Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Tuesday, October 9, 2018

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- **Chinese markets opened lower after surprise weekend policy easing by PBC (link)**
- **Brazilian markets rise following Sunday's first-round election result (link)**
- **Italian spreads at highest level since mid-2013; banks remain under pressure (link)**
- **Risk assets weaken, VIX rises as US yields continue to push higher (link)**

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Markets gloomy as stocks, bonds continue to slide

Global risk assets are weakening for the fourth straight session as Italian markets wobble and Treasury yields sustain their upwards momentum. Major equities markets have retreated every session since last Wednesday, with risk sentiment battered by Italy's budget drama, renewed jitters about the health of banks across Europe, and long-term Treasury yields' daily moves to fresh multi-year highs. Chinese markets fell sharply on Monday after re-opening from a week long holiday, as investors caught up with an eventful week in global markets and digested an unexpected 100 bps required reserve ratio cut by the PBOC. Emerging market currencies more broadly remain on the backfoot, down 0.5% since Friday and 1.3% since US yields broke out on Wednesday's session. Brazil bucked the trend, boosted by the results of Sunday's first round presidential election, which saw a strong preformance from the market-friendly right-wing candidate.

Key Global Financial Indicators

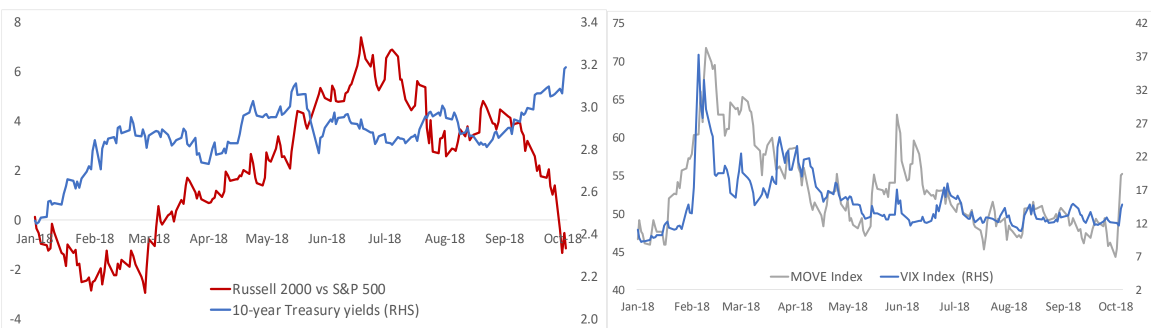
Last updated: 10/9/18 8:11 AM	Level		Change from Market Close				
	Last 12m	Index	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		2884	0.0	-1	0	13	8
Eurostoxx 50		3278	-1.0	-3	0	-9	-6
Nikkei 225		23469	-1.3	-3	5	13	3
MSCI EM		41	0.1	-5	-2	-10	-13
Interest Rates				bps			
US 10y Yield		3.23	0.0	17	29	87	83
Germany 10y Yield		0.54	1.1	12	15	10	11
Japan 10y Yield		0.16	0.6	3	5	11	11
FX / Commodities / Volatility				%			
Dollar index, (+) = $ appreciation		96.1	0.4	1	1	3	4
Brent Crude Oil ($/barrel)		84.5	0.7	0	10	51	26
VIX Index (%, change in pp)		17.5	1.8	5	3	8	6

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

Looking ahead to this week, data out this week may provide further guidance on the path of US rates and on the strength of the euro area economy. US CPI figures (Thursday) should provide a better view of the buildup in domestic pressures, against the background of an increasingly hawkish Fed. Quarterly earnings releases by large US financials (Friday) should also help shed some early light on the health of US corporates and the strength of the financial sector. In Europe, figures on industrial production in the UK (Wednesday) and the Euro Area (Friday) will be looked at carefully considering the relative weakness in recent economic data. Lastly in EM, special attention will be paid to India's CPI and IP numbers (Friday) given the RBI's latest decision not to raise rates, as the INR drops to historical lows against the USD. In Brazil, market attention will now turn to the second-round presidential election on October 28.

