



Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Tuesday, October 2, 2018

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- **Robust US PMI growth while Asia and Europe continue to slow** ([link](#))
- **US syndicated lending slides in Q3** ([link](#))
- **The euro weakens, Italian sovereign spreads continue to widen on budget concerns** ([link](#))
- **Reserve bank of Australia keeps policy rate at 1.5%, as expected** ([link](#))
- **Indonesian rupiah weakens past psychologically important 15,000 level** ([link](#))
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Market sentiment deteriorates on Italy's budget concerns

Headlines on the Italian budget have weakened the euro (-0.5%) and driven S&P futures and European bourses lower this morning. Italian sovereign spreads have continued to widen, with the 10-year spread to bunds reaching 295 bps. Italy's FM Tria acknowledged that the 2.4% deficit "does not comply exactly with some EU rules." Then soon after, Deputy PM Di Maio has sought to allay concerns by asserting that the government is still seeking dialogue with the EU. But EC president Junker upped the pressure by comparing the risks in Italy to those faced by Greece during the crisis. Market sentiment has also deteriorated in emerging markets, with the Indonesian rupiah (-0.9%) weakening past the psychologically important 15,000 level and the Turkish Lira (-1.1%) underperforming as Fitch downgraded 20 local banks while also assigning to them a negative outlook.

Key Global Financial Indicators

Last updated: 10/2/18 8:14 AM	Level		Change from Market Close				YTD
	Last 12m	Index	1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		2923	0.0	0	1	16	9
Eurostoxx 50		3390	-0.7	-1	0	-6	-3
Nikkei 225		24271	0.1	1	6	19	7
MSCI EM		43	0.0	0	-1	-4	-9
Interest Rates			bps				
US 10y Yield		3.07	-1.5	-3	21	73	66
Germany 10y Yield		0.44	-3.3	-11	11	-1	1
Japan 10y Yield		0.13	-0.6	0	2	6	8
FX / Commodities / Volatility			%				
Dollar index, (+) = \$ appreciation		95.6	0.3	2	0	2	4
Brent Crude Oil (\$/barrel)		84.6	-0.5	3	9	51	26
VIX Index (% change in pp)		12.3	0.3	0	-1	3	1

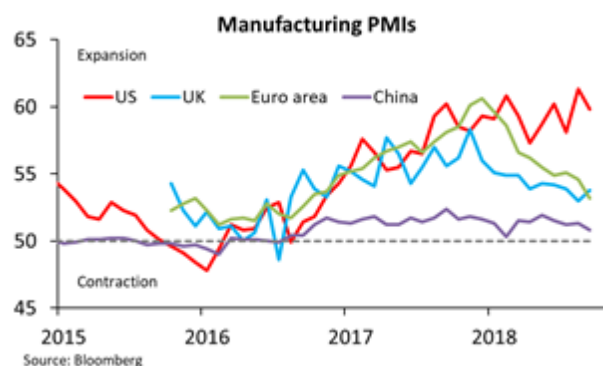
Colors denote **tightening**/**easing** financial conditions for observations greater than ± 1.5 standard deviations. Data source: Bloomberg.

United States

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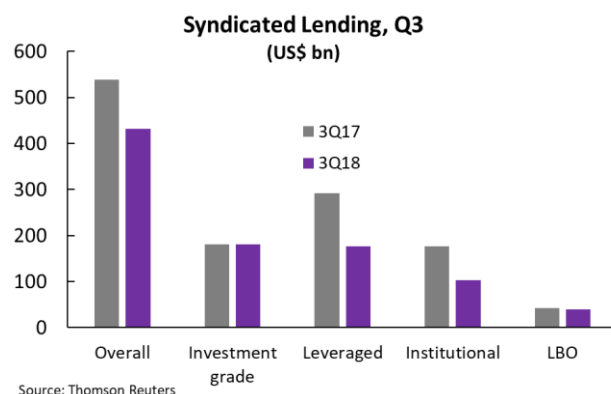
Stocks finished mixed Monday, as blue chip stocks rose while the Nasdaq finished slightly negative, despite a 0.5% gain in IT stocks. Stocks got an initial lift from the successful conclusion of the new NAFTA negotiation between the US and Canada over the weekend, but trended steadily lower through the balance of the session. Facebook lost 1.2% on news of a possible \$1.6 bn EU fine over a data breach. GE gained 7.1% after replacing its CEO and announcing a \$23 bn charge on its struggling power business. The Treasury curve steepened with a marginal rise in 2-year yields while 10-year yields ended 2 bps higher at 3.08%. Yields have finished above 3% since September 18th.

