



Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Friday, October 26, 2018

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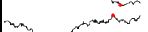
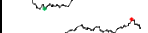
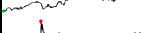
- **US syndicated loan covenant quality continues to deteriorate** ([link](#))
- **US effective Fed funds rate now roughly equal to interest on excess reserves** ([link](#))
- **Japanese equities suffer biggest weekly drop since February** ([link](#))
- **Venezuela's PDVSA seems likely to pay upcoming coupon on 2020 bond** ([link](#))
- **Russian central bank leaves policy rate unchanged at 7.5%, as expected** ([link](#))

[US](#) | [Europe](#) | [Other Mature](#) | [Emerging Markets](#) | [Market Tables](#)

Global equity markets sag again as US technology earnings disappoint

Global equity markets are seesawing back and forth as US Q3 earnings season progresses. Q3 US corporate earnings results have become one of the primary drivers of global market sentiment, and while results have generally met robust expectations (with some notable exceptions), more conservative forward guidance (particularly in the technology sector) has fanned fears that the US earnings cycle may be peaking. Tariffs have been a frequent topic in corporate earnings calls with analysts, reflecting concern that profit margins could be pressured by the rising cost of imported inputs. Some strategists have suggested, given the relatively softer tone in recent economic data outside the US, that no other economic 'engine' appears ready at this point to step in and drive global growth forward if the US expansion were to falter. Yesterday, major US equity indices rose for the first time in seven days on solid earnings from Microsoft, Twitter and Tesla. After the market close, however, relatively disappointing earnings from Amazon and Alphabet have rekindled nagging concerns about the prospects for US corporate earnings and the outlook for global growth more broadly.

Key Global Financial Indicators

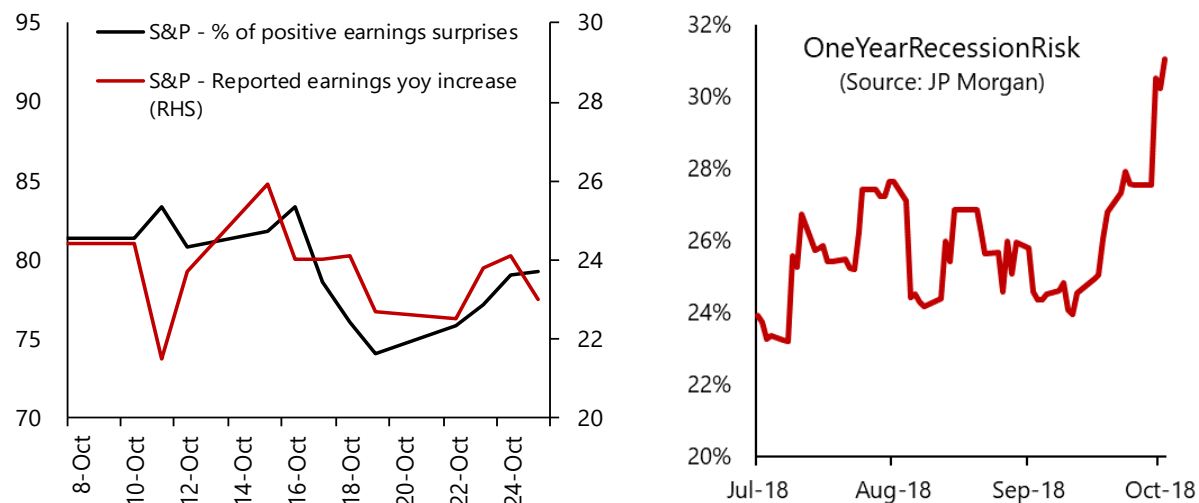
Last updated: 10/26/18 8:25 AM	Level	Change from Market Close					
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		2680	1.9	-3	-8	5	0
Eurostoxx 50		3118	-1.5	-3	-9	-14	-11
Nikkei 225		21185	-0.4	-6	-12	-3	-7
MSCI EM		39	-2.6	0	-9	-14	-17
Yields and Spreads			bps				
US 10y Yield		3.09	1.3	-11	4	63	68
Germany 10y Yield		0.35	-4.5	-11	-17	-6	-7
EMBIG Sovereign Spread		366	4.0	17	19	82	81
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		61.9	-0.1	-1	0	-9	-11
Dollar index, (+) = \$ appreciation		96.8	0.1	1	3	5	5
Brent Crude Oil (\$/barrel)		76.3	-0.8	-4	-6	29	14
VIX Index (% change in pp)		26.8	2.6	7	14	15	16