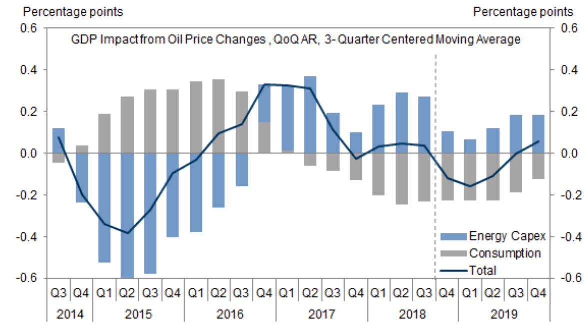
United States back to top

Optimism about the health of the US economy continued to provide support for US Treasury yields. Ten-year treasury yields rose by another 4 bps on Friday following the non-farm payrolls report, which included sizeable upward revisions to previous months employment figures and pushed the unemployment rate to a near-50 year low. Bond markets were closed in the US yesterday for the holiday, but 10-year Treasuries edged up to yields of 3.25% ahead of today's US trading session. **Equity markets sold off Friday as the increase in rates continued unabated, with the S&P and Nasdaq closing down 0.6% and 1.2%, respectively,** with the risk-sensitive Russell 2000 small-cap index falling by even more (see chart). Equity markets were open in the US yesterday, and prices were largely flat but **implied equity volatility continued its upward trend**, with the VIX now up by 5 points since last Wednesday (to 16.87). Greater investor uncertainty was also reflected in rising implied volatility in interest rates, captured in the MOVE index's 7 point rise on the week, to 55. Nonetheless, these levels are far lower than their recent peak in February during the so-called volatility tantrum.



Source: Bloomberg

Analysts see risks that domestic investments in US energy could falter despite higher oil prices, weighing on growth. The net effect on growth from higher oil prices depends on the relative strength of the reduction in consumption growth versus the increase in domestic energy producer investment, mainly in the shale oil sector. Recent market analysis estimates that so far, the net impact has been neutral, with lower consumption reducing growth by about 0.25ppts (annualized) so far this year and, conversely, higher energy capex raising it by an equal amount. The net impact will likely turn negative over the next year as investments in the US energy sector start to lag due to infrastructure bottlenecks (e.g., saturation of pipelines). These headwinds, evidenced by the recent flattening of the shale oil rig count, are projected to stay in place until the second half of 2019.



Source: Department of Commerce, Goldman Sachs Global Investment Research

Europe

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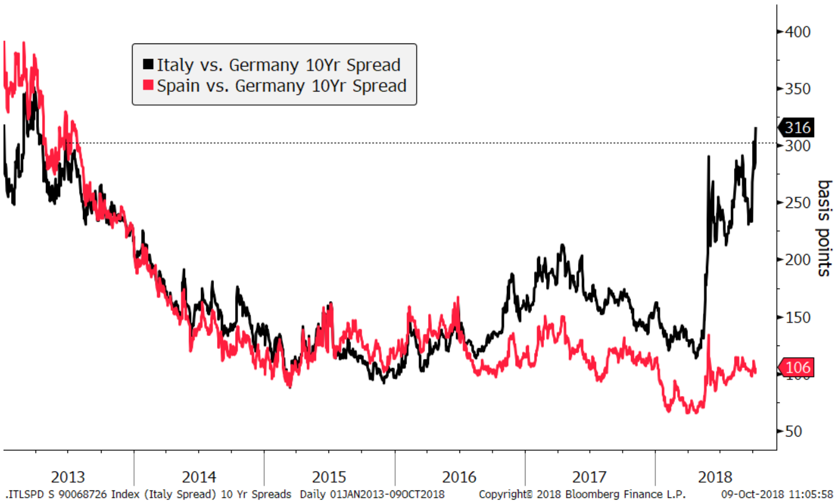
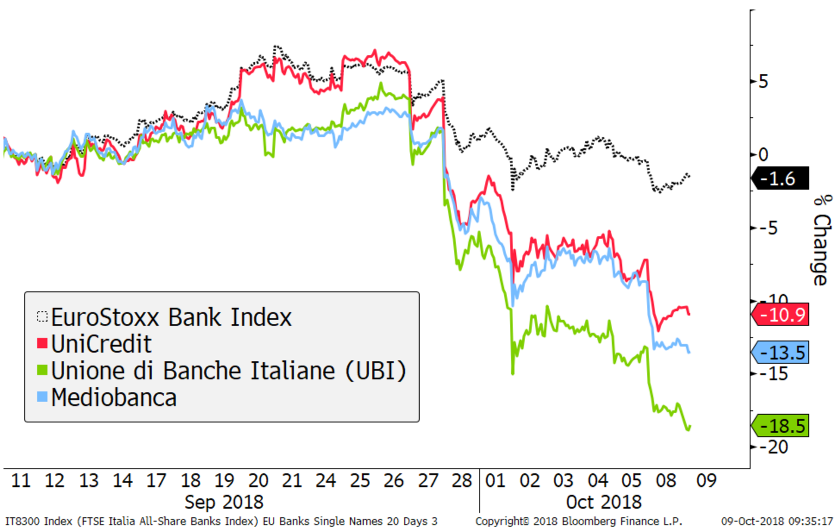
Yields tightened in Monday's session during a bout of risk aversion but are mostly stable this morning. The German 10-year is trading at 0.54%, near its recent highs. Italian yields are 30 to 25 bps higher over the last two sessions (see below). The BTP spread to bunds continues to move higher, rising above 300 bps for the first time since mid-2013. For comparison, Spain's spread is hovering around the 100 bps level.

