Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Thursday, September 27, 2018

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- **Treasury curve flattens and equities lower after FOMC hikes rates 25 bps (link)**
- **Italian yields spike on renewed budget concerns (link)**
- **IMF credit line with Argentina provisionally increased by $7.1 bn to $57.1 bn (link)**
- **Bank Indonesia hiked its policy rate 25 bps to 5.75%, in line with consensus (link)**
- **Philippine central bank raised its policy rate by 50 bps to 4.5%, as expected (link)**
- **Feature: Inaugural G-SIB Monitor tracks bank performance (see attachment)**

US | Europe | Other Mature | Emerging Markets | Market Tables

Markets trading with a mixed tone, with a focus on Italy's budget negotiations

The Fed raised the policy rate 25 bps, kept the median path for policy in the dotplot largely unchanged, and removed a reference to "accommodative" from its statement. Markets viewed the statement and post-meeting press conference as less hawkish than expected, leading to modestly lower treasury yields and a flatter curve. Elsewhere, the Hong Kong Monetary Authority raised its base rate 25 bps to 2.50%, in line with the Fed's interest rate move. Hibor rates are at their highest level since 2008. In Europe, renewed disagreements surrounding Italy's budget negotiations drove Italian government bond yields higher and weighed on European equities. Argentine bond spreads are tighter this morning, after the IMF provisionally agreed to increase its credit line to Argentina by $7.1 bn to $57.1 bn and front-loaded disbursements, reducing the need for Argentina to access markets through 2019.

Key Global Financial Indicators

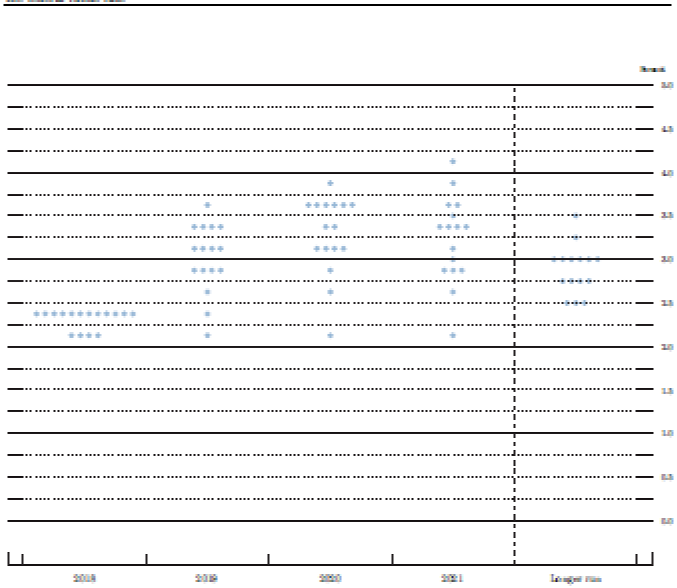
Last updated: 9/27/18 8:17 AM	Level		Change from Market Close				
	Last 12m	Index	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		2909	0.1	-1	0	16	9
Eurostoxx 50		3428	-0.1	1	-1	-4	-2
Nikkei 225		23797	-1.0	1	4	17	5
MSCI EM		43	0.2	1	-2	-3	-9
Interest Rates				bps			
US 10y Yield		3.05	0.4	-1	21	74	65
Germany 10y Yield		0.52	-1.0	5	14	5	9
Japan 10y Yield		0.12	-0.6	0	2	6	7
FX / Commodities / Volatility				%			
Dollar index, (+) = $ appreciation		94.5	0.4	1	0	1	3
Brent Crude Oil ($/barrel)		81.8	0.6	4	7	41	22
VIX Index (%, change in pp)		12.7	-0.2	1	1	3	2