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

United States

[back to top](#)

Equity markets took a breather yesterday, but pessimism returned overnight. During yesterday's session, indices reversed much of the previous day's losses with the S&P 500 advancing 1.9% and the Nasdaq climbing nearly 3%. The VIX declined 2 pts to 23 pts. Within the S&P 500, consumer discretionary and technology outperformed, helped by strong earnings from Tesla and others. Weaker-than-expected Q3 results from Amazon and Alphabet soured the post-market sentiment; this morning, equity futures pointed to a sharply lower open, in line with European shares. Investor concerns persist on the growth prospects in the US with rising probability of US recession within 1 year, per some analysts. Yesterday, Treasury yields rose up to 2 bps through the 5-year maturity. However, risk aversion in the overnight session has driven yields 4 to 3 bps lower across the 2- to 10-year sector.



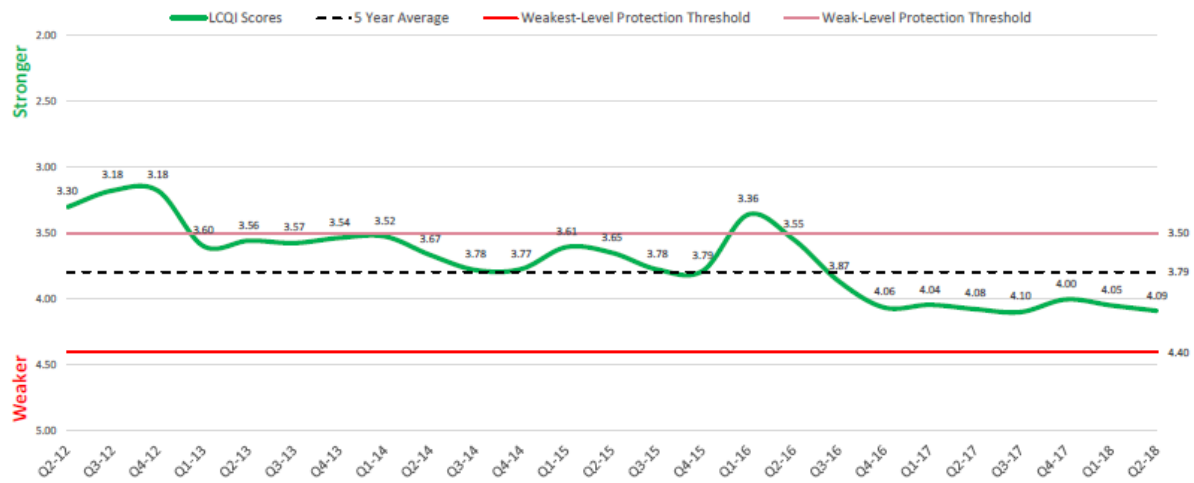
Source: Bloomberg, JP Morgan

In this morning's data, Q3 GDP came in at 3.5% qoq, marginally better than consensus expectations of 3.3%. Consumer spending accelerated to 4.0% qoq relative to expectations for a slight deceleration to a 3.3% qoq pace. Amongst other categories, inventories provided a strong support while trade was weaker. Core PCE was weaker than expectations, at 1.6% versus consensus expectations of 1.8% rise.

Moody's research indicated that the Loan Covenant Quality Indicator in the US deteriorated by four basis points to 4.09 in Q2 2018. The indicator is currently within one basis point of its worst levels of 4.10. Analysts highlighted that covenant protections are dramatically weaker today than before the last recession. Furthermore, weakness not limited to "cov-lite" loans, but diminished covenant protections were found across all risk categories. The signs of overheating and financial stability risks in the leveraged loan market is also discussed in [GFSR April 2018](#).

