Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Wednesday, October 31, 2018

- **US housing market continues to cool (link)**
- **US corporate credit growing above trend (link)**
- **"No deal" Brexit could lower UK GDP by 5.5% over 3 years, according to S&P (link)**
- **Dollar-denominated Asian bond yields rising on trade and growth fears (link)**
- **Turkish inflation surges to 24%; CBTR raises inflation forecasts (link)**

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Markets continue modest rebound, but sentiment remains fragile

Global equity markets, aided by month-end rebalancing and strong US Q3 earnings releases, recovered a portion of this month's losses. Despite today's gains, the MSCI world index is down more than 8% this month and on track for its worst monthly performance in 6 years. Implied volatility of at-the-money S&P 500 options remains elevated through most of 2019, while the term structure of Euro Stoxx options shows a lower, steeper curve. Analysts suggest that some familiar negative themes – Brexit, slowdown in China, and tensions in US-China and EU-Italy relations – could bring back the downward momentum. Looking ahead, the US midterms next Tuesday are getting increasing attention, with polling suggesting that Republicans are likely to lose their majority in the lower house of Congress.

Key Global Financial Indicators

Last updated: 10/31/18 8:10 AM	Level: Last 12m	Level: Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		2692	1.6	1	-8	5	1
Eurostoxx 50		3196	1.5	2	-6	-13	-9
Nikkei 225		21920	2.2	-1	-9	0	-4
MSCI EM		39	2.0	-2	-10	-16	-18
Yields and Spreads					bps		
US 10y Yield		3.15	3.8	4	8	77	74
Germany 10y Yield		0.39	1.6	-1	-9	2	-4
EMBIG Sovereign Spread		365	0.0	0	22	82	80
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		61.7	-0.1	0	-1	-10	-11
Dollar index, (+) = $ appreciation		97.0	-0.1	1	2	5	5
Brent Crude Oil ($/barrel)		76.3	0.5	0	-8	24	14
VIX Index (%, change in pp)		22.2	-1.1	-3	10	12	11

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

United States

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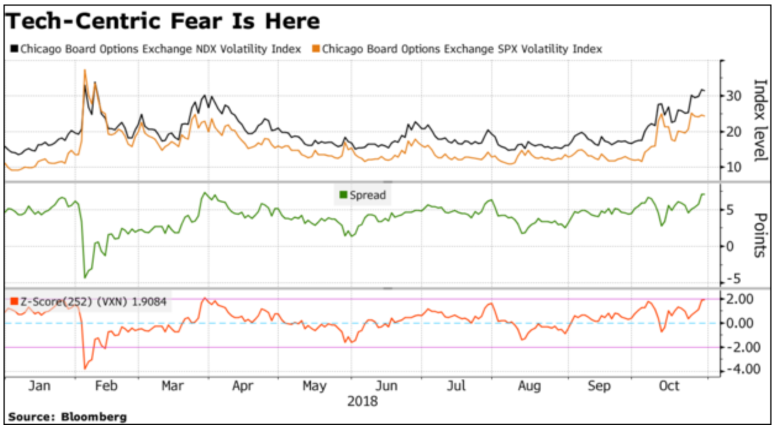
US stocks had a positive end to a choppy session. Major indices closed up 1.6 to 1.8%. But there was still substantial intraday volatility, with the S&P 500 twice erasing gains over 1% before rebounding in late in the day. Implied volatility measures remain elevated, with both the S&P 500's VIX index and the Nasdaq's NDX approaching their highs of early this year. GE cut its dividend to a nominal 1¢ and announced a $22 bn writedown. Treasury yields climbed, with the 2-year yield up 2 bps to 2.84% and the 10-year yield up 2 bps to 3.10%. Consumer confidence hit a third consecutive 18-year high according to Conference Board data.

