Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Monday, October 29, 2018

- **Equity prices start the week on a positive note after heavy losses last week (link)**
- **Chancellor Merkel reportedly will step down as leader of CDU (link)**
- **Right-wing candidate Bolsonaro wins Brazilian presidency, as expected (link)**
- **US earnings surprises not translating into stock gains (link)**
- **Italian yields sharply lower on ratings and cabinet comments (link)**
- **SPECIAL FEATURE: Fintech Update highlights blockchain and crypto-asset developments (see attachment)**

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Markets regain footing despite political shifts

Political shifts are dominating headlines this morning with large changes seen in both Germany and Brazil. Following a weak showing by her party in weekend elections, Chancellor Merkel will reportedly step down as leader of her party while remaining as Chancellor through her current term ending in 2021. Meanwhile, far-right candidate Jair Bolsonaro won the second round of Brazil's presidential election, as was widely anticipated by markets. Brazilian investors are optimistic on the expected policies of the new administration, as Brazilian assets have rallied leading up to the vote. Equity markets are starting the week in positive territory despite these shake-ups. European equities and S&P 500 futures are both up more than 1% so far this morning after suffering significant losses last week.

Key Global Financial Indicators

Last updated: 10/29/18 7:41 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		2659	-1.7	-4	-9	3	-1
Eurostoxx 50		3181	1.5	0	-6	-13	-9
Nikkei 225		21150	-0.2	-6	-12	-4	-7
MSCI EM		39	1.9	-3	-10	-16	-18
Yields and Spreads				bps			
US 10y Yield		3.10	-4.1	-10	4	69	69
Germany 10y Yield		0.39	3.9	-6	-8	1	-4
EMBIG Sovereign Spread		364	-2.0	13	21	80	79
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		62.2	0.0	0	0	-9	-11
Dollar index, (+) = $ appreciation		96.4	0.1	0	1	5	5
Brent Crude Oil ($/barrel)		77.5	-0.2	-3	-6	28	16
VIX Index (%, change in pp)		22.8	-1.4	3	11	13	12

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

Market volatility will likely remain elevated this week, as trade developments and corporate reports play out against a heavy pipeline of data releases on GDP, inflation and manufacturing, as well as some key central bank meetings. The WTO meets this week, with US metals tariffs and China's intellectual property policies high on the agenda. US data reports out this week are highlighted by Friday's print on unemployment and payrolls, which carry added importance as they are the last major releases before the critical November 6th midterm elections. There will be other US reports on spending (Monday), housing prices and consumer sentiment (Tuesday), and durable goods and trade (Friday). The US will also report manufacturing PMI this week, along with Canada, China, Japan, and most European majors. The week will also see GDP reports out of Canada, the euro area, France, Italy, Mexico, Spain, and CPI reports out of major Europeans mid-week. Analysts expect no central bank rate changes out of either Brazil or Japan (Wednesday), as well as the UK (Thursday). Several major tech firms and energy firms are announcing quarterly results this week.

United States

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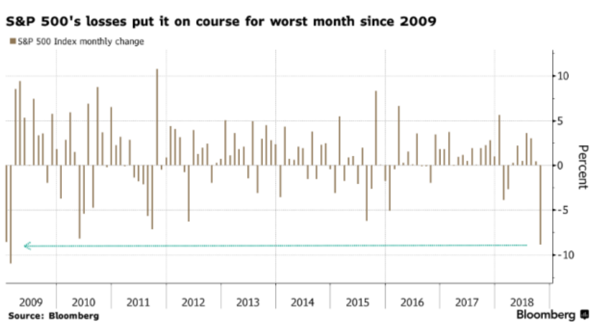
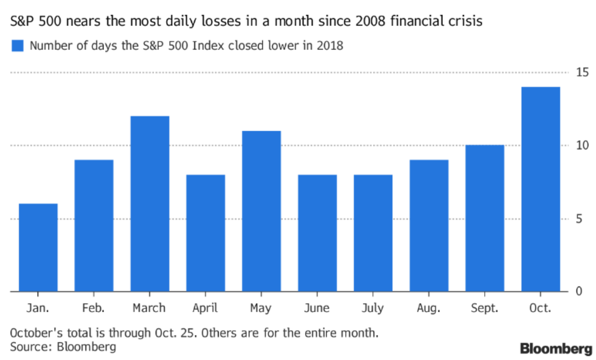
Stocks resumed their recent slump Friday, with the Dow industrials losing 1.2%, the broad market S&P 500 1.7%, and the tech-heavy Nasdaq 2.1%. Equity volatility remains elevated, with the VIX index closing at 24.2 pts Friday. And while October price moves have been abysmal, Cleveland Fed president Potter recently remarked that "while a deeper and mores persistent drop in equity markets could dash confidence and lead to a significant pullback in spending, we are far from this scenario." Bloomberg notes that legacy tech firms (which typically pay dividends) such as Apple and Microsoft have fared better than newer firms (which typically don't) and high valuation stocks such as Amazon, Facebook and Netflix.