Loan Covenant Quality Indicator (LCQI) hits close to record-worst

Loan covenant quality scores, 2012 - 2018 Q2



Source: Moody's Investors Service

The effective Fed funds rate has continued to inch up over the last few days (to 2.20% now), essentially eliminating the spread between interest on excess reserves (IOER) and Fed funds. Analysts

have highlighted that the Fed funds rate has risen due to a variety of factors including a rise in the Treasury bill supply, reserve draining and reallocation of FHLB cash away from the Fed funds market and into repo. With the dissipation of the 'IOER arbitrage' (the ability to borrow cash overnight and earn a spread by depositing the cash at the Fed), FBO participation has declined in both the Fed funds and Eurodollar markets. In contrast, domestic banks have had a different experience, as Fed funds have become a more economic source of borrowing than Eurodollar deposits – particularly from an LCR perspective. Domestic banks now make up an increasingly large share of the Fed funds market, up from 17% average in 2017 to 25% in 1H18.

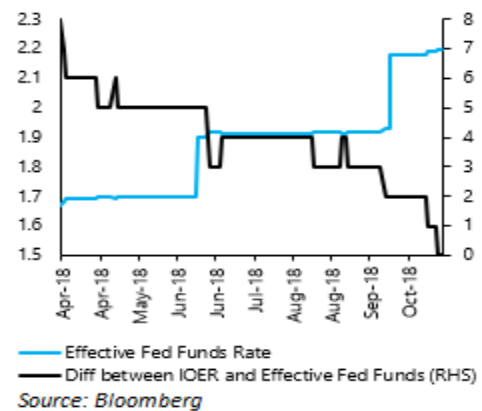
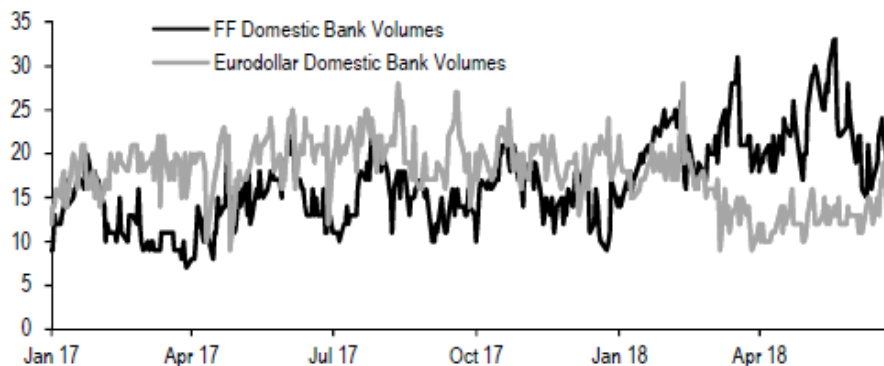
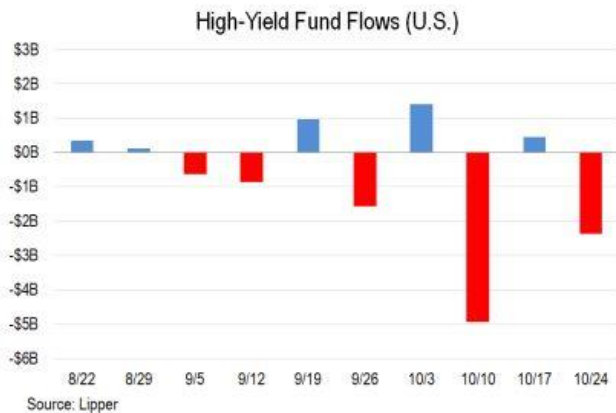


Exhibit 2: Domestic banks seemed to have substituted FF for Eurodollar deposits as a source of borrowing