US manufacturing gains remain strong but cooled somewhat in September, with trade tensions apparently impacting other countries more profoundly. The US PMI measure dipped to just below 60, but is still **near a 14-year high**, while PMIs cross Asia and Europe continued their ongoing downward slide—with the euro area falling to its lowest level in two years.



Some two-thirds of business economists are forecasting a US recession by end-2020, according to a survey by the National Association of Business Economists. The majority believed the next contraction would commence in 2020, and the survey also found that their sample economists expected one more rate hike this year, and three in 2019. Just over 40% said the primary downside risk was trade policy, which echoes earlier results from Bank of America's global survey where fund managers advised that a trade war was the "biggest tail risk" for a fourth straight month. The fund manager survey further advised that 48% of respondents felt that the current decoupling in the global economy would be resolved by US growth deceleration.

Syndicated lending slipped 20% in Q3 according to data from Thomson Reuters. The Q3 total of \$432 bn was the lowest quarter since 2016, and is down 49% from Q2. Although new issuance picked up during the quarter, refinancing activity dropped sharply compared to a year earlier. Leveraged lending (\$176.6 bn) is down some 40% from Q317, primarily due to a big fall in refinancings. And although issuance slowed in Q3, demand remains strong from money managers and retail loan funds according to Bloomberg, with S&P reporting 4.0% returns for the asset class so far this year. Reuters reported there were no leveraged loan defaults in August and the 12-month trailing default rate held steady at 2.3%. Merger funding is off sharply in Q3 following a robust first half of the year.

