



Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Monday, October 22, 2018

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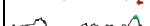


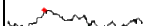





- **Markets pricing in uncertainty around upcoming US midterm elections** ([link](#))
- **US high yield bond supply slows as issuers continue to favor leveraged loans** ([link](#))
- **US G-SIBs Q3 2018 results modestly exceed market expectations** ([link](#))
- **Moody's downgrades Italy to lowest IG rating; spreads fall on stable outlook** ([link](#))
- **Foreign investors sell local Saudi shares as geopolitical risks remain elevated** ([link](#))
- **Further policy support measures triggers rally in Chinese equities** ([link](#))
- **Mexican assets weaken amid renewed US border tensions** ([link](#))

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Global risk assets rebound as worries over key sources of uncertainty ease

Equity markets stabilized as headlines tried to shine a more positive light on Chinese growth and Italian budget concerns. Asian and European equities are up across the board with Chinese stocks extending the rally from Friday, advancing over 4% for the biggest one-day gain since 2016. President Xi's promise of "unwavering" support for the country's private sector, and tax cuts propelled the stock gains. The 10-year Treasury yield pushed back up to 3.19% and Italian sovereign spreads tightened back below 300 bps following comments from EU commissioner Moscovici about the Italian budget that were interpreted as very constructive. Concerns around Italy's sovereign rating also eased after Moody's assigned a stable outlook despite its one notch credit rating downgrade to the lowest investment grade level. In emerging markets, the Mexican peso and equities have underperformed more recently amid renewed US border tensions related to migration.

Key Global Financial Indicators

Last updated: 10/22/18 8:05 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		2768	0.0	0	-6	7	4
Eurostoxx 50		3228	0.5	1	-6	-10	-8
Nikkei 225		22615	0.4	2	-5	5	-1
MSCI EM		40	0.5	-2	-8	-14	-16
Yields and Spreads			bps				
US 10y Yield		3.19	1.4	3	12	80	78
Germany 10y Yield		0.45	-0.6	-5	-1	0	3
EMBIG Sovereign Spread		350	1.0	0	4	70	65
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		62.4	0.0	0	1	-10	-10
Dollar index, (+) = \$ appreciation		95.8	0.1	1	2	4	4
Brent Crude Oil (\$/barrel)		80.0	0.3	-1	1	38	20
VIX Index (% change in pp)		18.9	-1.0	-2	7	9	8

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

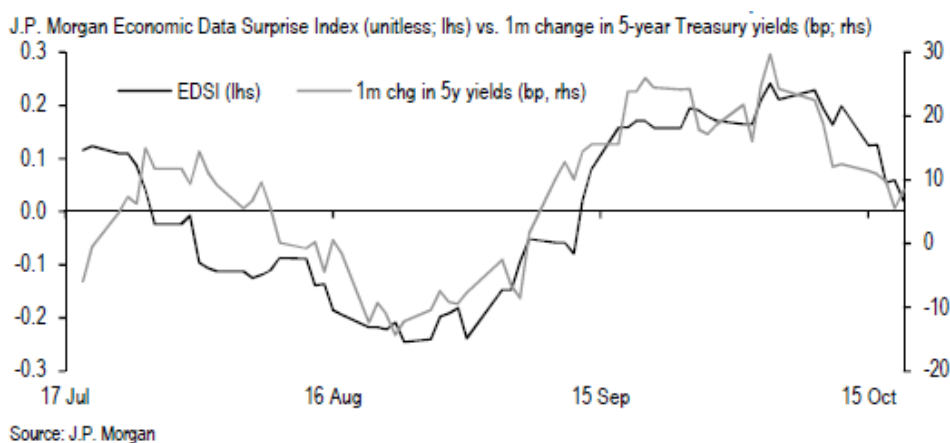
A politically heavy week is likely to give way to a host of data releases this week. Amongst the key data in the US, the focus is likely to be on durable goods on Thursday (consensus expect a mom decline of 1.5%) and preliminary GDP release for Q3 on Friday (consensus at 3.4% yoy vs 4.2% last quarter). Outside of the US, analysts expect the ECB's meeting on Thursday to remain relatively uneventful and to reiterate a data-dependent stance. But, market speculation continues about any further details on how the ECB will carry out the reinvestment of maturing bonds in its QE portfolio, and any guidance on rates (beyond the lift-off). Amongst other central bank decisions, Norway and Sweden are likely to keep rates on hold at 0.75% (Thursday) and -0.5% (Wednesday) respectively, but the market is likely to focus on the commentary in search for signs of setting expectations for potential policy tightening. Canada is expected to increase rates by 25 bps to 1.75% on Wednesday. Amongst other key economic releases, inflation prints are expected for Germany (Tuesday; PPI at 3.0% yoy), France and Japan (Friday; expected at 1.5%).

