



Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Wednesday, September 26, 2018

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- **US 10-year yield tests new 2018 high before retreating ([link](#))**
- **US consumer confidence measure rises sharply ([link](#))**
- **Denmark to raise countercyclical capital buffer ([link](#))**
- **Argentine peso weakens following resignation of central bank president ([link](#))**
- **Chinese equities gain on potential increase in MSCI index weight ([link](#))**

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Markets little changed ahead of today's Fed decision

Advanced economy equity markets and sovereign bond yields are stable as markets await today's FOMC announcement. Emerging markets are mixed with a few notable moves. Chinese equity markets rallied sharply on news that MSCI is undertaking consultation to increase the weight of Chinese equities in its indices. The Turkish lira continues to perform well on reports that authorities may release the captured American pastor soon. For today's FOMC, markets are fully expecting a 25bps hike, but, as always, there will be significant focus on the statement as well as the updated economic projections and DOT plot. GDP forecasts may be revised slightly higher given the data that has come in since the last projections. Analysts generally do not expect much change in the DOT plot. Beyond today's decision, market are pricing a high likelihood for a further hike in December, and two more hikes in 2019.

Key Global Financial Indicators

Last updated: 9/26/18 8:31 AM	Level	Index	Change from Market Close				YTD
	Last 12m		1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		2916	0.0	0	1	17	9
Eurostoxx 50		3423	0.1	2	0	-3	-2
Nikkei 225		24034	0.4	3	6	18	6
MSCI EM		43	0.4	2	-1	-4	-9
Interest Rates			bps				
US 10y Yield		3.09	-0.9	2	28	85	68
Germany 10y Yield		0.54	-0.8	5	19	13	11
Japan 10y Yield		0.13	-0.7	0	3	9	8
FX / Commodities / Volatility			%				
Dollar index, (+) = \$ appreciation		94.4	0.2	0	-1	1	2
Brent Crude Oil (\$/barrel)		81.3	-0.7	2	7	39	22
VIX Index (% change in pp)		12.2	-0.2	0	0	2	1

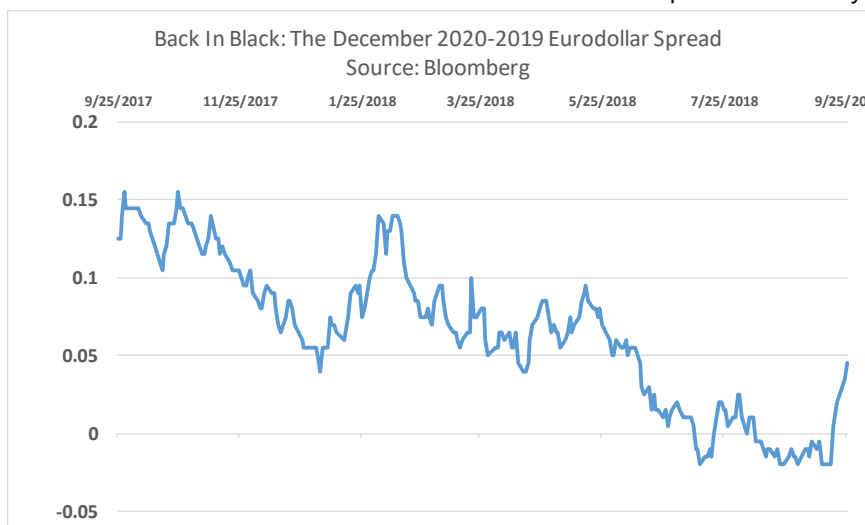
Colors denote **tightening/easing** financial conditions for observations greater than ± 1.5 standard deviations. Data source: Bloomberg.