Italian Spreads Over 300 bps



The EuroStoxx 600 index is unchanged today after falling 1.5% yesterday, led by the Italian MIB (-2.5%). Of note, several banks—including Unicredit, UBI and Mediobanca—had their trading halted yesterday after falling more than 5%. The Italian banking sub-index is down 0.8% today, the same as the equivalent German index.

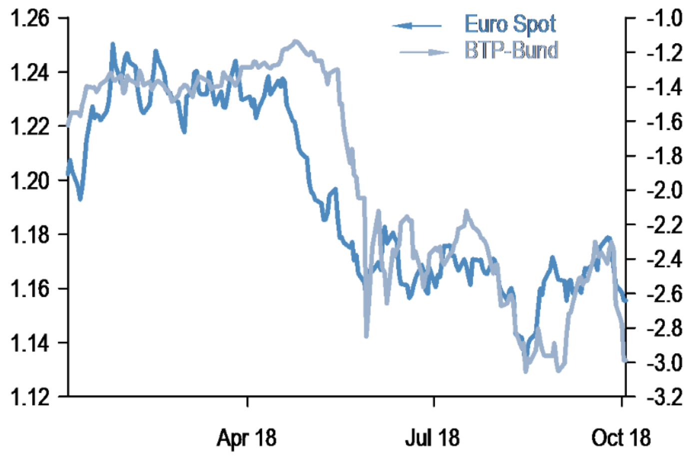
Selected Italian Banks



Italy

Assets remain under pressure as tensions surrounding the budget escalated further. The EC described the government's proposed budget deficit target of 2.4% for 2019 as a "source of serious concern." Deputy PM Di Maio remained defiant, saying he will "not retreat" because of market pressure. **This morning, however, the price moves moderated on headlines that the country's Budget Office may reject the proposal.** If the budget is rejected, the parliament committee could ask the government to review its targets. However, analysts note that the budget watchdog does not have any legally binding power, so this process is unlikely to have a major impact in discussions.

Analysts at JPM note the strong co-movement between the euro exchange rate and Italian spreads since the new government took power. They calculate a correlation of around 90%, where 10 bps in the bund/BTP spread equates to 0.5 cents move in the euro-dollar cross.



Source: J.P. Morgan

Brexit

The ECB has cautioned banks about booking "back-to-back" trades. Banks will have a maximum of three years after Brexit to curtail this practice, which allows trades and loans originating in the EU to be booked in the UK. EU regulators are signaling that financial institutions should be restricting business activities in third countries. Moreover, asking them to cut down on these trades is a way to ensure they will bring more substantive operations to their EU branches and subsidiaries, instead of keeping "brass plate" entities.

Other Mature Markets back to top

Japanese equities sold off for a fourth day while currency market volatility increased as investors remain focused on US-China trade tension. The benchmark Topix index slid 1.8%, weighed down by losses in technology and auto stocks. Meanwhile, a technical glitch with one of four trading system servers at the Tokyo Stock Exchange contributed to intraday market volatility; the Nikkei Volatility Index reached its highest level since July 5th. **The yen extended recent gains against the dollar for a fourth day to ¥113.17** amid elevated trade tension. Bloomberg noted that demand for protection against more yen gains has increased recently. The 1-month risk reversals – the difference in implied volatility between call and put options – for the USD-JPY currency pair widened to 0.84 on Monday. Meanwhile, implied yen volatility reached the highest level since August 16th.