Source: Federal Reserve Bank of New York

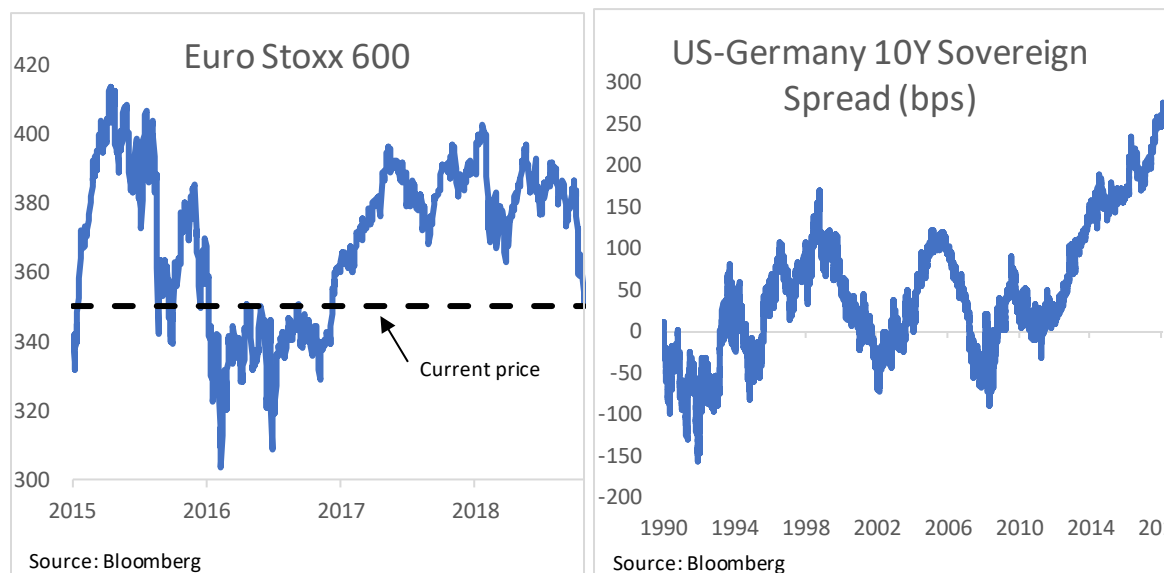
US high yield funds reported an outflow of \$2.4bn for the week ending Oct 24, per Lipper's analysis, extending the year-to-date outflow from US HY funds to \$24.8bn. The outflows were primarily driven by ETFs, which recorded an exit of \$1.85bn, while mutual funds saw an outflow of \$0.5bn.



Europe

[back to top](#)

Equities sank as pessimism returned over the Q3 earnings season. The Euro Stoxx 600 shed 1.7% and is at its lowest level since December 2016. All sectors were firmly in the red, including banks which declined by 1.8%. Sovereign yields declined by 1-4 bps, except in Italy which saw a modest increase in yields. Ten-year Bund yields were down 4 bps and are now 6 bps lower year-to-date. This has contributed to a further widening of the spread between 10-year US Treasuries and Bunds, which is near all-time highs. There was little market reaction to the ECB's statement yesterday. The bank kept all rates unchanged as unanimously expected, while it reiterated that it anticipates new QE purchases to end this year. The ECB's policy statement also repeated previous language on rates remaining at current levels at least through the summer of 2019, and reinvestments, which are expected to continue for an "extended period of time" following the end of QE.



Germany

Several of Germany's public-sector banks are considering a merger, according to reports. Helaba, NordLB, DekaBank and LBBW were named as candidates for a new merged bank which could become the nation's second largest lender. The discussions have been prompted due to overcapacity and intense competition in the sector according to sources. The reports follow periodic speculation that Commerzbank (-2.4%) and Deutsche Bank (-4%) are considering a merger as political support for institutions that can serve the country's large exporters grows.

UK

The Bank of England has reinforced its message to banks to prepare for any possible Brexit scenario.

In a speech yesterday, deputy governor Sam Woods said that the bank has been working with firms to boost their liquidity buffers so they would be able to accommodate a "severe dislocation in financial markets". Speaking at the same event, FCA head Andrew Bailey said that UK regulators urgently need their EU counterparts to start working on cross-border memorandums of understanding. Overnight reports suggest that Brexit negotiations are currently on hold due to a disagreement within PM May's cabinet on the best way to proceed.

