



Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Wednesday, October 24, 2018

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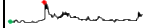
- **Earnings and political uncertainties drive volatile US trading session ([link](#))**
- **European Commission rejects Italian budget and seeks revision and resubmit ([link](#))**
- **TLTRO II and NSFR could pressure European banks' funding starting in 2019 ([link](#))**
- **Oil prices tumble as Saudi energy minister pledges to keep market supplied ([link](#))**
- **Riksbank maintains policy stance but sees rate hike in December or February ([link](#))**
- **Argentine peso depreciation drives September trade balance into surplus ([link](#))**

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Markets remain nervous amid mixed earnings and lingering political tensions

Markets are showing signs of steadying after investor risk aversion intensified yesterday and initially pulled global equity markets down between 1 to 3%. After yesterday's Asian and European trading sessions saw sentiment deteriorating further, US equities weakened significantly at the open, with the S&P 500 down as much as 2.3%, only to retrace and close a modest 0.6% lower. The risk-off impulses initially boosted safe haven assets as the 10-year US Treasury declined 8 bps to 3.11% but gave some of it back and is now trading near 3.15%. Beyond the persistent political uncertainties, contacts cited potential drivers as another mixed set of cautious corporate earnings announcements alongside weakness in commodity prices. On the latter, oil prices declined over 4% yesterday on expectations of lower demand and Saudi Arabia's pledge to keep the market supplied. In Europe, Italian yields rose yesterday after the EC formally asked for a revised and resubmitted budget, which was consistent with expectations.

Key Global Financial Indicators

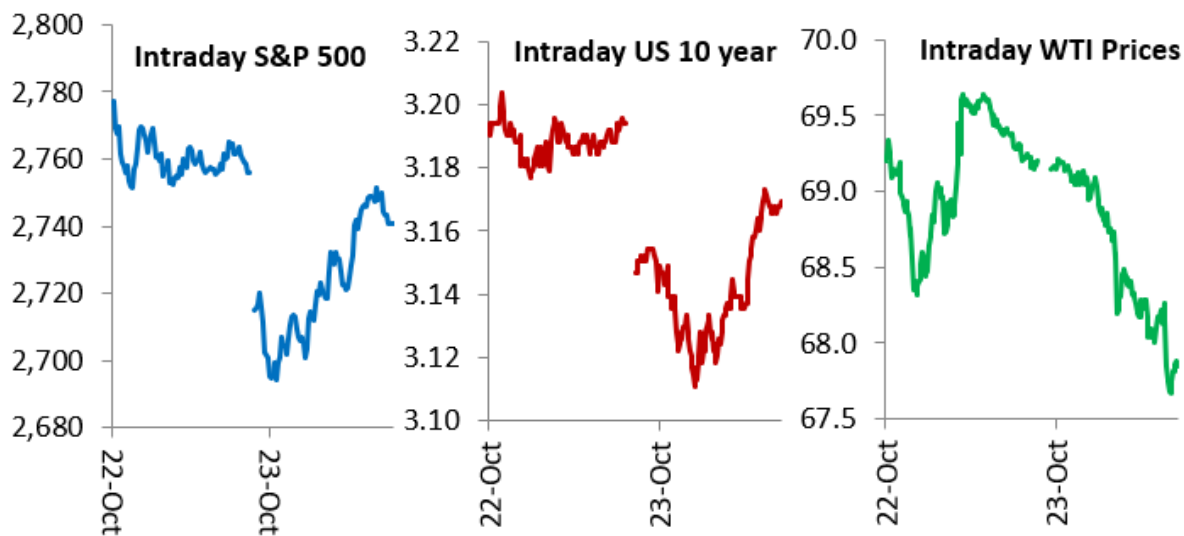
Last updated: 10/24/18 8:08 AM	Level		Change from Market Close				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		2741	-0.6	-2	-6	7	3
Eurostoxx 50		3181	1.3	-2	-7	-12	-9
Nikkei 225		22091	0.4	-3	-7	1	-3
MSCI EM		40	0.6	-3	-7	-14	-16
Yields and Spreads			bps				
US 10y Yield		3.15	-2.1	-6	6	73	74
Germany 10y Yield		0.41	0.0	-5	-10	-7	-2
EMBIG Sovereign Spread		359	4.0	15	14	80	74
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		62.2	-0.1	-1	1	-9	-11
Dollar index, (+) = \$ appreciation		96.4	0.5	1	2	5	5
Brent Crude Oil (\$/barrel)		76.5	0.0	-4	-6	31	14
VIX Index (% change in pp)		20.8	0.1	3	9	10	10