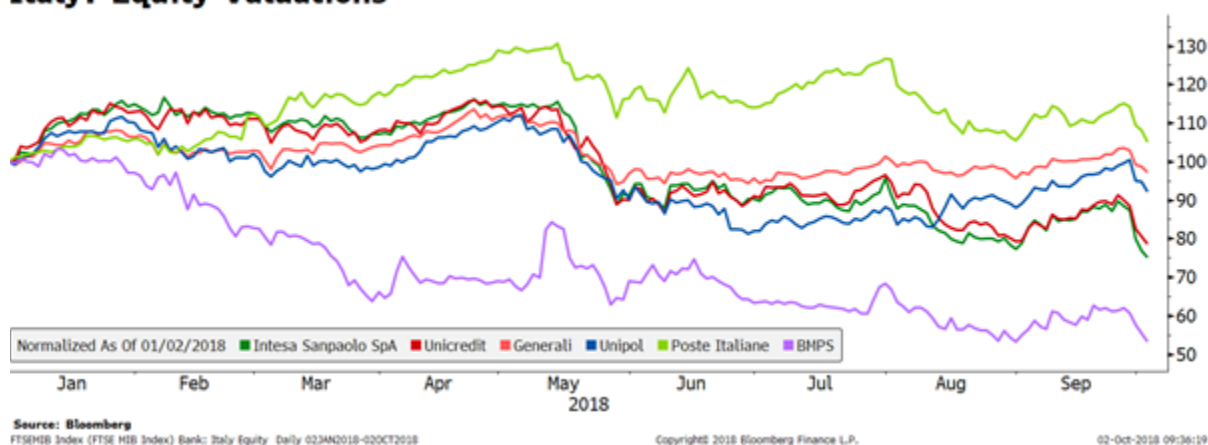


Europe

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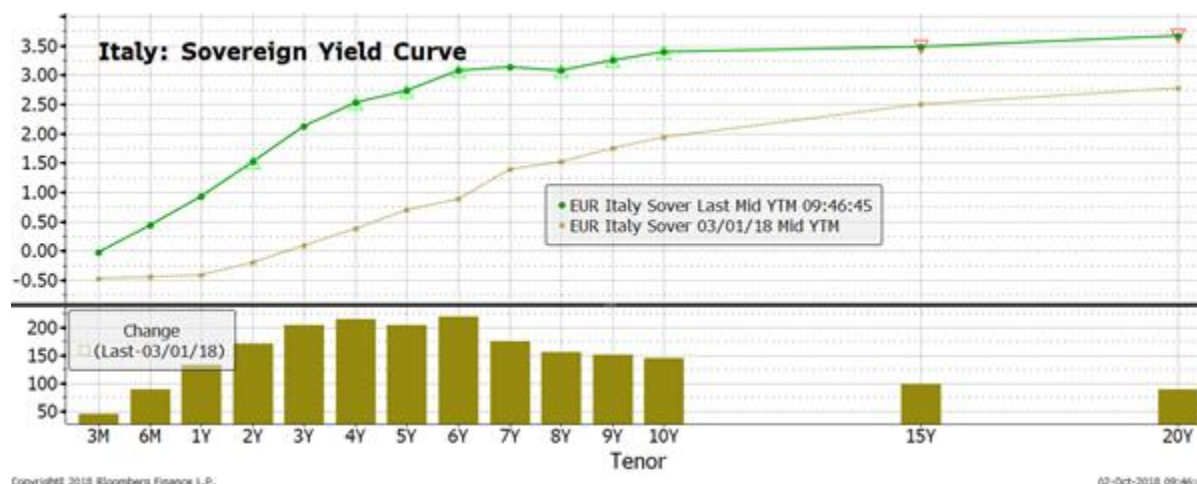
European equities are down today, led by losses in Italy: the broad Titans 30 Index is 1.0% lower while Italian bank stocks have lost 1.4% in value today: Unicredit (-1.6%), Intesa (-1.4%), Monte dei Paschi (-3.2%). Stocks of Italian insurance companies – many of which invest heavily in sovereign debt – are also markedly down: Generali (-1.4%), Unipol (-2.3%), Poste Italiane (-2.3%).

Italy: Equity Valuations



Other main indices in Europe: EuroStoxx 600 (-0.4%), DAX (-0.4%), CAC 40 (-0.6%), and FTSE 100 (-0.4%).

Euro area sovereign bond markets are showing signs of flight-to-safety as the yield on 10-year German and French bonds dropped 4 bps today to 0.43% 0.79%, respectively. Similarly, the risk reversal of German bunds has crossed into positive (i.e., bullish) territory – another sign of risk-off sentiment. **The Italian yield curve continues to shift upwards:** the 2-year yield surged 17 bps to 1.48% while the 10-year yield increased 9 bps to 3.38%. **The 10-year spread to bunds widened as much as 295 bps** this morning, exceeding this year's previous peak levels seen in August.



Concerns over Italy have spilled to the euro (-0.5%), pushing the common currency to \$1.15 this morning. **Sterling (-0.6%)** is also weaker – at \$1.30 – as local press suggest that PM May is ready to make a new Brexit offer to the EU to maintain trade links after 2020.

On **Brexit news, the FT reported on a number of planned moves by financial institutions away from London.** Bank of America and HSBC have announced the relocation of about 1,000 employees each to Paris, while Morgan Stanley and Blackrock plan to add 80 and 200-300 trading jobs in the French capital, respectively.

Other Mature Markets [back to top](#)

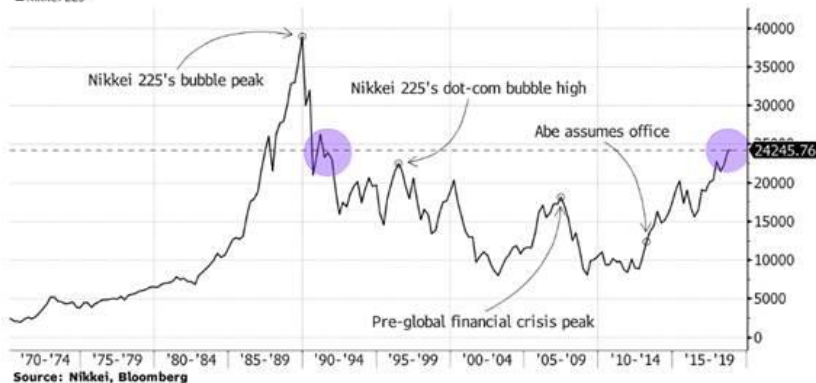
Japan

Equities extended gains, while the yen strengthened against the dollar. The Topix index closed 0.3% higher, while the Nikkei inched up 0.1%. Energy and healthcare stocks led gains. The yen appreciated 0.2% against the dollar. Ten-year bond yields dipped 0.4 bps to 0.12%. Nonetheless, analysts expect yields in the super-long end space to rise as the BoJ reduces purchases. In a cabinet shuffle announced today, key government positions were largely unchanged apart from the replacement of the defense minister. Finance Minister Taro Aso stated that an increase in the nation's sales tax scheduled for October 2019 is on track, given current economic conditions.

