Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Monday, September 24, 2018

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- **Dow posts second straight record close but S&P 500 and tech stocks falter(link)**
- **US 10-year closes week above 3% for the first time since May(link)**
- **Planned rise in debt issuance could increase funding costs of European banks (link)**
- **Oil prices jump as OPEC signals no rush to boost supply (link)**
- **EM bond funds see first weekly net inflows since July (link)**

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Equities retreat amid increased trade concerns

China canceled planned trade talks with the US, renewing market concerns that tensions could persist. The two countries had previously planned talks for later this week before China backed out citing the need for negotiations to "be held in an environment of mutual respect." Chinese markets are closed today, along with several others in Asia, but European markets are lower so far this morning. Oil markets have resumed their rally with Brent currently trading above $80 per barrel as OPEC ignored US calls to increase supply. If it closes above that level, it will be the first time since 2014.

Key Global Financial Indicators

Last updated: 9/24/18 7:28 AM	Level		Change from Market Close				
	Last 12m	Index	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		2930	0.0	1	2	17	10
Eurostoxx 50		3417	-0.4	2	0	-4	-2
Nikkei 225		23870	0.8	5	6	18	5
MSCI EM		43	0.5	3	0	-5	-8
Interest Rates				bps			
US 10y Yield		3.08	1.5	9	27	83	67
Germany 10y Yield		0.47	0.7	1	12	2	4
Japan 10y Yield		0.13	0.0	2	3	10	9
FX / Commodities / Volatility				%			
Dollar index, (+) = $ appreciation		94.1	-0.1	0	-1	2	2
Brent Crude Oil ($/barrel)		80.7	2.4	3	6	42	21
VIX Index (%, change in pp)		12.4	0.7	-1	0	3	1

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

Markets are bracing for a potentially eventful week. Wednesday's FOMC meeting is widely expected to yield a 25bps rate hike and indications of another hike in December. However, any significant changes in the dot plot estimates of future rates could have a major impact, especially in an environment when the 10-year yield has risen nearly 25 bps over the past month. As usual, the Fed Chair's press conference will be scrutinized for clues about future policy. The Italian budget is another focus, with the government scheduled to present its budget and growth targets on Thursday.

The US data calendar has some big releases, including the latest GDP estimate and durable goods on Thursday and the Fed's favored core PCE measure of inflation on Friday. The latest Michigan consumer survey and Chicago PMI are also due on Friday. In the UK Brexit negotiations are likely to continue their domination of the headlines and local markets, especially after Friday's sharp depreciation of the pound. The updated UK GDP report comes out on Friday. In the euro area, today's IFO business survey from Germany is a highlight of the week, along with euro area consumer confidence and German CPI on Thursday and French CPI on Friday. PMI data comes out from China on Thursday and the next Brazilian central bank meeting will be held on Wednesday.

