Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Thursday, September 06, 2018

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- **US firms using repatriated cash to buy back stock rather than increase capex (link)**
- **Bank of Canada remains on hold as expected (link)**
- **EM lending conditions tightened during Q2 (link)**
- **EM CDS spreads reach multiyear wides (link)**
- **Argentina's central bank shifts strategy to intervene directly in FX markets (link)**

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Trade issues linger in muted price action

Argentine and Turkish assets recovered modestly yesterday, but trade concerns and tightening global liquidity continue to weigh on longer-term EM sentiment. Investors await a decision on whether the US will impose additional tariffs on Chinese goods. Trade worries have also been a running theme for developed markets, as Brexit and NAFTA negotiations continue. The British pound rallied up to 0.8% against the euro on reports that Germany might be willing to table some details regarding the UK's post-Brexit status, but price action reversed shortly afterwards as reports clarified that the German government's stance was unchanged. The Canadian dollar remains near its weakest levels year to date as trade discussions with the US intensified.

Key Global Financial Indicators

Last updated: 9/6/18 8:26 AM	Level Last 12m	Index	Change from Market Close 1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		2889	-0.3	0	1	17	8
Eurostoxx 50		3320	0.1	-3	-5	-3	-5
Nikkei 225		22488	-0.4	-2	0	16	-1
MSCI EM		42	-1.4	-5	-5	-7	-11
Interest Rates				bps			
US 10y Yield		2.90	-0.6	4	-4	79	49
Germany 10y Yield		0.38	-0.5	3	-1	3	-5
Japan 10y Yield		0.11	-0.4	0	0	10	6
FX / Commodities / Volatility				%			
Dollar index, (+) = $ appreciation		95.1	-0.1	1	0	3	3
Brent Crude Oil ($/barrel)		77.6	0.4	0	5	43	16
VIX Index (%, change in pp)		13.9	0.0	2	3	2	3

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

United States

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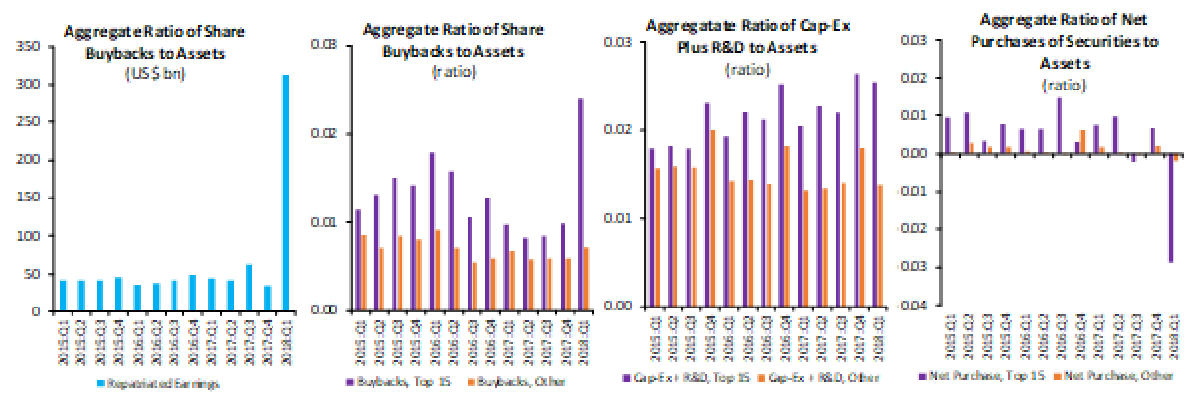
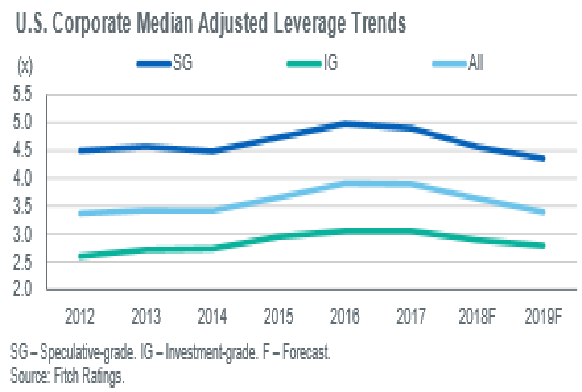
Tech stocks slid Wednesday while blue chips managed small gains. Tech stocks (-1.5%) were pressured as the US Justice Department advised that it was looking into tech companies regarding competition and free speech issues. The FANG+ index (Facebook, Amazon, Apple, Netflix, (Alphabet) Google) slid 2.8%. Investors are also on edge over trade, with US-Canada talks ongoing after faltering last week, and with a China tariff announcment possibly due out today. A jump in the trade deficit also weighed on sentiment. The 10-year Treasury yield rose following the trade numbers, but finished flat on the day.