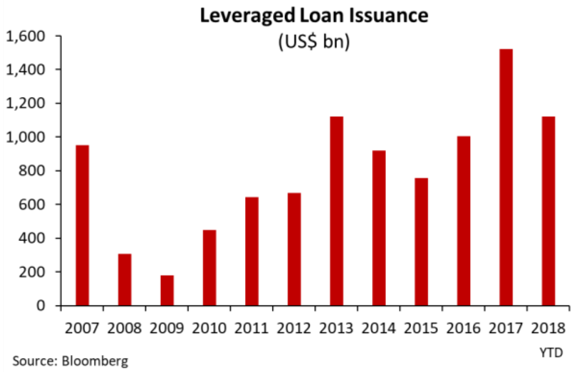


Index	Move week ended Oct 26
Cboe High-Yield Corporate Bond ETF Volatility Index (VXHYG)	23.1%
Cboe Volatility Index (VIX)	21.5%
Merrill Lynch Option Volatility Estimate (MOVE)	20.5%
Cboe/COMEX Gold Volatility Index (GVXX)	8.1%
JPMorgan Global FX Volatility Index (JPMVXYGL)	4.8%
Cboe/NYMEX Oil Volatility Index (OIV)	3.7%
BofA Merrill Lynch Global Financial Stress indicator, net change (GFSI)	0.11
BofA Merrill Lynch GFSI Skew indicator, net change (GFSISKEW)	0.15
BofA Merrill Lynch Market Risk indicator, net change (GFSIRMKT)	0.18

Source: Bloomberg

The housing sector continues to cool. Housing prices decelerated for a 5th straight month, according to Case-Shiller data. Rising borrowing costs and lofty valuations are hampering the market even as job growth has been robust and unemployment remains historically low. BankRate notes that the 30-year mortgage rate has been at or above 4.7% since early October after starting the year at 3.85%. Existing home sales fell in September to the lowest level in 3 years, while new home sales are the worst since December 2016. Housing starts also dropped in September, in part due to hurricane activity.

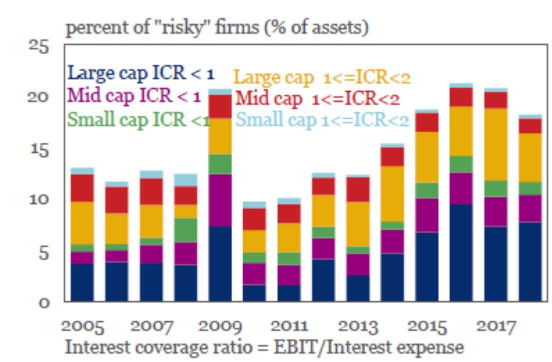
The head of the Fed's risk surveillance and data warned this week against the "material loosening of terms and weakness in risk management" in the **booming leveraged loan market**. In addition, Janet Yellen likewise noted last week the systemic risks arising from leveraged loans. Bloomberg data indicate that US leveraged loan issuance so far this year has exceeded $1 tn, and S&P believes that 2018 will eclipse last year's total. Investors have been flocking to leveraged loans because they have floating rate coupons (which are attractive in rising rate environments) and have seniority over unsecured bonds. But increased investor interest has been coupled by a serious deterioration in lending standards and covenants. Bloomberg has noted that merger-related loans with leverage over 6x have been on the rise. While these highly leveraged loans accounted for 17.6% of merger financing in 2015, they doubled to 35.3% this year. Leveraged loans have returned 4.1% so far thjs year, compared with a 0.8% gain for high-yield bonds and a 3.0% loss for investment-grade bonds.