United States

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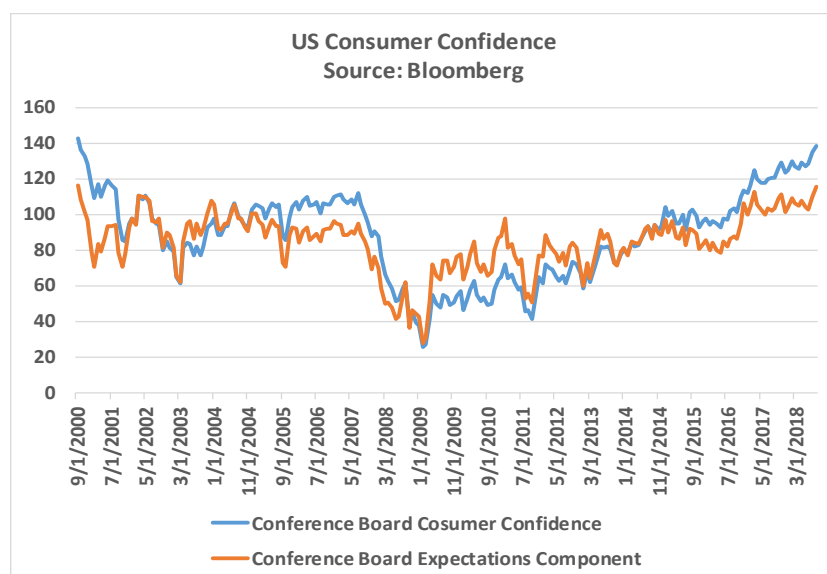
The 10-year Treasury yield tested the 2018 high of 3.11% early in the US session before dropping back slightly to end at 3.09%. The two-year note set a new post crisis high of 2.84%. President Trump's General Assembly speech contained no surprises for markets and comments from US Trade Representative Lighthizer that Canada and the US were still a "fair amount of distance" apart on a trade deal also had little impact on the day's trading. The five-year Treasury auction was quite weak, in keeping with the recent trend of weak short maturity auctions and strong 10 and 30-year auctions. Most stocks ended slightly lower while the Nasdaq posted a second straight fractional gain.

Interest rate futures markets have extended their estimates of higher rates into 2020. The spread between the December 2020 and December 2019 eurodollar futures contract is back in positive territory after spending much of the summer in the red. Earlier, the markets were expecting rates in 2020 to be lower, implying that the rate hike cycle would end in 2019 and that the Fed would move to an easing mode shortly after. The most recent push higher follows a repricing in the market to four hikes in 2018 and two full hikes in 2019. Higher Treasury yields, generally strong economic data and more optimistic forecasts for the US economy have all played a role in pushing interest rate forecasts higher. Today's FOMC statement, dot plot and press conference will be scrutinized for clues about the Fed's intentions.



The Conference Board measure of consumer confidence for September was much stronger than expected at 138.4 versus the consensus forecast of 132.1.

This was the third consecutive increase in confidence and the highest since the early part of the century. The expectations index component also increased sharply, implying that consumers expect the economy to remain strong through the end of the year. The Richmond Fed survey was also much better than expected (29 vs. 20) with manufacturing strong but services weakening slightly. In contrast, the July Case-Shiller home price index was close to



forecasts but the year on year growth was lower than expected (5.9% vs. 6.2%). The FHFA house price index was also weaker than expected (0.2% vs. 0.3%).

US real interest rates have increased in recent weeks and are testing the top of the 5-year range.

Some believe that the fact they have been rangebound for so long explains why higher yields have had no impact on investor demand for US equities, which are back near record high levels. Historically, real rates have increased during rate hike episodes and investors are watching real rates today for clues regarding the timing of the next break higher in Treasury yields.