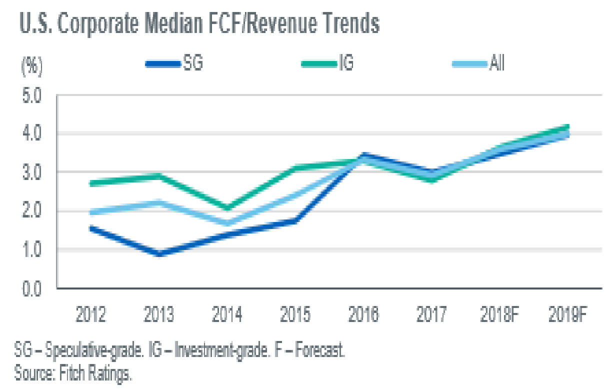
US firms with sizeable overseas cash balances have been using to money to boost share buybacks, with scant evidence they are using such funds to increase capital expenditures. Research published by the Federal Reserve suggested that US non-financial firms had been holding around $1 tn overseas, and some 80% was held by just 15 (mostly tech) firms. A new tax regime witnessed the repatriation of just over $300 bn in Q1, which prompted a surge in share buybacks. The ratio of buybacks to assets for the Top 15 more than doubled in Q1, while dividends were little changed. However, the Fed found there was no obvious boost in capital spending, which had nevertheless already been trending higher. Since most overseas cash is invested in fixed-income securities, the Top 15 have been selling their bond holdings to fund their buybacks. In Q1, they were net sellers of 3% of their total assets (of $66 bn).



Sources: Bloomberg, Compustat, Federal Reserve

Fitch finds that **US corporate fundamentals have been broadly stable** over the last 12 months, with continued strong global growth prospects. It sees downward revisions limited to sectors already confronting secular challenges, and that rising commodity prices would generally boost upward revisions. Fitch expects median leverage to decline to 3.6x by the end of the year, fueled by improving EBITDA and some debt repayments. It feels that firms are generally prepared to weather a series of prospective rate hikes, having proactively refinanced their debt and extended debt maturities.





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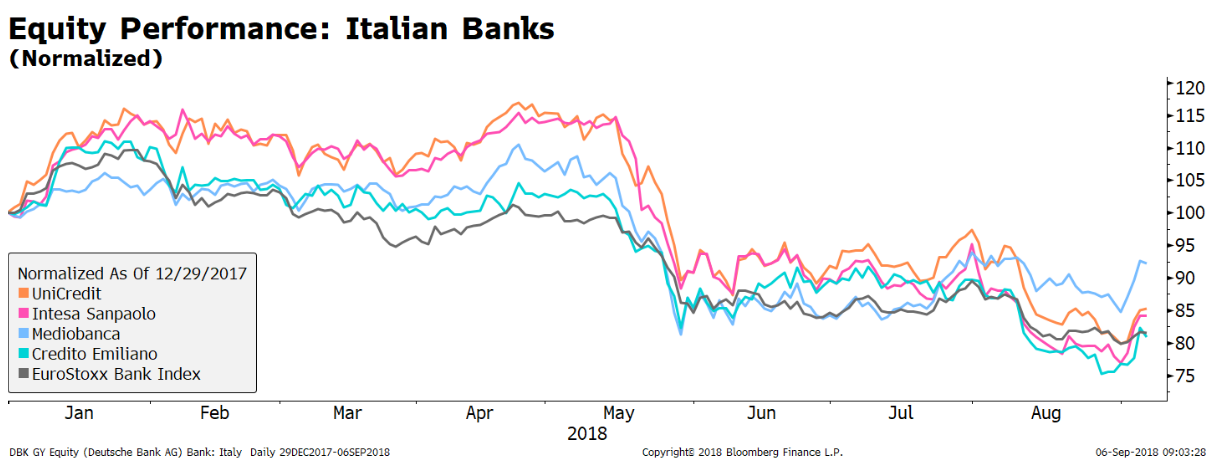
The main European bourses are slightly higher, with the DAX and CAC 40 up 0.1% and 0.2%, respectively. Bank stocks are flat on the day. Spanish BBVA (-1.8%), however, is down on investors' concerns over its exposures across EMs, including Turkey and Argentina.