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

United States back to top

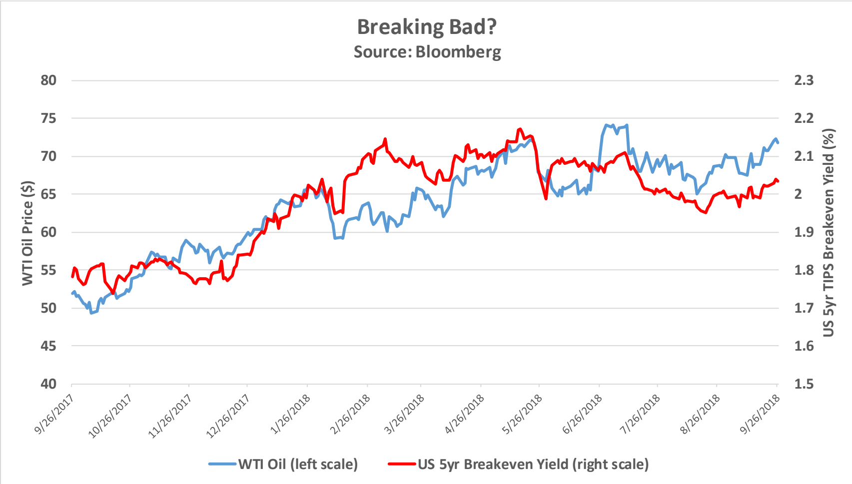
The FOMC hiked the policy rate 25 bps and removed "accommodative" reference from statement, as expected. The overall tone of the statement and press conference were viewed as neutral to mildly dovish. The FOMC raised the policy rate 25 bps to a target range of 2.00-2.25% and dropped its reference to monetary policy being "accommodative," interpreted by markets that after eight rate hikes the Fed is getting closer to the end of its hiking cycle. The GDP estimate for 2018 was raised to 3.1% from 2.8% and to 2.5% from 2.4% for 2019. Despite continued strength in the economy, the dotplot median forecast stayed at one more hike this year (for a total of four), three rate hikes for 2019, one hike in 2020, and the terminal rate increased marginally (to 3% from 2.875%). Interest rate projections for 2021, included for the first time at this meeting, were at the same level as the 2020 median dot. Fed Chair Powell's post-meeting press conference contained no surprises and elicited limited further impact on markets.

Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate



Given that the market was priced for a hawkish FOMC outcome, treasury yields ended the day 1-4 bps lower, flattening the curve. Market forecasts for the odds of a hike in December remain at 78%. December 2019 fed funds futures were little changed at 2.82%, pricing in a 60 bps increase over December 2018 fed funds contracts. The much larger and more liquid eurodollar futures market is pricing rate increases of just 48 bps for 2019, indicating that the market and the Fed remain divided on whether a third hike will occur next year. Meanwhile, stocks lost ground as the S&P 500, Dow and Nasdaq all posted modest losses. On the data front, **new home sales** increased in August compared to July, coming in close to forecasts at 629K (versus 630K). On a month-on-month basis, this represents a 3.5% increase versus the consensus forecast of 0.5%. This morning, **US durable goods** came in much stronger than expected at 4.5% versus 2% forecast. However, the ex-transportation component printed at just 0.1% (vs. 0.4% expected). The latest estimate for Q2 GDP was in line with forecasts at 4.2%. Core PCE was 2.1% (vs. 2%). The market response was limited.

Higher oil prices weigh on TIPS breakeven inflation rates. Oil prices are important determinants of breakeven yields through their impact on CPI, and their influence is strongest for shorter maturity TIPS. Five-year breakeven inflation rates were generally steady through much of the summer, but the latest break higher in oil prices has led to a modest uptick. A significant increase in real yields could be a negative sign for markets, pushing up risk premiums for stocks and sending nominal interest rates higher. Some contacts disagree, pointing out that higher oil prices could cause a slowdown in the economy and a quicker end to the Fed hiking cycle than markets currently anticipate. They point to 2008, when the peaking of brent oil prices at $147 caused breakevens to fall sharply as markets repositioned for a slowing economy even as oil prices remained elevated.