Within emerging markets, the focus will be on central bank meetings with consensus expecting no change in policy rates for Indonesia on Tuesday, Turkey on Thursday, Russia and Colombia on Friday. In South Africa, the medium-term budget policy statement is scheduled for release on Wednesday.

United States

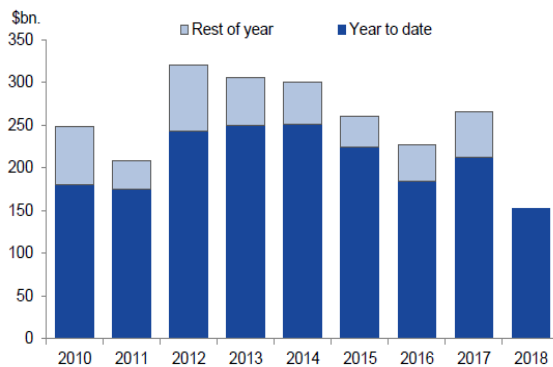
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Rounding out a relatively volatile week, Friday did not see any major market moves in the US with a broadly flat S&P 500 and 10-year Treasury yields up 1 bp to 3.19%. The VIX hit an intra-day high of 21 but ended flat at 19. The focus last week was on the FOMC meeting minutes, which revealed the committee may favor raising rates above neutral in order to reduce the risk of an overshoot of its inflation target. Overall risky assets stabilized somewhat last week, with credit spreads only marginally tighter. Treasury yields ground higher, with 2- and 30-year yields rising between 4 and 5 bps respectively. Analysts highlight that economic data has come in line with expectations lately, helping anchor yields. Three-month LIBOR continues to inch upwards and has reached 2.48%, the highest level since 2008, with market analysts increasingly focusing on any potential year-end disruption in the money markets.



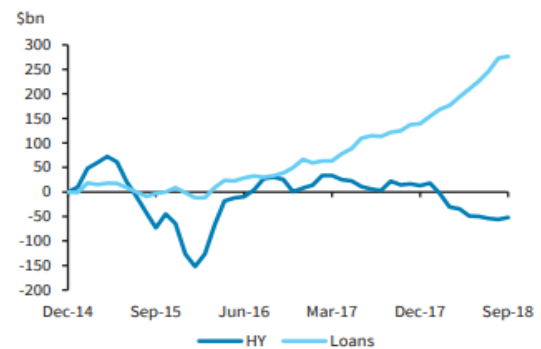
High yield bond supply remains low in the US with issuers continuing to favor leveraged loans. 2018 is on track to register the lowest annual figure for high yield supply since the crisis, with only \$152 billion issued YTD (down 29% yoy), a trend which is likely to continue in 2019 per analysts. On the other hand, the leveraged loan market continues to see blockbuster issuance, despite the rise in the yields. The potential financial stability risks from the leveraged loan market were also mentioned in the latest FOMC minutes, and covered in [April 2018 GFSR](#).

Exhibit 5: 2018 is on track to register the lowest annual figure for HY supply since the crisis



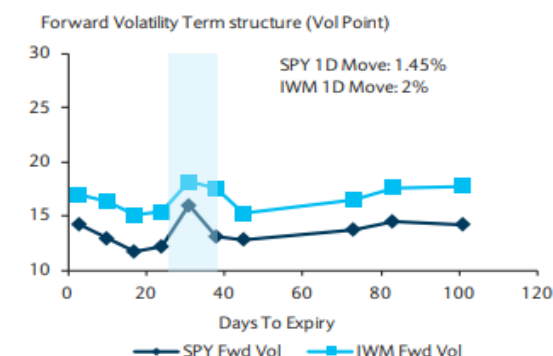
Source: Dealogic, Goldman Sachs Global Investment Research

