of political headlines

Political concerns may take center stage this week amidst a relatively light data calendar. The EU summit starting tomorrow will resume Brexit discussions. The official US Treasury report on currency manipulation is yet to be released but is expected shortly. Meanwhile, Italian budget and other political developments remain on many minds. In the US, the main data releases are today's retail sales data and the housing report on Wednesday. The latest FOMC minutes also come out on that day. In the euro area, the ZEW German business confidence surveys are due tomorrow and euro area CPI on Wednesday. The latest unemployment report is expected in the UK tomorrow along with inflation data the day after. Japan releases inflation data on Thursday, while in China, markets will focus on the latest GDP estimate, retail sales and industrial production due on the same day (US eastern time). Swedish opposition leader Kristersson faces a Tuesday deadline to form a new government.

Key Global Financial Indicators

Last updated: 10/15/18 8:11 AM	Level		Change from Market Close				YTD
	Last 12m	Index	1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		2767	1.4	-4	-5	8	3
Eurostoxx 50		3202	0.2	-3	-4	-11	-9
Nikkei 225		22271	-1.9	-6	-4	5	-2
MSCI EM		40	2.9	-1	-4	-14	-14
Interest Rates			bps				
US 10y Yield		3.15	-1.3	-8	15	88	74
Germany 10y Yield		0.49	-0.7	-4	4	9	6
Japan 10y Yield		0.14	-0.6	-1	3	8	10
FX / Commodities / Volatility			%				
Dollar index, (+) = \$ appreciation		95.1	-0.2	-1	0	2	3
Brent Crude Oil (\$/barrel)		81.3	1.1	-3	4	42	22
VIX Index (%, change in pp)		21.9	0.6	7	10	12	11

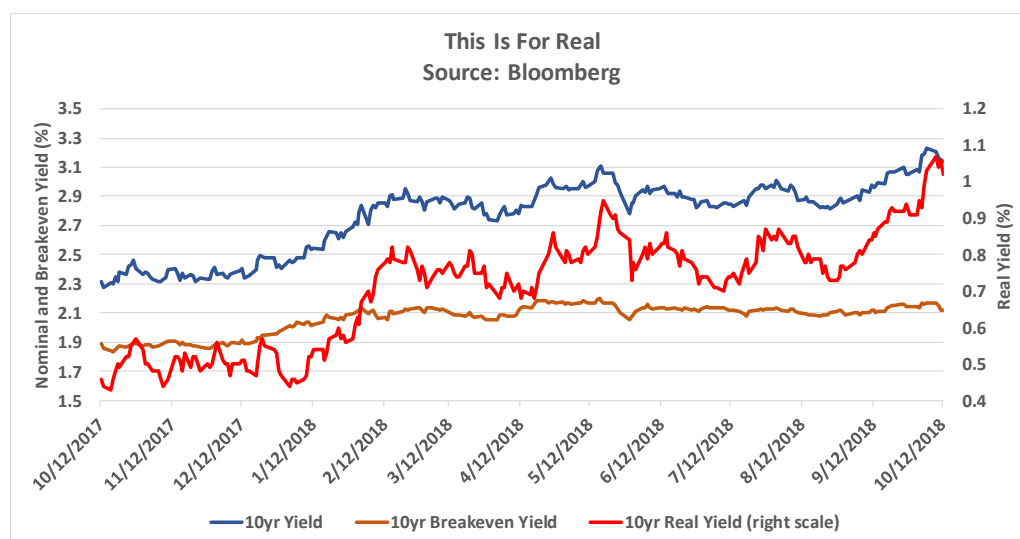
Colors denote **tightening/easing** financial conditions for observations greater than ± 1.5 standard deviations. Data source: Bloomberg.

United States

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US markets ended a six-day losing streak on Friday as stocks finally turned in a positive performance. The S&P 500 gained 1.4% and the Dow was up 1.2%. The Nasdaq outperformed again (up 2.3%) as the technology sector continued to rebound. The S&P 500 move was its largest gain in six months, bringing it back within its 200-day moving average which it breached on Thursday. Earlier, the index had posted six consecutive days of losses amounting to nearly 7% cumulatively. Traders highlighted a range of factors underpinning the decline, including systematic strategies, Commodity Trading Advisors (CTAs), momentum-driven accounts cutting positions in response to increased volatility, reduced depth in S&P futures and risk assets catching up to the repricing in rates markets. The VIX hit 25 pts intra-day but ended down 3.7% at 21.31 pts.