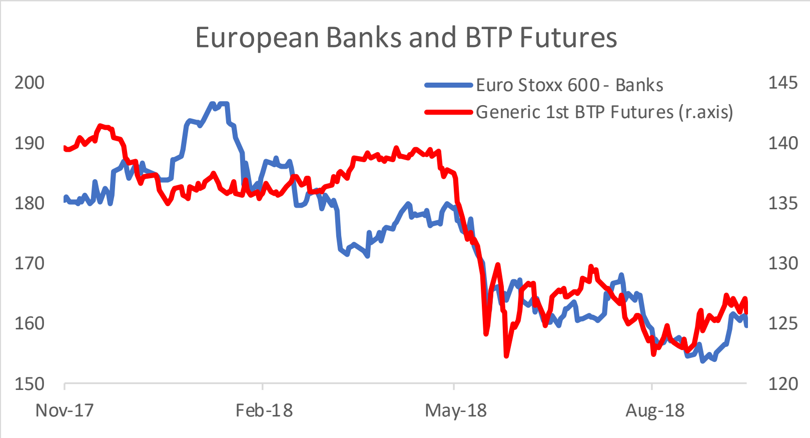


Europe

back to top

Equities declined as investors mulled yesterday's Fed meeting and political developments in Italy. The Euro Stoxx 600 shed 0.4% while Italian stocks declined by 1.5%. European banks dropped by 0.9%, with Italian banks hard-hit, falling 3-4%. The correlation between Italian debt pricing and European bank equities has been strong in recent months. Apart from Italy, broader sovereign bond yields declined by approximately 2 bps in the long end.

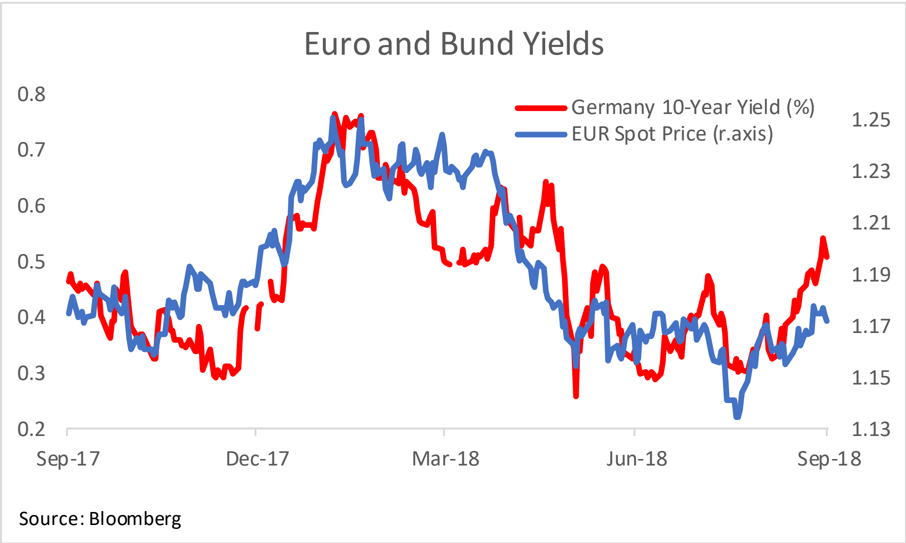
BTP yields rose sharply on local media reports of renewed disagreements on the budget. The coalition government was thought to have settled on a deficit target close to 1.9%, but according to Italian media, both ruling parties are now pushing for a 2.4% target. FM Tria is said to oppose a deficit larger than 2%, resulting in some reports saying that he must change his stance or resign. A meeting set for later today, which was supposed to finalize the budget, has now reportedly been postponed. The yield on 10-year Italian government debt rose as much as 10 bps while the 2-year is up 11 bps.



Source: Bloomberg

Other Mature Markets back to top

Major currencies were little changed yet again. The dollar index showed little reaction to yesterday's Fed rate hike, but rose 0.3% this morning. The euro declined by 0.2% for the second day in a row to trade at $1.17. The single currency has been range-bound recently despite a pick-up in sovereign yields. Sterling lost 0.3% but remains above $1.31 on limited news on the Brexit front. The Japanese yen was flat at ¥112.7. The Swiss franc, a proxy for safe haven demand, has weakened recently and was down 0.2% against the euro. The Canadian dollar weakened 0.5% to a one-week low after US president Trump expressed disappointment with the slow pace of talks over NAFTA, and reiterated a threat to impose tariffs on Canadian autos.