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

United States

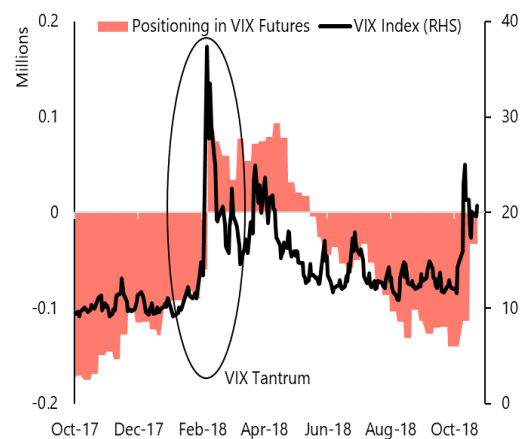
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The S&P 500 closed down with a relatively modest decline of 0.6%, after having fallen as much as 2.3% intra-day, amid significant intraday volatility. The weak US open was on the back of a 1.5% decline in EuroStoxx and a 2.7% decline in Nikkei overnight. Furthermore, while US corporate earnings profile remains strong, two bellwether companies (CAT, MMM) lowered guidance before the open citing higher costs which acted as an additional catalyst for market concerns. The sell-off was broad-based, while the recovery was led by the tech-sector along with relatively sanguine earnings calls through the day. The VIX touched intra-day highs of 24.5 though settled at 20.7 at market close. Treasuries also traded with significant intraday volatility. 10-year yield closed 3 bps down to 3.17%, after touching the intraday-lows of 3.11%. This morning, S&P 500 futures point to a slight gain at the open, while the 10-year Treasury yield is down 2 bps to 3.15%



Source: Bloomberg

Implied volatility in US equity markets (VIX) picked up to 20.8 from 19.6 yesterday, after touching an intra-day high of 24.5. The VIX has remained high in October after having moderated to relatively low levels post the VIX tantrum episode in February. This sharp reversal is also evident in the positioning in VIX futures. The short positioning in VIX futures had increased gradually over the last few months, almost reaching the pre-VIX tantrum levels. However, these have declined sharply from net short of 140k contracts at the end of September to now just 33k, suggesting a significant unwinding of these positions.

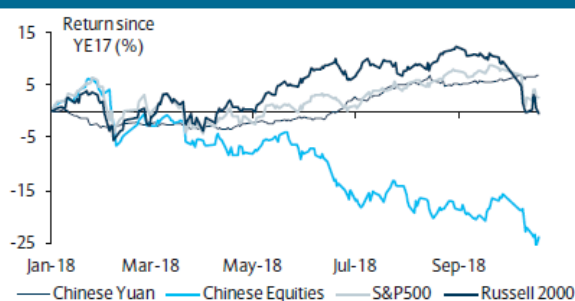


Source: Bloomberg

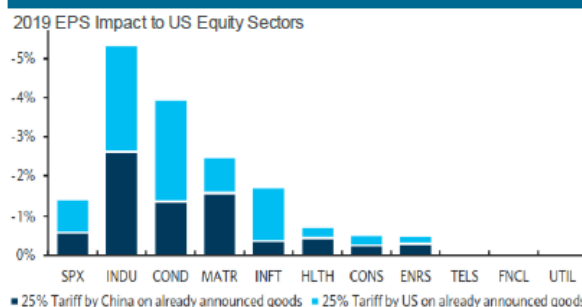
Concerns about the US-China trade war has escalated recently both due to the increased rhetoric from both sides, as well as increasing focus by investors on the potential affects on 2019 earnings.