Change in Amount Outstanding since 2014: High Yield Bonds versus Leveraged Loans

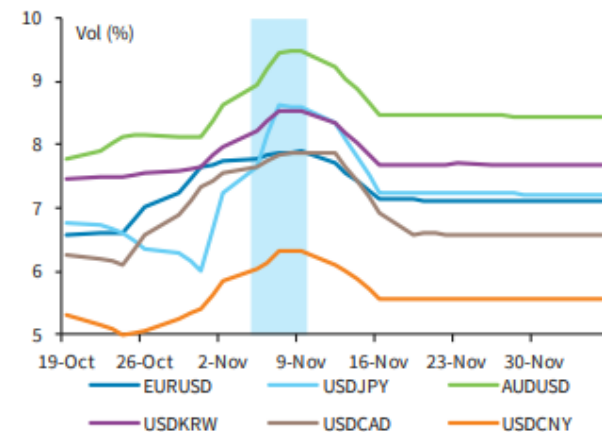


Source: Bloomberg Barclays Indices, S&P LCD, Barclays Research

Investors have started pricing in the mid-term election risk into US equities as derived from the forward volatility term structure. As per Barclays analysts, small-cap equities are pricing in a ~2% one-day move in IWM ETF (proxy for U.S. small-cap equities), and SPX index is pricing in a 1.5% move. A similar term structure bump can also be seen in the FX spot and options markets. On the other hand, in the context of the already elevated volatility due to trade war concerns, emerging markets and especially Chinese equities are not pricing in any significant additional risk as per the analysis. A similar term structure bump can also be seen in the FX spot and options markets.



Source: Bloomberg, Barclays Research.
 Note: SPY and IWM forward volatility term structure snapshot is as of 10/9/2018. SPY ETF is the proxy for SPX and IWM ETF is the proxy for US Small Caps (RTY).

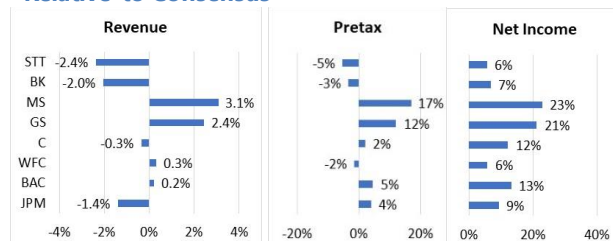


Source: Bloomberg, Barclays Research

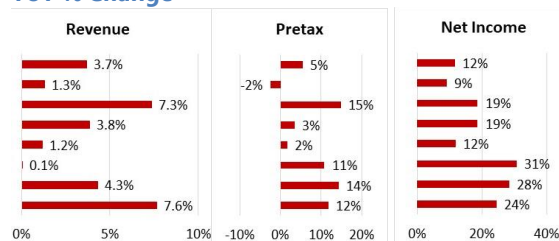
US G-SIBs' 3Q18 results modestly exceeded market expectations. The eight US G-SIBs have all reported 3Q18 financial results. Net income exceeded analyst forecasts for all, though this partly reflected lower-than-expected tax charges. Traditional lending banks (C, WFC, BAC, JPM) all reported robust net interest income on slightly wider margins and below-expected loan-loss provision charges. Investment banks outperformed on revenues (the second-best quarter over the past eight years for combined trading and investment banking). Other fee income sources, particularly transaction banking and custody services, were weaker. Management comments were generally constructive on the US economy and continue to assert that rising interest rates support earnings. G-SIBs' share performance last week reflected relative performance, with investment banks (MS +6.8%, GS +5.5%) outperforming and transaction banks (STT -10.2%, BK -2.2%) faring poorly. Traditional lending banks' shares were stable.

U.S. Systemically Important Banks: 3Q18 Results

Relative to Consensus



YoY % Change



Note: STT=State Street, BK=BONY Mellon, MS=Morgan Stanley, GS=Goldman Sachs, C=Citi, WFC=Wells Fargo, BAC=Bank of America, JPM=JPMorgan.