Euro area sovereign bond markets are steady. Prices are unchanged for most 10-year bonds, leaving yields at: 0.37% for Germany; 0.71% for France; 1.45% for Spain; and 1.87% for Portugal. Italian 10-year bond yields are 11bps higher at 3.04%. Yields on 10-year gilts are also flat at 1.44%.

Fitch's has downgraded to 'negative' the outlook of Italy's major banks, following the revision of the country's outlook. The banks affected include Unicredit (+0.8%), Intesa (+0.5%), Mediobanca (-0.2%), and Credito Emiliano (-1.7%). The agency also warned that it would likely downgrade the banks if the sovereign's rating was downgraded.



The Riksbank kept rates on hold at -0.5%, as expected, and stated it will not raise rates next month either but perhaps at its December or February meeting.

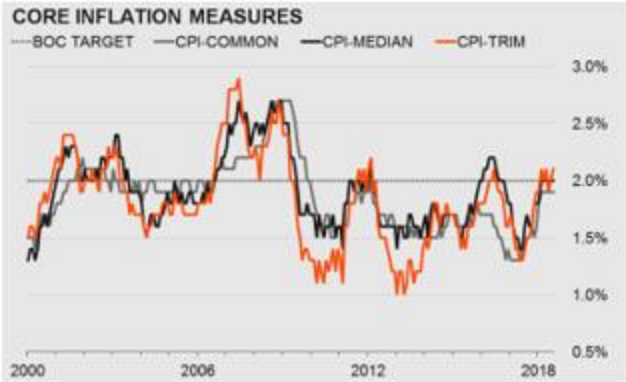
Other Mature Markets back to top

Japan

Equities slid for a sixth day, as a strong earthquake and increasing likelihood of new US tariffs weighed on sentiment. The Topix shed 0.7%, and the Nikkei lost 0.4%. Shares of exporters bore the brunt of losses amid concerns that planned tariffs by the US on another $200 bn of Chinese goods could materialize in the coming days. Meanwhile, shares of airline companies and power provider Hokkaido Electric Power also suffered large losses after the 6.7 magnitude earthquake left Hokkaido without power. By contrast, **the yen gained (+0.14%), its first in four days** as the broader dollar index softened on speculation of Brexit progress. In a news interview, BoJ Board member Katoaka noted that the central bank's biggest risks still revolve around its battle to generate stable inflation of 2%. Additional easing, specifically a lowering of yields for long bonds, is "necessary". Market observers interpreted his comments as opposition to BoJ's policy tweak from July when the central bank included a more flexible target for the benchmark 10-year note. JGB yields were little changed on the day.

Canada

The Bank of Canada kept rates steady at 1.5% as widely expected. The bank advised it was ready to continue hiking, but that it is holding off to see how NAFTA negotiations proceed. Analysts believe concluding a new trade agreement would give the bank a green light, and investors are expecting up to three more increases over the next year, starting with a hike at the October meeting. Besides trade, the central bank painted a largely positive picture of the economy, noting the economy has been operating near capacity "for some time," and that wage growth was "moderate," while the housing market was stabilizing.