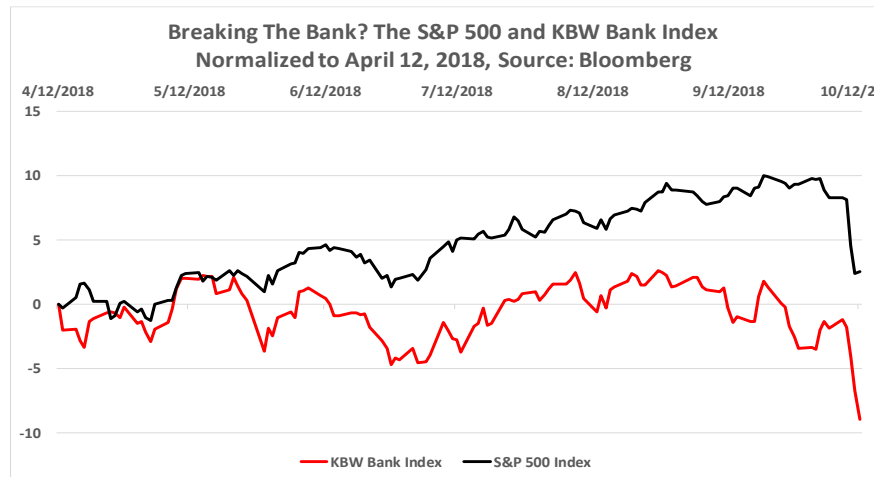
There was no obvious catalyst for the rally, but sentiment was more positive for a variety of reasons, including hopes for a reduction in US-China trade tensions, improved Chinese trade data, rumors of progress in the Brexit negotiations and the freeing of pastor Brunson by Turkish authorities. However, the US performance was in stark contrast to the sea of red in Europe, with the DAX closing at its worst level since February 2017 and the Stoxx 600 index at its lowest since December 2016. Treasury yields were little changed on Friday but the break over the 1% level for the 10-year real yield earlier in the week is seen as a harbinger of higher 10-year Treasury yields, especially as inflation (TIPS breakeven yields) remained contained. In other news, the University of Michigan consumer confidence survey was slightly better than expected (100.5 vs. the 99 forecast).



This morning, the Empire Manufacturing Index printed at 21.1 (20.0 consensus) while September retail sales rose only 0.1% mom (0.6% mom consensus). Price action was minimal immediately following the releases.

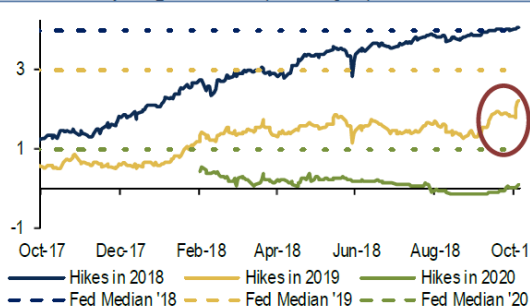
US bank stocks were mixed despite relatively good results from the big banks. After a generally positive report from JP Morgan, Citigroup reported that Q3 2018 profits were up 12% over Q3 2017 and that earnings-per-share was \$1.73 versus the \$1.69 analyst consensus forecast. Some analysts were especially heartened by a 9% increase in fixed income trading revenue after JP Morgan had earlier reported a decline in fixed income trading revenue. Wells Fargo also had good results, reporting a 32% increase in Q3 profits. However, the KBW bank index was down by 0.8%, headlined by JP Morgan (-1.1%). Weak results from PNC bank triggered a sharp decline in the S&P regional bank index, which was down 2.6% and has lost 8.5% over the past four trading sessions. PNC reported weak loan growth and disappointed analysts

with its guidance for the next quarter. Its share price fell by over 5.5%, its largest one-day decline in three years. The banking sector has sharply underperformed the overall market as investors fret about slow loan growth, doubts about the positive impact of rising interest rates and high costs. Smaller banks have come under especially heavy pressure as they rely heavily on their loan books to make money. However, Citi, Wells Fargo, and Bank of America all saw their share prices end the week in the black, as did Goldman. Morgan Stanley ended with a small loss.



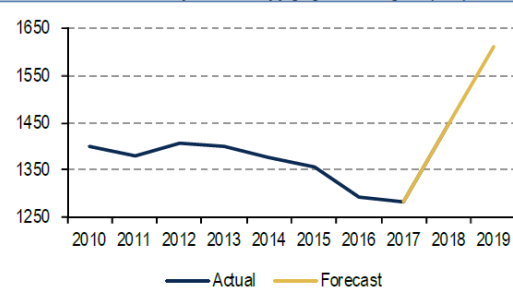
The market is pricing the odds of a December rate hike at close to 80%. However, the gap between market forecasts for future hikes and the FOMC dot plot remains quite wide. The market expects two hikes in 2019 and a slight decline in rates in 2020 versus the dot plot forecast of close to four hikes next year and at least one more hike in 2020. Some analysts predict that heavy new supply of Treasuries will force rates higher across the board and close the gap in hike expectations. Rising US budget deficits and the gradual withdrawal of Fed Treasury purchases could reinforce these trends.