Exhibit 2: US 10-year real rates: Testing the multi-year range



Source: Bloomberg, Morgan Stanley Research

Exhibit 3: US 10-year real rates have risen in previous late-cycle periods

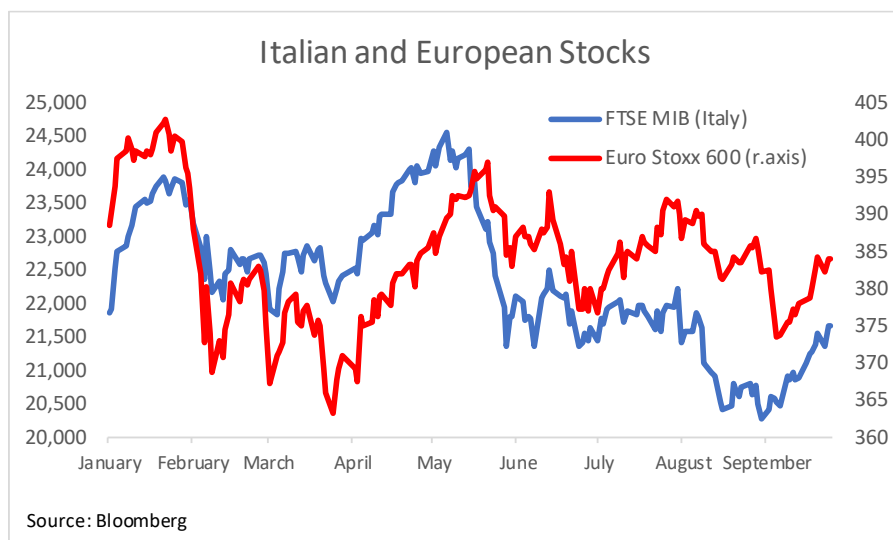


Source: Bloomberg, Morgan Stanley Research

Europe

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Sovereign yields declined for the first time this week ahead of today's FOMC meeting. Most 10-years were down 1-3 bps with Italy (-3 bps) again seeing the biggest move. The Italian 2-year was down 6 bps as optimism remained over the country's budget negotiations. **Equities were flat, including the Euro Stoxx 600.** Italian stocks declined slightly but are still up almost 7% this month. Banks were marginally lower, including Deutsche Bank (-1.1%) which declined after speculation suggested it was now mulling a merger with UBS (-1.2%).

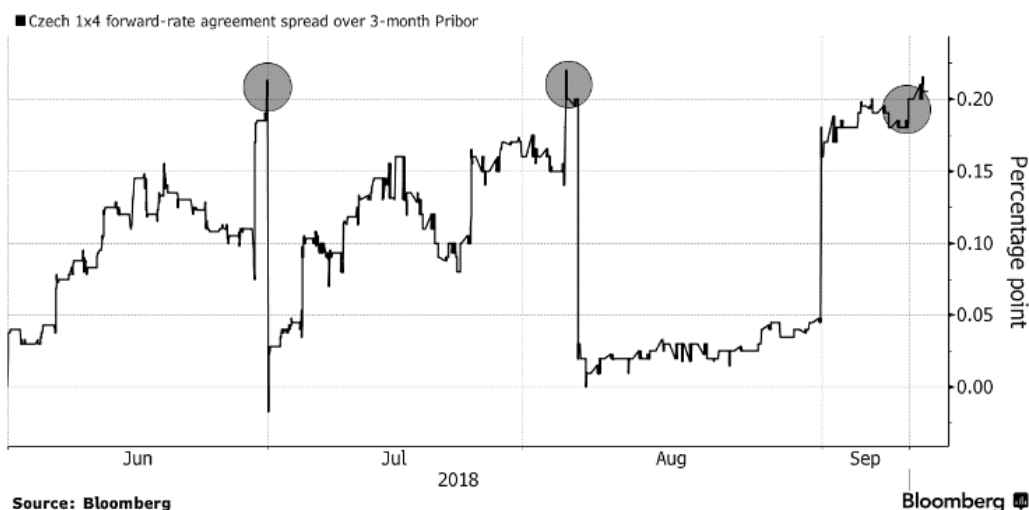


Denmark's countercyclical capital buffer will rise from 0.5% to 1% after a recommendation from the country's Systemic Risk Council. The recommendation was made due to concerns that Danske Bank's money laundering case posed a risk to the financial sector and its reputation. Both S&P and Fitch have revised Danske's outlook to negative while the European Commission has asked the EBA to investigate whether Danish and Estonian authorities' AML operations were adequate. Danske's share price has stabilized in the last two sessions, but it remains a third below its 2018 highs.