The market pressures have mainly been reflected in Chinese equities and currency, although S&P 500 and Russell 2000 (representing the small cap firms) have also come under pressure in the last month. In terms of actual earnings impact, while the impact on the full S&P 500 index is expected to be relatively limited (at -1.4%), analysts highlight there is substantial variation across sectors. On the already announced tariffs, industrials (-5%) and consumer discretionary (-4%) industries are expected to be the most impacted. For the information technology sector, while the earnings impact on the current scenario is relatively limited (at -2%), this is likely to escalate to 7% in the case of an escalation in the trade war.

Markets Reacted Differently to Trade Tension

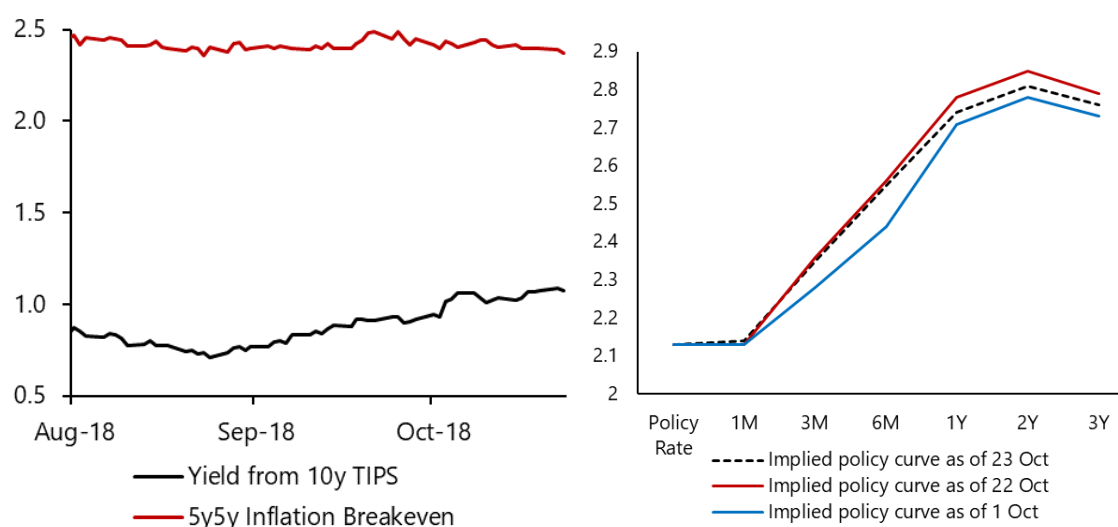


In US, Indus EPS Could be Affected the Most*



Source: Barclays

Most of the increase in 10-year yields since the end of August (by 28 bps to 3.15% now) seems to be driven by an increase in real rates, reflecting the expectations of a stronger growth trajectory in the US. This is shown in 10-year TIPS yields rising from Aug-end level of 0.77% to 1.08% now. On the other hand, inflation breakeven rates have remained relatively stable. (Chart 1) This increasingly positive outlook on the US economy was also reflected in a steepening in the market implied pace of policy rate hikes. However, the flight to quality move today also contributed to a repricing of the curve with market implied policy rates declining by 2-4 bps across the curve.