Sources: Bloomberg, Bank of Canada

Emerging Markets

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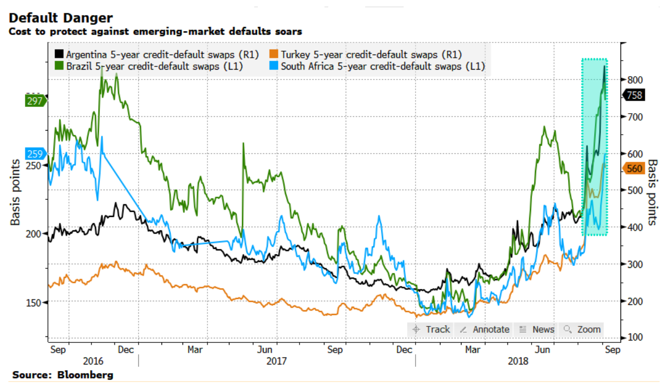
Key Emerging Market Financial Indicators

Last updated:	Level		Change				
9/6/18 8:32 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Prices/Returns of Major EM Benchmarks					%		%
MSCI EM Equities		41.72	-1.4	-5	-5	-7	-11
MSCI Frontier Equities		27.61	0.1	-3	-7	-10	-17
Hard Currency Sovereign Debt		815.42	0.1	-1	-2	-4	-5
Local Currency Sovereign Debt		15.80	-0.1	-4	-8	-19	-17
Major EM FX vs. USD					%, (+) = EM currency appreciation		
China Renminbi		6.83	0.0	0	0	-4	-5
Indonesian Rupiah		14935	0.2	-1	-3	-11	-9
Indian Rupee		71.88	-0.6	-1	-4	-11	-11
Argentine Peso		38.62	0.0	0	-29	-55	-52
Brazil Real		4.11	0.8	1	-9	-25	-19
Mexican Peso		19.21	0.7	-1	-4	-7	2
Russian Ruble		68.39	-0.3	0	-7	-16	-16
South African Rand		15.29	0.8	-4	-12	-17	-19
Turkish Lira		6.56	0.7	2	-19	-48	-42
Dollar vs. Mature FX (DXY index)		95.13	-0.1	1	0	3	3

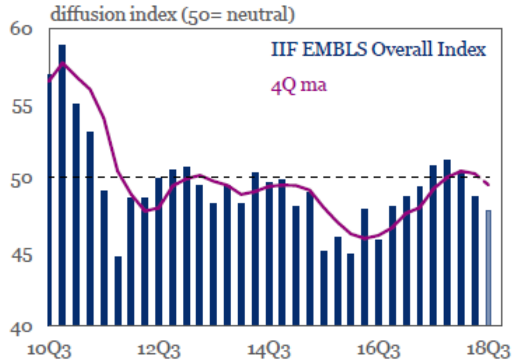
Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

The costs of default protection in vulnerable EMs have soared to multi-year highs. In Argentina, the implied default probability over the next five years jumped to 41%, the highest level since the current government wrapped up legal negotiations with most creditors. Turkey's implied default probability surged to 31%, the highest since the GFC. Brazil's implied default odds rose to 18%, the highest since its last recession in 2016. Finally, South Africa's implied default odds increased to 15%, the highest since the 2016 US election. Turkey and Argentina are now considered by analysts as having "substantial" medium-term default risks, as they expect recessions and see rising political risks ahead of upcoming elections.