Japan

Equities closed lower today, ending the recent rally. The Topix fell 1.2%, with machinery shares leading losses. The Nikkei closed 1% lower, breaking an eight-day winning streak as investors took profit. However, shares of some automakers rose after the US stated that it will not impose further tariffs on Japanese automakers while bilateral trade talks are ongoing. **The yen was little changed, trading near its weakest level in two months.** Ten-year government bond yields fell slightly, as traders covered their positions after the BoJ maintained purchases during its regular operation today. According to analysts, the BoJ could continue its stealth tapering of super-long maturities in its debt purchase plan for October to be announced on Friday.

Emerging Markets

back to top

Last updated:	Level		Change				
9/27/18 8:20 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Prices/Returns of Major EM Benchmarks				%			%
MSCI EM Equities		43.00	0.2	1	-2	-3	-9
MSCI Frontier Equities		28.82	-0.2	3	1	-7	-13
Hard Currency Sovereign Debt		826.90	0.1	1	0	-2	-4
Local Currency Sovereign Debt		16.49	0.9	2	-1	-14	-13
Major EM FX vs. USD				%, (+) = EM currency appreciation			
China Renminbi		6.88	0.0	0	-1	-4	-5
Indonesian Rupiah		14882	0.2	-1	-2	-10	-9
Indian Rupee		72.55	-0.2	-1	-4	-10	-12
Argentine Peso		38.53	0.0	-1	-20	-54	-52
Brazil Real		4.04	-0.2	1	1	-21	-18
Mexican Peso		18.86	-0.1	0	-1	-4	4
Russian Ruble		65.71	0.2	1	3	-11	-12
South African Rand		14.09	0.3	1	1	-4	-12
Turkish Lira		6.01	1.6	3	2	-41	-37
Dollar vs. Mature FX (DXY index)		94.52	0.4	1	0	1	3

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

Emerging markets were unfazed by the Fed's rate hike on Wednesday, although Chinese equities fell today by almost 0.8%. The Shanghai Composite index closed 0.5% lower, while the Shenzhen index fell 1.3%, after industrial profit growth slowed to 9.2% in August from 16% a month ago. In **Brazil**, the *real* strengthened 1.0%, shrugging off new polls that indicated the left-wing candidate is gaining ground. Other significant EM developments on Wednesday included the announcement of the increase of the IMF credit line to **Argentina** and a revised monetary framework. Markets welcomed the plan, with Argentine bonds 20-60 bps tighter this morning and CDS spreads 20 bps tighter. **EMEA** assets are mixed this morning within narrow ranges.

Argentina

After local markets closed, the IMF agreed to increase Argentina's credit line by $7.1 bn, bringing the total package to $57.1 bn. Additionally, the disbursements will be front-loaded, resulting in an additional $19 bn of resources available through 2019, alleviating Argentina's need to tap markets though that period. The resources available under the program are no longer treated as precautionary but discretionary, i.e. can be used for budget purposes. In turn, Argentina will tighten fiscal policy, let its exchange rate float, only intervening when there is "extreme overshooting." The central bank will set a wide "zone of non-intervention" for the peso, ranging between 34 and 44 per dollar, which will be adjusted by 3% each month, and can hold dollar sales of $150 mn in "extreme cases." Additionally, the central bank will switch from inflation targeting to targeting monetary aggregates, aiming for zero change in the monthly average of the monetary base until the end of June 2019 (versus 2% growth recently). The stabilization of the monetary base will be achieved through daily interventions in the Leliq market that will continue be restricted to banks operating locally. The plan, which is subject to approval by the IMF board, was generally in line with market expectations. Ahead of the announcement, the peso was 0.8% weaker, lagging broader EM FX markets on the day, and bond spreads were marginally wider across the curve. This morning, bond spreads are sharply tighter on reduced rollover risk.