Source: Bloomberg

Europe

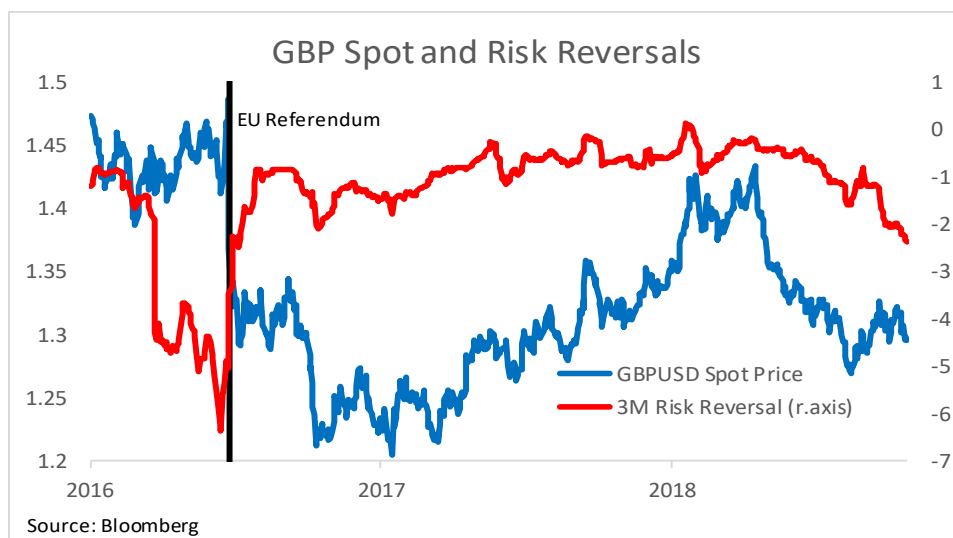
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Equities were marginally higher across the continent this morning. The Euro Stoxx 600 rose by 0.5% while banks underperformed, declining by 0.3%. Deutsche Bank (-3.2%) was amongst the worst performers after disappointing results, while Metro Bank in the UK plunged by as much as 13% on news that it will have to issue more equity. Swedbank (+2.3%) was among the few banks in the green as it downplayed concerns about money laundering. **Sovereign yields were a fraction lower in most countries.** Italy (-6 bps, see below) saw the biggest move amongst the 10-years, reversing some of yesterday's increases, while France and Germany were one bp lower.

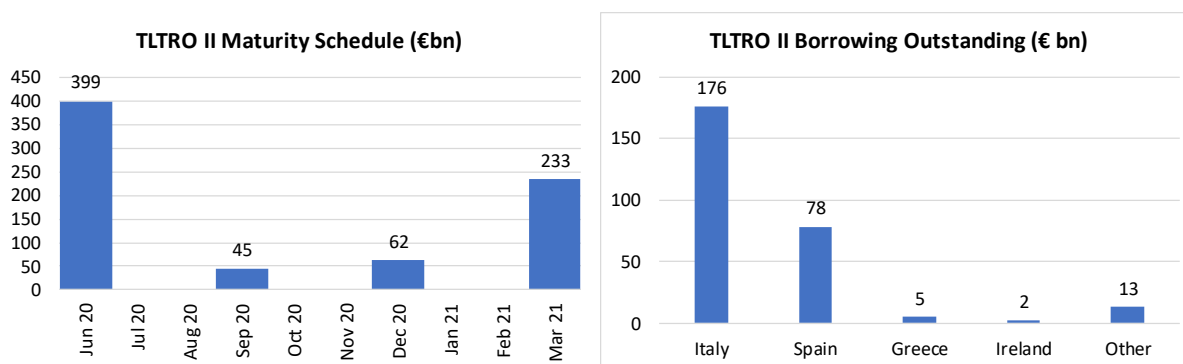
Italian yields continued to rise yesterday afternoon after the European Commission rejected the government's budget. The rejection is an unprecedented move and means that Rome has three weeks to submit a new plan that doesn't violate EU fiscal rules. Deputy prime minister Di Maio said that the government would "not give up" on its plans which saw a 2.4% deficit projection for next year. 10-year yields rose 10 bps in response to the news but are 6 bps lower this morning at 3.53%. Cabinet undersecretary Giorgetti said that Italian banks would need a recapitalization if the BTP-to-Bund spread reached 400 bps. The spread is slightly off its recent highs but remains elevated at 314 bps.



The UK is set to step up its guidance to firms regarding a "no deal" Brexit. According to Brexit secretary Raab, efforts will switch "from warning businesses to telling them to act". The move comes as many of the required measures for a "no deal" cannot be implemented immediately and that November was the deadline for many of them. Raab also said that the deadline for a deal to be agreed is now the end of November so as to allow for ratification in parliament. Separately, the National Audit Office yesterday warned that a "no deal" scenario would lead to serious security weaknesses at the border, in addition to delays and regulatory non-compliance opportunities. In UK markets, the sterling is hovering just below \$1.3 while risk reversals continue to touch new lows.