Czech Republic

The Czech central bank is expected to raise rates today for a 3rd consecutive meeting. Most analysts expect the Czech National Bank to increase interest rates by 25 bps to 1.5%. The price level in the country has been growing at a 2.5% clip (year-on-year) and remains within the CNB's target band of 1.0%-3.0%. Nonetheless, top central bank officials have signaled their intention to continue raising policy rates progressively. Some market participants also expect an additional rate hike before end-2018.

September hike is done deal for money market investors



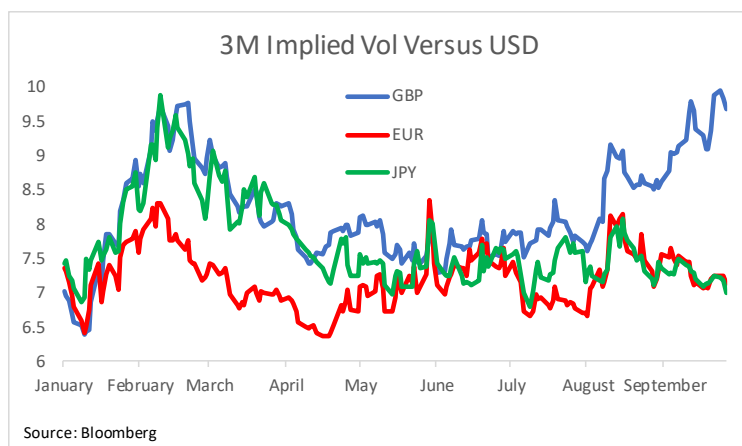
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Japan

Equity moves were muted today, following a steady rise over the past seven days. The Topix was unchanged as stocks traded ex-dividend, while the Nikkei edged up 0.4%. **The yen appreciated 0.1%, but still hovered near a two-month low.** In an auction held today, demand for ¥400bn of 40-year JGBs was sufficient, with a bid-to-cover ratio of 3.24, somewhat close to an average of 3.38 over the past six offerings. Ten-year bond yields fell 1bp. Long-end JGB yields have risen lately after the BoJ cut the amount of longer-dated bonds it offered to purchase at a regular debt-purchasing operation on Friday. Meanwhile, **Japan stated that it is likely to agree to US demands for bilateral trade negotiations if the US does not impose additional tariffs on Japanese cars,** according to Bloomberg.

Currency Markets

The dollar was unchanged this morning after two consecutive flat sessions. The euro remained at \$1.18 and the yen at ¥112.8. Sterling stabilized at \$1.32 after rising earlier in the week. After sustained low levels throughout the summer, implied sterling volatility has begun to rise as Brexit negotiations go down to the wire. Other major currencies have seen continued low volatility and even some declines in September.



Emerging Markets

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Key Emerging Market Financial Indicators

Last updated: 9/25/18 8:04 AM	Level Last 12m	index	Change 1 Day	7 Days	30 Days	12 M	YTD
Prices/Returns of Major EM Benchmarks			%				%
MSCI EM Equities		42.74	-1.1	3	-1	-4	-9
MSCI Frontier Equities		28.77	0.2	4	0	-7	-13
Hard Currency Sovereign Debt		825.97	0.1	1	0	-3	-4
Local Currency Sovereign Debt		16.39	-0.1	2	-1	-16	-14
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.87	0.1	0	-1	-4	-5
Indonesian Rupiah		14914	0.1	0	-2	-11	-9
Indian Rupee		72.72	0.3	0	-4	-10	-12
Argentine Peso		37.29	0.0	7	-17	-53	-50
Brazil Real		4.09	0.0	2	0	-23	-19
Mexican Peso		18.98	-0.1	-1	-1	-6	4
Russian Ruble		65.66	0.4	3	3	-12	-12
South African Rand		14.37	0.0	4	-1	-7	-14
Turkish Lira		6.14	0.2	4	0	-42	-38
Dollar vs. Mature FX (DXY index)		94.05	-0.1	-1	-1	2	2