Chart 1: Market pricing of Fed hikes (# hikes / year)



Source: BofA Merrill Lynch Global Research, Bloomberg

Chart 2: 10Y duration equivalent supply by calendar year (\$bn)



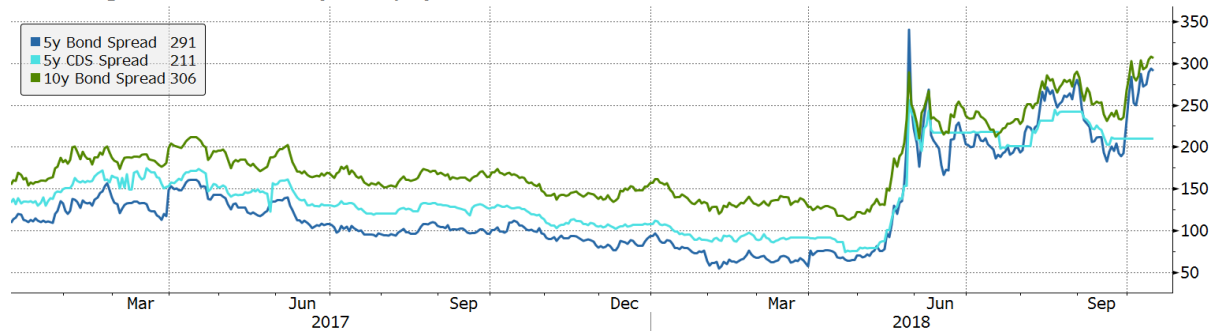
Source: BofA Merrill Lynch Global Research

Europe

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Italian PM Tria is expected to submit a draft budget to the European Commission and Eurogroup today. The plan still contemplates a deficit-to-GDP path of 2.4% in 2019, 2.1% in 2020 and 1.8% in 2021, which is expected to clash with EU's rules. A formal reaction from Brussels is expected within a week of submission. The spread between Italian and German 10-year yields has recently breached the 300 bp barrier, but the ISDA basis – seen by market participants as a measure of euro break-up risk – has steadily declined since September.

Italy-Germany Spreads (Sovereign Bond and CDS spreads, bps)



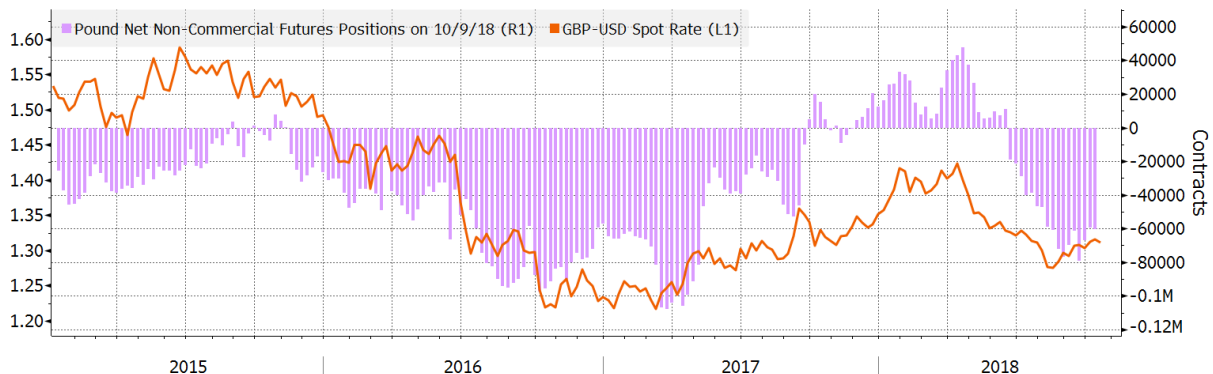
Eurozone Political Risk Measures (ISDA Basis: spread between 5y CDS using ISDA's 2014 and 2003 legal definitions)



EU and UK leaders failed to bridge differences during informal Brexit negotiations yesterday. The in-promptu one-hour meeting between UK's Brexit secretary Mr. Raab and EU chief negotiator Mr. Barnier was intended to smooth key disagreements ahead of Wednesday's EC formal summit. Before dispatching Mr. Raab to Brussels, PM May had warned that current proposals were a 'non-starter' for Britain. The Raab and Barnier teams could not agree on a number of long-standing issues, such as the future of the Irish/Northern Irish border. Pundits now expect the EU to call for a no-deal summit in November.