TLTRO II repayments and NSFR phase-in could pressure European (particularly Italian) banks' long-term funding needs. The summary of a September 25 discussion between the European Central Bank and money market participants, published Monday, suggests that the confluence of TLTRO II (targeted long-term refinancing operations) mandatory repayment and the phase-in of bank net stable funding ratio (NSFR) requirements could trigger the next episode of significant balance sheet management stress among European banks. Total bank repayment of TLTRO II funding will total about €740 bn, with the first significant (nearly €400 bn) tranche in June 2020. However, the NSFR requirement that banks replenish long-term (> 1 year) funding up to a year ahead of maturity may trigger a need for banks to refinance aggressively starting in mid-2019. Italian banks, with €176 bn of the €275 bn of TLTRO II borrowings ascribed to individual banks, likely face the greatest refinancing pressure. While a range of outcomes (from new ECB funding to deleveraging of bank balance sheets) are possible, at this point banks and their regulators reportedly have yet to agree on a specific response.



Source: Bloomberg

Currency Markets

The Swedish krona was the main mover after the Riksbank kept rates at -0.5%. The currency erased earlier gains and weakened by approximately 0.5% against most major currencies as some traders expected the bank to provide a more hawkish statement, but rather the committee just reiterated its previous stance that rates may increase in either December or February. The dollar was moderately stronger with the DXY index up 0.4% to 96.3, its strongest level since mid-August. The euro was 0.5% weaker at \$1.14 as preliminary PMI figures for October disappointed (52.7 composite versus 53.9 expected). Sterling shed 0.5% to trade just above \$1.29 while the yen was 0.2% weaker at ¥112.7.

Commodities

Oil prices tumbled over 4% yesterday as the Saudi energy minister said that OPEC was in a "produce as much as you can mode". Investors have closely followed the geopolitical developments surrounding Saudi Arabia and their implication for oil, with some expecting a reduction in production as a response to international criticism. However, prices have continued to drift lower and are now at their lowest levels since mid-August. Brent is little changed this morning, hovering above \$76 per barrel after reaching \$86 earlier this month. WTI is at \$66.3 per barrel, down from the highs of \$76.4 at the beginning of the month.

Other Mature Markets [back to top](#)

Japan

Equities gained (Topix +0.1; Nikkei +0.4%) on heavy trading volumes. Financials and resource stocks declined, but gains in defensive sectors allowed the indices to close in positive territory. **The October flash manufacturing PMI rose to 53.1 from 52.5 last month.** The index ticked up across most indicators, with the exception of future expectations which continued to soften. **Ten-year JGB yields fell 1.8 bps to 0.12%. The yen was little changed.**

Emerging Markets [back to top](#)

Key Emerging Market Financial Indicators

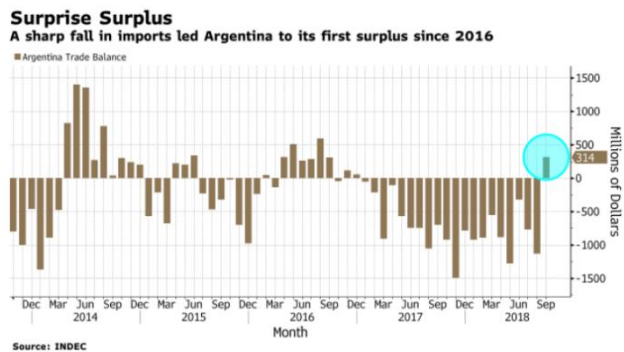
Last updated: 10/24/18 8:14 AM	Level		Change				
	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		39.66	0.6	-3	-7	-14	-16
MSCI Frontier Equities		26.98	0.4	-2	-6	-16	-19
EMBIG Sovereign Spread (in bps)		359	4.0	15	14	80	74
EM FX vs. USD		62.22	-0.1	-1	1	-9	-11
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.94	-0.1	0	-1	-4	-6
Indonesian Rupiah		15197	0.0	0	-2	-11	-11
Indian Rupee		73.16	0.6	1	-1	-11	-13
Argentine Peso		36.60	-0.4	-2	2	-52	-49
Brazil Real		3.70	-0.3	0	10	-12	-11
Mexican Peso		19.35	-0.3	-2	-2	-1	2
Russian Ruble		65.28	0.4	0	1	-12	-12
South African Rand		14.35	-0.6	-1	0	-4	-14
Turkish Lira		5.71	0.6	-2	8	-34	-33
EM FX volatility		9.96	0.0	0.5	-1.7	1.8	2.1

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

Chinese equities (+0.3%) had a rare session of calm, after four consecutive days of swings in excess of 2%. Other Asian markets were also little changed, as were most EMEA bourses. Latin American markets generally weakened yesterday, keying off volatile market developments in the US. Equities fell, notably in Mexico by 1.1%, while local markets were relatively calm in Argentina with the peso trading near the lower end of the no intervention zone. Markets are also awaiting details on the dollar auction process, as part of the IMF loan proceeds will be disbursed before the year's end and will be converted by the Treasury into pesos.