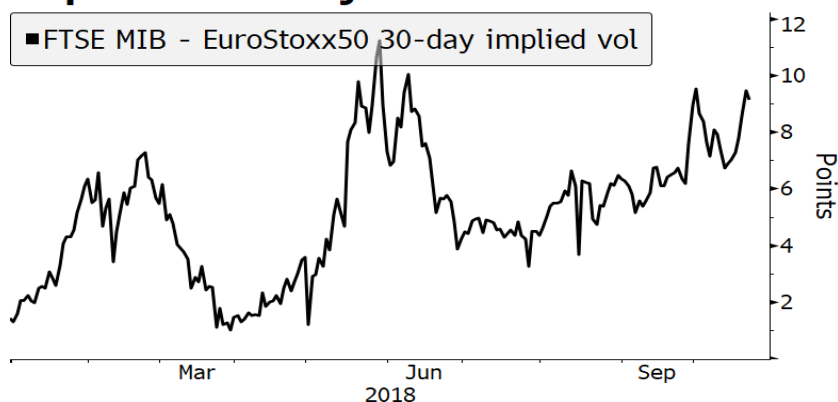
Source: Bloomberg

Europe

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Stocks are broadly higher and yields mostly lower across the region. Core yields are flat but are falling across Southern Europe, notably in Italy where the 2-year is down 7 bps (see below). The EuroStoxx is up 0.3% with Italy (+0.7%) outperforming. Despite the last few days of better news flow, implied volatility for Italian stocks remains elevated relative to that of the broader EuroStoxx index, even though the difference is well below the highs of the year (chart).

Implied Volatility for Italian Stocks



Source: Bloomberg

BBG002S1D1G8 BVOL Index (FTSEMIB 1M 100 VOL) Italy Eq. Vol. Daily 29DEC2017-22OC

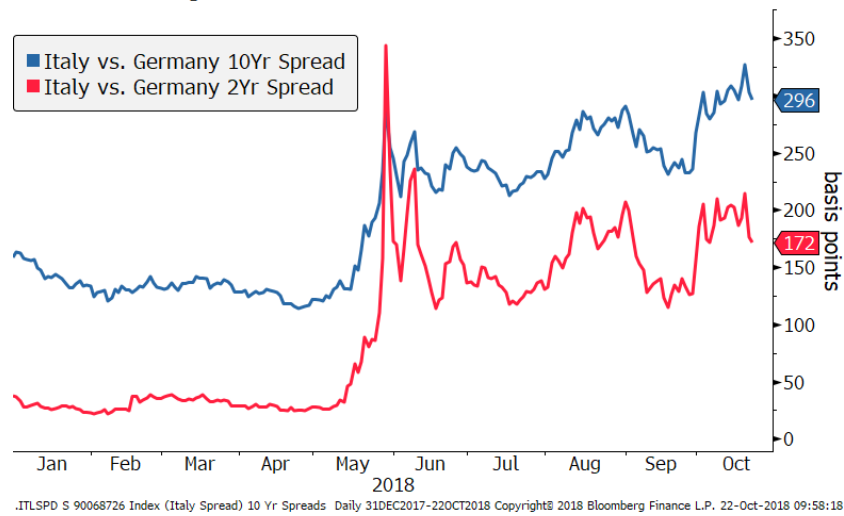
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Italy

Yields are broadly lower on a combination of positive headlines starting last Friday. Moody's cut the sovereign rating by one notch but kept it as investment grade (Baa3, lowest IG level). It also changed the outlook from negative to stable. This was a better-than-expected outcome on all accounts: some expected a downgrade below investment grade and the upgrade in outlook added a positive surprise. S&P announces its decision at the end of the week with most expecting a change in outlook from stable to negative but no downgrade from BBB. **The news added to the already improved sentiment late last week following a more conciliating tone by the EC.** European economic affairs commissioner Pierre Moscovici said the commission will be looking to "reduce tensions and maintain a constructive dialogue." **Lastly, reports this morning quote cabinet undersecretary Giancarlo Giorgetti hinting at a softer approach towards the budget.** He suggested the government could modify its spending if growth disappoints. All in all, the 10-year Italian-German spread fell some 30 bps over the last two sessions and is now back below the 300 bp level.

Italian Spreads



Other Mature Markets

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Japan

Equities gained (Topix +0.1; Nikkei +0.4%) with real estate and defensive sectors outperforming. After opening deep in the red, Japanese stock markets closed well off intraday lows in sympathy with the rally in Chinese stocks. In line with the risk-on sentiment, **the yen depreciated 0.2% against the dollar, while 10-year JGB yields rose 0.6 bps to 0.145%.** In its Financial System Report the BoJ said that the financial system remains stable and bank lending continues to support the economy. The BoJ expressed various concerns on the health of the financial system from a long-term perspective, but did not warn that the threat is immediate.