Emerging Markets

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Key Emerging Market Financial Indicators

Last updated:	Level		Change				YTD
10/9/18 8:14 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Prices/Returns of Major EM Benchmarks					%		%
MSCI EM Equities		40.90	0.1	-5	-2	-10	-13
MSCI Frontier Equities		28.24	0.9	-1	2	-11	-15
Hard Currency Sovereign Debt		820.58	0.0	-1	0	-3	-4
Local Currency Sovereign Debt		16.21	0.2	-1	2	-14	-15
Major EM FX vs. USD				**%, (+) = EM currency appreciation**			
China Renminbi		6.92	0.1	-1	-1	-4	-6
Indonesian Rupiah		15314	-0.4	-2	-3	-12	-11
Indian Rupee		74.40	-0.7	-1	-2	-12	-14
Argentine Peso		37.50	0.1	2	0	-53	-50
Brazil Real		3.77	0.2	4	8	-15	-12
Mexican Peso		18.99	-0.3	-1	1	-2	3
Russian Ruble		66.79	-0.3	-2	6	-13	-14
South African Rand		15.04	-1.3	-5	1	-8	-18
Turkish Lira		6.14	-0.5	-3	5	-40	-38
Dollar vs. Mature FX (DXY index)		96.14	0.4	1	1	3	4

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

Emerging markets exhibited a mixed performance yesterday. While weakness in China (CNY depreciated by 0.9% vs USD) and uncertainty over South Africa's finance minister weighed on the overall sentiment (ZAR depreciated by 0.5% vs USD), a surprisingly strong performance by the right-wing party in Brazilian elections led to a rally in Latam assets. Brazilian Real appreciated by 1.6% vs USD, along with equity markets rising by 4.6%. Sentiment was generally favorable this morning with most EMEA bourses up 0.3-0.6%. Local currencies were little changed against the dollar.

In the week ahead, there will be a focus on **South Africa** with market contacts concerned about a potential rating downgrade by Moody's (Friday, 12 October) and the uncertainties around Finance Minister Nene. **For Turkey**, August balance of payments is scheduled to be released on Thursday (with Bloomberg consensus expecting a surplus of USD 2.5bn vs a deficit of USD1.75bn in Aug) along with a court hearing for the US pastor who is under house arrest on Friday. Amongst other data releases, CPI inflation is scheduled to be reported for Mexico (Tuesday) at 5.0% yoy (vs 4.9% in Aug) and Peru is expected to keep its key rate on hold at 2.75% on Thursday.

Issuance

After a record start to the year, and then the slowest summer of issuance since 2007, EM sovereign hard currency issuance appears to be picking up again per analysts. In the past two weeks, Papua New Guinea made its debut dollar bond issue totaling US$500mn, while Albania issued a EUR500mn bond after a two-year hiatus. Other issuers include Hungary (EUR1bn) and Colombia (US$1.5bn). Analysts highlight that the September rally likely opened a window for issuance, though EMBIG Diversified yields are still on the higher end of the 3y range.

China

The RMB and Chinese equity markets stabilized following sharp selloffs yesterday. The RMB held steady in Tuesday's session after declining 0.9% on Monday to RMB 6.92 per USD. Equities were little changed following the 4% loss yesterday. Markets had re-opened Monday after being closed for an eventful week in global markets, due to the Golden Week holiday.

In a surprise decision over the weekend, **the PBC lowered banks' reserve requirements (RRR) by 100 bps, effective October 15th.** The move was bigger and earlier than expected. Analysts noted that the RRR reduction will help offset RMB 450 bn due to mature from the medium-term lending facility on October 15th and increase liquidity in the banking system by a net RMB 750 bn; many see this as solidifying the PBC's easing bias as it looks to bolster sagging market sentiment amid a weaker growth outlook and rising trade tension. Bloomberg estimated that overseas investors sold $1.4 bn of domestic Chinese shares through exchange links with Hong Kong on Monday. Meanwhile, citing high banking sector liquidity, the PBC skipped its open market operations on the day. Money market rates have stabilized today after declined sizably yesterday. The 7-day interbank repo rate held steady at 2.55%, compared to 2.90% at the end of September.