Brazil

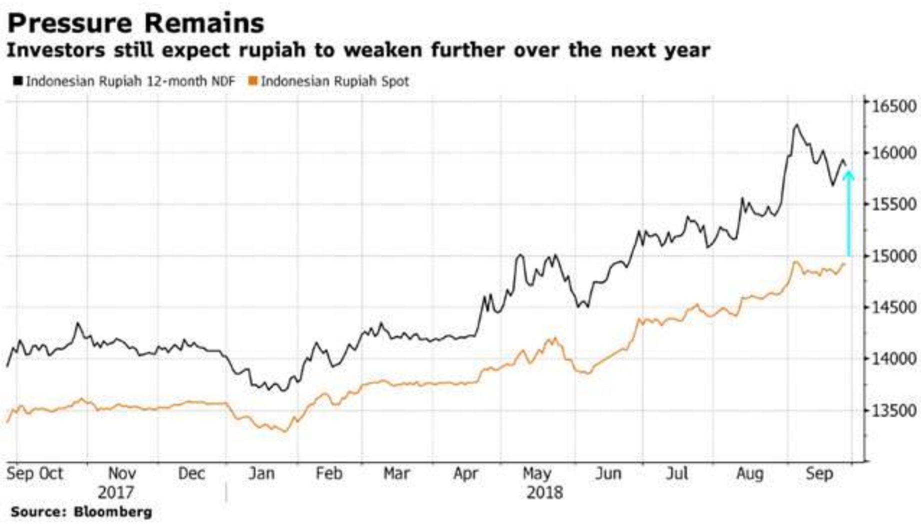
A public opinion poll released on Wednesday shows left-wing candidate Haddad beating right-wing Bolsonaro in a run-off scenario. The newly released Ibope poll now shows Haddad garnering 42% of votes, versus 38% for Bolsonaro. Additionally, new data showed Bolsonaro's popularity stalling, around 27%, while voting intentions for Haddad continue to grow. Meanwhile, the poll showed Bolsonaro's rejection rating growing to 44%, while Haddad's is at 27%. The *real* shrugged off the poll results, gaining 1% to 4.03 per dollar.

China

Non-financial corporate debt as a fraction of GDP rose in early 2018, according to data by the BIS. The ratio climbed to 164.1% in Q1 2018, from 160% during Q4 2017, erasing more than half the progress Chinese firms made in reducing leverage after the ratio peaked at 167% in Q2 2016. Notably, the reversal in the deleveraging process occurred before the trade dispute with the US began, which could further delay progress on deleveraging. **Equities fell as industrial profit growth slowed** to 9.2% in August from 16% a month ago, against the backdrop of trade tensions. The Shanghai Composite index closed 0.5% lower, while the Shenzhen index fell 1.3%. The onshore and offshore yuan appreciated slightly, in line with most regional currencies. Bond yields fell 3 bps.