Source: Bloomberg

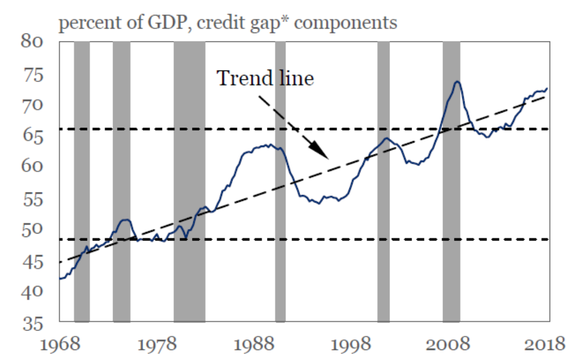
The Institute of International Finance gauges that the **corporate credit has been growing above trend** lately. The IIF also points to other worrying aspects in corporate credit space: declining profit margins, greater reliance on short-term debt, higher borrowing costs, and a deterioration in liquid holdings. While it does not see an immediate problem for large firms, it believes these developments represent "a significant future liability in a rising-rate environment." The IIF also advises that a considerable number of firms have are holding high amounts of debt relative to their earnings. It reckons some 20% of US firms are having difficulties covering their interest expenses with their corporate earnings—which is particularly the case for smaller firms. It believes over half of these firms have interest coverage ratios (ICRs) of less than 2.

Chart 3: Despite stronger earnings growth this year, many U.S. companies still struggle with debt service



Source: IIF, Bloomberg

Chart 2: U.S. corporate debt—growing above trend again



**difference b/w debt/GDP and its long-term trend; shaded areas = recessions; dashed lines = +- 1 standard deviation from the mean. Source: IIF, Fed, NBER*

Europe

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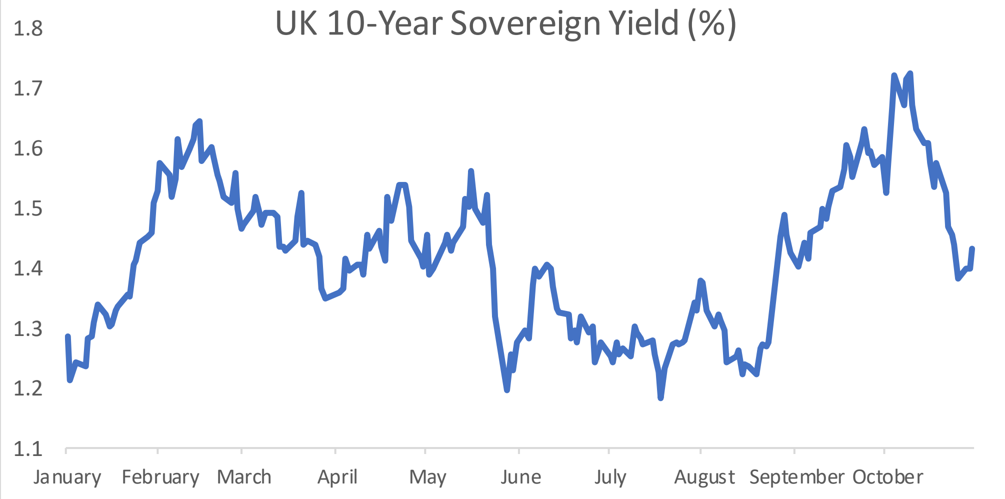
Equities followed Asian and US stocks higher. All major bourses were up more than 1% while the Euro Stoxx rose by 1.5%. The gains were broadly shared among sectors although energy stocks (2.5%), industrials (+1.9%), and IT companies (1.9%) were particularly strong. Banks were 1.6% higher, taking this week's gains to 3.3%. Standard Chartered jumped by 4.8% as investors welcomed the bank's Q3 earnings. BTP yields dropped, with 10-year BTP yields down 7 bps. Spanish and Portuguese debt yields saw minor declines while German and French yields rose modestly. 10-year Gilts were 4 bps higher after a two-week spell saw them drop from 1.73% to 1.38%.



Source: Bloomberg

The risk of a "no deal" Brexit scenario has increased sufficiently enough for it to become a rating consideration, according to S&P. In a new report, the agency says a "no deal" would pull the UK economy into a moderate recession with a GDP hit of 5.5% over three years. The report contributed to a weakening of sterling yesterday. The currency is now trading at $1.27, its lowest level since August. There has been very little news on talks between the UK and EU recently as negotiators work behind the scenes to resolve the outstanding issues. Separately, the ECB said that Brexit was a key risk as the bank set out its supervisory priorities for the year ahead. Banks' preparedness as well as the supervisor's expected increase in activity due to relocation of activity were highlighted as key areas.