Other Mature Markets

[back to top](#)

Japan

Equities continued to decline, completing their worst week since February on concerns over the earnings outlook and global growth. The Topix fell 0.3% (-5.7% for the week), while the Nikkei declined 0.4% (-6% for the week) on heavy trading volumes. Tech stocks underperformed in the wake of earnings misses after the US close, while a weak print in capital goods orders weighed on industrials. The yen appreciated 0.4% on safe haven demand. Meanwhile, CPI inflation in Tokyo printed at 0.6% for the BoJ's preferred core-core measure (excl. fresh food and energy). With inflation still a long way off the BoJ's 2% target, analysts expect no change in policy at next week's MPC meeting. However, Bloomberg reports that some BoJ officials would be comfortable with 10-year JGB yields rising above the central bank's upper limit of 0.2%. On the day, 10-year JGB yields fell 0.6 bps to 0.1%.

Slump






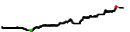








Topix caps biggest weekly drop since February



Emerging Markets

[back to top](#)

Key Emerging Market Financial Indicators

Last updated: 10/26/18 8:26 AM	Level		Change				YTD
	Last 12m	index	1 Day	7 Days	30 Days	12 M	
Major EM Benchmarks			%				%
MSCI EM Equities		39.12	0.2	0	-9	-14	-17
MSCI Frontier Equities		26.80	0.9	-1	-7	-16	-19
EMBIG Sovereign Spread (in bps)		366	4.0	17	19	82	81
EM FX vs. USD		61.85	-0.1	-1	0	-9	-11
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.95	0.0	0	-1	-4	-6
Indonesian Rupiah		15217	-0.2	0	-2	-11	-11
Indian Rupee		73.47	-0.3	0	-1	-12	-13
Argentine Peso		36.77	0.7	0	4	-52	-49
Brazil Real		3.71	0.0	0	9	-11	-11
Mexican Peso		19.56	-0.4	-1	-4	-2	1
Russian Ruble		65.86	-0.4	-1	0	-12	-12
South African Rand		14.72	-0.6	-2	-4	-3	-16
Turkish Lira		5.63	0.0	0	8	-32	-33
EM FX volatility		9.94	0.0	0.0	-1.3	1.8	2.1

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

EM equities were mostly lower this morning, tracking developed markets in Asia and Europe. In Asia, China, India and Malaysia were all slightly lower while Russia (-1.3%) saw the biggest losses in the EMEA region. Local currencies were flat against the dollar this morning. Most Latin American equity markets rebounded yesterday, tracking a recovery in the US, with the exception of Colombia (-1.2%). Regional currencies in Latin America generally strengthened, helped by higher oil prices.

Venezuela

PDVSA, the state-owned oil company, is widely expected by market participants to pay the upcoming coupon on its 2020 bond. The value of the 2020 bond has surged to 91 cents from 80 cents in early September (figure). This is in marked contrast with other PDVSA bonds that are priced at roughly 20 to 25 cents. The 2020 bond is special because PDVSA has pledged half the ownership of its US subsidiary, Citgo, as collateral. (The other half of Citgo is pledged as collateral on a loan from the Russian oil company Rosneft). Reports said Venezuela traditionally protects strategic assets and was preparing to make a \$949 mn payment due October 29. Venezuela has defaulted on all its other obligations over the year and is behind on \$7 bn in payments. A Canadian mining company is already seeking to seize PDVSA's foreign assets, while ConocoPhillips and Rosneft could try to appropriate PDVSA assets if it misses another payment. Meanwhile, the country's oil production has plunged to the lowest level since the 1940s, and PDVSA's oil refineries operate at a very low capacity.