New High

Nikkei 225 soars to its highest in almost 27 years

■ Nikkei 225

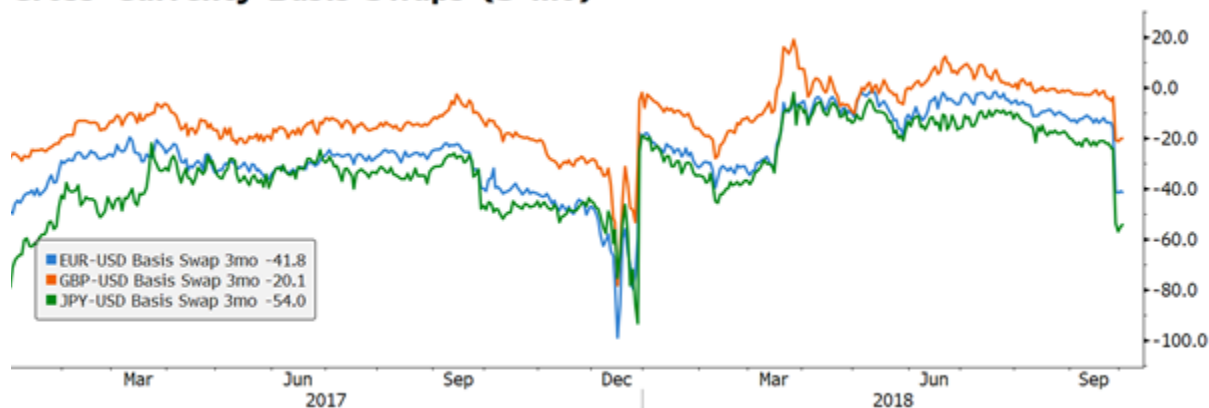


Currencies

Dollar funding conditions in money markets have tightened notably compared to recent months.

The 3-month cross-currency basis spreads for the euro-dollar, pound-dollar, and yen-dollar pairs have moved into negative territory in recent days.

Cross-Currency Basis Swaps (3 mo)



Source: Bloomberg
BUBSC Curncy (EUR-USD XCCY BASIS 3M) Non Hdt: XC Basis Swp 3M Daily 013AN017-02

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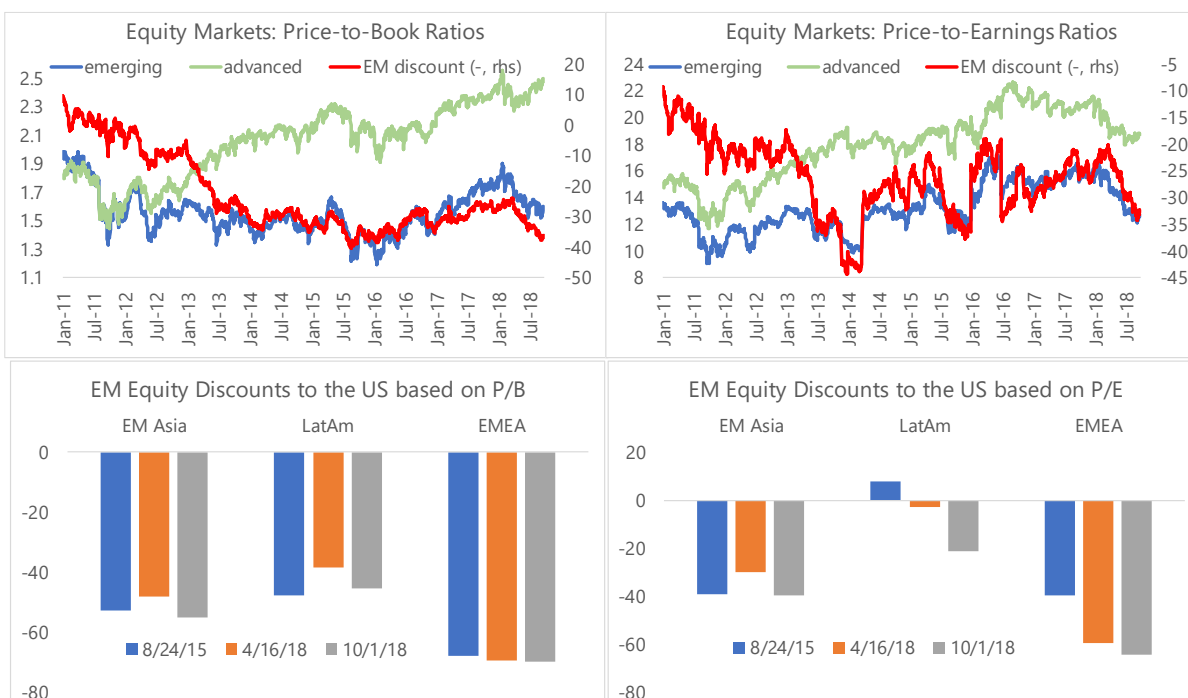
Emerging Markets