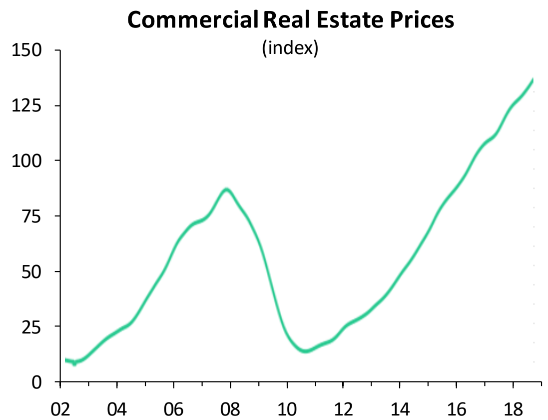
More companies are beating earnings estimates than typical, but share prices have faltered. With nearly half of the S&P 500 reporting their Q3 results so far this season, FactSet finds that the share of companies with earnings beating their estimates (77%) is above the 5-year average of 71%. Despite this fact, these companies have seen their share prices fall by 1.5% (comparing the price 2 days before the release to 2 days after). In more typical quarters, companies with positive earnings surprises have seen their share prices rise by 1.0%. And the S&P 500 is on track to have its worst month since 2009. Tech stocks have been a key driver of the recent market downturns. Still, FactSet is expecting S&P 500 firms to finish out the quarter with earnings growth of 22.5%.



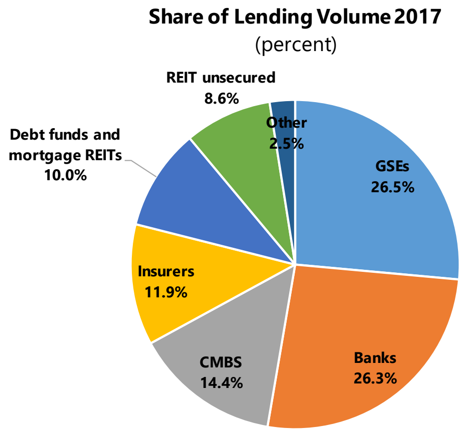


Commercial real estate (CRE) prices continue to increase and are well above their pre-crisis peak. But while CRE has been growing in the mid-single digit range, Bank of America expects prices to slow modestly over the coming year in the wake of higher interest rates and greater economic uncertainty. While bank funding for CRE has been slipping lately, Fed surveys indicate that they have been loosening their lending standards in order to compete with other sectors such as government-sponsored enterprises (GSEs), commercial mortgage-backed securities (CMBS), and real estate investment trusts (REITs). Bloomberg notes that the capitalization rates (net operating income/property value) have been declining steadily over the past several years. Despite this, Deloitte gauges that the volume of CRE transactions will likely grow by 13% over the next 18 months.

Treasury yields dropped Friday, as investors sought out safe havens in the wake of another equity rout, with the 2-year falling 4 bps to 2.81% and the 10-year 4 bps to 3.08%. Fed funds futures are presently forecasting 50 bps of rate hikes through the first half of 2019. The advance read on Q3 GDP came in at a solid 3.5%. New home sales dropped 13.2% yoy in September, the biggest drop since April 2011. Sales were especially depressed in the northeast where new tax provisions restricting federal tax deductions for state and local taxes have hit hardest.



Sources: Bloomberg, Green Street Advisora, Real Capi8tal Analytics



Trade

The **World Trade Organization's** dispute body is meeting this week in Geneva. Two key agenda items will be US tariffs on steel and aluminum and China's intellectual property policies. The US has maintained that its metals tariffs are necessary to protect national security, which is somewhat uncharted territory for the WTO. Seven WTO members have imposed retaliatory tariffs on more than $25 bn of US goods in retaliation to the initial US tariffs. The US has imposed tariffs on $250 of Chinese products, provoking retaliation.