The pace of RMB depreciation over the coming months is expected to be limited. The currency's sharp and rapid depreciation since April – with a loss of about 10% since then – has pushed the CNY from 6.28/USD at the end of April to 6.92 currently. In large part because of this sizable depreciation and expectations for the PBC to maintain some stability in the currency, expectations for further losses in the RMB are limited. The offshore CNH forward curve – the spread between 1-month and 12-month forward contracts remain far flatter than levels seen in 2016. A survey of select investment bank forecasts suggests expectations for the RMB to depreciate to around 7.2/USD by year end.

Falling and Flat

CNH curve has a long way to go to match 2016 levels

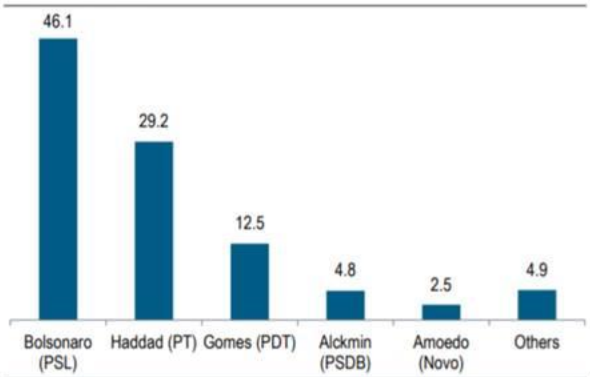
Source: Bloomberg

.CNHFWD G Index (CNH 1m vs 12m) CNH Forwd vs Spot Daily 01JAN2016-09OCT2018 Copyright© 2018 Bloomberg Finance L.P. 09-Oct-2018 14:33:35

Brazil

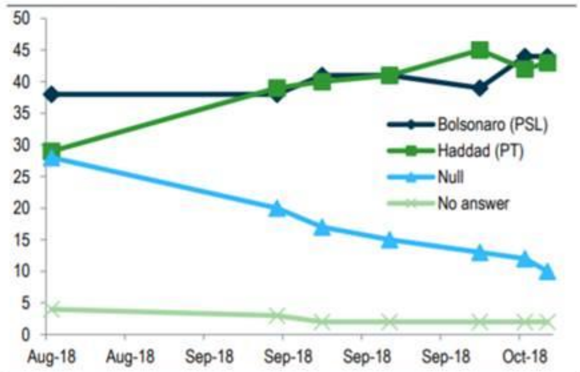
Sunday's elections nearly saw the right-wing anti-establishment candidate take the presidency in the first round. Jair Bolsonaro received 46% of valid votes, compared with Haddad (from the left-wing PT) with 29% in second place. While the outcome was expected by markets, Bolsonaro's margin was considerably higher than the recent polls suggested. **Polls for the second-round (October 28) show the two candidates are roughly tied, but contacts widely see Bolsonaro as having the upper hand** due to: (1) better 1st round performance, and (2) equal TV campaign time as his opponent, which he has heretofore lacked. **Favorable local elections results were an additional supportive factor.** There was clear shift in both houses away from established parties (particularly left-leaning) towards right and newer parties, especially those associated with Bolsonaro. This will help ease, but not dispel, investor's concerns about Bolsonaro's ability to govern should he win.

Figure 1: Preliminary first-round results
% of valid votes



Source: High Electoral Court (TSE), Standard Chartered Research

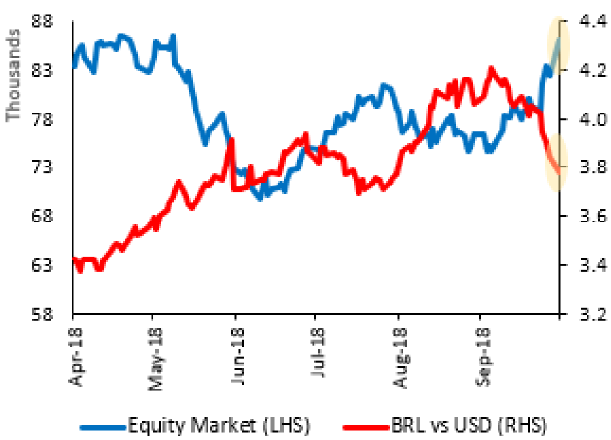
Figure 2: Polls for the second round of elections
% of voter intentions