Argentina

The trade balance improved on the back of a sizeable currency depreciation. The trade balance turned into a surplus in September for the first time since December 2016 (figure), following a sharp depreciation of the peso and significant declines in investment and economic activity. The September surplus of \$314 mn exceeded both the expected deficit of \$150 mn and a \$698 mn deficit a year ago. The increase in trade balance was driven by a notable fall in imports of capital and consumer goods, which outweighed a weakening in exports. Nevertheless, equities dropped 0.7% yesterday and the peso weakened 0.4%, as global markets edged lower after a volatile session.

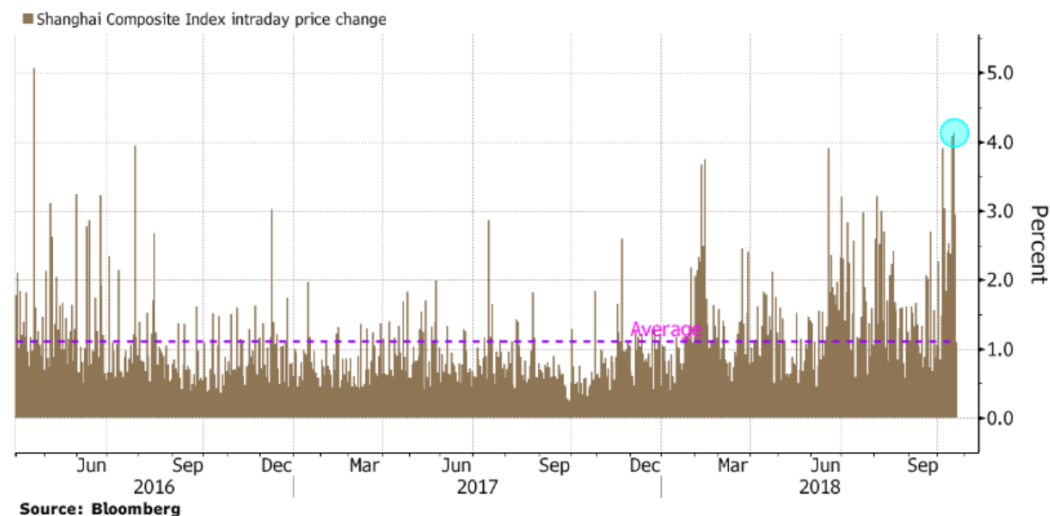


China

Chinese stocks in Shanghai (+0.3%) ended the day with a small gain after a volatile session. Strong earnings results boosted financials with the sector advancing 2.1% on the day. Meanwhile, the tech-heavy Shenzhen index declined 0.2%. According to local news, 17 private companies in Shenzhen have so far received government capital support to ease liquidity crunches related to stock pledges for loans. **The onshore yuan was little changed, while the offshore yuan depreciated 0.1%.**