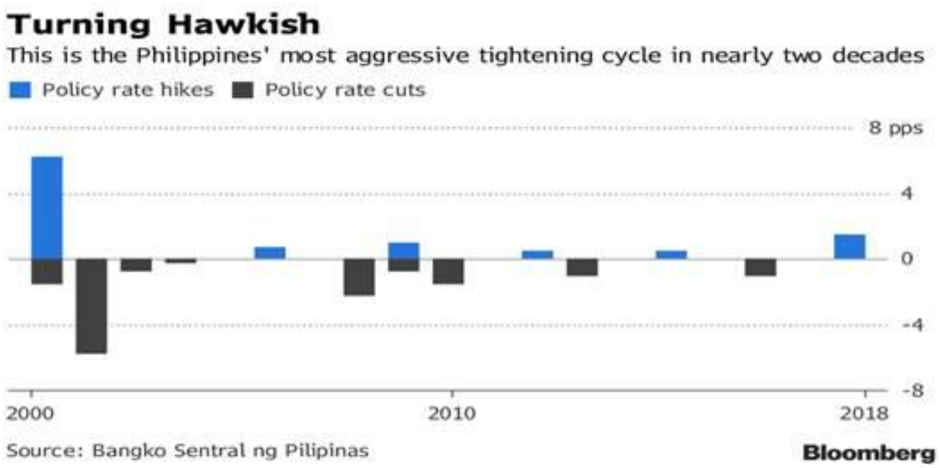
Indonesia

Bank Indonesia raised its policy rate by 25 bps to 5.75%, in line with expectations. This marked the central bank's fifth rate hike since May, with a cumulative increase of 150 bps in the policy rate over that period, in an attempt to stem depreciation pressures amid a sell-off in emerging markets. BI governor Perry stated that growth is expected to be around 5-5.4% this year, while inflation should remain within the 2.5-4.5% target range. **The central bank also announced the launch of a domestic non-deliverable forward market (DNDF)**, which allows lenders to offer NDF contracts to be settled in the local currency. Over 20 local and foreign banks will be allowed to quote the new instruments to clients with underlying exposures. DNDF contracts have to be settled in rupiah based on BI's spot dollar rate. This new framework could be operational in the coming weeks. Notably, banks will not be allowed to extend rupiah and forex loans to DNDF participants. The rupiah was little changed against the dollar. Equities rose 0.6%, while bond yields fell 5 bps.



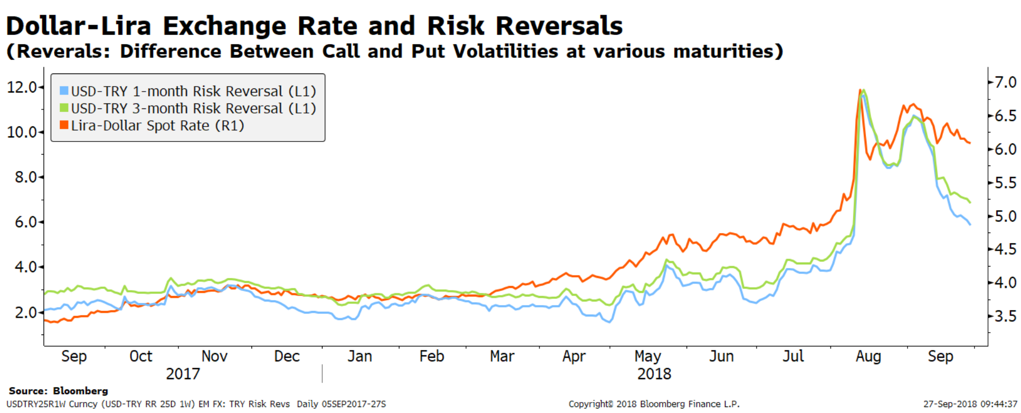
Philippines

The central bank (BSP) raised its policy rate by 50 bps to 4.5%, as expected. The central bank has raised rates by 150 bps since May, in an attempt to curb rising price pressures and also to stem depreciation pressures. This marks the central bank's most aggressive tightening cycle in nearly two decades, as it aims to anchor inflation expectations and return CPI back to target over the medium term. According to BSP's latest forecasts, inflation is now expected to come in at 5.2% and 4.3% in 2018 and 2019, respectively, falling outside the target range of 2-4%. BSP officials stated that the central bank is ready to take further policy action, projecting inflation to peak in Q3 this year. The peso appreciated 0.2%. Equities rose 0.7%.