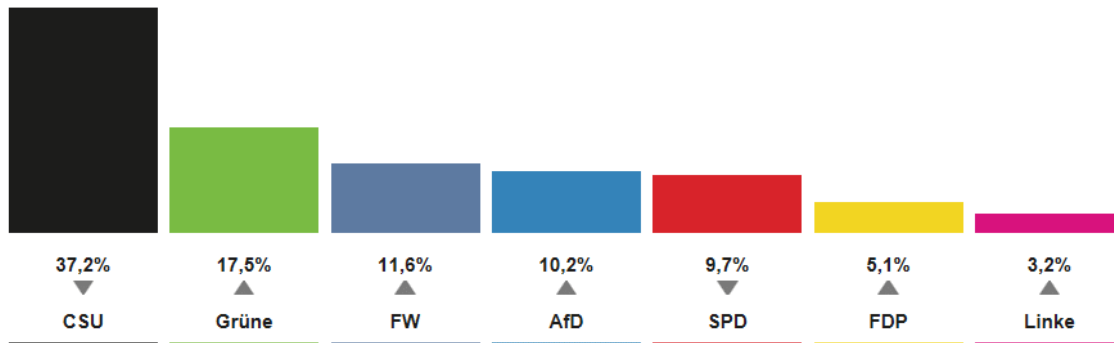
The pound (-0.3%) weakened to \$1.31 against the dollar on news of yet another stalemate in Brexit talks. Data on FX speculative positions reveal that traders remain heavily bearish on sterling, although negative sentiment has not reached the levels seen in the Brexit vote aftermath.

Pound Net Non-Commercial Futures Contracts



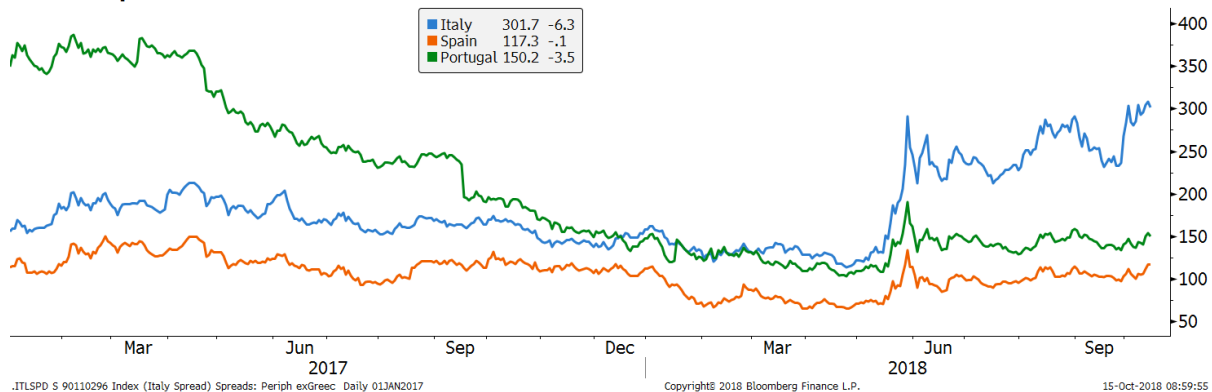
Germany

Support for mainstream parties collapsed in yesterday's election in Bavaria. Despite emerging as the winning party, the conservative CSU only garnered 37.2% of the vote, down from 48% in the last election. The socialist SPD obtained only 9.7%, compared with over 18% previously. The Green Party obtained 17.5%, while the right-wing AfD got 10.2% and earned representation in the regional parliament for the first time.



Portugal's 10-year yields are at 2.00% (-3bps) after **Moody's upgraded Portugal's rating to Baa3 from Ba1, while revising its outlook to stable from positive.** The agency noted the sustainable downward trend in the country's general government debt and increased economic resilience.

Selected European Sovereign Spreads to 10yr Bunds (in basis points)



Piraeus Bank has requested more time from the ECB to raise capital. The Greek lender had attempted to issue Tier 2 notes in recent weeks to satisfy a request by the ECB to increase its capital buffers. The bank, however, is arguing that unfavorable conditions in funding markets have prevented it from successfully issuing the securities. Piraeus share prices are 1.2% higher today, but have lost about 60% in value since end-2017.

Other Mature Markets [back to top](#)

Japan

The yen appreciated and equities tumbled amid a resurgence of risk aversion. The yen advanced to 111.73 against the US dollar (+0.4%) while the Topix shed 1.6%, erasing gains seen in September. At 1,675, the Topix is just a hair shy of its weakest level for the year. Meanwhile, amid the bearish sentiment, **JGBs**






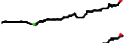


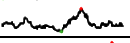



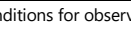

gained. The yield on the 2-year note fell 0.4 bp to -0.13% and the yield on the 10-year note fell 0.8 bps to 0.13%. At the IMF-World Bank Annual Meetings last week, BoJ Governor Kuroda noted that bond yields – not the amount of asset purchases – would offer the first signs of BoJ's exit from its monetary stimulus, though he stressed that policy settings will remain at their current levels for now. Analysts noted that Governor Kuroda's comments further underscored the symbolic nature of the JGB purchase amount: originally slated for ¥80 tn, actual BOJ purchases amount to close to half of that pace thus far.