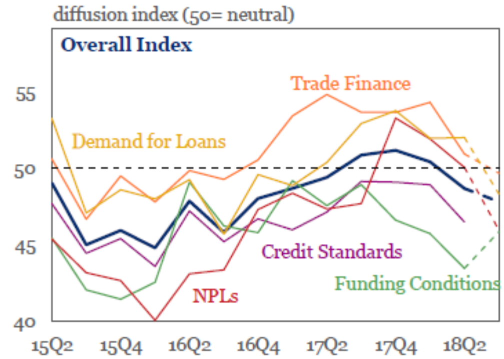
Lending conditions tightened in emerging markets during Q2, according to the recent survey by the Institute of International Finance. The tightening move comes after three quarters of easing. A breakdown of the overall index reveals that credit standards and funding conditions weakened further during the quarter, though trade finance and loan demand remained in easing territory (above 50). Overall lending conditions deteriorated in Latin America and Europe, but the IIF noted Asia and sub-Saharan Africa continued to observe solid conditions. Survey respondents are expecting a further tightening of lending conditions in Q3.

Chart 1: IIF EM Bank Lending Conditions Index*



Diffusion index: above 50 = easier conditions, below 50 = tighter conditions
**Average of 14 lending condition indices, light shade denotes expectation in the next 3 months*
Source: IIF

Chart 2: EM Bank Lending Conditions by Category



**Dashed line denotes expectation in the next 3 months*
Source: IIF

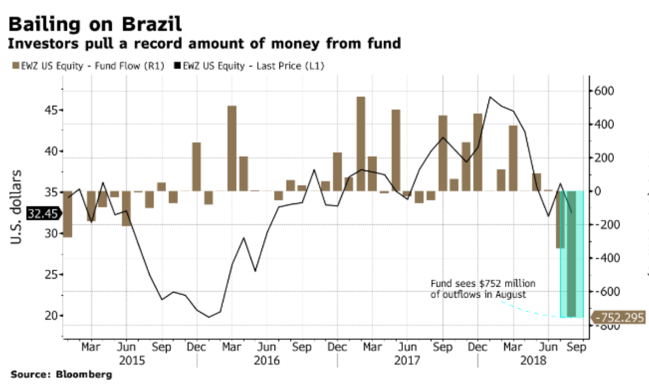
[1]Values below 50 indicate a tightening in bank lending conditions and values above 50 indicate easing. For NPLs, values below 50 indicate a rise in NPLs and vice-versa. The 2018Q2 survey covering 94 EM banks was conducted during July 2018.

Argentina

The currency, debt, and equity markets rebounded yesterday. The peso gained 1.2%, 2019 bond yields fell 200 bps to 8.05% and equities rallied 4.1%. The positive price action was attributed to (i) FX intervention and additional FX supply in the market; (ii) hopes for bilateral contingent credit lines (these were later dispelled); and (iii) technical factors, e.g. repositioning following overshooting. The BCRA auctioned $100mn in dollars at 38.8958 per dollar and, in a shift of strategy, sold a further $150mn via direct FX intervention. Traders commented that direct intervention has so far appeared to be more impactful than auctioning dollars. Overall FX trading volumes were reasonably strong. Nonetheless, confidence, low liquidity, and withdrawals remain ongoing concerns. Yesterday's press conference with economy minister Dujovne provided little new information. Dujovne dispelled speculation of Argentina seeking funds outside of the IMF, noting that Argentina is not in talks with the US Treasury, IDB, CAF, or others. He confirmed that the IMF board is likely to vote on the request for accelerated disbursements by the end of September.

Brazil

The largest Brazil ETF shed a record amount of assets in August, underscoring selling pressures from retail investors. The iShares MSCI Brazil ETF, which holds $5 bn in assets, tumbled over 10% in August and is now close to its lowest level since the 2016 recession. Outflows accelerated in August to $0.7 bn, the largest amount since its inception in 2000. Separately, the country's **PMI services fell to 46.8 in August** from 50.4 the previous month. Equities rose 0.7% yesterday (down 4% on a weekly basis). The real marginally strengthened but exchange rate volatility edged higher.



EM Asia

Despite initial stabilization, equities extended their broad-based declines late in the session. The MSCI Asia Pacific ex-Japan Index is down for a sixth day. Gains in Indonesia (+1.0%, its first in 6 sessions) and Malaysia (+0.2%, also the first in 6 days) were offset by losses elsewhere that ranged from -0.2%

(Korea) to as much as -1% (Hong Kong and Vietnam). Chinese bourses fell further from their sizable losses yesterday. The Shanghai Composite (-0.5%) continues to hover near its lowest level in 2 ½ years. The tech-heavy Shenzhen Composite (-0.7%) has dipped to its lowest level in over 3 years.