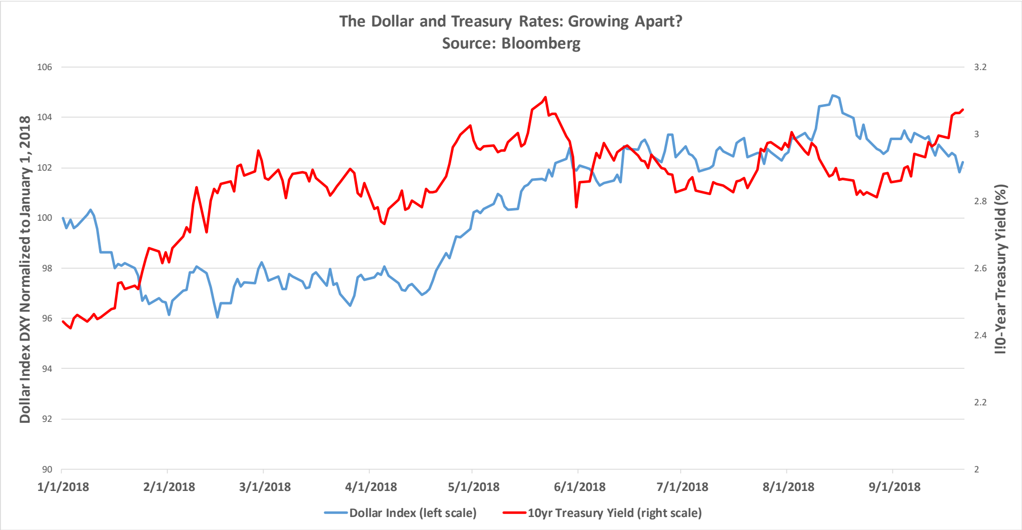
United States back to top

The Dow eked out a second consecutive record close after posting a fractional gain, but the overall market tone was negative as technology stocks continued their decline and the S&P 500 also fell slightly. Friday marked an important milestone for the key S&P and MSCI global indexes which act as benchmarks for a substantial portion of the equity market. The benchmark providers are reorganizing their sector classifications by combining telephone companies and selected media and internet stocks into a new category known as "communications services." As a result, names such as Google (Alphabet) and Facebook will be removed from the technology sector, which will have a significant impact on funds and ETFs that use the old technology classification as their benchmarks. These changes to the Global Industry Classifications Standard Structure (known as GICS) will become effective on Monday. Markets have been adjusting to these changes for several months, with the new XLC communications sector ETF seeing significant inflows. The quarterly rolling of equity options and futures ("Quadruple Witching") also introduced some volatility into Friday's trading.

The 10-year Treasury yield marked its first Friday close above 3% since May 18th. On that occasion, the close followed the 2018 high of 3.11% set on the prior day but yields subsequently began to decline again as trade tensions took center stage. Over the past month the Treasury market has seen another selloff with yields pushing higher on the perception that the impact of the tariffs may not be as high as originally feared. The two-year hit a new post-crisis high of 2.81% on Thursday before dipping slightly yesterday. The 10-year/two-year yield spread narrowed to its post-crisis low of 19 bps on August 24, but it has subsequently steepened to 27 bps as the Treasury selloff has taken hold. The latest CFTC futures data confirm that short positions continue to dominate for longer maturity Treasury futures among both speculative and real-money investors. Treasury yields were little changed over the past two sessions.

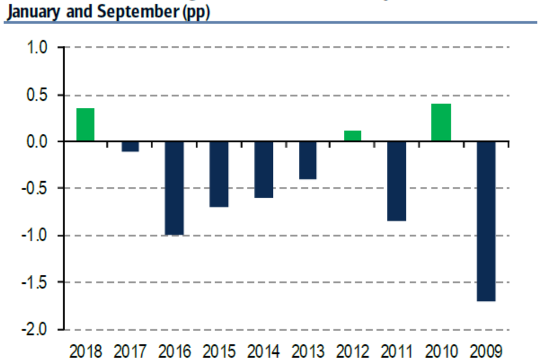
Instrument	One Month Change (bps since 8/21/18)
2yr Treasury	+20
5yr Treasury	+24
10yr Treasury	+24
30yr Treasury	+21

There has been widespread speculation about why the dollar has weakened despite the recent runup in US interest rates. One theory is that dollar weakness is due to profit taking after a strong rally from the 2018 low back in February. Others think the heavy corporate issuance of recent weeks has led to heavy Treasury sales for hedging purposes, pushing rates higher in a move unrelated to the dollar. Yet another theory is that the perceived ebbing of trade tensions has led to a recovery in risk appetite, strengthening the EM currencies and the majors versus the dollar on greater optimism about global economic strength. The truth probably lies in some combination of these factors, but some worry that trade tensions could resurface at any time and that the dollar's decline could easily reverse.



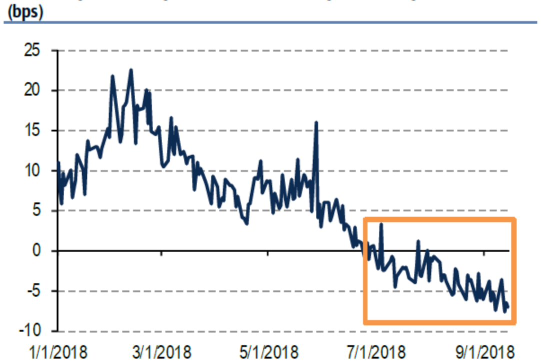
Interest rate markets remain relatively subdued despite the unexpected strength of the US economy. Analysts have been taken by surprise by US growth and have been forced to revise their growth estimates upwards in 2018. This has happened just three times in the past decade. However, the bond market seems surprisingly unaffected. Although market interest rate estimates and the Fed dot plot are converging for 2018 and 2019, markets still predict no further rate hikes in 2020 and have even priced in a small amount of rate cuts. The recent increase in Treasury yields has not yet affected this trend.