Source: Datafolha, Standard Chartered Research

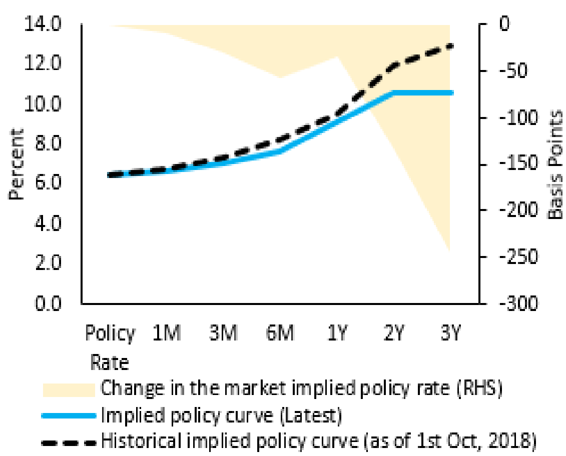
Markets reacted positively with equities up 4.6% and the currency appreciating by 1.6% against the USD. Brazilian financial institutions' shares rallied by 9% on Monday (compares with flat performance in overall EM financials), extending the rise this month to 20%. The strong market performance was also evident in sovereign yields, with Brazil's 10-year yield declining by 50 bps to 10.84 percent today, extending the yield compression to almost 150 bps in the last one month. The market reprieve in domestic financial conditions is also reflected in a **sharp flattening of the market implied policy curve** with markets reducing expected rate hikes over the next three years to 400 bps, down from almost 650bps at the beginning of October.

Brazil: Currency (vs USD) and Equity market trend



Source: Bloomberg

Brazil: Market implied policy rate curve



Source: Bloomberg

Turkey

The lira has held steady in the last couple of sessions after heavy declines last week. The currency was marginally weaker this morning ahead of FM Albayrak's unveiling later today of the government's plan to tackle inflation. Last week's currency declines were in part driven by inflation figures which showed prices rising at a much faster pace than expected by analysts. The focus this week will be on current account data for August as well as a hearing for American pastor Andrew Brunson. The hearing could shed light on any possible thawing in diplomatic relations between Turkey and the US.

Uruguay

Uruguay Peso depreciated by 0.6% vs the USD as Fitch revised the outlook from stable to negative on fiscal deficits and growing public debt. Uruguayan debt has a stable outlook and an investment grade rating with S&P (BBB), Moodys (Baa2), and R&I (BBB), although at around BBB is just one step away from speculative grade.

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Global Financial Indicators

Last updated: 10/9/18 8:12 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
United States		2884	0.0	-1	0	13	8
Europe		3278	-1.0	-3	0	-9	-6
Japan		23469	-1.3	-3	5	13	3
China		2721	0.2	-2	1	-19	-18
Asia Ex Japan		66	-0.5	-6	-4	-10	-13
Emerging Markets		41	0.1	-5	-2	-10	-13
Interest Rates				basis points			
US 10y Yield		3.23	0.0	17	29	87	83
Germany 10y Yield		0.54	1.1	12	15	10	11
Japan 10y Yield		0.16	0.6	3	5	11	11
UK 10y Yield		1.70	3.0	18	25	35	51
Credit Spreads				basis points			
US Investment Grade		99	1.2	2	-5	2	8
US High Yield		329	1.2	5	-16	-38	-47
Europe IG		73	0.7	4	12	16	28
Europe HY		292	0.9	12	11	43	58
EMBIG Sovereign Spread		343	0.0	6	-26	59	58
Exchange Rates				%			
Dollar Index (DXY)		96.13	0.4	1	1	3	4
USDEUR		1.14	-0.5	-1	-1	-3	-5
USDJPY		113.2	0.0	0	-2	0	0
EM FX vs. USD		61.3	-0.5	-1	2	-11	-12
Commodities				%			
Brent Crude Oil ($/barrel)		84	0.7	0	10	51	26
Industrials Metals (index)		120	0.2	-1	4	-7	-13
Agriculture (index)		43	-0.3	1	2	-10	-9
Implied Volatility				%			
VIX Index (%, change in pp)		17.5	1.8	5.5	2.6	7.8	6.4
10y Treasury Volatility Index		4.3	0.1	0.9	0.7	0.0	0.8
Global FX Volatility		8.4	0.0	0.2	-0.7	0.5	1.0
EA Sovereign Spreads				10-Year spread vs. Germany (bps)			
Greece		414	2.9	26	23	45	45
Italy		313	9.4	10	49	154	154
Portugal		147	2.9	-1	-5	-5	-5
Spain		109	2.5	-3	1	-5	-5