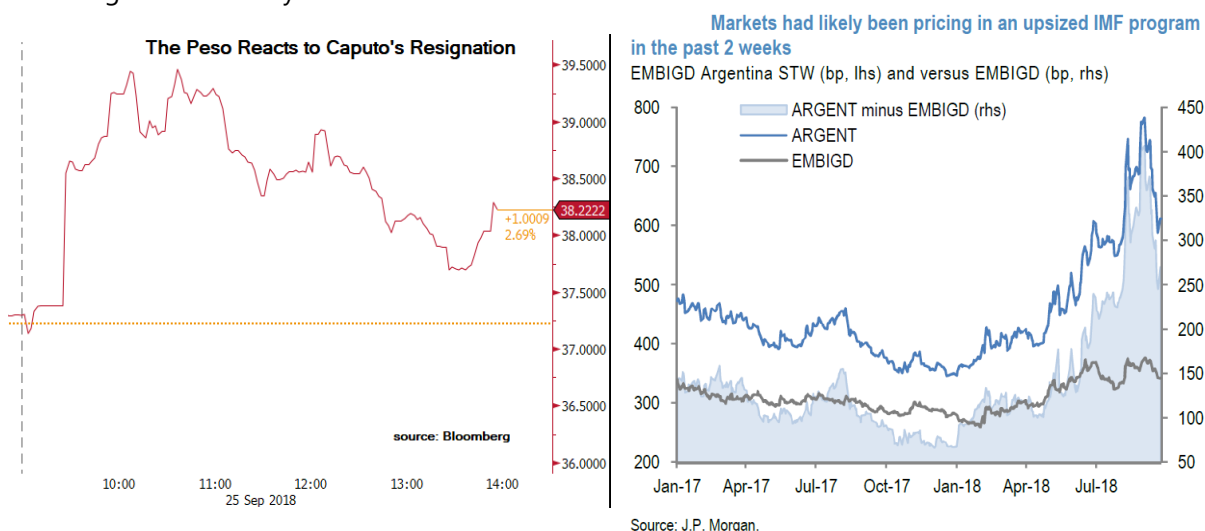
Colors denote **tightening**/**easing** financial conditions for observations greater than ± 1.5 standard deviations. Data source: Bloomberg.

On an otherwise quiet day for EMs, the Argentine peso led losses (-2.4%) yesterday after the central bank president Mr. Caputo resigned on Tuesday morning. The peso had weakened by as much as 5.8% after the news before recovering later in the day as markets digested news of his replacement. The main EM indices were largely unaffected however (MSCI EM: +0.4%, EMBIG: -1.0%, EMFX: +0.2%). In Brazil, the real shrugged off Monday's poll results and reversed earlier losses, closing at +0.4%. In Asia, amid a lack of headlines on trade this morning, equities' performance was mixed. Stocks in the Philippines (-0.9%), India (-0.5%), and Vietnam (-0.11%) dropped, while China (+0.9%) and South Korea (+0.7%) posted sizeable gains. **The Turkish lira (+0.5%) continues to strengthen to the U.S. dollar on speculation that the Turkish authorities will release detained American pastor Andrew Brunson.** On the monetary policy front, the Nigerian and Kenyan central banks left rates unchanged yesterday.

Argentina

Argentina's central bank president Luis Caputo resigned on Tuesday. Markets initially reacted strongly, citing the timing of the resignation (amid ongoing negotiations with the IMF and the current strike in Argentina) as a reason for concern. Following the announcement, the peso depreciated by as much as 5.8%, but trimmed the losses by the close of day. Shortly after the announcement, Guido Sandleris was appointed to be the new BCRA president. Market commentary on Sandleris, a previous professor at Johns Hopkins University, and an economics PhD holder from Columbia University, was mainly positive, as participants referred to him as "good on paper and has the credentials". Evidently, yields on Argentine bonds that had spiked on the immediate aftermath of the news returned near their initial levels a few hours later. Meanwhile, 5yr CDS spreads widened by over 70bp intraday, before settling around 30bp tighter.