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Correlation between Topix and Shanghai Composite comes off lows



Emerging Markets

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Key Emerging Market Financial Indicators

Last updated: 10/22/18 8:06 AM	Level		Change				YTD
	Last 12m	index	1 Day	7 Days	30 Days	12 M	
Major EM Benchmarks			%				%
MSCI EM Equities		39.67	0.5	-2	-8	-14	-16
MSCI Frontier Equities		27.02	0.3	-3	-6	-15	-18
EMBIG Sovereign Spread (in bps)		350	1.0	0	4	70	65
EM FX vs. USD		62.38	0.0	0	1	-10	-10
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.94	-0.2	0	-1	-4	-6
Indonesian Rupiah		15189	0.0	0	-2	-11	-11
Indian Rupee		73.56	-0.3	0	-1	-12	-13
Argentine Peso		36.54	0.2	0	8	-52	-49
Brazil Real		3.70	0.4	1	11	-13	-11
Mexican Peso		19.29	0.0	-2	-2	-1	2
Russian Ruble		65.31	0.3	1	1	-12	-12
South African Rand		14.31	0.7	0	0	-4	-13
Turkish Lira		5.67	-0.5	2	8	-34	-33
EM FX volatility		10.02	0.8	-0.1	-1.6	1.9	2.2

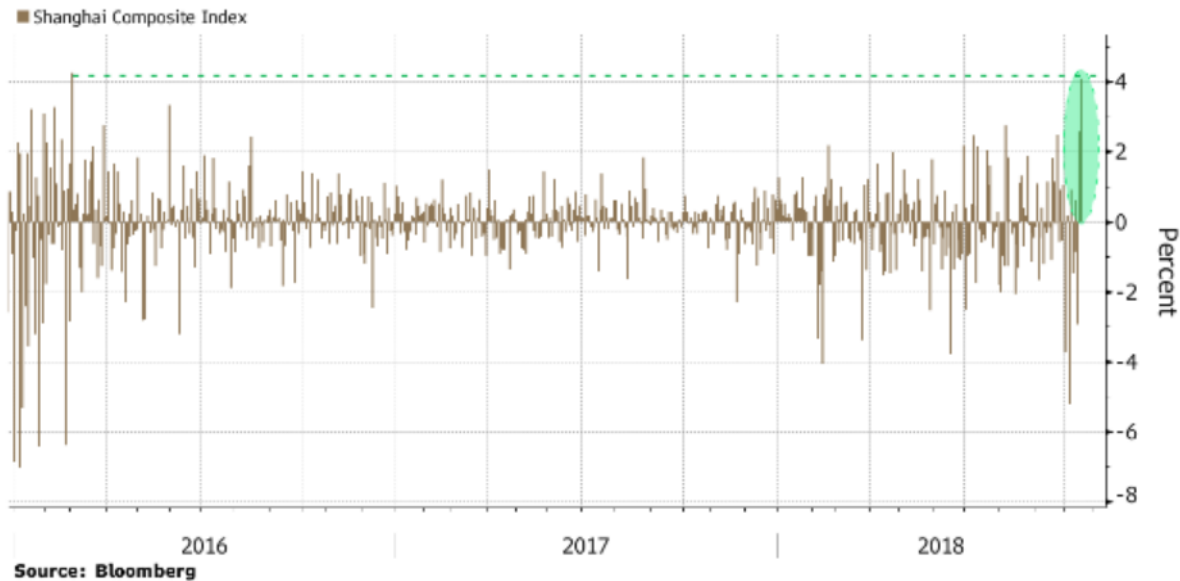
Colors denote **tightening/easing** financial conditions for observations greater than ± 1.5 standard deviations. Data source: Bloomberg.

EM currencies traded within tight ranges on Monday morning, amid a dearth of news. The largest moves were for the Russian ruble (+0.3%) and the Turkish lira (-0.3%). Similarly, EMEA equities moved within a $\pm 0.2\%$ corridor, except for larger losses in Hungary (-0.8%) and Saudi Arabia (-1.9% - see EMEA section). Latin American currencies, in turn, closed mixed last Friday, as the Brazilian real gained on good prospects for the market's favored presidential candidate and the Mexican peso continued to slide on negative rhetoric from the US.