What a Ride

Swings in China's equity market are getting wilder

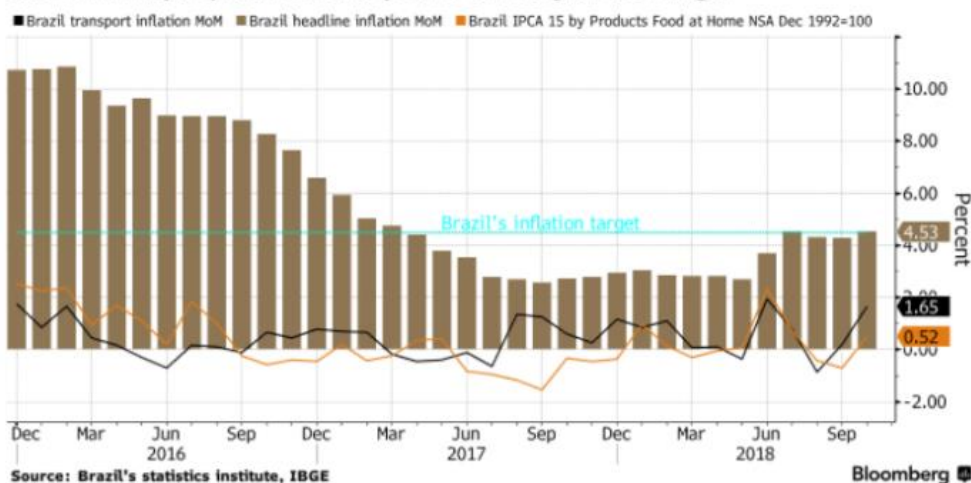


Brazil

Bolsonaro rejects credit defaults and supports partial privatization plans. Right-wing presidential candidate Bolsonaro rejected outright the possibility of default under his presidency in a TV interview. He said he would privatize oil refineries and some state-owned companies that do not fulfil their social role and run deficits, but also that “the oil question is something else” and considers the energy sector strategic. This was viewed by analyst as meaning Petrobras could potentially be excluded from privatized. The presidential front-runner also confirmed that his market-friendly advisor Guedes would become his finance minister. Separately, analysts continued to focus on tensions between Guedes’s plans to fully privatize Petrobras and power generator Eletrobras, and Bolsonaro’s support for economic nationalism. In economic news, **Brazil’s mid-October inflation edged higher to 4.53% yoy**, a notch above the midpoint of the target range and slightly below the expected 4.59% (figure).

Above Target

Costs of transport, food at home push IPCA-15 just over target



South Africa

The rand was little changed after inflation numbers came in slightly above expectations. CPI for September was unchanged at 4.9% yoy (4.8% expected) while the core figure was 4.2% as expected. The data keeps inflation within the central bank’s 3-6% band. The bank has kept interest rates unchanged at 6.5% since March but markets expect a cumulative increase of approximately 130 bps over the next three years. In addition to the inflation figures, markets are awaiting the mid-term budget speech which newly appointed finance minister Mboweni will present later today. Mboweni is expected to explain how recent wage increases for civil servants will be funded as well as higher expenditures among public companies.

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Global Financial Indicators

Last updated: 10/24/18 8:10 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		2741	-0.6	-2	-6	7	3
Europe		3181	1.3	-2	-7	-12	-9
Japan		22091	0.4	-3	-7	1	-3
China		2603	0.3	2	-7	-23	-21
Asia Ex Japan		64	-1.4	-3	-9	-14	-16
Emerging Markets		40	0.6	-3	-7	-14	-16
Interest Rates			basis points				
US 10y Yield		3.15	-2.1	-6	6	73	74
Germany 10y Yield		0.41	0.0	-5	-10	-7	-2
Japan 10y Yield		0.14	-1.7	-1	0	7	9
UK 10y Yield		1.47	-0.4	-11	-15	11	28
Credit Spreads			basis points				
US Investment Grade		103	1.1	3	5	8	12
US High Yield		359	10.1	17	31	-2	-16
Europe IG		75	-1.0	2	5	20	30
Europe HY		297	-4.1	6	26	59	64
EMBIG Sovereign Spread		359	4.0	15	14	80	74
Exchange Rates			%				
Dollar Index (DXY)		96.43	0.5	1	2	3	5
USDEUR		1.14	-0.7	-1	-3	-3	-5
USDJPY		112.7	-0.3	0	0	1	0
EM FX vs. USD		62.2	-0.1	-1	1	-9	-11
Commodities			%				
Brent Crude Oil (\$/barrel)		76	0.0	-4	-6	31	14
Industrials Metals (index)		119	0.3	0	-1	-11	-14
Agriculture (index)		44	-0.3	-2	4	-10	-8
Implied Volatility			%				
VIX Index (% change in pp)		20.8	0.1	3.4	8.6	9.6	9.8
10y Treasury Volatility Index		4.2	0.2	0.5	0.5	-0.4	0.6
Global FX Volatility		8.2	0.0	0.2	-0.5	0.4	0.8
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		389	-1.7	3	29	20	20
Italy		314	-4.6	5	70	155	155
Portugal		156	-3.6	7	17	5	5
Spain		121	-4.5	2	20	7	7