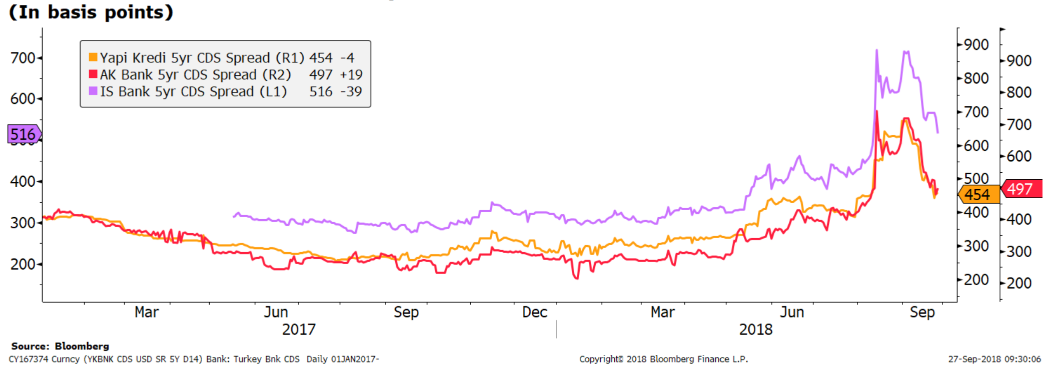


Turkey

While contacts still bemoan the lack of a comprehensive economic strategy to address Turkey's vulnerabilities, market sentiment has improved somewhat. The improvement in sentiment stems largely from the latest rate hike by the central bank to support the lira, as well as renewed hopes of the release of an American pastor and an ensuing easing of tensions with the US. The Turkish lira (+0.4%) has strengthened 12% from its weakest level versus the dollar in August. Risk reversals have also tilted more bullishly for the lira. Similarly, CDS spreads for the main Turkish banks have come down from their highs this summer.



Turkish Banks Senior CDS Spreads
(In basis points)



Czech Republic

The Czech central bank raised its key policy rates by 25 bps yesterday, as expected. The 2-week repo rate was raised to 1.5%, the Lombard rate to 2.5%, and the discount rate to 0.5%. Inflation reached 2.5% last month, surpassing the 2% target of the central bank, but still within the ±1 percentage point band. The hike in rates is the sixth tightening in policy in just over a year, thus further diverging from the monetary policy stance in the eurozone. The accompanying statement, however, was seen as cautious regarding further rate hikes. The Czech koruna weakened 0.4% this morning.

Poland

Moody's maintained its 'stable' outlook for Polish banks, on the back of strong growth and improving bank loan quality. The agency expects GDP growth to reach 5% in 2018 and 4.2% in 2019. The agency also noted that banks' "capital will also remain strong, supported by balanced loan growth and stronger earnings, while dividend payments should remain moderate."

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Global Financial Indicators

Last updated: 9/27/18 8:18 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		2909	0.1	-1	0	16	9
Europe		3428	-0.1	1	-1	-4	-2
Japan		23797	-1.0	1	4	17	5
China		2792	-0.5	2	0	-17	-16
Asia Ex Japan		71	0.1	1	-2	-1	-7
Emerging Markets		43	0.2	1	-2	-3	-9
Interest Rates					basis points		
US 10y Yield		3.05	0.4	-1	21	74	65
Germany 10y Yield		0.52	-1.0	5	14	5	9
Japan 10y Yield		0.12	-0.6	0	2	6	7
UK 10y Yield		1.58	-1.4	-1	30	20	39
Credit Spreads					basis points		
US Investment Grade		97	-0.4	-1	-4	-5	6
US High Yield		330	0.2	3	-12	-44	-45
Europe IG		68	-0.2	0	2	10	23
Europe HY		270	0.5	4	-16	16	37
EMBIG Sovereign Spread		346	-1.0	-5	-13	54	61
Exchange Rates					%		
Dollar Index (DXY)		94.54	0.4	1	0	1	3
USDEUR		1.17	-0.3	-1	0	0	-3
USDJPY		112.9	-0.1	0	-2	0	0
EM FX vs. USD		62.1	0.1	0	0	-10	-11
Commodities					%		
Brent Crude Oil ($/barrel)		82	0.6	4	7	41	22
Industrials Metals (index)		120	-0.8	2	-1	-4	-14
Agriculture (index)		42	-0.3	0	-2	-14	-12
Implied Volatility					%		
VIX Index (%, change in pp)		12.7	-0.2	0.9	0.5	2.8	1.6
10y Treasury Volatility Index		3.4	-0.1	-0.1	-0.2	-0.8	-0.2
Global FX Volatility		8.4	0.0	-0.2	-0.4	-0.1	1.0
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		407	1.7	-1	-14	-172	-5
Italy		291	5.0	3	-25	76	89
Portugal		188	-1.9	-1	4	-58	-7
Spain		152	-0.7	1	11	-13	-5