Europe

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Equities started the week on the front foot after heavy losses last week. The Euro Stoxx 600 was up 1.2% with nearly all sectors in positive territory. Banks outperformed, rising by 1.9% as Italian lenders soared on declining yields and soothing comments from the government (see below). HSBC (+4.5%) also saw large gains as it delivered strong revenue growth for Q3. **Sovereign yields were mixed in morning trading.** France and Germany saw modest increases while Italian yields dropped sharply on ratings action and government comments.

Chancellor Merkel is prepared to step down as leader of the CDU according to reports. Local elections in Hesse over the weekend saw both the CDU and SPD lose over 10 percentage points of support. The elections, which saw gains for both the Greens and AfD, were widely seen as a proxy for the level of support in the federal government. While the coalition parties didn't do as badly as some had feared, the results have put further strains on the coalition. Merkel is said to want to remain chancellor for the time being but be willing to step down as party leader despite comments in the past where she said the two were bound together. Some reports have suggested that she will step down in 2021 once her current term ends. Recriminations are expected to continue in the coming days as renewed questions arise about the viability of the coalition government.

Italian yields declined sharply this morning. Analysts attributed the moves to commentary over the weekend as well as S&P's decision to keep the sovereign's credit rating unchanged at BBB, although the outlook was lowered to negative from stable. Some local media reported compromises taking place within the government to make the budget more palatable to the EU. Meanwhile, FM Tria and deputy PM downplayed the risks to banks over the fall in government bond prices. The 10-year yield fell 12 bps while the 2-year was down 15 bps. The government now has just over two weeks to submit a revised budget after the EC rejected the previous one.

Other Mature Markets

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Canada

The Canadian government sent formal notice of its ratification of the **Comprehensive and Progressive Agreement for Trans-Pacific Partnership** (CPTPP). The product of the US pull-out from the Trans-Pacific Partnership, the CPTPP is being spearheaded by the Japan and now has been signed off by 5 nations (out of 11), with Australia on the verge of formalizing adoption as well. The pact will kick in 60 days after being ratified by six countries.

Emerging Markets

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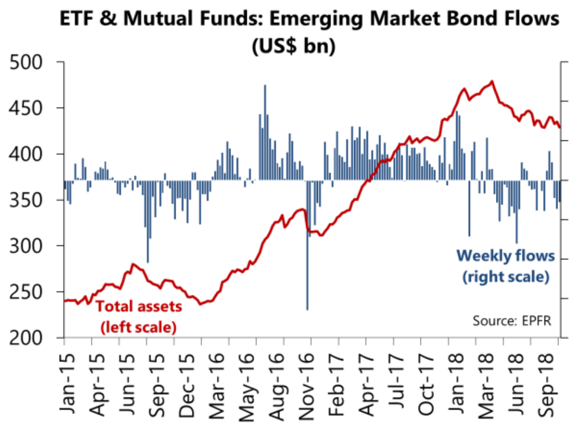
Key Emerging Market Financial Indicators

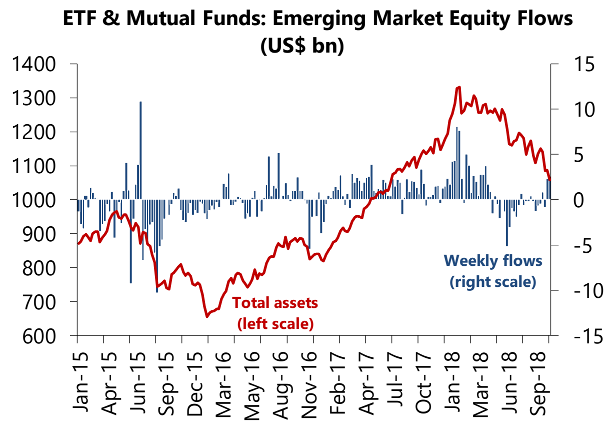
Last updated:	Level		Change				
10/29/18 7:45 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		38.67	1.8	-3	-10	-16	-18
MSCI Frontier Equities		26.81	0.0	-1	-6	-16	-19
EMBIG Sovereign Spread (in bps)		364	-2.0	13	21	80	79
EM FX vs. USD		62.25	0.0	0	0	-9	-11
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.96	-0.2	0	-1	-4	-6
Indonesian Rupiah		15223	0.0	0	-2	-11	-11
Indian Rupee		73.45	0.0	0	-1	-12	-13
Argentine Peso		36.83	-0.2	-1	5	-52	-49
Brazil Real		3.64	1.7	2	11	-9	-9
Mexican Peso		19.61	-1.3	-1	-5	-2	0
Russian Ruble		65.56	0.1	-1	-1	-12	-12
South African Rand		14.47	0.9	-1	-2	-3	-14
Turkish Lira		5.52	1.2	3	8	-32	-31
EM FX volatility		9.99	-0.1	0.2	-0.4	1.8	2.1