S&P has lowered the outlook on 11 Italian banks on the turmoil in the country's sovereign debt markets. Intesa Sanpaolo, Banca IMI and Mediobanca are among the banks to have their outlook lowered with the rating agency warning that "concerns about sovereign creditworthiness could impair the banks' funding profiles". Italian bank stocks were nevertheless in the green in today's trading on lower sovereign yields and positive sentiment in Europe. The move by S&P comes after the agency lowered the outlook on the sovereign rating earlier this month. The European Commission has set a November 13 deadline for the government to provide revisions to its budget.

Other Mature Markets

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Japan

Japanese stocks moved higher today, with the Topix and Nikkei both advancing about 2.2%. Separately, the Bank of Japan has announced today some adjustments to its monthly bond purchase program. The changes will affect the frequency of purchases of short- to medium-maturity bonds.

	NOVEMBER		OCTOBER	
Residual maturity	Buying per operation	Frequency	Buying per operation	Frequency
Up to 1 year	10b to 100b yen	2	10b to 100b yen	2
1 to 3 years	250b to 450b yen	4	200b to 400b yen	5
3 to 5 years	300b to 550b yen	4	250b to 450b yen	5
5 to 10 years	300b to 600b yen	5	300b to 600b yen	5
10 to 25 years	150b to 250b yen	5	150b to 250b yen	5
More than 25 years	10b to 100b yen	5	10b to 100b yen	5
Inflation-linked bonds	25b yen	2	25b yen	2
Floating-rate bonds	100b yen	Even Months	100b yen	Even Months

Source: BOJ

Emerging Markets

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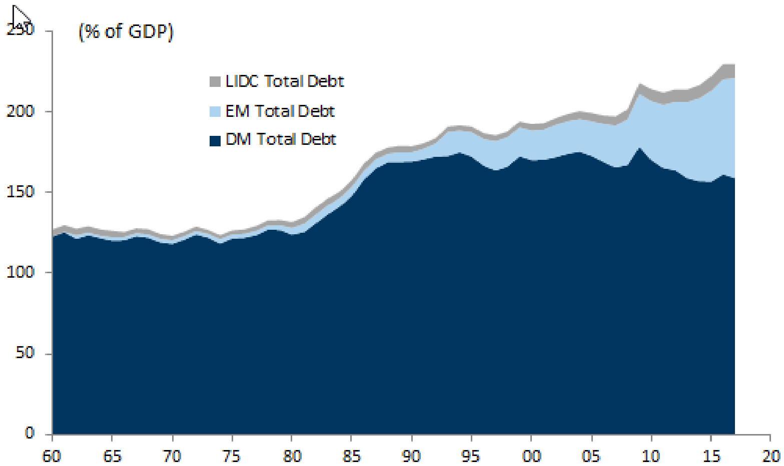
Key Emerging Market Financial Indicators

Last updated:	Level		Change				
10/31/18 8:12 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		38.74	-0.5	-2	-10	-16	-18
MSCI Frontier Equities		26.91	1.1	0	-5	-15	-19
EMBIG Sovereign Spread (in bps)		365	0.0	0	22	82	80
EM FX vs. USD		61.68	-0.1	0	-1	-10	-11
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.97	-0.1	0	-1	-5	-7
Indonesian Rupiah		15203	0.1	0	-2	-11	-11
Indian Rupee		73.96	-0.4	-1	-1	-12	-14
Argentine Peso		36.74	0.5	0	7	-52	-49
Brazil Real		3.70	0.0	1	9	-12	-10
Mexican Peso		20.12	-0.3	-3	-7	-5	-2
Russian Ruble		65.74	-0.4	0	-1	-11	-12
South African Rand		14.80	-1.4	-2	-4	-5	-16
Turkish Lira		5.49	-0.3	4	8	-31	-31
EM FX volatility		9.99	0.0	0.1	-0.4	1.9	2.1