Currencies fluctuated in a narrow range with some of the most battered currencies stabilizing. Although news of tentative progress in Brexit negotiations initially weighed on the dollar and boosted EM Asian currencies, most of the gains were reversed late in the session as trade concerns once again took hold of sentiment. The won gave up initial gains to end the day weaker (-0.2%), one of the underperformers of the day. The Indian rupee depreciated further (-0.2%) to 71.89, a fresh-record low. In addition to negative confidence shocks from pressure on EM currencies, the widening current account deficit – on the back of sharp increases of crude oil imports – also weighed on the currency. Offsetting these losses were the rupiah, which outperformed (+0.2%), posting its first gain in 8 days. The RMB also stabilized, with the onshore CNY unchanged at 6.830 and the offshore CNH at 6.836, a touch stronger (+0.07%).

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
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 Schmittman
Economist
Ilan Solot
Financial Sector Expert
Nour Tawk
Economist
Martin Edmonds
Senior Data Mgt Officer
Yingyuan Chen
Senior Research Officer
Rohit Goel
Research Officer
Yang Li
Research Assistant

Global Financial Indicators

Last updated: 9/6/18 8:29 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
United States		2889	-0.3	0	1	17	8
Europe		3320	0.1	-3	-5	-3	-5
Japan		22488	-0.4	-2	0	16	-1
China		2692	-0.5	-2	-1	-20	-19
Asia Ex Japan		69	-1.7	-4	-3	-3	-9
Emerging Markets		42	-1.4	-5	-5	-7	-11
Interest Rates				basis points			
US 10y Yield		2.90	-0.6	4	-4	79	49
Germany 10y Yield		0.38	-0.5	3	-1	3	-5
Japan 10y Yield		0.11	-0.4	0	0	10	6
UK 10y Yield		1.45	0.4	-1	14	44	26
Credit Spreads				basis points			
US Investment Grade		104	0.4	3	7	-8	13
US High Yield		345	1.6	6	6	-60	-30
Europe IG		65	-0.9	-3	0	11	20
Europe HY		288	-3.4	-6	-8	53	55
EMBIG Sovereign Spread		377	0.0	12	46	80	92
Exchange Rates				%			
Dollar Index (DXY)		95.13	-0.1	1	0	3	3
USDEUR		1.16	0.0	0	1	-2	-3
USDJPY		111.3	0.2	0	0	-2	1
EM FX vs. USD		60.4	0.1	0	-6	-15	-13
Commodities				%			
Brent Crude Oil ($/barrel)		78	0.4	0	5	43	16
Industrials Metals (index)		117	1.3	-4	-3	-11	-16
Agriculture (index)		42	-0.1	0	-7	-14	-11
Implied Volatility				%			
VIX Index (%, change in pp)		13.9	0.0	1.6	2.6	2.3	2.9
10y Treasury Volatility Index		3.7	-0.1	0.0	0.0	-0.8	0.2
Global FX Volatility		9.0	0.0	0.2	0.9	0.7	1.6
EA Sovereign Spreads				10-Year spread vs. Germany (bps)			
Greece		444	-11.3	7	44	-103	33
Italy		305	11.4	-17	14	102	103
Portugal		188	0.4	-4	13	-97	-7
Spain		146	0.6	-2	6	-11	-11