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

Emerging markets performance was mixed on Monday morning, following the victory of Mr. Bolsonaro in Brazil's presidential election. Most EM currencies traded within a narrow ±0.2% corridor, except the Turkish lira (+1.0%) and the Mexican peso (-1.2%). Stocks were also mixed, with the largest gains this morning in India (+2.3%), Russia (+1.1%), Hungary (+1.1%), and the Czech Republic (+1.0%). Turkish equities were 3.4% down on the day.

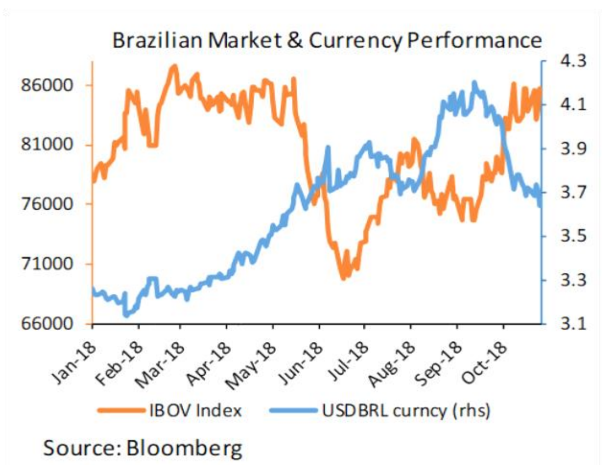
Emerging markets bond and equity fund flows continued their divergence for a second week. EPFR reported that bond funds shed $1.1 bn last week and $1.5 the week before, while equity funds took in $2.5 bn last week, building on the $2.3 bn of inflows in the previous week. Still, slumping equity prices have seen the value of EM equity fund assets under management fall to $1,058 bn last week from a peak of $1,331 bn in late January. EM equity prices have fallen almost 19% year-to-date in dollar terms.





Brazil

Jair Bolsonaro, a former army captain, won 2nd round of the presidential election with 55.2% of the valid votes. His opponent Fernando Haddad of the leftist worker's party received 44.8% of the valid votes. Over the past 6 weeks, the real has strengthened 13.5% against the dollar and Ibovespa has gained 15% as investors have been pricing in a victory by Bolsonaro. Much of the vote of confidence that markets are placing on Bolsonaro hinges on his choice of economic adviser: University of Chicago-trained economist Paulo Guedes. Analysts perceive 2019 as a transition year for Brazil.



Argentina

The IMF's executive board approved a $56.3 bn ($50 bn previously) credit line for Argentina, right after their government approved the 2019 budget proposal in the lower chamber despite protests.

The government budget includes a very large fiscal adjustment in 2019, to reduce the primary fiscal deficit from 2.6% to 0% of GDP. The short-term inflation outlook still looks cloudy, but analysts expect the CPI rising to 6% m/m in October. High inflation together with strong contraction activity could increase the social political risks through year end. Still, there are signs that the agreement has halted a slide in investor confidence. The peso is up more than 10 percent in October, on pace for its best month since 2003 despite slipping slightly on Friday. The spreads and yields on the government's hard currency debt are lower from its peak in early September. The spread on the EMBIG's Argentina sub-index closed Friday at 670 bps, more than 100 bps lower than its recent high.

China

China's growth woes continued to weigh on A-shares and the renminbi. The slowdown in profit growth at industrial firms for the fifth consecutive month in September raised concerns over a cooling economy as sales of raw materials and manufactured goods receded. This, together with disappointing earnings from liquor producers, added selling pressure in the equity market. The Shanghai A-share index slid 2.2% while the Shenzhen SME board tumbled 2.3%. Risk-off sentiment prevailed in the currency market, with the renminbi weakening by 0.2% against the US dollar.