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

Asian bourses advanced 1% to 3%, as month-end rebalancing helped win back some of this month's losses. Currencies mostly weakened against the dollar, with the Indian rupee (-0.4%) suffering the largest loss today. **EMEA** markets mirrored the price action in Asia, with equity gains and currency moves in the same order of magnitude as Asian peers. **Latin American** markets closed mixed yesterday. The Mexbol went down a further 1% on continuing fallout from the scotched airport proposal. The Brazilian Ibovespa gained 3.7% and the real strengthened 0.6% to the dollar after conciliatory remarks by Bolsonaro on defending the constitution, individual freedoms, reducing the size of government, and fostering economic growth. Argentina's peso strengthened by 0.5% against USD and the Merval went up almost 2% due to a positive sentiment on US stocks and EMFX peers.

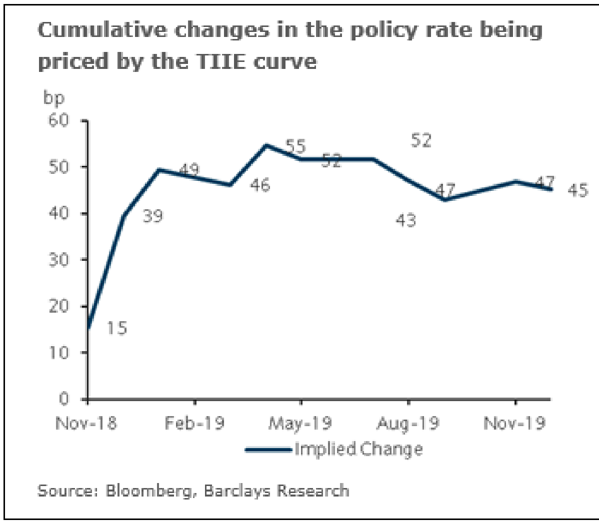
According to a Goldman Sachs analyst report, global gross debt measured as a share of GDP (including public and private debt) has risen above pre-Global Financial Crisis (GFC) levels. This increase has been driven in large part by rising private sector debt in emerging market (EM) economies. While developed (DM) economies still dominate outstanding debt levels, EM's share of total global debt has increased materially since the crisis. In addition, the report notes that the net international investment positions and current account balances of several individual EM economies look relatively exposed. While there has been an improvement over time across EMs in general, Turkey, Mexico and Brazil are significant net debtors, together with Australia and the US among DM economies.

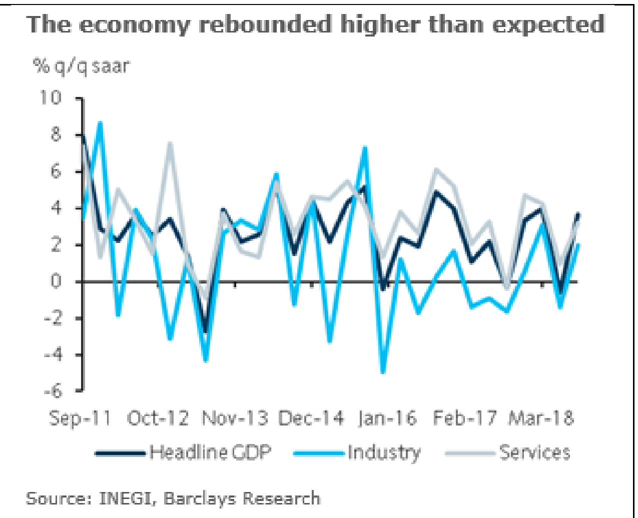


Source: Goldman Sachs

Mexico

The Mexican peso has weakened 3.8% against the dollar this week after the Mexico City airport was cancelled – a decision which reanimated concerns about the pragmatism of the AMLO presidency. The TIIE curve has priced expectations for additional policy rate hikes next month and beyond (see chart). Among data releases, Mexico's GDP grew 2.5% yoy (vs. expected 2.4%) in the third quarter. The performance was mostly driven by services and industry which increased 3.4% and 1.1% yoy respectively. Analyst believe that despite the strong rebound, the economy dynamism could remain soft next year.