Chart 1: Revision of GDP growth forecast of current year between January and September (pp)



Source: Bloomberg; BofA Merrill Lynch Global Research

Chart 2: 1y rates two years forward minus 1y rates one year forward (bps)



Source: Bloomberg; BofA Merrill Lynch Global Research

Europe

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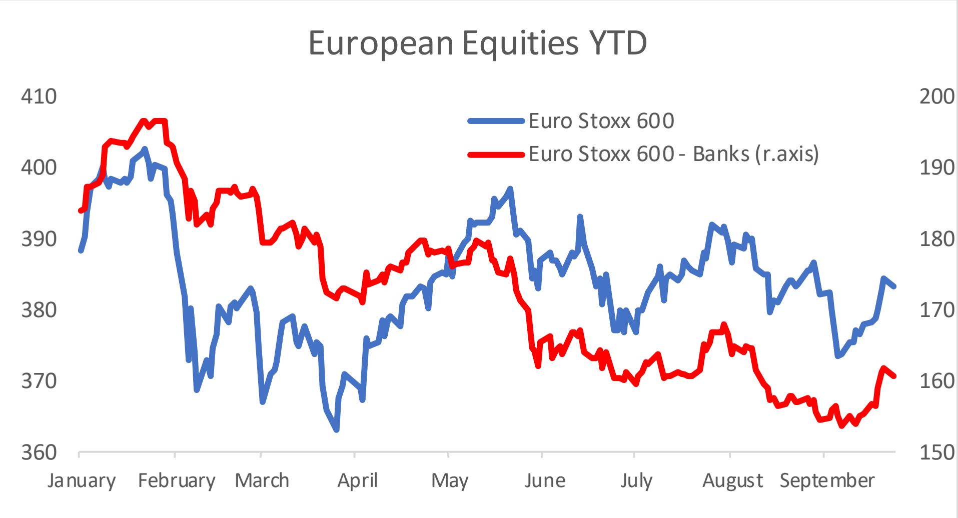
Equities opened lower on further concerns over US-China trade tensions. The losses were moderate however, with the Euro Stoxx 600 0.4% lower. Banks (-0.8%) underperformed, most notably Danske Bank (-2.7%) which continues to struggle to get to grips with its money laundering scandal. The bank is expected to name a new CEO shortly, but S&P has said that the scale of the scandal has put the Danish government's AAA-rating at risk. In Germany, there is increased speculation over a potential merger between Deutsche Bank (-0.1%) and Commerzbank (-1.1%). Reports suggest that the deal could result in 10,000 job losses.



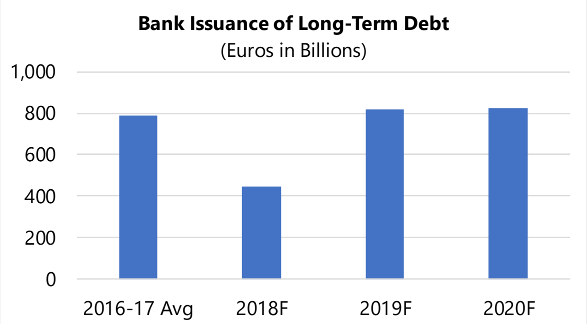
Source: Bloomberg

Sovereign yields were modestly higher, except in Italy where further budget concerns caused BTPs to rise by 4-6 bps. FM Tria is set to unveil the government's budget targets on Thursday and remains under pressure from various sides regarding the size and composition of the deficit. Latest reports suggest that he will fix the 2019 deficit at 1.6% while deputy PM Salvini said in an interview that foreign investors had told him that the deficit isn't a problem. Conversely, Bank of Italy governor Visco warned that deficit spending required caution.

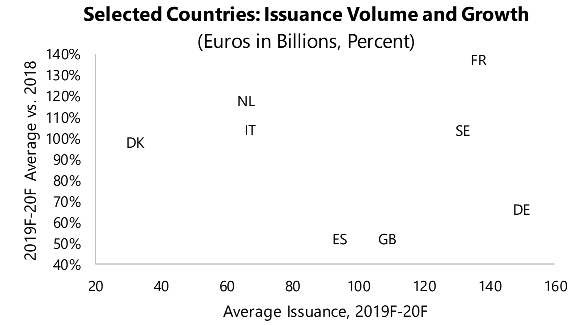
Gilt yields rose by 2 bps as investors mulled further political tension over the weekend. Reports suggested that certain figures within the government had started to plan a snap election while talk of a second referendum has also intensified. Separately, the Labour party is expected to put forward a proposal at its ongoing annual conference whereby companies would be forced to hand over 10% of their equity to employees within ten years. The Conservative party conference gets underway on Sunday.