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: 10/9/2018 8:15 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		6.92	0.1	-0.8	-1	-4	-6		3.6	-2.0	-2	1	-12	-36
Indonesia		15314	-0.4	-1.7	-3	-12	-11		8.5	5.2	39	-6	171	191
India		74	-0.7	-1.5	-2	-12	-14		8.1	-6.6	-1	-8	100	64
Philippines		54	-0.3	0.1	-1	-5	-8		6.4	0.0	-1	33	158	158
Thailand		33	-0.5	-2.3	-1	1	-2		3.0	3.0	8	13	73	64
Malaysia		4.16	0.1	-0.4	0	2	-2		4.1	0.0	2	-3	21	19
Argentina		38	0.1	1.5	0	-53	-50		23.2	0.3	-98	-142	854	719
Brazil		3.77	0.2	4.5	8	-15	-12		9.3	-45.6	-69	-126	66	28
Chile		684	-0.8	-3.3	2	-7	-10		4.8	0.0	2	2	27	4
Colombia		3031	0.5	-0.4	2	-3	-2		6.7	-3.3	5	3	33	40
Mexico		18.99	-0.3	-1.0	1	-2	3		8.1	-3.3	17	6	96	43
Peru		3.3	0.0	-0.4	0	-2	-3		5.8	0.0	10	15	43	52
Uruguay		33	0.2	0.0	-1	-11	-13		10.4	0.0	-8	-146		181
Hungary		285	-0.5	-1.7	-1	-7	-9		2.8	4.0	12	22	119	150
Poland		3.77	-0.5	-1.4	-1	-3	-8		2.7	0.0	7	1	-20	-3
Romania		4.1	-0.5	-1.0	-2	-5	-5		4.6	14.0	32	31	141	81
Russia		66.8	-0.3	-1.9	6	-13	-14		8.5	9.9	32	-31	105	125
South Africa		15.0	-1.3	-4.5	1	-8	-18		9.9	3.9	22	16	50	57
Turkey		6.14	-0.5	-2.5	5	-40	-38		22.1	29.4	240	-5	1104	1013
US (DXY; 5y UST)		96	0.4	0.7	1	3	4		3.07	-0.2	12	25	111	86

	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		2721	0.2	-2	1	-19	-18		181	1	-2	-2	36	29
Indonesia		5797	0.6	-1	-1	-2	-9		187	0	3	-19	22	21
India		34299	-0.5	-6	-11	8	1		160	0	-1	-6	37	50
Philippines		7059	0.1	-1	-7	-16	-18		99	1	4	-6	10	4
Malaysia		1774	-0.1	-1	-1	1	-1		122	1	-7	-12	1	12
Argentina		30547	1.3	-6	2	14	2		677	4	47	-46	307	327
Brazil		86084	4.6	9	13	14	13		255	-13	-27	-65	19	21
Chile		5327	0.0	0	2	-3	-4		118	1	-5	-21	-7	-1
Colombia		1485	-0.7	-2	1	0	-2		171	1	3	-11	-16	-3
Mexico		48093	0.1	-4	-2	-4	-3		260	3	3	-20	23	15
Peru		19358	-1.4	-1	2	0	-3		129	4	-4	-18	-11	-8
Hungary		36752	0.0	0	-1	-3	-7		107	1	-5	-9	18	19
Poland		57350	-0.3	-3	0	-11	-10		49	0	1	-5	1	2
Romania		8525	0.0	0	3	6	10		170	2	1	-16	44	56
Russia		2458	0.1	0	6	17	16		214	0	4	-23	31	36
South Africa		53811	-0.8	-3	-6	-6	-10		317	1	20	-30	50	63
Turkey		96122	0.0	-2	3	-5	-17		475	0	40	-76	179	186
Ukraine		548	-0.3	2	4	85	74		553	0	-3	-39	96	98
EM total		24	0.3	-4	-2	-7	-8		343	0	6	-26	59	58

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