Late in the day, **the government announced an extra budget to pay for disaster relief and indicated that a long-delayed sales-tax hike would take place next year as scheduled.** The ¥936 bn (\$8.4 bn) supplemental budget for the fiscal year that ends in March will include funds for regions hit by earthquakes, typhoons and flooding, and added ¥100 bn to reserve funds in case of more disasters, the first such move since 1961.

Emerging Markets

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Key Emerging Market Financial Indicators

Last updated: 10/15/18 8:19 AM	Level		Change				
	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		40.29	2.9	-1	-4	-14	-14
MSCI Frontier Equities		27.74	1.6	-1	0	-13	-16
EMBIG Sovereign Spread (in bps)		352	0.0	12	-20	66	67
EM FX vs. USD		62.21	0.2	1	2	-11	-11
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.92	0.0	0	-1	-5	-6
Indonesian Rupiah		15220	-0.2	0	-2	-11	-11
Indian Rupee		73.82	-0.3	0	-2	-12	-13
Argentine Peso		36.69	-0.2	3	4	-53	-49
Brazil Real		3.75	0.7	1	10	-16	-12
Mexican Peso		18.83	0.1	1	0	1	4
Russian Ruble		65.55	0.8	2	4	-13	-12
South African Rand		14.43	0.6	3	3	-8	-14
Turkish Lira		5.77	1.8	6	9	-37	-34
EM FX volatility		10.61	1.1	0.1	-1.3	2.5	2.8

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

Latin American currencies were little changed on Friday, except for the Mexican peso (+0.6%), but equities closed mostly lower. Of note, Argentina's main index rallied 7%, but this was not enough to offset losses from earlier sessions (-2.0% on the week). Asset prices in EMEA are mixed. The most notable moves have been in Turkey, where equities and the lira continue to rally (+1.5% and +0.6%, respectively), and Saudi Arabia, which has come under pressure from diplomatic tensions (equities down 5% over the last three sessions). Asian currencies weakened against the dollar while equities suffered broad-based losses as U.S. President Trump threatened to impose another round of tariffs on China. The Indian rupee underperformed (-0.6%) as traders expect India's trade deficit to widen to a record level. Meanwhile, the Korean won shed 0.3% ahead of Bank of Korea's policy meeting on Thursday after weakening to its one-year low last week. By contrast, the Singapore dollar held steady, outperforming others. Following news of its program request to IMF last week, yields on Pakistan's sovereign bonds were little changed on the day. The yield on the 10-year benchmark note, having risen by about 150 bps since early October, was

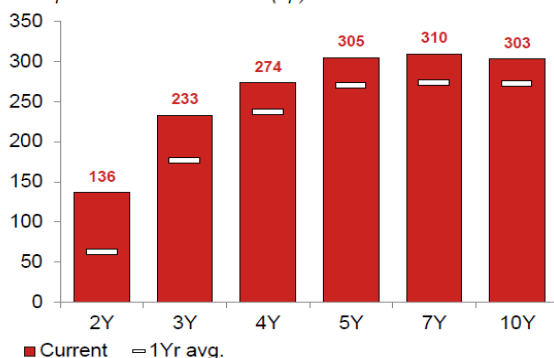
unchanged at 11.56% on the day. The 5-year note, which saw even less trading, edged higher by 2.6 bps to 10.96%. EMBIG spread fell 2 bps to 377 on Friday and has fallen 25 bps since September as some oil importing countries continue to experience high stress.

Brazil

Analysts at Nomura calculate that there is approximately 136 bps of risk premium embedded in the 2-year part of the DI futures curve and approximately 220 bps in longer tenors. The analysts suggest that in the short term, recent movements in risk-reduction are based on the lower probability of a left-wing victory in the upcoming second round of the presidential elections. While in the longer term, a further reduction of risk-premia will be highly dependent upon the likelihood of meaningful fiscal reforms next year, which are still uncertain and will be a key focus of markets after the election.