European Banks

Planned sharp rise in long-term debt issuance could drive up funding costs through 2020F. The European Banking Authority's Report on Funding Plans, published on Friday, revealed that surveyed banks plan to increase long-term debt issuance to slightly above €800 bn in each of 2019 and 2020, nearly double the €444 bn currently forecast for 2018. Among the larger country peer groups, banks from France, Sweden and the Netherlands intend to increase issuance particularly sharply. The EBA attributes these sharp increases to expected asset growth, the redemption of TLTRO in the euro area (and of the Term Funding Scheme in the UK, although UK banks' increase is below the European average), and the implementation of TLAC for GSIBs and of MREL for other others. The survey suggests that banks expect their long-term funding costs to remain stable in 2018 compared with 2017, while a separate questionnaire suggests market analysts expect funding costs to rise. The EBA concludes that a sharp increase in issuance volume combined with anticipated monetary tightening and curbing of central banks' support measures augurs further funding cost increases over the next few years.



Source: European Banking Authority



Source: European Banking Authority

Other Mature Markets

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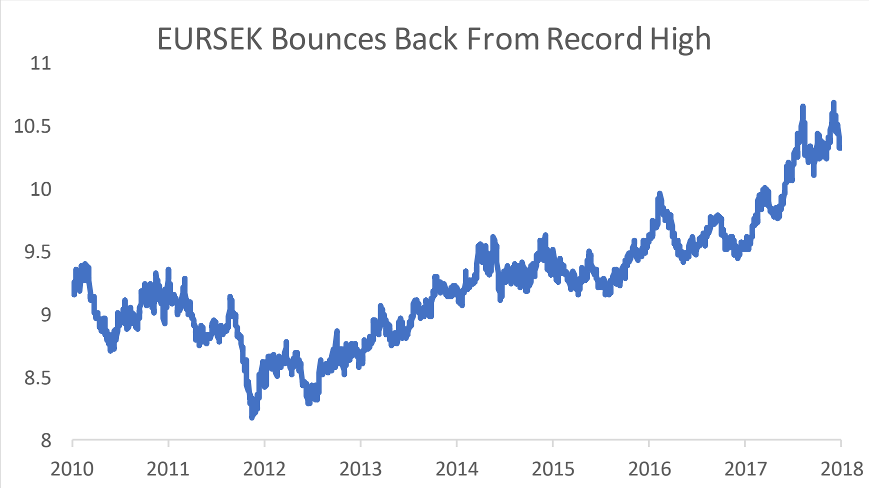
Japan

The yen held steady amid thin trading. The currency reversed initial gains in early trading to end the day little changed following reports that China canceled trade talks with the US in the latest trade spat. Trading was limited as Japan, China and South Korea were all closed for national holidays. For the week, investors will look to the release of Tokyo CPI on Thursday; the September print is expected to moderate from +1.2% to +1.1% yoy

Currency Markets

The dollar was little changed in morning trading. The DXY index was down 0.1% to 94.1 as the greenback moved sideways against most major currencies. The Swedish krona, up 0.3% against the euro, continued to advance. It is now almost 4% stronger than the all-time lows reached late last month. Sterling also gained some ground after heavy losses on Friday. Speculation over the weekend about a snap election and a new Brexit referendum did not hurt the currency, which is up 0.3% to 1.31 against the dollar.



Source: Bloomberg

Commodities

Brent crude climbed above $80 after OPEC signaled little urgency in in boosting output. The move comes despite pressure from the US with president Trump demanding action to increase supply. Brent gained 2.3% to trade at $80.6 per barrel, while WTI gained 2% to $72.2.