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Key Emerging Market Financial Indicators

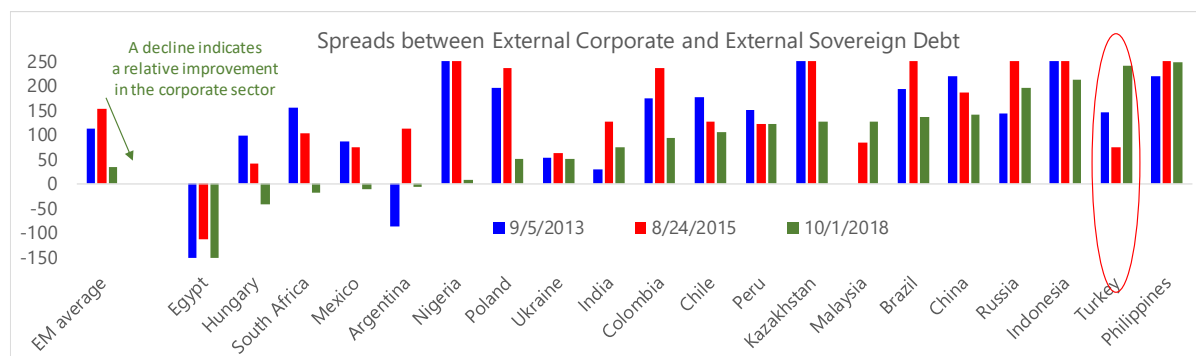
Last updated: 10/2/18 8:17 AM	Level		Change				YTD
	Last 12m	index	1 Day	7 Days	30 Days	12 M	
Prices/Returns of Major EM Benchmarks			%				%
MSCI EM Equities		42.93	0.0	0	-1	-4	-9
MSCI Frontier Equities		28.50	0.2	-1	2	-10	-14
Hard Currency Sovereign Debt		830.24	-0.1	1	1	-2	-3
Local Currency Sovereign Debt		16.40	0.1	0	1	-14	-14
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.87	0.0	0	-1	-3	-5
Indonesian Rupiah		14993	-0.2	0	-1	-10	-9
Indian Rupee		73.37	0.0	-1	-3	-11	-13
Argentine Peso		39.50	0.0	-3	-4	-56	-53
Brazil Real		3.99	0.8	2	4	-21	-17
Mexican Peso		18.76	-0.2	1	2	-3	5
Russian Ruble		65.35	-0.5	1	4	-11	-12
South African Rand		14.36	-1.0	0	3	-5	-14
Turkish Lira		6.00	-1.1	3	11	-41	-37
Dollar vs. Mature FX (DXY index)		95.54	0.3	1	0	2	4

As investors eye the right point to re-enter EMs, the depth of EM equity discounts has reached 2015-16 stress levels. Analysts increasingly discuss whether now is the right time to increase exposures to EMs to benefit from a rebound. Some commentators compare the current levels of EM discounts to those at the turnaround points in the past episodes of EM stress. In equity markets, the EM discount relative to advanced markets based on the price-to-book ratio (-36% on 10/1) has almost reached the maximum depth of -40% observed in the 2015-16 China worries episode (first panel). Similarly, the EM discount based



on the price-to-earnings ratio has nearly converged to the lowest levels in 2015-16 (second panel). Across regions, current levels of relative underperformance in EM Asia are similar to those in 2015 (third and fourth panels), driven by China. The P/E ratios in Latin America and EMEA suggest the present valuation levels are much lower than those in the last episode. The deepest discounts relative to the US are in EMEA—based on both metrics—pulled down by Russia and Turkey.