Betting on Payday

PDVSA bonds near record high on optimism government will save Citgo

■ PDVSA bond due Oct. 27, 2020



China

The yuan recovered late in the trading session after sliding towards its weakest in a decade. Both the onshore and offshore yuan were little changed on the day. However, at 6.95, the yuan remains close to the psychologically import level of 7 against the dollar. Meanwhile, China and Japan agreed to revive their \$29 bn currency swap agreement as part of a number of cooperation agreements announced during PM Abe's visit to Beijing. Equities were little changed today (-0.2%). Indices in Shenzhen and Shanghai posted a weekly gain, the only one in Asia, following the announcement of fiscal stimulus and other support measures earlier in the week.

Decade Low

Yuan pares loss before falling toward weakest level since 2008

■ Onshore yuan spot



Source: CFETS, Bloomberg

Malaysia

The government is considering to issue a global bond for the first time in 2 years. The bond could either be dollar- or yen-denominated, according to Bloomberg. The potential offering comes against the backdrop of slowing growth and concerns that the budget deficit may widen next year to between 3 to 4%. Bond yields have been relatively stable in recent months, but the ringgit has been under depreciation pressures that were partially met by intervention in the forward market. On the day, the ringgit depreciated 0.2% and 10-year bond yields rose 1.3bps to 4.2%.











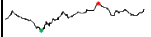












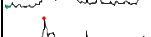





Russia

Market reaction was limited as the central bank kept interest rates unchanged as expected. The benchmark rate was left at 7.5%, as predicted by all but two of the 41 analysts surveyed by Bloomberg. The decision comes after the bank surprised markets in September with its first rate hike since 2014 ahead of an expected rise in inflation. Consumer prices rose at an annualized pace of 3.4% last month but ruble weakness and a rise in VAT may lead to a rise above the central bank's target of 4% by the end of the year and reach 6% in H1 2019 according to some estimates. The ruble was 0.3% weaker against the dollar on the day but has strengthened by 7% since the lows of last month.

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***Mohamed Jaber***Senior Financial Sector Expert***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 Schmittmann***Economist***Ilan Solot***Financial Sector Expert***Nour Tawk***Economist***Martin Edmonds***Senior Data Mgt Officer***Yingyuan Chen***Senior Research Officer***Rohit Goel***Research Officer***Piyusha Khot***Research Assistant***Xingmi Zheng***Research Assistant*

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Global Financial Indicators

Last updated: 10/26/18 8:27 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		2681	1.9	-3	-8	5	0
Europe		3119	-1.4	-3	-9	-14	-11
Japan		21185	-0.4	-6	-12	-3	-7
China		2599	-0.2	2	-7	-24	-21
Asia Ex Japan		63	1.9	-1	-11	-15	-17
Emerging Markets		39	-2.6	0	-9	-14	-17
Interest Rates			basis points				
US 10y Yield		3.08	1.3	-11	4	62	68
Germany 10y Yield		0.35	-4.6	-11	-17	-6	-8
Japan 10y Yield		0.11	-0.4	-4	-1	4	7
UK 10y Yield		1.39	-5.0	-19	-20	1	20
Credit Spreads			basis points				
US Investment Grade		105	-0.1	2	7	12	13
US High Yield		374	4.7	27	44	14	-2
Europe IG		77	2.2	4	10	25	33
Europe HY		307	6.9	12	37	70	73
EMBIG Sovereign Spread		366	4.0	17	19	82	81
Exchange Rates			%				
Dollar Index (DXY)		96.82	0.1	1	3	2	5
USDEUR		1.13	-0.3	-1	-3	-3	-5
USDJPY		112.1	0.3	0	1	2	1
EM FX vs. USD		61.9	-0.1	-1	0	-9	-11
Commodities			%				
Brent Crude Oil (\$/barrel)		76	-0.8	-4	-6	29	14
Industrials Metals (index)		116	-1.3	-2	-3	-13	-16
Agriculture (index)		43	0.5	-2	3	-11	-9
Implied Volatility			%				
VIX Index (% change in pp)		26.9	2.6	7.0	14.0	15.6	15.8
10y Treasury Volatility Index		4.6	0.3	0.8	1.1	0.1	1.1
Global FX Volatility		8.2	0.0	0.2	-0.2	0.5	0.9
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		397	12.3	7	44	28	28
Italy		313	3.3	10	80	154	154
Portugal		158	3.5	2	21	6	6
Spain		122	3.2	-5	22	8	8

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

Data source: Bloomberg.