China

Chinese equities rallied (Shanghai +4.1%, Shenzhen +4.9%) on very heavy volumes. Following Friday's supportive comments by Chinese authorities, **further announcements of policy measures over the weekend led to the strongest stock market rally since 2016.** Announcements included tax and fee cuts next year amounting to at least 1% of GDP, stock purchases by state funds and insurance companies, looser M&A and financing restrictions, share buybacks by listed companies to improve liquidity, and faster policy roll-out. Also, President Xi vowed his "unwavering" support for the country's private sector. Meanwhile, Chinese brokerages are discussing the feasibility of setting up relief funds with local SoEs to ease share-pledge risks of listed companies. According to UBS, 10% of the market cap in A-shares is pledged as collateral, with 2% close to forced liquidation. Risks are concentrated in small- and mid-caps with high pledge ratios. **The offshore and onshore yuan depreciated 0.1%.**

Strong Rally Shanghai Composite Index posts its biggest gain since March 2016

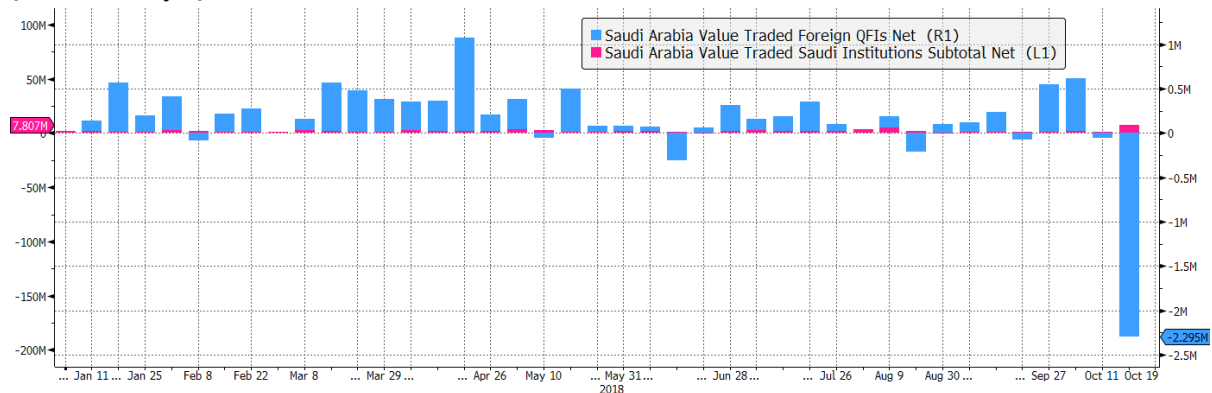


Saudi Arabia

International investors sold about \$1.1bn-worth of Saudi local shares last week. The sell-off has been linked by analysts to the ongoing investigation about the disappearance of the journalist Jamal Khashoggi. According to Bloomberg, most of the sales came from so-called 'qualified foreign institutional investors' accounts, which were first authorized to trade directly in Saudi Arabia in 2015. Reportedly, local retail investors were also net sellers last week. On the other hand, Saudi institutional investors were net buyers.

Saudi Arabia: Net Trade Value, Institutional Investors

(in billion Saudi riyals)



Source: Bloomberg
 SRNTFQFN Index (Saudi Arabia Value Traded Foreign QFIs Net) EM: Saudi Inst Inves

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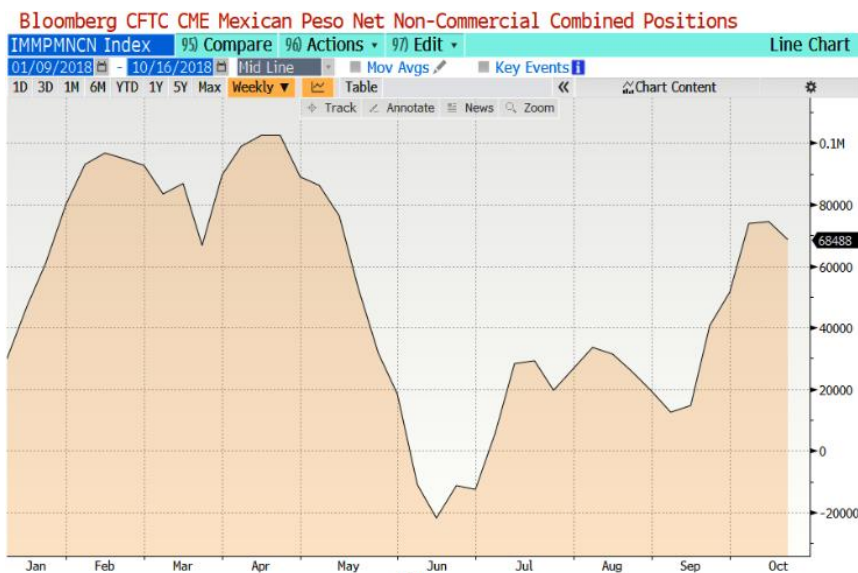
Brazil