The EM corporate sector has weathered the recent market turbulence better compared to past episodes. Analysts pointed out that the EM corporate sector has been more resilient to market pressures relative to the sovereign sector, as the growth in public debt has outpaced the increase in private debt in recent years. Indeed, the difference between the costs of external corporate debt and external sovereign debt is lower in this episode compared to the 2013 taper tantrum and to the China and oil worries period of 2015-16 for most EMs (figure). The only notable exception is Turkey, where the corporate sector is heavily reliant on FX funding.



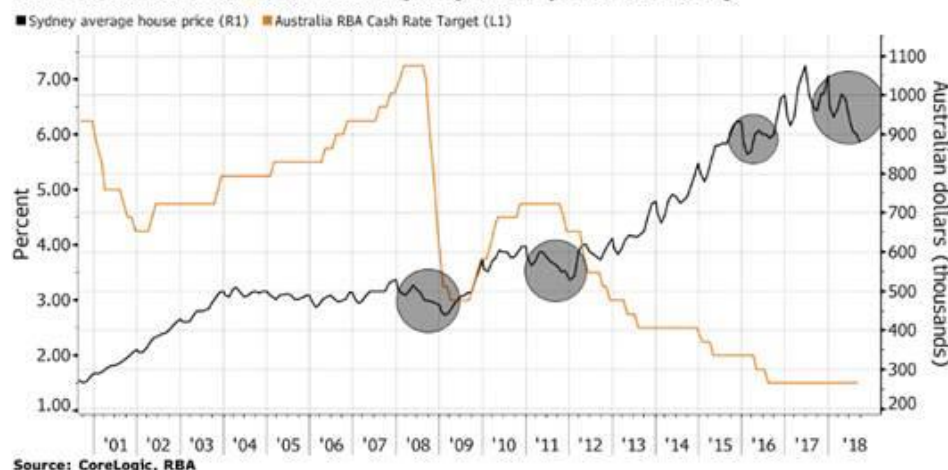
Two EM countries issued external public debt last week, while corporate issuance was scant. Hungary sold \$1.2 bn in EUR-denominated 7-year bonds with a 1.25% coupon. Papua New Guinea (rated B) placed \$0.5 bn in 10-year bonds at 8.625%. Corporates borrowed only \$0.6 bn after a massive issuance of \$19 bn the prior week.

Australia

The Reserve Bank of Australia kept the cash rate unchanged at 1.5%, as expected. Policy rates have been kept unchanged for 24 straight meeting. With core inflation falling below the lower bound of the RBA's 2% to 3% target range, faster wage growth and inflation closer to the 2.5% target would likely be needed before the RBA raises interest rates. Analysts note that the combination of mortgage rate hikes by 3 of the 4 largest banks and falling house prices could weigh on consumer spending. The Aussie dollar depreciated 0.7%, after having weakened nearly 11% since its peak in January. Bond yields were little changed. Equities fell 0.7%.

Minding the House

The RBA hasn't hiked rates while Sydney house prices are falling



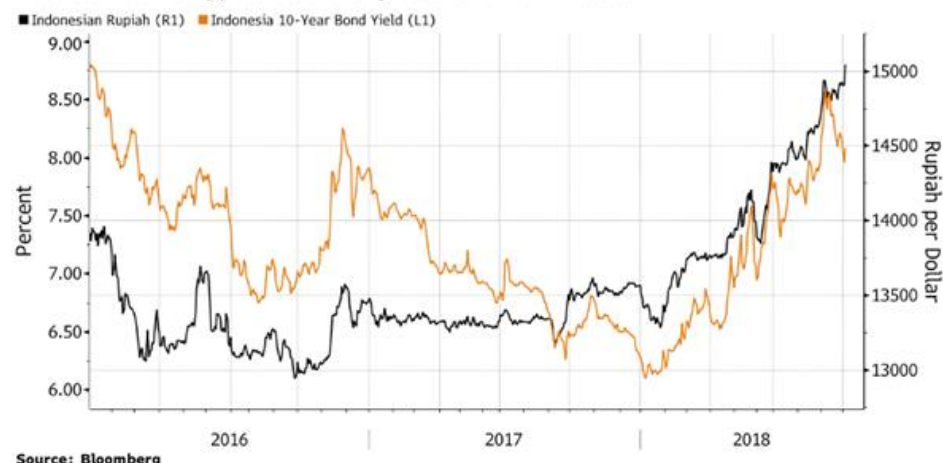
Indonesia

The rupiah depreciated to a 20 year low, while bond yields rose 14 bps, as concerns over rising oil prices mount. The rupiah traded above 15,000 against the dollar (-0.9%) this morning, its weakest since the Asian Financial Crisis, amid higher oil prices and broad dollar strength. According to analysts, while Bank Indonesia (BI) will likely intervene in both the FX and bond markets, BI could find it challenging to support the IDR given higher oil prices which is expected to worsen the current account deficit. Ten-year

bond yields denominated in local currency jumped 14 bps to 8.06%. Dollar-denominated sovereign bond yields rose 4 bps, underperforming the region. Equities fell 1.2%.