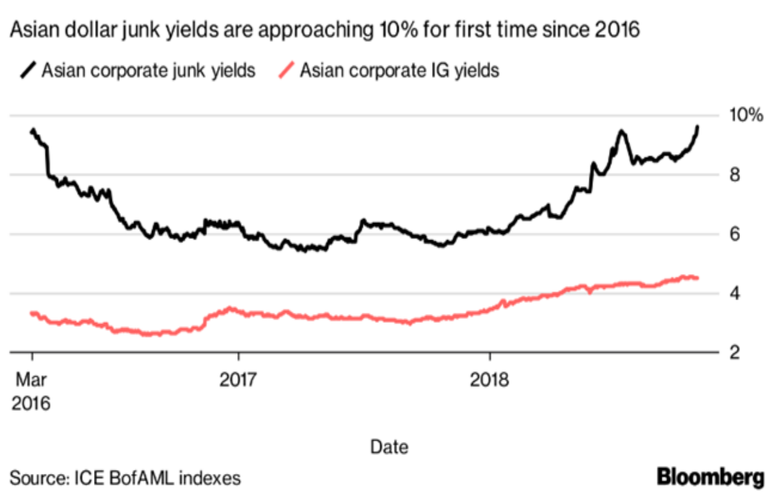


China

The renminbi weakened by 0.17% to close at 6.9734 against US dollar after touching an intra-day low of 6.9751. Market sentiments were weighed by weaker-than-expected PMI readings as the impact of US-China trade conflicts started to drag on real activities. The official manufacturing PMI dropped for the second month to 50.2 in October from 50.8 in September, while the non-manufacturing PMI fell to 53.9 from 54.9 over the same period. The new orders component of the manufacturing PMI fell to 50.8, mainly dragged by shrinking export orders. In the equity market, both Shanghai and Shenzhen A-share Indices gained 1.4%, in part driven by bargain hunting trade. For October as a whole, the Shanghai A-share fell by 7.8%.

Emerging Asia

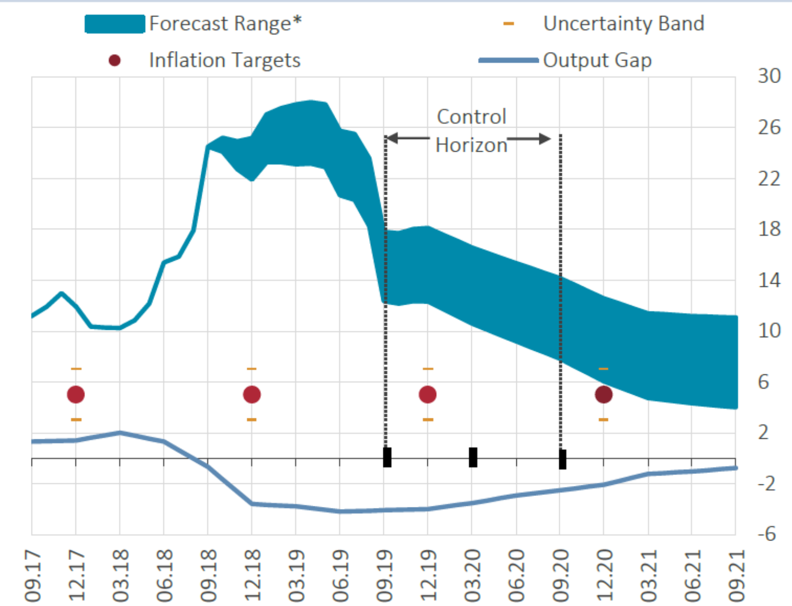
Rising downside risk to the Chinese economy, higher refinancing costs and a slump in stocks have widened the yield spread between speculative and investment grade dollar bonds issued in Asia. US President Trump's plans to expand tariffs to cover the full range of Chinese imports, combined with increasing signs of a slowdown in the Chinese economy, have pushed the yields of dollar-denominated Asian junk bonds to nearly 10%. These are the highest yields observed since March 2016. Higher US dollar rates mean that companies that raised US dollar funds offshore need to pay more for refinancing. Real estate developers would be particularly hard hit, given their sizable US dollar bond issuance in recent years. In the face of higher funding costs and weaker demand, the chairman of Evergrande, one of the biggest property developers in China, made an unusual move to buy US$1 billion of its newly issued dollar notes with face value of US$1.8 billion, and the coupon rates of different tranches of the notes are all over 10%.