Private Company Financing Nation Ranking by Volume – 2018 YTD

Target Nation	Rank	Value ($bn)	Deal No.	%Share	2017 YTD Rank
China	1	134.4	1,879	52.3	1
United States	2	51.2	1,248	20.1	2
India	3	26.2	531	10.2	3
United Kingdom	4	7.2	341	2.8	4
Singapore	5	4.5	121	1.8	5
France	6	3.7	344	1.4	10
South Korea	7	3.7	75	1.4	7
Japan	8	3.2	1,039	1.3	12
Germany	9	3.0	206	1.2	8
Canada	10	2.9	50	1.1	15

Source: Dealogic

Chinese regulators urged lenders to avoid forced liquidation of pledged shares, as part of efforts to help stabilize the stock market. According to Chinese financial magazine Yicai, the Beijing branch of the China Banking and Insurance Regulatory Commission (CBIRC) said unrealized losses or lending risks associated with shares that banks hold as collateral against loans will not be part of regulatory inspections. Banks are also encouraged to increase lending to those listed companies facing temporary difficulties. Underscoring the liquidity stress, about US$620 billion of A-shares have been pledged for loans, putting companies under pressure as stock markets tumble and the prospect of forced liquidation rises. To stem stock market rout, the National People's Congress streamlined the requirements on share buyback. Companies can now repurchase shares with approval from two-thirds of the board if deemed necessary to protect shareholders' interests, or for convertible bond exchanges. Previously, firms were only allowed to buy back shares for purposes including stock incentives, and it was mandatory to go through shareholder meetings for approval.

Over half of the funds raised globally in private equity placements globally this year have been in China. The $134.4 bn raised there is up 67% from the same period last year. But earlier this year, the Asset Management Association of China advised that the number of private funds in the country had dropped as the stock market slumped. Still, Wind Information gauges that the total assets under management in the private fund sector hit 11.1 tn yuan ($1.6 tn) at the end of last year, and grew to 12.6 tn by the middle of this year.

India

India is considering allowing payments for some Chinese exports to be settled in yuan instead of US dollars. The measure is intended to reduce the demand for dollars by Indian importers, thus allowing India to save on dollars to pay for increasing crude prices. Indian oil imports are estimated to reach this year a record high since 2001 of $125bn. The rupee has depreciated by about 15% this year – a move that has been mirrored in an increase of sovereign debt yields. For China, accepting payment in yuan instead of dollars would broaden the international standing of the yuan towards becoming a major trade currency.

The rise in bond yields has mirrored the drop in rupee

Source: Bloomberg

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Global Financial Indicators

Last updated: 10/29/18 7:42 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		2659	-1.7	-4	-9	3	-1
Europe		3181	1.5	0	-6	-13	-9
Japan		21150	-0.2	-6	-12	-4	-7
China		2542	-2.2	-4	-10	-26	-23
Asia Ex Japan		62	-1.5	-3	-12	-17	-19
Emerging Markets		39	1.9	-3	-10	-16	-18
Interest Rates					basis points		
US 10y Yield		3.10	-4.1	-10	4	69	69
Germany 10y Yield		0.39	3.9	-6	-8	1	-4
Japan 10y Yield		0.11	-0.3	-4	-2	4	6
UK 10y Yield		1.41	2.8	-12	-16	6	22
Credit Spreads					basis points		
US Investment Grade		106	1.3	4	9	13	15
US High Yield		380	11.4	34	50	21	5
Europe IG		75	-2.1	1	8	24	30
Europe HY		299	-5.7	4	25	70	65
EMBIG Sovereign Spread		364	-2.0	13	21	80	79
Exchange Rates					%		
Dollar Index (DXY)		96.41	0.1	0	1	2	5
USDEUR		1.14	0.1	-1	-1	-2	-5
USDJPY		112.4	-0.4	0	1	1	0
EM FX vs. USD		62.2	0.0	0	0	-9	-11
Commodities					%		
Brent Crude Oil ($/barrel)		77	-0.2	-3	-6	28	16
Industrials Metals (index)		118	0.1	-2	-2	-10	-15
Agriculture (index)		44	0.6	0	4	-10	-8
Implied Volatility					%		
VIX Index (%, change in pp)		22.8	-1.4	3.2	10.7	13.0	11.8
10y Treasury Volatility Index		4.7	0.4	1.0	1.4	0.7	1.2
Global FX Volatility		8.5	0.1	0.5	0.3	0.7	1.1
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		383	-12.4	-6	11	14	14
Italy		291	-18.3	-13	23	132	132
Portugal		148	-7.8	-9	7	-4	-4
Spain		114	-7.8	-11	11	0	0