Under Siege

Indonesia currency, bonds under pressure amid EM selloff



Turkey

The Turkish Lira underperformed peers (-1.1%) this morning as Fitch ratings downgraded 20 local banks while also assigning to them a negative outlook. The action involved both state-owned, local private banks, and foreign-owned subsidiaries such as ING Turkey. The downgrades were by one notch, due to expected pressure on performance, asset quality and capitalization due to a weaker lira, higher central bank rates and weaker growth. Fitch also noted that Turkish authorities are facing increasing challenges in providing FX liquidity to banks. Turkey's bank equity sub-index is down 1.7% on the day and 35% on the year, vastly underperforming the XU100 index.

Turkish Bank Stocks (YTD)



Argentina

The currency strengthened on Monday, erasing Friday's 4.3% sell-off. The peso strengthened 4.4% against the US dollar to 39.47, the best performance among major currencies. The currency is now approximately at the halfway point of the 'no-intervention zone'. Market participants reported little activity in offshore NDFs, while onshore banks were seen as net sellers of dollars. Yields on dollar bonds rose up to 9 bps through the 10-year maturity. Five-years CDS spreads widened 56 bps to 587 bps. Yesterday, the BCRA sold ARS 71 bn in LELIQs in the first daily auction under the new monetary policy framework. The auction resulted in a LELIQ rate of 67.175%, slightly higher than 65% rate which had been the reported expectation among market participants.






























Mexico

The period of uncertainty for Mexico has nearly come to a close with the revised NAFTA/USMCA agreement. The peso surged to a two-month high on the news during the day but finished little changed yesterday. Commentators noted that the revisions to the original NAFTA accord were modest. The auto sector in the region will likely benefit, as the proportion of auto parts that originate from the region was increased to 70% from 62.5%, and 40% of a car now has to come from workers making \$16 per hour. The steel and aluminum tariffs on Mexico and Canada will remain in place, until another option such as quotas has been found. The USMCA agreement has so far protected Mexico and Canada from potential auto tariffs which the US administration is still considering. Mexican equities rose 0.8% yesterday, on NAFTA and higher oil prices.

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Global Financial Indicators

Last updated: 10/2/18 8:16 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		2923	0.0	0	1	16	9
Europe		3390	-0.7	-1	0	-6	-3
Japan		24271	0.1	1	6	19	7
China		2821	1.1	3	4	-16	-15
Asia Ex Japan		70	-0.2	0	-1	-3	-8
Emerging Markets		43	0.0	0	-1	-4	-9
Interest Rates			basis points				
US 10y Yield		3.07	-1.5	-3	21	73	66
Germany 10y Yield		0.44	-3.3	-11	11	-1	1
Japan 10y Yield		0.13	-0.6	0	2	6	8
UK 10y Yield		1.55	-3.5	-8	13	23	36
Credit Spreads			basis points				
US Investment Grade		97	-0.5	-2	-6	-4	5
US High Yield		325	1.2	-3	-20	-45	-50
Europe IG		69	1.5	0	1	13	24
Europe HY		279	5.0	8	-19	29	45
EMBIG Sovereign Spread		339	3.0	-7	-29	54	54
Exchange Rates			%				
Dollar Index (DXY)		95.56	0.3	2	0	2	4
USDEUR		1.15	-0.3	-2	-1	-2	-4
USDJPY		113.9	0.0	-1	-2	-1	-1
EM FX vs. USD		62.0	-0.3	0	1	-11	-11
Commodities			%				
Brent Crude Oil (\$/barrel)		85	-0.5	3	9	51	26
Industrials Metals (index)		121	0.3	0	2	-4	-13
Agriculture (index)		42	0.0	1	-1	-12	-11
Implied Volatility			%				
VIX Index (% change in pp)		12.3	0.3	-0.1	-0.5	2.9	1.3
10y Treasury Volatility Index		3.5	0.1	-0.1	-0.2	-0.9	0.0
Global FX Volatility		8.1	0.0	-0.5	-0.8	-0.1	0.7
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		432	9.9	25	-8	-127	20
Italy		336	6.1	48	12	120	134
Portugal		189	-1.3	0	-3	-54	-5
Spain		154	0.5	1	6	-16	-3