Turkey

The Turkish lira weakened 0.6% after the release of the central bank's Inflation Outlook. According to the report, inflation in September surpassed 24%, nearly five times the CBT's inflation target. The Bank also raised its end-2018 inflation forecast to 23.5% (from 13.4% in July) and to 15.2% for end-2019, from 9.3%. **Trade data** released this morning showed the smallest deficit in almost a decade, at $1.9bn as largely expected. Equities in Istanbul gained 0.8% this morning, although they have lost 10% in value this month.

Chart 1.3.1: Inflation and Output Gap Forecasts*



Source: CBRT, TURKSTAT.

* Shaded area denotes the 70 percent confidence interval for the forecast.

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

Global Financial Indicators

Last updated: 10/31/18 8:13 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		2692	1.6	1	-8	5	1
Europe		3195	1.5	2	-6	-13	-9
Japan		21920	2.2	-1	-9	0	-4
China		2603	1.4	0	-8	-23	-21
Asia Ex Japan		62	1.7	-3	-12	-17	-19
Emerging Markets		39	2.0	-2	-10	-16	-18
Interest Rates					**basis points**		
US 10y Yield		3.15	3.8	4	8	77	74
Germany 10y Yield		0.39	1.6	-1	-9	2	-4
Japan 10y Yield		0.13	0.5	-1	0	6	8
UK 10y Yield		1.44	3.7	-2	-14	10	25
Credit Spreads					**basis points**		
US Investment Grade		108	0.8	4	10	14	16
US High Yield		380	-2.3	11	52	14	5
Europe IG		74	-2.0	-2	7	24	29
Europe HY		298	-4.9	-2	24	73	64
EMBIG Sovereign Spread		365	0.0	0	22	82	80
Exchange Rates					%		
Dollar Index (DXY)		96.96	-0.1	1	2	3	5
USDEUR		1.13	-0.1	0	-2	-3	-6
USDJPY		113.1	0.0	-1	1	0	0
EM FX vs. USD		61.7	-0.1	0	-1	-10	-11
Commodities					%		
Brent Crude Oil ($/barrel)		76	0.4	0	-8	24	14
Industrials Metals (index)		115	-0.2	-3	-5	-14	-17
Agriculture (index)		42	-0.3	-2	2	-12	-11
Implied Volatility					%		
VIX Index (%, change in pp)		22.2	-1.1	-3.0	10.1	12.1	11.2
10y Treasury Volatility Index		4.6	0.0	0.5	1.3	0.5	1.1
Global FX Volatility		8.4	0.0	0.2	0.1	0.7	1.0
EA Sovereign Spreads					**10-Year spread vs. Germany (bps)**		
Greece		385	-3.6	-6	13	16	16
Italy		303	-7.2	-18	36	145	145
Portugal		148	-3.3	-10	7	-3	-3
Spain		117	-2.7	-6	14	3	3

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

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Emerging Market Financial Indicators