Analysts viewed the resignation as an indication of disagreement between Caputo and the economy minister. Further, they interpreted that the change in leadership would mean less central bank intervention in the FX market, with a shift from the targeting of floatation bands Caputo had set. They also speculated that, going forward, the floatation band targeted could be much wider, with a ceiling at ARSUSD40, or even that the bands would be removed, and a free-floating regime would be implemented. **Additionally, other market participants viewed that the change in governorship would speed up the IMF negotiations.** Indeed, after the resignation of Caputo, economy minister Dujovne announced that the agreement with the IMF was "imminent", and that the resignation had not been a surprise. Analysts interpreted that the frictions reported in the local press between IMF staff and the BCRA's policymakers had caused delays in the negotiations and created a lack of coordination. They thus viewed that Caputo's resignation would unlock the discussions for the program, and smooth over the remaining discrepancies. Going forward, analysts speculate that the BCRA will intervene in the FX only to smooth out volatility, but not to target the currency level.



China

Chinese equities strengthened after MSCI announced that it might raise the weight of Chinese stocks in its global indices starting next year. Nearly \$2trn in assets are tied to MSCI's emerging markets gauge. Under the new rules, MSCI is considering lifting a cap on free-float-adjusted market value to 20%, from 5% for CNY-denominated stocks in two stages. **The Shanghai index rose 0.9%, while the Shenzhen index closed up 0.7%.** Both the onshore and offshore yuan depreciated slightly, despite a stronger-than-expected CNY fixing by the PBoC.

PRO-FORMA WEIGHT IN MSCI EM INDEX

With an increase of the inclusion factor of China A Large Cap securities to 20%, the pro forma index weight of China A shares in the MSCI Emerging Market Index would be 2.8% in August 2019. The addition of China A Mid Cap securities with an inclusion factor of 20% in May 2020 would increase the pro forma weight further to 3.4%



Qinghai Provincial Investment Group Co.'s, an aluminum producer with links to the local government, obtained funds to repay \$300mn of bonds due today. Investors were watching the case of the cash-strapped firm closely, as questions over local governments' implicit guarantees have been rising. China's local governments are under pressure to tighten their fiscal policies as Beijing deepens a multi-year financial crackdown. Meanwhile, **China's move to introduce new rules for foreign issuers is expected to attract more borrowers to the country's bond market**, according to analysts. Under the new rules, the PBoC requires overseas financial institutions to have paid-up capital of \$1.5bn, maintain profitability for the past 3 years, while ratings reports are no longer mandatory.

Brazil

The central bank meeting minutes released on Tuesday show the BCB communicating that it would be ready to tighten monetary policy in case inflationary pressures increase. The board members stated that the bank will be ready to unwind the current easy monetary policy, in case the current challenges in EMs, and the uncertainty in Brazil, remain and impact inflation. Last week, the central bank left the benchmark rate unchanged, despite the depreciation of the real this year. The bank explained that the pass-through from the depreciation to prices has been limited, with annual inflation still falling below target. However, policy-makers have raised their inflation expectations for 2018, to 4.28% from 4.09% last week. The DI curve was mainly unchanged.

Defying Currency Sell-Off

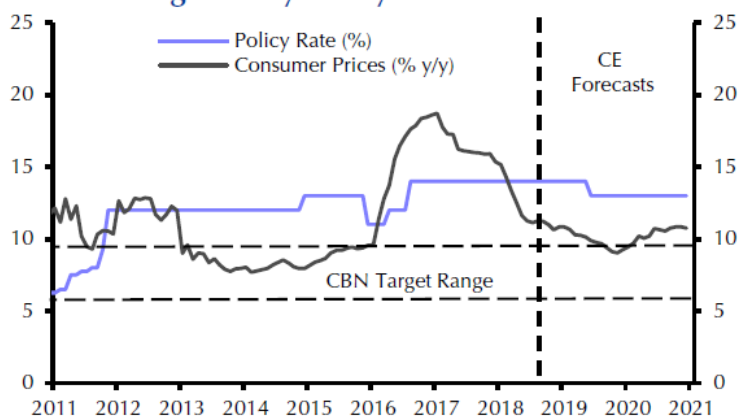
Unlike in 2015, this time Brazil has kept rates stable as real weakens



Nigeria

The Nigerian Central Bank voted to keep rates at 14.0% yesterday. The decision was anticipated by most market analysts, even though inflation has failed to converge to the CBN's target rate. The MPC struck a hawkish note however, as the CB governor said that he expects inflation to accelerate in coming months.