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

back to top

Emerging Market Financial Indicators

Last updated: 9/27/2018 8:18 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		6.88	0.0	-0.5	-1	-4	-5		3.7	-0.6	1	7	-8	-32
Indonesia		14883	0.2	-0.7	-2	-10	-9		8.4	-2.7	-9	33	164	173
India		73	-0.2	-1.2	-4	-10	-12		8.2	-3.4	-5	14	115	73
Philippines		54	0.2	-0.1	-1	-6	-8		6.5	7.4	26	53	162	161
Thailand		32	0.1	-0.2	0	3	0		2.9	-1.0	-4	6	67	56
Malaysia		4.14	0.1	0.0	-1	2	-2		4.1	0.2	-1	2	23	18
Argentina		39	0.0	-0.8	-20	-54	-52		23.2	-34.8	-107	68	858	720
Brazil		4.03	0.0	1.1	1	-21	-18		10.0	-12.9	-28	-18	149	101
Chile		663	0.0	0.6	-1	-4	-7		4.8	0.5	6	9	45	5
Colombia		3000	0.0	0.2	-2	-2	-1		6.6	-0.7	-2	14	27	35
Mexico		18.94	-0.5	-0.6	-1	-4	4		8.0	-6.9	-9	13	109	30
Peru		3.3	0.0	-0.2	0	-1	-2		5.7	-1.4	5	16	37	45
Uruguay		33	0.0	-0.5	-4	-12	-13		10.5	-6.4	-50	1		192
Hungary		276	-0.2	-0.5	0	-4	-6		2.6	-1.2	-2	20	126	138
Poland		3.65	-0.3	-0.2	0	1	-5		2.6	-3.1	1	3	-11	-10
Romania		4.0	-0.2	-0.7	0	-2	-2		4.3	0.0	3	3	134	49
Russia		65.7	0.2	0.9	2	-11	-12		8.3	2.4	-6	-2	79	105
South Africa		14.2	-0.1	0.9	0	-4	-13		9.7	-7.6	-2	20	42	36
Turkey		6.08	0.5	1.9	1	-41	-38		20.7	-17.0	-32	-403	985	878
US (DXY; 5y UST)		95	0.4	0.7	0	1	3		2.94	-0.3	-1	20	104	73

	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		2792	-0.5	2	0	-17	-16		186	-3	1	2	39	34
Indonesia		5929	1.0	0	-2	1	-7		190	-2	-5	3	23	24
India		36324	-0.6	-2	-6	17	7		163	-4	-2	6	38	53
Philippines		7321	0.7	3	-6	-11	-14		99	1	3	-8	10	4
Malaysia		1799	0.0	0	-1	2	0		130	-1	0	-6	3	20
Argentina		33943	-0.3	2	33	34	13		583	-28	-42	-103	178	233
Brazil		78656	0.0	1	1	7	3		290	-5	-32	-34	43	56
Chile		5334	0.0	-2	1	1	-4		132	1	0	-9	4	13
Colombia		1487	-0.1	-1	-4	0	-2		174	0	-2	-5	-15	0
Mexico		49606	-0.1	0	-2	-1	1		256	-1	-10	-21	18	11
Peru		19604	0.1	2	-1	7	-2		136	0	-2	-14	-8	-1
Hungary		36319	0.9	1	-1	-2	-8		112	0	2	-18	23	24
Poland		59317	-0.2	2	-3	-7	-7		46	1	3	-21	-3	-1
Romania		8404	0.3	1	1	6	8		173	4	0	-13	43	59
Russia		2461	1.4	2	6	18	17		232	1	3	-13	52	54
South Africa		56172	-0.7	0	-6	2	-6		323	0	-1	14	50	69
Turkey		100235	1.1	4	10	-1	-13		454	0	5	-65	164	165
Ukraine		536	-0.3	-1	1	83	70		550	0	3	-17	77	95
EM total		25	-0.4	0	-2	-1	-4		346	-1	-5	-13	54	61

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