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: 9/6/2018 8:35 AM	Exchange Rates: Level, Last 12m	Exchange Rates: Level, Latest	Change (in %), 1 Day	Change (in %), 7 Days	Change (in %), 30 Days	Change (in %), 12 M	YTD	Local Currency Bond Yields (GBI EM): Level, Last 12m	Level, Latest	Change (in basis points), 1 Day	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.					
China		6.83	0.0	0.2	0	-4	-5		3.6	2.0	0	16	-15	-38
Indonesia		14935	0.2	-0.9	-3	-11	-9		8.7	19.6	66	68	180	203
India		72	-0.6	-1.1	-4	-11	-11		8.2	2.4	14	25	131	75
Philippines		54	-0.4	-0.4	-2	-5	-7		5.9	0.1	-1	0	105	107
Thailand		33	0.0	0.0	2	1	-1		2.8	2.0	5	7	58	53
Malaysia		4.14	0.4	-0.5	-1	2	-2		4.1	2.8	7	7	24	22
Argentina		39	0.0	0.3	-29	-55	-52		24.1	-74.4	21	384	828	805
Brazil		4.11	0.8	0.9	-9	-25	-19		10.7	-1.4	48	128	184	166
Chile		682	0.5	-0.4	-5	-9	-10		4.8	3.3	2	-7	40	-1
Colombia		3097	0.0	-2.1	-6	-6	-4		6.6	1.6	7	3	6	32
Mexico		19.21	0.7	-0.5	-4	-7	2		8.0	0.1	14	30	105	36
Peru		3.3	0.1	-0.3	-1	-2	-2		5.5	0.4	1	10	7	31
Uruguay		33	-0.7	-1.8	-8	-12	-13		11.6	17.4	107	132		305
Hungary		280	0.6	0.1	-1	-8	-7		2.6	2.6	14	14	79	130
Poland		3.70	0.5	-0.5	0	-4	-6		2.6	1.7	6	9	-1	-7
Romania		4.0	0.1	-0.1	1	-3	-2		4.4	0.0	1	-32	153	52
Russia		68.4	-0.3	-0.3	-7	-16	-16		8.6	6.1	17	91	104	127
South Africa		15.3	0.8	-3.7	-12	-17	-19		9.8	1.5	29	50	59	47
Turkey		6.56	0.7	1.5	-19	-48	-42		23.1	-8.6	-76	332	1249	1115
US (DXY; 5y UST)		95	-0.1	0.6	0	3	3		2.76	-0.7	1	-4	108	56

	Equity Markets: Level, Last 12m	Level, Latest	Change (in %), 1 Day	7 Days	30 Days	12 M	YTD	Bond Spreads on USD Debt (EMBIG): Level, Last 12m	Level, Latest	Change (in basis points), 1 Day	7 Days	30 Days	12 M	YTD
								basis points						
China		2692	-0.5	-2	-1	-20	-19		187	0	-1	0	34	35
Indonesia		5776	1.6	-4	-5	-1	-9		214	7	25	26	30	48
India		38243	0.6	-1	1	21	12		166	5	8	12	26	56
Philippines		7639	-1.5	-3	-2	-4	-11		109	-2	0	3	9	14
Malaysia		1799	0.2	-1	1	1	0		137	1	2	2	0	27
Argentina		28769	4.1	13	0	19	-4		732	-12	-42	150	330	382
Brazil		75092	0.5	-4	-7	2	-2		329	-6	-9	69	67	95
Chile		5141	0.1	-2	-4	1	-8		139	-3	-2	5	10	20
Colombia		1509	0.0	-2	-1	0	0		180	-2	-1	2	-15	6
Mexico		48595	-0.6	-3	-1	-4	-2		282	-3	3	7	36	37
Peru		18942	-1.2	-4	-6	5	-5		146	-2	-1	2	-5	9
Hungary		37205	0.2	0	0	-2	-6		120	-1	-8	1	20	32
Poland		58668	-0.1	-3	-2	-9	-8		60	0	-7	-4	5	13
Romania		8334	0.3	0	2	4	7		186	2	7	17	45	72
Russia		2339	0.8	0	2	16	11		237	-1	0	44	60	59
South Africa		57233	0.2	-3	1	3	-4		360	1	48	87	104	106
Turkey		93336	0.6	0	-1	-15	-19		567	-33	12	144	286	278
Ukraine		527	-0.2	0	2	81	67		611	-7	41	106	125	156
EM total		25	-1.5	-4	-3	-2	-6		377	0	12	46	80	92

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