Chart 1: Nigeria Key Policy Rate & Consumer Prices

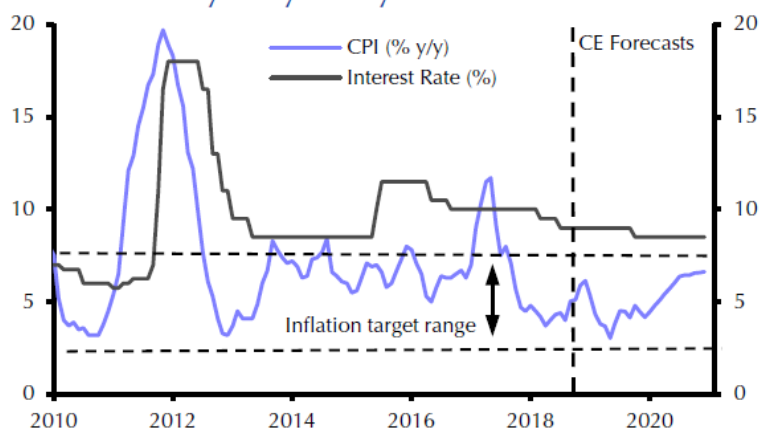


Sources: CBN, NBS, Capital Economics

Kenya

The Central Bank of Kenya left policy rates at 9.0%, as expected. The CB noted that inflation remains within the target band, and that Kenya's external vulnerabilities are easing.