Markets rose modestly as polls confirm presidential candidate Bolsonaro's lead in the upcoming election. Datafolha survey showed the right-wing candidate Bolsonaro maintained a considerable lead of 18% over Workers' Party's candidate Haddad, while a DataPoder360 survey revealed an even greater lead of 28%. Reports said Bolsonaro's team was considering several names to replace the central bank's governor Goldfajn after the year's end. In addition, the presidential frontrunner's team proposed payroll tax cuts (offset by other, less distortionary measures), re-iterated support for pension reform, and anticipated a gradual reduction in import tariffs. The real edged slightly higher and the stock market gained 0.4% on Friday.

Fitch assigns a 70% likelihood to Bolsonaro's victory and expects moderate reforms under his presidency. The rating agency said that Bolsonaro would need support from parties in the Congress to build consensus and pass new legislation. Fitch expects that reforms would likely be moderate and insufficient to meet market expectations. Planned privatization of state-owned enterprises—including an acceleration in Petrobras's divestments—would generate significant foreign inflows. Fitch gauged that the biggest risk would arise from a shift in a Bolsonaro administration's views from the market-oriented ones voiced by his economic advisors to nationalist and protectionist measures advocated by Bolsonaro himself, based on his voting record. Finally, Fitch anticipates that a Haddad presidency would result in a political standoff between the executive and legislative branches of government, which could pose significant political and economic risks.

Mexico









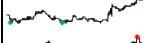











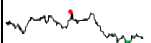








The peso continued to weaken and investor bets on its appreciation dropped on negative political comments from the US. President Trump repeated his pledge to send the military to close the Mexican border if necessary to stop immigrants. The currency dropped 0.6% Friday, bringing the weekly decline to 2.2%, the worst among major emerging markets. Separately, US CFTC data showed that net speculative positions on the peso fell for the first time in six weeks during the week ending October 16 (figure). Leveraged funds also cut their bullish positions. On the bright side, Vanguard—which actively manages over \$1 tn of its \$5.1 tn assets—named Mexico as the top "investor darling" because of the new USMCA trade deal and reduced concerns about its president-elect.



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Global Financial Indicators

Last updated: 10/22/18 8:08 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		2768	0.0	0	-6	7	4
Europe		3227	0.5	1	-6	-10	-8
Japan		22615	0.4	2	-5	5	-1
China		2655	4.1	3	-5	-21	-20
Asia Ex Japan		64	1.1	-2	-10	-15	-16
Emerging Markets		40	0.5	-2	-8	-14	-16
Interest Rates			basis points				
US 10y Yield		3.19	1.4	3	13	80	78
Germany 10y Yield		0.45	-0.6	-5	-1	0	3
Japan 10y Yield		0.15	0.5	1	2	8	11
UK 10y Yield		1.54	-3.2	-7	-1	21	35
Credit Spreads			basis points				
US Investment Grade		103	2.2	1	2	7	11
US High Yield		346	-0.2	-2	18	-14	-29
Europe IG		73	-1.1	-2	3	18	28
Europe HY		290	-4.7	-5	19	52	57
EMBIG Sovereign Spread		350	1.0	0	4	70	65
Exchange Rates			%				
Dollar Index (DXY)		95.83	0.1	1	2	2	4
USDEUR		1.15	-0.2	-1	-2	-2	-4
USDJPY		112.8	-0.2	-1	0	1	0
EM FX vs. USD		62.3	0.0	0	1	-10	-10
Commodities			%				
Brent Crude Oil (\$/barrel)		80	0.2	-1	1	38	20
Industrials Metals (index)		120	1.0	1	-1	-9	-13
Agriculture (index)		44	0.0	-2	4	-9	-8
Implied Volatility			%				
VIX Index (% change in pp)		18.9	-1.0	-2.4	7.2	8.9	7.8
10y Treasury Volatility Index		3.7	0.0	-0.2	0.3	-0.6	0.2
Global FX Volatility		8.1	0.1	-0.1	-0.5	0.3	0.8
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		386	-2.8	-2	26	18	18
Italy		299	-3.5	-5	62	140	140
Portugal		155	-1.4	5	14	3	3
Spain		124	-3.6	6	21	10	10