Fig. 3: Risk premium based on a PCA study incorporating key local and external variables

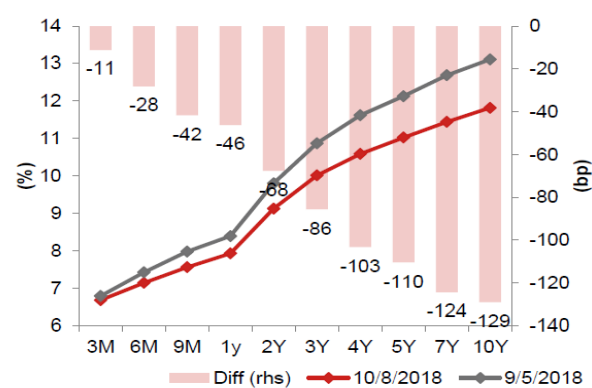
Risk premia across DI curve (bp)



Note: Data used in the PCA are Brazil's 5yr CDS, the generic 1yr DI rate, US2yr, US5yr and US10yr swap rates, USD/BRL, CRB commodity index, and the performance on the S&P500. A 24-month linear regression model is estimated using the first three principal components of the above system of variables. Source: Nomura, Bloomberg.

Source: Nomura

Fig. 4: Change in DI curve between now and before the first round election



Note: Data is as of EOD 11 October. Rates are based on synthetic generic rates based on DI futures rates. Source: Bloomberg, Nomura.

Emerging Asia

Asian currencies weakened against the dollar while equities suffered broad-based losses as U.S. President Trump threatened to impose another round of tariffs on China in an interview with CBS' "60 Minutes" over the weekend. The Indian rupee underperformed (-0.6%) as traders expect India's trade deficit to widen to a record level. Meanwhile, the Korean won shed 0.3% ahead of Bank of Korea's policy meeting on Thursday after weakening to its one-year low last week. By contrast, the Singapore dollar held steady, outperforming others.

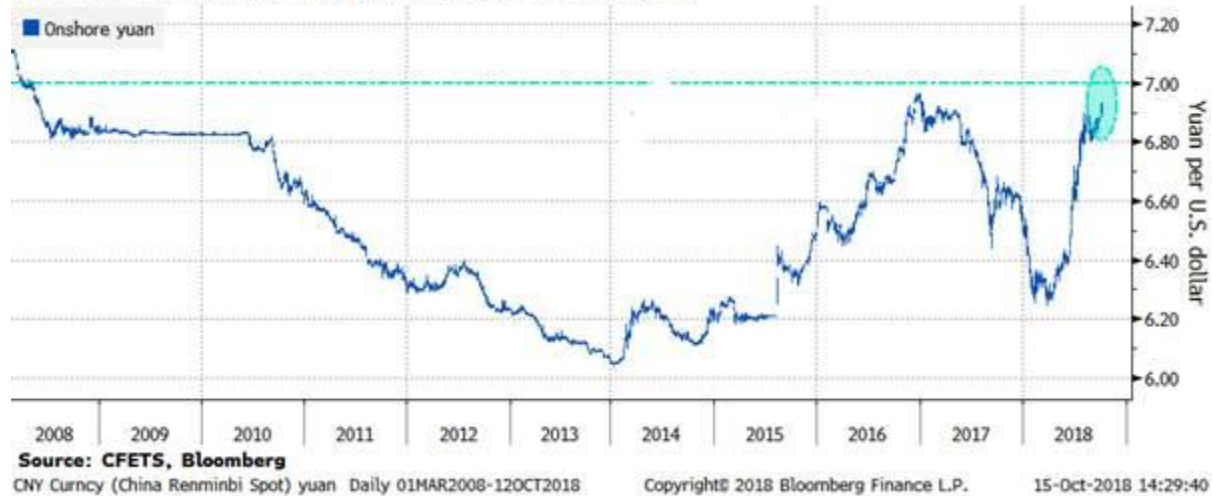
China

The RMB held steady around the 6.92 level despite a weaker-than-expected fixing from the PBC. Despite recent depreciation, a Bloomberg survey suggests broadly-held expectations for the RMB to not weaken past the key psychological level of 7 per dollar until the middle of next year; non-deliverables forwards suggest the same thing. Survey respondents noted that weakening beyond 7 for the first time in a decade would further strain relations with the U.S. and spur capital outflows, two scenarios that would be unwelcome with Chinese authorities. In the coming days, investors will focus on the US Treasury's decision on whether to name China as a currency manipulator; this decision will have repercussion for the next phase of trade negotiations between the two countries and broader market performance. **Chinese equities suffered renewed losses.** The Shanghai Composite lost 1.2% on the day with shares of consumer

staples underperforming. Analysts noted that concerns over slower growth have weighed on car sales and purchases of other consumer items with little reprieve expected in the near term.