[back to top](#)

Emerging Market Financial Indicators

Last updated: 10/26/2018 8:28 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		6.95	0.0	-0.2	-1	-4	-6		3.5	-1.5	-3	-12	-28	-44
Indonesia		15217	-0.2	-0.2	-2	-11	-11		8.7	1.3	2	33	159	208
India		73	-0.3	-0.2	-1	-12	-13		8.0	0.0	-5	-23	88	53
Philippines		54	0.4	0.2	1	-3	-7		6.6	-0.7	0	20	176	174
Thailand		33	-0.6	-1.6	-2	0	-2		2.9	0.5	3	5	67	63
Malaysia		4.18	-0.2	-0.5	-1	1	-3		4.1	2.4	4	5	16	23
Argentina		37	0.7	-0.5	4	-52	-49		20.3	4.9	-63	-323	490	432
Brazil		3.70	0.0	0.2	9	-11	-11		8.9	5.9	-1	-124	33	-11
Chile		692	-0.6	-1.6	-4	-9	-11		4.8	1.3	-5	1	35	5
Colombia		3175	-0.3	-2.6	-5	-6	-6		6.8	0.5	9	21	42	56
Mexico		19.55	-0.3	-1.4	-4	-2	1		8.4	-2.9	20	31	103	69
Peru		3.3	-0.1	-0.3	-1	-3	-3		5.8	-5.0	4	15	48	61
Uruguay		33	0.1	-0.2	0	-10	-12		10.7	0.0	14	12		211
Hungary		286	-0.3	-1.8	-4	-7	-9		2.7	-0.6	-6	5	129	144
Poland		3.80	-0.4	-1.9	-4	-4	-8		2.6	1.7	-2	-7	-25	-14
Romania		4.1	-0.2	-1.3	-3	-4	-5		4.6	0.0	1	31	119	80
Russia		65.8	-0.3	-0.6	0	-12	-12		8.4	1.8	1	4	94	107
South Africa		14.7	-0.6	-2.0	-4	-3	-16		10.0	3.2	22	24	16	67
Turkey		5.64	0.0	0.1	8	-32	-33		19.8	-54.2	13	-106	818	789
US (DXY; 5y UST)		97	0.1	1.2	3	2	5		2.92	-3.7	-12	-2	84	72

	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		2599	-0.2	2	-7	-24	-21		191	4	9	2	54	39
Indonesia		5785	0.5	-1	-2	-4	-9		221	5	21	29	64	55
India		33349	-1.0	-3	-9	1	-2		167	0	1	0	54	57
Philippines		7064	1.4	-1	-3	-15	-17		120	6	15	22	35	25
Malaysia		1683	-0.2	-3	-6	-3	-6		135	8	11	4	22	25
Argentina		29335	4.2	3	-14	5	-2		678	7	16	67	309	328
Brazil		84084	1.2	0	7	11	10		265	2	7	-30	28	31
Chile		5142	0.0	0	-4	-7	-8		141	3	10	10	26	22
Colombia		1395	0.0	-4	-6	-5	-8		189	4	4	15	3	15
Mexico		46276	0.7	-2	-7	-6	-6		284	4	18	27	38	39
Peru		18658	0.0	-2	-5	-6	-7		155	1	10	19	20	18
Hungary		36078	-1.5	-4	0	-10	-8		127	3	12	15	38	39
Poland		54567	-1.3	-4	-8	-14	-14		68	5	12	23	22	21
Romania		8410	-1.0	-2	0	7	8		193	2	9	24	69	79
Russia		2287	-1.9	-2	-6	12	8		225	-2	6	-6	46	47
South Africa		51006	-1.2	-2	-10	-13	-14		336	14	24	13	51	82
Turkey		91651	-2.2	-5	-8	-15	-21		447	-14	5	-7	143	158
Ukraine		561	-0.1	0	4	88	78		593	1	34	43	127	138
EM total		23	1.8	0	-8	-11	-12		366	4	17	19	82	81

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