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: 10/24/2018 8:15 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	-0.1	-0.2	-1	-4	-6		3.6	0.6	-2	-10	-24	-41
Indonesia		15197	0.0	-0.3	-2	-11	-11		8.7	-1.1	-8	43	173	211
India		73	0.6	0.6	-1	-11	-13		8.0	-1.5	-1	-19	91	56
Philippines		54	0.2	0.3	1	-4	-7		6.6	0.6	1	33	178	175
Thailand		33	-0.3	-1.1	-1	1	-1		2.9	0.0	2	4	72	64
Malaysia		4.17	-0.1	-0.4	-1	2	-3		4.1	0.1	3	3	17	21
Argentina		37	-0.4	-1.9	2	-52	-49		20.2	0.3	-224	-320	514	416
Brazil		3.70	-0.3	-0.5	10	-12	-11		8.8	-0.9	-14	-134	18	-25
Chile		684	0.0	-1.9	-2	-8	-10		4.8	-2.6	-5	7	35	5
Colombia		3119	-1.1	-2.1	-4	-5	-4		6.8	3.5	3	16	42	50
Mexico		19.35	-0.3	-2.4	-2	-1	2		8.3	-4.8	23	26	109	65
Peru		3.3	-0.1	-0.1	-1	-3	-3		5.8	2.6	7	20	50	60
Uruguay		33	-0.5	-0.3	0	-10	-13		10.7	6.2	19	-10		211
Hungary		284	-0.7	-1.3	-3	-7	-9		2.8	0.0	-6	11	135	151
Poland		3.78	-0.9	-1.3	-3	-4	-8		2.6	-4.1	-2	-3	-21	-13
Romania		4.1	-0.6	-0.8	-3	-4	-5		4.6	0.0	1	33	121	80
Russia		65.3	0.4	0.3	1	-12	-12		8.3	2.1	-2	-6	90	101
South Africa		14.3	-0.6	-0.7	0	-4	-14		9.8	1.5	-1	7	26	44
Turkey		5.71	0.6	-2.1	8	-34	-33		20.8	51.9	94	-34	929	889
US (DXY; 5y UST)		96	0.5	0.9	2	3	5		2.98	-2.9	-8	2	94	78

	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		2603	0.3	2	-7	-23	-21		189	0	8	5	53	37
Indonesia		5709	-1.5	-3	-3	-4	-10		213	2	14	26	55	47
India		34034	0.6	-3	-6	4	0		166	0	1	2	50	56
Philippines		7129	-0.9	0	-4	-14	-17		112	2	6	18	25	17
Malaysia		1690	-0.4	-3	-6	-3	-6		122	-6	-1	-6	7	12
Argentina		28360	-0.7	-4	-14	1	-6		657	-8	-3	44	302	307
Brazil		85300	-0.3	0	9	12	12		258	2	7	-32	29	24
Chile		5114	0.0	-1	-5	-8	-8		136	1	12	5	21	17
Colombia		1434	-0.4	-3	-4	-2	-5		185	1	9	14	2	11
Mexico		46449	-1.1	-4	-6	-7	-6		275	2	21	14	33	30
Peru		18709	-1.0	-3	-4	-6	-6		150	1	10	18	15	13
Hungary		36787	-1.1	1	3	-6	-7		121	2	7	11	36	33
Poland		55662	0.3	-2	-5	-12	-13		62	0	-1	20	17	15
Romania		8616	-0.3	-1	3	9	11		187	4	4	18	64	73
Russia		2342	1.6	-3	-4	14	11		224	4	12	-4	46	46
South Africa		50976	-0.4	-3	-11	-12	-14		319	7	10	-1	53	65
Turkey		93814	0.4	-5	-6	-12	-19		457	12	15	6	164	168
Ukraine		561	0.1	0	4	88	78		588	27	27	40	134	133
EM total		24	-1.1	-2	-7	-11	-11		359	4	15	14	80	74

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