Emerging Markets

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Key Emerging Market Financial Indicators

Last updated:	Level		Change				
9/24/18 7:30 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Prices/Returns of Major EM Benchmarks					%		%
MSCI EM Equities		43.23	0.5	3	0	-5	-8
MSCI Frontier Equities		28.70	0.5	4	0	-8	-13
Hard Currency Sovereign Debt		825.74	0.1	0	0	-3	-4
Local Currency Sovereign Debt		16.40	0.1	2	-1	-16	-14
Major EM FX vs. USD					%, (+) = EM currency appreciation		
China Renminbi		6.86	0.0	0	-1	-4	-5
Indonesian Rupiah		14878	-0.2	0	-2	-10	-9
Indian Rupee		72.63	-0.5	0	-4	-10	-12
Argentine Peso		37.16	0.2	6	-17	-53	-50
Brazil Real		4.05	0.0	2	1	-22	-18
Mexican Peso		18.88	-0.2	0	0	-5	4
Russian Ruble		65.91	0.8	3	2	-13	-12
South African Rand		14.22	0.7	5	0	-6	-13
Turkish Lira		6.22	1.1	1	-3	-43	-39
Dollar vs. Mature FX (DXY index)		94.10	-0.1	0	-1	2	2

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

Emerging markets continued to recover last week, as a weaker US dollar eased pressures, amid seemingly revived some global risk appetite (MSCI EM: +3%, EMBIG spread: -11, EMFX: 1%). Despite renewed uncertainty for the outlook on trade between China and the US, analysts have commented that current EM valuations may have bottomed out. During the week, currency gains were led by LatAm, as Argentina appreciated by +7%, followed by Brazil and Chile (+3%). Meanwhile, the South African rand appreciated by 4% for the week, and China's yuan by 0.2%. On Friday, the Argentine peso again led gains (+2.6%) and was followed by the Brazil real (+0.6%). This morning, the Turkish lira appreciated about 1.0% (reversing part of Friday's 1.5% loss), while the South African rand stayed flat. Other EMEA currencies were also stable, while equities in the region were mixed. The largest drop was in the Czech Republic (-0.3%) and the largest gain in Poland (+0.8%).

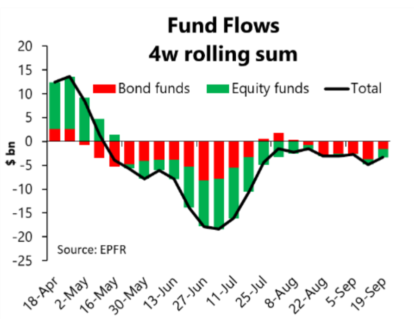
EM Asia

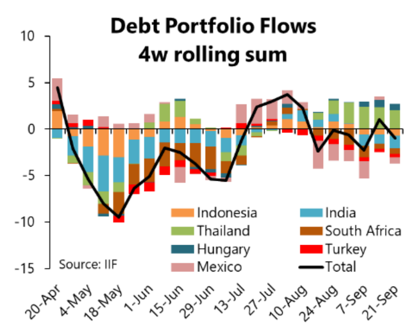
Asian currencies and equities suffered broad-based losses on fear of a protracted US-China trade war. The US' 10% tariffs on $200bn of Chinese imports and China's retaliatory tariffs came into effect today. This, combined with China's decision to cancel trade talks with the US, raised the possibility for a protracted and costly trade war. The MSCI's Asia-Pacific ex-Japan Index fell 0.8%. **Hong Kong bore the brunt of investor concerns, with its Hang Seng Index falling 1.6%,** underperforming others. Hong Kong's H-share Index that mainly consists of Mainland firms listed in Hong Kong suffered a bigger loss, falling 1.8%. Asian EM currencies weakened against the US dollar on risk-off sentiments, with the **Indonesian rupiah**

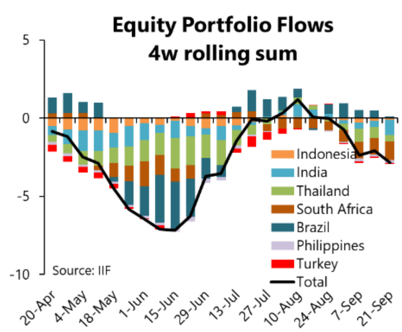
and Indian rupee losing 0.4% and 0.5%, respectively. For the week ahead, investors will look to central bank policy decisions for market direction. The RBA is expected to keep its target cash rate unchanged at 1.50% in its policy meeting (October 2nd). Bank Indonesia, by contrast, is expected to raise its target rate by 25 bps to 5.75% (September 27th).

EM Funds and Portfolio Flows

EM bond and equity fund outflows receded last week[1]. EM weekly bond fund flows were positive for the first time since July +\$0.5bn, compared to -\$1.6bn in the previous week according to EPFR. EM equity fund flows were -\$0.7bn, versus a -\$1.2bn the previous week. **Meanwhile, non-resident EM portfolio outflows were lower compared to the prior week [2].** According to IIF estimates, outflows from India increased, but inflows in Thailand and Indonesia were higher. EM equity flows in total were +\$3.1bn (-\$0.3bn excluding Korea, China, Taiwan).