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: 10/29/2018 7:46 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		6.96	-0.2	-0.1	-1	-4	-6		3.5	-0.3	-1	-12	-32	-44
Indonesia		15223	0.0	-0.2	-2	-11	-11		8.7	2.7	-1	38	160	211
India		73	0.0	0.2	-1	-12	-13		8.0	0.4	-4	-19	89	54
Philippines		54	-0.1	0.3	1	-4	-7		6.6	0.7	1	14	177	175
Thailand		33	-0.4	-1.1	-3	0	-2		2.9	0.1	2	6	67	63
Malaysia		4.18	-0.1	-0.5	-1	1	-3		4.1	0.9	4	6	16	24
Argentina		37	-0.2	-0.8	5	-52	-49		20.3	0.0	-32	-288	477	432
Brazil		3.64	1.7	1.9	11	-9	-9		8.7	-17.2	-19	-129	-2	-28
Chile		686	0.2	-0.4	-4	-7	-10		4.8	-2.3	-5	-2	32	3
Colombia		3180	-0.2	-3.2	-6	-5	-6		6.8	2.0	12	23	41	58
Mexico		19.61	-1.3	-1.1	-5	-2	0		8.3	-1.3	13	37	103	67
Peru		3.3	-0.1	-0.5	-1	-3	-3		5.9	2.2	8	19	45	63
Uruguay		33	-0.2	-0.2	1	-11	-13		10.8	7.1	17	26		218
Hungary		284	0.0	-1.0	-2	-6	-9		2.6	-8.4	-15	-2	121	136
Poland		3.79	-0.1	-1.1	-2	-4	-8		2.5	-5.0	-11	-9	-28	-19
Romania		4.1	-0.1	-0.5	-2	-4	-5		4.6	-3.0	-2	28	115	77
Russia		65.6	0.1	-0.6	-1	-12	-12		8.4	2.2	4	4	95	109
South Africa		14.5	0.9	-1.0	-2	-3	-14		9.9	-9.6	7	22	-1	58
Turkey		5.52	1.2	2.6	8	-32	-31		19.6	-22.3	-46	-112	775	767
US (DXY; 5y UST)		96	0.1	0.4	1	2	5		2.93	2.4	-12	-2	90	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		2542	-2.2	-4	-10	-26	-23		184	-8	1	1	47	32
Indonesia		5755	-0.5	-1	-4	-4	-9		218	-4	12	33	55	52
India		34067	2.2	0	-6	3	0		169	2	7	6	60	59
Philippines		7109	0.6	-2	-2	-14	-17		116	-5	9	20	24	21
Malaysia		1684	0.0	-2	-6	-4	-6		130	-6	8	1	17	20
Argentina		29370	0.1	2	-12	7	-2		670	-2	4	49	305	320
Brazil		85720	1.9	2	8	13	12		261	-2	4	-25	27	27
Chile		5124	0.0	0	-3	-7	-8		138	-4	7	14	21	19
Colombia		1397	0.1	-4	-7	-3	-8		188	-2	2	21	4	14
Mexico		45803	-1.0	-3	-7	-7	-7		286	-1	13	29	40	41
Peru		18576	-0.4	-2	-5	-7	-7		154	-3	7	22	17	17
Hungary		36249	0.9	-3	-2	-9	-8		126	-2	10	16	33	38
Poland		54605	1.1	-3	-7	-15	-14		64	-5	7	17	13	17
Romania		8491	0.9	-1	1	8	10		197	4	14	24	76	83
Russia		2319	1.1	0	-6	12	10		227	1	9	-4	47	49
South Africa		51630	1.6	-1	-7	-12	-13		342	5	32	21	54	88
Turkey		90542	-3.4	-6	-9	-16	-21		442	-6	2	-11	135	153
Ukraine		556	-0.8	-1	3	86	77		594	-1	43	45	132	139
EM total		23	-1.5	-3	-9	-14	-13		364	-2	13	21	80	79

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