Chart 2: Kenya Key Policy Rate & Consumer Prices





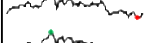


























Sources: CBK, KNBS, CapitalEconomics

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Global Financial Indicators

Last updated: 9/25/18 8:02 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		2920	0.0	1	2	17	9
Europe		3420	0.3	2	0	-3	-2
Japan		23940	0.3	4	6	18	5
China		2781	-0.6	5	2	-17	-16
Asia Ex Japan		70	-1.2	3	-1	-2	-8
Emerging Markets		43	-1.1	3	-1	-4	-9
Interest Rates			basis points				
US 10y Yield		3.10	1.3	5	29	88	70
Germany 10y Yield		0.54	2.5	6	19	14	11
Japan 10y Yield		0.13	0.0	2	3	11	9
UK 10y Yield		1.63	1.7	6	35	30	44
Credit Spreads			basis points				
US Investment Grade		99	0.5	-2	-3	-5	7
US High Yield		328	-0.5	-5	-18	-50	-47
Europe IG		69	-0.3	10	4	11	25
Europe HY		271	-0.2	-9	-15	10	38
EMBIG Sovereign Spread		342	-3.0	-13	-20	48	57
Exchange Rates			%				
Dollar Index (DXY)		94.06	-0.1	-1	-1	2	2
USDEUR		1.18	0.3	1	1	-1	-2
USDJPY		112.8	0.0	0	-2	-1	0
EM FX vs. USD		61.7	0.1	1	-1	-12	-11
Commodities			%				
Brent Crude Oil (\$/barrel)		82	0.6	4	8	39	22
Industrials Metals (index)		120	-0.4	4	0	-4	-13
Agriculture (index)		42	0.1	3	-2	-14	-12
Implied Volatility			%				
VIX Index (% change in pp)		11.9	-0.3	-0.9	-0.1	1.7	0.8
10y Treasury Volatility Index		3.6	0.2	0.4	0.1	-0.7	0.1
Global FX Volatility		8.7	0.0	0.1	-0.1	0.2	1.3
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		405	-6.4	-3	-15	-151	-7
Italy		286	-8.6	7	-29	76	85
Portugal		189	-0.9	4	7	-56	-5
Spain		152	-0.3	2	13	-10	-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: 9/25/2018 8:05 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		6.87	0.1	-0.2	-1	-4	-5		3.7	0.0	3	8	-8	-31
Indonesia		14914	0.1	-0.3	-2	-11	-9		8.3	3.4	-25	32	159	171
India		73	0.4	0.0	-4	-10	-12		8.2	1.9	-2	18	120	77
Philippines		54	0.0	-0.5	-2	-7	-8		6.3	7.7	4	42	150	150
Thailand		32	0.0	0.4	0	2	0		2.9	-1.2	-1	8	69	58
Malaysia		4.13	0.0	0.1	-1	2	-2		4.1	0.3	-2	3	21	18
Argentina		37	0.0	6.6	-17	-53	-50		23.6	16.1	-126	102	892	753
Brazil		4.12	-0.8	1.0	-1	-23	-20		10.1	4.0	-27	-6	165	113
Chile		672	0.0	1.8	-2	-6	-8		4.8	2.3	1	5	41	0
Colombia		3003	0.0	0.4	-2	-3	-1		6.6	-0.7	0	13	29	34
Mexico		18.99	-0.1	-1.0	-1	-6	3		8.0	-2.9	-1	18	115	36
Peru		3.3	0.0	0.1	0	-1	-2		5.7	4.5	7	15	41	44
Uruguay		33	-0.1	1.0	-3	-12	-12		10.5	-25.6	-54	4		195
Hungary		275	0.1	0.9	1	-5	-6		2.6	-1.9	-2	20	124	138
Poland		3.64	0.3	0.9	0	-1	-4		2.6	2.1	0	5	-12	-8
Romania		4.0	0.2	0.7	0	-2	-2		4.3	0.0	1	1	146	47
Russia		65.7	0.4	2.6	3	-12	-12		8.3	-4.4	-25	-4	82	103
South Africa		14.4	0.0	3.6	-2	-7	-14		9.7	0.0	-15	22	52	37
Turkey		6.14	0.1	3.9	0	-42	-38		20.9	-31.4	-36	-390	999	891
US (DXY; 5y UST)		94	-0.2	-0.6	-1	2	2		2.98	1.2	4	27	114	77

	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		2781	-0.6	5	2	-17	-16		183	-1	1	-3	35	31
Indonesia		5874	-0.1	1	-2	0	-8		186	-1	-8	-9	17	20
India		36652	1.0	-2	-4	16	8		166	2	-1	9	40	56
Philippines		7332	-1.4	1	-6	-11	-14		92	-2	-4	-20	-1	-3
Malaysia		1794	-0.3	0	-1	1	0		126	-2	-1	-13	-3	16
Argentina		33164	-3.4	6	32	32	10		614	1	-41	-85	229	264
Brazil		77984	-1.8	2	2	5	2		289	-1	-38	-37	40	55
Chile		5386	0.0	0	2	2	-3		130	-1	0	-13	0	11
Colombia		1492	0.6	0	-3	1	-1		169	-2	-6	-13	-22	-5
Mexico		49417	0.1	0	0	-2	0		259	-2	-6	-24	17	14
Peru		19575	-0.2	4	0	8	-2		132	0	-5	-22	-14	-5
Hungary		35876	0.3	-1	-1	-6	-9		108	-2	-1	-25	8	20
Poland		59416	0.9	3	-1	-7	-7		40	-2	-6	-29	-13	-7
Romania		8340	-0.4	1	1	6	8		169	0	-9	-17	43	55
Russia		2433	0.1	1	7	18	15		226	-2	-4	-20	46	48
South Africa		56718	-0.8	1	-4	2	-5		316	-4	-11	3	43	62
Turkey		99959	0.4	5	11	-2	-13		442	-9	-28	-75	144	153
Ukraine		539	-0.1	0	3	85	71		548	0	-3	-15	57	93
EM total		25	-0.5	2	-1	-1	-4		342	-3	-13	-20	48	57

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