Brazil

Inflation in Brazil surprised analysts on the downside, as it slowed through mid-September. Data released on Friday showed that twelve-month inflation fell to 4.28%, while the median forecast by economists surveyed by Bloomberg was at 4.36%. A low inflation print helps to support the central bank's decision earlier this week to hold interest rates at 6.5%, despite the volatility from the presidential elections, which has affected the real**. In other news, new election poll results released Sunday evening (Poder360) showed Bolsonaro still leading the polls at 26%, and left-wing candidate Haddad's popularity jumping to 22% for the first round.** Last week's poll result (Datafolha) had voting intentions at 28% for Bolsonaro, with Haddad behind him at 16%. Market participants will be awaiting the new poll releases scheduled for this week, for more insight on the presidential race.

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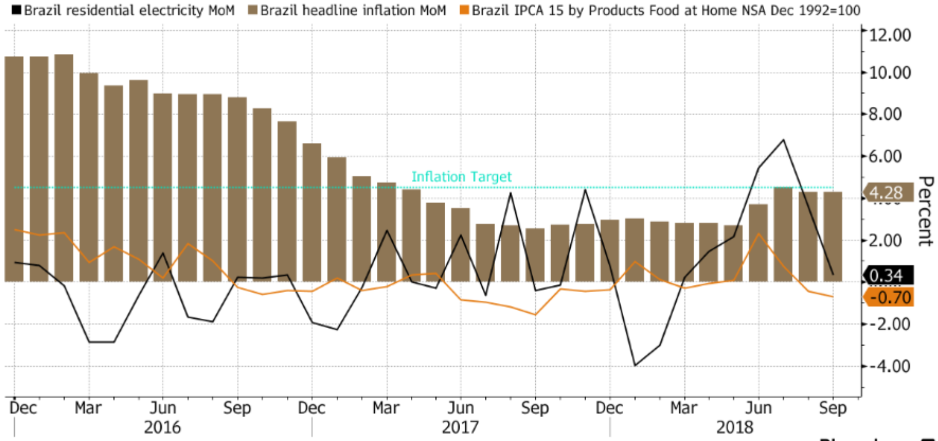
[1] Weekly EM bond and equity fund data from EPFR are released on Thursday afternoon for the week ending close of business Wednesday.

[2] Sample of countries as shown in the charts.