Last updated: 10/31/2018 8:14 AM	Exchange Rates: Level Last 12m	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Local Currency Bond Yields (GBI EM): Level Last 12m	Latest	Change (in basis points) 1 Day	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.					
China		6.97	-0.1	-0.4	-2	-5	-7		3.5	-2.6	-7	-14	-44	-48
Indonesia		15203	0.1	0.0	-2	-11	-11		8.7	-3.7	-6	51	156	205
India		74	-0.4	-1.1	-1	-12	-14		8.0	0.9	-7	-20	81	49
Philippines		53	0.3	0.6	1	-4	-7		6.6	-0.1	0	16	177	175
Thailand		33	0.4	-0.6	-3	0	-2		2.9	1.1	-2	7	64	62
Malaysia		4.18	-0.1	-0.4	-1	1	-3		4.1	0.0	3	7	14	24
Argentina		37	0.5	-0.4	7	-52	-49		20.7	38.0	55	-307	518	472
Brazil		3.70	0.1	1.0	9	-11	-10		8.6	-7.9	-14	-145	-17	-40
Chile		696	-0.3	-1.0	-6	-9	-12		4.8	2.1	0	2	35	5
Colombia		3208	-0.6	-2.8	-7	-6	-7		6.9	-2.4	10	26	47	60
Mexico		20.12	-0.3	-2.6	-7	-5	-2		8.7	1.0	39	77	138	104
Peru		3.4	-0.2	-0.8	-2	-3	-4		5.9	3.2	11	26	49	71
Uruguay		33	-0.2	0.1	1	-11	-12		10.8	0.0	12	34		222
Hungary		286	-0.1	-0.8	-3	-7	-10		2.6	-1.8	-17	-2	119	134
Poland		3.82	-0.2	-0.9	-3	-5	-9		2.5	2.6	-2	-8	-24	-15
Romania		4.1	0.0	-0.6	-2	-4	-5		4.6	-1.0	-6	23	116	74
Russia		65.7	-0.4	-0.1	-1	-11	-12		8.4	1.7	5	10	90	107
South Africa		14.8	-1.2	-1.4	-4	-4	-16		9.9	4.1	10	26	18	55
Turkey		5.49	-0.3	3.9	8	-31	-31		19.0	-61.7	-184	-104	715	705
US (DXY; 5y UST)		97	-0.1	0.5	2	3	5		2.98	2.2	4	3	96	77

	Equity Markets: Level Last 12m	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Bond Spreads on USD Debt (EMBIG): Level Last 12m	Latest	Change (in basis points) 1 Day	7 Days	30 Days	12 M	YTD
								basis points						
China		2603	1.4	0	-8	-23	-21		182	-3	-11	-1	42	30
Indonesia		5832	0.7	2	-2	-3	-8		217	-1	0	32	55	51
India		34442	1.6	1	-5	4	1		172	0	6	11	58	62
Philippines		7140	1.8	0	-2	-15	-17		115	-1	-1	19	23	20
Malaysia		1709	1.4	1	-5	-2	-5		131	2	5	2	22	21
Argentina		29426	1.8	4	-12	5	-2		662	-3	-25	41	301	312
Brazil		86886	3.7	2	10	17	14		257	-1	-9	-29	20	23
Chile		5016	0.0	-2	-5	-10	-10		139	0	-1	15	21	20
Colombia		1395	0.2	-3	-7	-2	-8		186	-3	-2	19	3	12
Mexico		43538	-0.8	-6	-12	-10	-12		304	1	22	47	57	59
Peru		18641	0.3	0	-5	-6	-7		155	3	0	23	18	18
Hungary		36968	1.4	1	-1	-7	-6		124	-1	-1	14	31	36
Poland		55196	1.1	0	-6	-15	-13		62	-3	-5	15	17	15
Romania		8552	0.7	-1	2	9	10		198	0	11	29	71	84
Russia		2334	1.5	0	-6	13	11		222	-2	-6	-9	41	44
South Africa		52312	3.1	3	-6	-11	-12		336	0	13	15	48	82
Turkey		91414	1.6	-2	-9	-17	-21		438	0	-24	-15	136	149
Ukraine		563	1.5	0	5	87	79		604	6	11	55	139	149
EM total		23	1.5	-2	-9	-13	-13		365	0	0	22	82	80

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