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: 10/22/2018 8:01 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)						
	Level		Change (in %)					Level		Change (in basis points)				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
	vs. USD		(+) = EM appreciation					% p.a.						
China		6.94	-0.2	-0.4	-1	-4	-6		3.5	-1.7	-3	-9	-25	-43
Indonesia		15189	0.0	0.2	-2	-11	-11		8.7	5.7	-5	30	184	212
India		74	-0.3	0.4	-1	-12	-13		8.0	0.1	-5	-20	96	58
Philippines		54	-0.2	0.5	1	-4	-7		6.6	-0.4	2	39	177	174
Thailand		33	-0.5	-0.1	-1	1	-1		2.9	1.4	-2	1	71	61
Malaysia		4.16	-0.1	-0.1	-1	2	-3		4.1	1.3	1	1	21	20
Argentina		37	0.2	0.4	8	-52	-49		20.7	-30.9	-193	-363	562	464
Brazil		3.71	0.2	1.8	11	-15	-11		8.9	1.2	-34	-138	39	-9
Chile		678	0.4	-0.1	-1	-7	-9		4.9	-2.6	-2	9	30	8
Colombia		3078	0.5	0.6	-2	-5	-3		6.7	-0.6	-5	9	43	47
Mexico		19.29	0.0	-2.3	-2	-1	2		8.2	5.8	8	16	107	55
Peru		3.3	0.1	0.1	-1	-3	-3		5.8	-1.4	-4	16	49	55
Uruguay		33	-0.2	0.3	1	-10	-13		10.6	3.4	10	-41		201
Hungary		281	-0.1	-0.8	-2	-7	-8		2.8	0.7	-15	10	134	151
Poland		3.73	0.0	-0.7	-2	-4	-7		2.6	3.9	1	3	-12	-8
Romania		4.1	-0.1	-0.8	-2	-4	-4		4.6	0.0	0	33	128	79
Russia		65.3	0.3	0.5	1	-12	-12		8.3	-0.9	-15	-6	95	105
South Africa		14.3	0.8	0.5	1	-4	-13		9.8	4.8	-4	13	36	51
Turkey		5.67	-0.5	2.1	9	-34	-33		20.1	36.4	-61	-97	872	813
US (DXY; 5y UST)		96	0.1	0.8	2	2	4		3.05	0.0	4	10	103	84

	Equity Markets							Bond Spreads on USD Debt (EMBIG)							
	Level		Change (in %)					YTD	Level		Change (in basis points)				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	Last 12m		Latest	1 Day	7 Days	30 Days	12 M		
									basis points						
China		2655	4.1	3	-5	-21	-20		184	2	0	-1	46	32	
Indonesia		5840	0.1	2	-2	-2	-8		205	5	6	12	44	39	
India		34134	-0.5	-2	-7	5	0		162	-4	-4	-3	50	52	
Philippines		7236	1.2	4	-2	-14	-15		108	3	1	11	18	13	
Malaysia		1722	-0.6	0	-5	-1	-4		125	1	-1	-4	9	15	
Argentina		28673	1.1	4	-16	6	-5		662	0	24	76	305	312	
Brazil		84220	0.4	2	6	10	10		259	1	2	-34	32	25	
Chile		5119	0.0	-1	-6	-7	-8		132	1	7	1	8	13	
Colombia		1452	-0.6	-1	-2	-1	-4		185	0	4	12	1	11	
Mexico		47437	0.9	0	-4	-5	-4		266	0	5	5	25	21	
Peru		18895	-0.9	-2	-4	-4	-5		146	1	3	12	8	9	
Hungary		37186	-0.8	2	4	-5	-6		116	1	1	5	34	28	
Poland		56875	0.4	1	-2	-11	-11		57	1	-7	14	18	10	
Romania		8612	0.1	2	3	9	11		183	-1	0	11	57	69	
Russia		2354	0.4	-1	-3	14	12		219	0	-1	-11	38	41	
South Africa		52511	0.8	0	-8	-9	-12		310	-2	-19	-11	49	56	
Turkey		96428	0.0	-2	-2	-11	-16		441	-1	-6	-13	155	152	
Ukraine		561	0.1	1	4	88	78		549	-10	-19	0	105	94	
EM total		24	0.8	-2	-8	-11	-11		351	2	1	5	71	66	

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