Cheaper Living

Costs of electricity, food at home help keep IPCA-15 below target



Source: Brazil's statistics institute, IBGE Bloomberg

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Global Financial Indicators

Last updated: 9/24/18 7:29 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		2930	0.0	1	2	17	10
Europe		3417	-0.4	2	0	-4	-2
Japan		23870	0.8	5	6	18	5
China		2797	2.5	4	2	-17	-15
Asia Ex Japan		71	0.5	2	0	-2	-7
Emerging Markets		43	0.5	3	0	-5	-8
Interest Rates					basis points		
US 10y Yield		3.08	1.5	9	27	83	67
Germany 10y Yield		0.47	0.7	1	12	2	4
Japan 10y Yield		0.13	0.0	2	3	10	9
UK 10y Yield		1.58	2.5	4	30	22	39
Credit Spreads					basis points		
US Investment Grade		98	0.3	-2	-3	-6	7
US High Yield		329	1.2	-3	-20	-48	-47
Europe IG		69	0.8	9	3	10	24
Europe HY		269	3.8	-13	-17	8	35
EMBIG Sovereign Spread		344	-2.0	-14	-18	53	59
Exchange Rates					%		
Dollar Index (DXY)		94.10	-0.1	0	-1	2	2
USDEUR		1.18	0.2	1	1	-1	-2
USDJPY		112.6	0.0	-1	-1	-1	0
EM FX vs. USD		61.9	0.2	1	0	-12	-11
Commodities					%		
Brent Crude Oil ($/barrel)		81	2.4	3	6	42	21
Industrials Metals (index)		121	-0.6	6	1	-3	-13
Agriculture (index)		42	-0.3	2	-2	-15	-12
Implied Volatility					%		
VIX Index (%, change in pp)		12.4	0.7	-1.3	0.4	2.8	1.3
10y Treasury Volatility Index		3.4	-0.1	0.2	-0.1	-0.7	-0.1
Global FX Volatility		8.7	0.1	0.1	-0.1	0.1	1.3
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		410	3.2	7	-10	-144	-1
Italy		289	6.2	5	-26	79	88
Portugal		187	0.3	4	5	-57	-7
Spain		150	0.3	1	10	-13	-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:	Exchange Rates							Local Currency Bond Yields (GBI EM)						
9/24/2018	Level		Change (in %)					Level		Change (in basis points)				
7:31 AM	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		6.86	0.0	0.0	-1	-4	-5		3.7	0.4	2	6	-8	-31
Indonesia		14878	-0.2	0.3	-2	-10	-9		8.3	-11.7	-27	31	154	168
India		73	-0.5	-0.1	-4	-10	-12		8.2	-2.3	-4	20	118	75
Philippines		54	0.1	0.0	-2	-6	-8		6.3	-1.4	3	32	142	142
Thailand		32	0.0	0.5	1	2	0		2.9	-0.2	-1	11	68	60
Malaysia		4.13	0.1	0.2	-1	2	-2		4.1	-0.5	-3	3	21	18
Argentina		37	0.2	6.4	-17	-53	-50		23.4	-74.3	-170	121	870	737
Brazil		4.05	0.0	2.1	1	-22	-18		10.1	-15.1	-42	-19	162	109
Chile		667	-0.1	2.9	-1	-6	-8		4.8	-1.6	-2	-1	38	-2
Colombia		2999	0.0	0.6	-1	-2	-1		6.6	-0.3	-1	9	25	35
Mexico		18.88	-0.2	-0.2	0	-5	4		8.1	-1.5	5	21	115	39
Peru		3.3	0.0	0.6	0	-1	-2		5.6	-0.5	4	8	36	40
Uruguay		33	-0.4	0.8	-3	-12	-13		10.8	-12.1	-55	32		221
Hungary		275	0.4	1.1	1	-5	-6		2.7	-3.1	2	15	121	139
Poland		3.66	0.3	0.7	1	-1	-5		2.6	-0.5	-2	5	-17	-10
Romania		4.0	0.1	0.4	1	-2	-2		4.3	1.0	1	-10	150	47
Russia		65.9	0.8	3.3	2	-13	-12		8.4	-4.4	-15	4	85	107
South Africa		14.2	0.7	4.9	0	-6	-13		9.7	-0.8	-9	12	49	37
Turkey		6.22	1.1	1.5	-3	-43	-39		21.2	-9.2	24	-358	1037	923
US (DXY; 5y UST)		94	-0.1	-0.4	-1	2	2		2.96	1.4	7	25	110	76

	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		2797	2.5	4	2	-17	-15		185	0	1	-1	37	33
Indonesia		5958	0.4	0	0	1	-6		194	-1	-7	-1	26	28
India		36842	-0.8	-2	-4	14	8		166	1	-4	8	44	56
Philippines		7383	3.5	0	-2	-11	-14		95	-1	-8	-18	6	0
Malaysia		1811	0.4	1	1	2	1		130	0	-4	-9	1	20
Argentina		34514	4.2	15	33	40	15		624	-1	-32	-62	243	274
Brazil		78116	-0.1	5	4	3	2		321	-1	-8	13	74	87
Chile		5446	0.0	4	4	3	-2		132	0	-1	-11	3	13
Colombia		1486	-1.3	-1	-3	0	-2		175	-1	1	-8	-11	1
Mexico		49511	-0.2	0	0	-2	0		265	-1	-2	-13	23	20
Peru		19488	1.6	3	0	8	-2		136	-2	-4	-18	-8	-1
Hungary		35858	-0.8	-1	-3	-6	-9		110	0	0	-24	20	22
Poland		58312	0.1	1	-2	-9	-9		42	-1	-8	-28	-1	-5
Romania		8403	0.6	3	2	7	8		171	-1	-8	-15	51	57
Russia		2415	0.6	2	5	17	14		228	-1	-8	-29	51	50
South Africa		57031	0.9	1	0	2	-4		320	-4	-9	-15	54	66
Turkey		97351	1.3	3	8	-6	-16		452	3	-23	-99	167	163
Ukraine		539	-0.1	1	3	85	71		548	1	1	-39	93	93
EM total		26	0.8	2	0	-2	-3		350	-1	-8	-18	60	65

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