Edging Closer

China's yuan moves toward 7 per dollar as trade tensions ratchet up



Pakistan

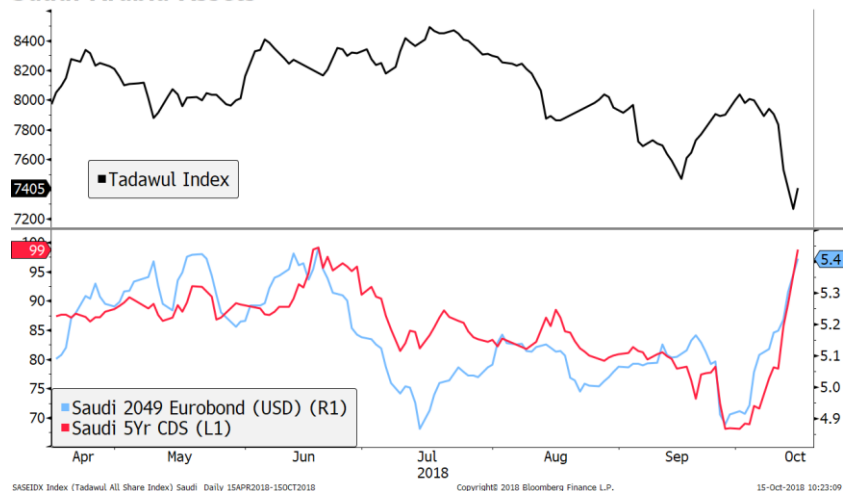
Following news of its program request to the IMF last week, yields on **Pakistan's** sovereign bonds were little changed on the day. The yield on the 10-year benchmark note, having risen by about 150 bps since early October, was unchanged at 11.56% on the day. The 5-year note, which saw even less trading, edged higher by 2.6 bps to 10.96%.

Saudi Arabia

Asset prices are under pressure amid developing diplomatic tensions surrounding the disappearance of a prominent Saudi journalist. Some

observers have accused Saudi Arabia of responsibility for the disappearance of Jamal Khashoggi, though the Kingdom vehemently denies it. The dispute escalated after US President Trump threatened "severe punishment" if the accusations were verified, to which the Saudi government promised to "respond with greater action." The Kingdom's Eurobond yields and CDS prices are sharply higher, while its main equity index is up 2% today after falling 7% over the previous two sessions.

Saudi Arabia Assets



Turkey

The lira is entering its seventh consecutive session of appreciation, with the latest leg helped by easing tensions with the US. Turkish authorities released US pastor Andrew Brunson on Friday, capping a favorable week for local assets. On the week, the lira gaining 4.2%, stocks rose 2% and shorter-dated swap rates declined as much as 500 bps, with the moves continuing in today's session.




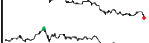













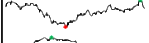











Turkish Assets YTD



List of GMM Contributors (Global Markets Analysis Division, MCM Department)
Anna Ilyina*Division Chief***Peter Breuer***Deputy Division Chief***Will Kerry***Deputy Division Chief***Sergei Antoshin***Senior Economist***John Caparusso***Senior Financial Sector Expert***Sally Chen***Senior Economist***Fabio Cortés***Senior Economist***David Jones***Senior Financial Sector Expert***Sanjay Hazarika***Senior Financial Sector Expert***Rebecca McCaughrin***Senior Financial Sector Expert***Juan Solé***Senior Economist***Jeffrey Williams***Senior Financial Sector Expert***Akihiko Yokoyama***Senior Financial Sector Expert***Dimitrios Drakopoulos***Financial Sector Expert***Tryggvi Gudmundsson***Economist***Henry Hoyle***Financial Sector Expert***Robin Koepke***Economist***Thomas Piontek***Financial Sector Expert***Jochen Schmittman***Economist***Ilan Solot***Financial Sector Expert***Nour Tawk***Economist***Martin Edmonds***Senior Data Mgt Officer***Yingyuan Chen***Senior Research Officer***Rohit Goel***Research Officer***Yang Li***Research Assistant*