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: 10/2/2018 8:17 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		6.87	0.0	0.0	-1	-3	-5		3.6	0.0	-3	7	-10	-34
Indonesia		14993	-0.2	-0.4	-1	-10	-9		8.2	-2.0	-19	-8	137	152
India		73	0.0	-0.9	-3	-11	-13		8.1	-4.2	-12	0	108	65
Philippines		54	-0.3	-0.1	-2	-6	-8		6.4	-1.0	8	50	160	158
Thailand		32	-0.3	0.1	1	3	1		2.9	1.7	-2	6	64	56
Malaysia		4.14	-0.1	-0.2	0	2	-2		4.1	-0.2	-1	2	21	17
Argentina		39	0.0	-3.1	-4	-56	-53		24.2	38.4	64	-52	896	817
Brazil		3.99	0.8	2.2	4	-21	-17		10.0	-9.0	-16	-43	145	97
Chile		660	-0.2	1.1	4	-3	-7		4.8	-0.9	2	3	34	2
Colombia		3000	0.0	0.1	2	-2	-1		6.6	1.6	1	6	26	35
Mexico		18.76	-0.2	1.2	2	-3	5		7.9	-0.1	-9	2	99	27
Peru		3.3	0.0	-0.1	0	-1	-2		5.7	-2.9	-3	14	29	42
Uruguay		33	0.0	-0.5	-2	-12	-13		10.5	0.3	-7	-96		189
Hungary		280	-0.4	-1.7	0	-5	-7		2.6	1.0	0	13	114	137
Poland		3.72	-0.5	-1.9	-1	-1	-6		2.6	-2.3	-2	2	-19	-10
Romania		4.0	-0.4	-2.1	-1	-3	-4		4.3	-2.0	2	1	123	49
Russia		65.4	-0.5	0.7	4	-11	-12		8.2	-3.7	-10	-19	69	93
South Africa		14.4	-1.0	-0.1	3	-5	-14		9.7	5.3	-3	11	40	34
Turkey		6.00	-1.1	2.6	11	-41	-37		19.7	-36.6	-119	-430	880	773
US (DXY; 5y UST)		96	0.3	1.5	0	2	4		2.95	-1.2	-3	21	102	74
	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		2821	1.1	3	4	-16	-15		184	6	-1	-3	40	32
Indonesia		5876	-1.2	0	-2	-1	-8		184	6	-4	-4	17	18
India		36526	0.8	1	-5	17	7		163	2	-3	6	40	53
Philippines		7132	-1.2	-3	-9	-14	-17		95	5	1	-13	5	0
Malaysia		1798	0.3	0	-1	2	0		129	2	0	-8	5	19
Argentina		32585	-2.6	-2	11	24	8		637	7	31	-134	262	287
Brazil		78624	-0.9	1	3	6	3		295	3	0	-43	55	61
Chile		5298	0.0	-1	1	-1	-5		123	3	-7	-17	-4	4
Colombia		1513	0.5	1	-2	2	0		170	2	-3	-13	-14	-4
Mexico		49841	0.7	1	1	-1	1		260	3	-2	-22	28	15
Peru		19570	0.0	0	1	4	-2		134	3	0	-14	-6	-3
Hungary		36757	-0.3	2	-1	-3	-7		112	4	-1	-14	24	24
Poland		58695	-0.4	-1	-3	-9	-8		49	4	4	-17	0	2
Romania		8504	0.7	2	3	8	10		168	-1	-1	-16	39	54
Russia		2462	-0.4	1	5	19	17		210	2	-19	-24	24	32
South Africa		55437	-0.6	-3	-6	-1	-7		297	2	-23	-30	32	43
Turkey		97445	-1.1	-2	5	-6	-16		435	2	-16	-145	151	146
Ukraine		537	-0.3	0	2	82	70		555	2	6	-31	84	100
EM total		25	0.2	0	-1	-2	-4		339	3	-7	-29	54	54

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