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Global Financial Indicators

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Japan		22271	-1.9	-6	-4	5	-2
China		2568	-1.5	-5	-4	-24	-22
Asia Ex Japan		65	2.7	-2	-7	-14	-15
Emerging Markets		40	2.9	-1	-4	-14	-14
Interest Rates			basis points				
US 10y Yield		3.15	-1.3	-8	15	88	74
Germany 10y Yield		0.49	-0.7	-4	4	9	6
Japan 10y Yield		0.14	-0.6	-1	3	8	10
UK 10y Yield		1.61	-2.8	-7	8	24	42
Credit Spreads			basis points				
US Investment Grade		101	0.2	2	-1	3	10
US High Yield		348	-5.2	20	10	-23	-27
Europe IG		74	0.4	2	14	19	30
Europe HY		294	0.7	3	12	52	61
EMBIG Sovereign Spread		352	0.0	12	-20	66	67
Exchange Rates			%				
Dollar Index (DXY)		95.05	-0.2	-1	0	2	3
USDEUR		1.16	0.3	1	-1	-2	-3
USDJPY		111.7	0.4	1	0	0	1
EM FX vs. USD		62.2	0.2	1	2	-11	-11
Commodities			%				
Brent Crude Oil (\$/barrel)		81	1.1	-3	4	42	22
Industrials Metals (index)		120	0.0	0	5	-8	-13
Agriculture (index)		44	0.0	1	5	-11	-8
Implied Volatility			%				
VIX Index (% change in pp)		21.9	0.6	7.1	9.9	12.3	10.9
10y Treasury Volatility Index		3.9	-0.2	-0.2	0.8	0.0	0.4
Global FX Volatility		8.4	0.1	-0.1	-0.3	0.6	1.0
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		439	-1.5	-25	30	-115	28
Italy		357	-0.9	0	59	148	155
Portugal		203	-1.6	6	17	-31	8
Spain		170	2.1	11	21	9	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: 10/15/2018 8:20 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		6.92	0.0	0.2	-1	-5	-6		3.6	-2.2	-6	-8	-17	-40
Indonesia		15220	-0.2	0.0	-2	-11	-11		8.8	6.0	31	7	190	216
India		74	-0.3	0.3	-2	-12	-13		8.1	-2.0	-8	-19	99	63
Philippines		54	-0.1	0.2	0	-5	-8		6.6	0.0	15	36	174	172
Thailand		33	0.3	0.8	0	1	0		2.9	-0.3	1	5	77	63
Malaysia		4.15	0.0	0.0	0	2	-3		4.1	0.2	0	-4	20	19
Argentina		37	-0.2	3.2	4	-53	-49		22.6	-23.2	-62	-232	748	657
Brazil		3.75	0.7	0.7	10	-16	-12		9.3	0.0	-49	-116	61	25
Chile		679	0.0	0.3	1	-9	-9		4.9	0.9	6	9	26	10
Colombia		3095	-0.2	-2.0	-2	-5	-4		6.8	2.8	8	14	51	51
Mexico		18.83	0.1	0.6	0	1	4		8.1	-1.4	0	8	94	46
Peru		3.3	-0.2	-0.3	0	-2	-3		5.8	2.5	7	21	56	59
Uruguay		33	-0.2	0.3	-1	-11	-13		10.5	-3.3	9	-95		190
Hungary		279	0.4	1.4	0	-7	-7		2.9	4.4	20	32	143	166
Poland		3.71	0.2	1.3	-1	-3	-6		2.6	-3.2	-6	-1	-17	-9
Romania		4.0	0.1	0.8	-1	-4	-3		4.6	0.0	12	30	124	79
Russia		65.6	0.8	1.6	4	-13	-12		8.5	-6.2	5	-3	109	120
South Africa		14.4	0.6	2.9	3	-8	-14		9.9	-0.4	2	12	48	55
Turkey		5.77	1.8	5.9	9	-37	-34		20.7	-71.0	-110	-205	947	874
US (DXY; 5y UST)		95	-0.2	-0.7	0	2	3		3.01	-0.7	-6	10	111	80

	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		2568	-1.5	-5	-4	-24	-22		184	-4	2	-4	44	32
Indonesia		5727	-0.5	-1	-3	-3	-10		202	3	13	-7	39	36
India		34865	0.4	1	-8	7	2		166	-2	6	-5	50	56
Philippines		6927	-1.1	-2	-7	-18	-19		109	0	9	4	18	14
Malaysia		1729	-0.1	-3	-4	-2	-4		127	-3	3	-9	8	17
Argentina		29598	7.2	-2	-2	9	-2		656	-27	-2	-42	290	306
Brazil		82921	-0.9	0	10	8	9		261	-5	-16	-66	22	27
Chile		5145	-0.5	-2	-4	-6	-8		124	-3	4	-17	-3	5
Colombia		1463	0.2	-2	-2	-2	-3		179	0	9	-5	-10	5
Mexico		47444	-0.2	-1	-4	-5	-4		260	-3	2	-19	11	15
Peru		19231	0.0	-1	2	-2	-4		143	-1	11	-2	-2	6
Hungary		36478	0.4	-1	1	-6	-7		114	-2	6	-1	22	26
Poland		56297	-0.4	-2	-2	-14	-12		61	0	14	7	12	14
Romania		8425	0.4	-1	3	5	9		183	-1	13	-4	53	69
Russia		2392	-0.4	-3	1	14	13		225	2	11	-22	40	47
South Africa		52749	-1.4	-3	-7	-9	-11		334	2	22	-23	74	80
Turkey		98482	1.9	2	4	-7	-15		464	-6	-6	-83	175	175
Ukraine		554	0.7	1	4	86	76		571	10	12	-14	120	116
EM total		24	2.7	-2	-5	-10	-9		352	0	12	-20	66	67

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