GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, SEPTEMBER 16, 2019

- **Oil prices surge after attack on Saudi facilities** (link)
- **US tech valuations close to record levels** (link)
- **Survey finds limited demand for US ultra-long Treasury bonds** (link)
- **Chinese August economic data disappoint expectations** (link)
- **Equities and currencies of oil importers in Asia hit by surge in oil prices** (link)

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

Risk rally stalls as geopolitical concerns rise

The strong September recovery in risk markets that continued through last week hit a road block following the weekend attack on Saudi Arabia's oil facilities. Brent oil prices surged as much as $12 per barrel when markets opened this morning, the largest intraday move on record in dollar terms according to Bloomberg. Price gains have since moderated, with the rise in oil prices having been reduced by about half that. The attacks drove a broader rise in geopolitical risk, leading to a shift to safe haven assets and driving sovereign bond yields lower. While US treasury 10-year yields rose over 30 bps last week on increasing sentiment for trade talks, they are giving back some of those gains this morning. This has taken some of the focus off of several important central bank decisions during the forthcoming week. Most notably, the FOMC is expected to cut rates on Wednesday, with Fed futures markets pricing in 23 bps (or 96% likelihood of a 25 bps cut) ahead of the meeting.

Key Global Financial Indicators

Last updated: 9/16/19 8:08 AM	Level: Last 12m	Level: Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		3007	-0.1	1	4	4	20
Eurostoxx 50		3531	-0.5	1	6	6	18
Nikkei 225		21988	1.1	4	8	-5	10
MSCI EM		42	-1.0	2	7	1	8
Yields and Spreads					bps		
US 10y Yield		1.84	12.4	20	29	-116	-84
Germany 10y Yield		-0.48	-2.8	11	21	-93	-72
EMBIG Sovereign Spread		335	6	1	-31	-23	-79
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		61.0	-0.3	1	0	0	-2
Dollar index, (+) = $ appreciation		98.4	0.2	0	0	4	2
Brent Crude Oil ($/barrel)		66.7	10.8	7	14	-15	24
VIX Index (%, change in pp)		15.1	1.3	0	-3	3	-10

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

Central banks take center stage again this week with the FOMC, Indonesian and Brazilian central meetings due on Wednesday and the BOE, Norges Bank, Swiss National Bank and BOJ meetings on Thursday. Fed Chair Powell's press conference is likely to attract even more interest than usual after the ECB's shift to open-ended forward guidance and its new QE proposal. The US data calendar is relatively light with tomorrow's industrial production report being the most likely to move markets, although housing reports later in the week could also have an impact. The euro area features the German ZEW business sentiment survey tomorrow, euro area CPI on Wednesday and euro area consumer confidence on Friday. The UK reports inflation data on Wednesday and retail sales on Thursday. Japan reports inflation data on Thursday. Meanwhile, Israel holds its election re-run tomorrow.

United States back to top

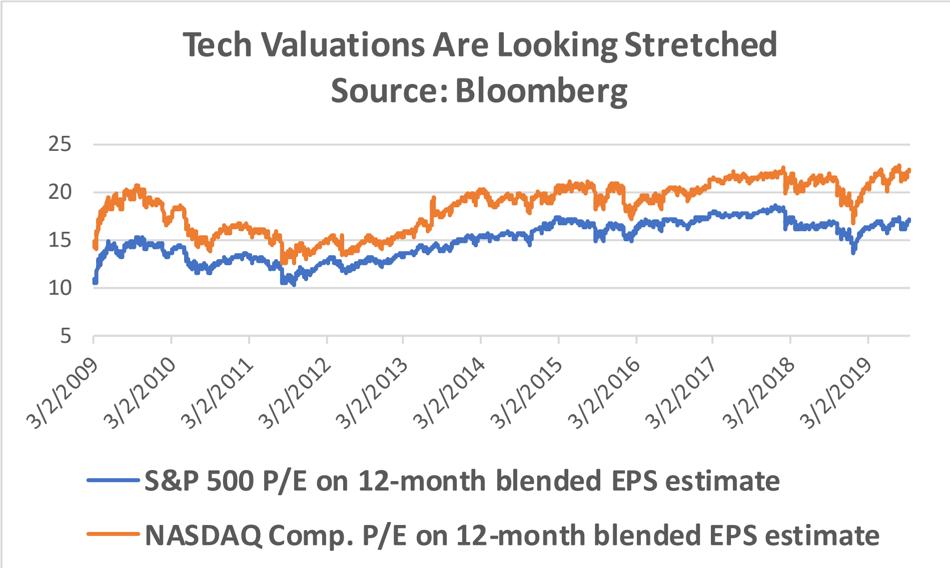
Treasury yields continued their relentless rise on Friday with increases of 8-12 bps across the curve. The move appears to be an unwind of earlier flight-to-quality buying as trade fears gave way to hopes of a compromise. Most benchmark yields reached their 2019 lows at the beginning of September after the new tariffs went into effect and began their upward march when the first positive statements from the US administration came out shortly afterwards. Friday's price action was also driven by stronger than expected retail sales and consumer confidence data. As the selloff in Treasuries intensified during the session, stocks gave up their intraday gains to end mixed, although they remain within striking distance of new records for all the major indexes. Canada's TSX index did manage to set a new record on Friday.

Recent Moves in the US Treasury Market

Source: Bloomberg

Bond Maturity	Move From 2019 Low
Two-Year	+37 bps (since September 4)
Five-Year	+44 bps (since September 4)
Ten-Year	+44 bps (since September 3)
30-Year	+42 bps (since August 27)

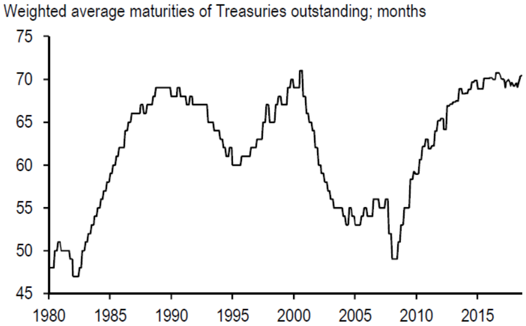
Technology valuations are being called into question by some investors as US equity markets trade near all-time highs. The blended forward P/E for the Nasdaq is much higher than the S&P 500 and is close to the all-time high valuation of 22.7x that it reached in July when the index last hit a record. The S&P multiple remains well below the 18.5x level it reached at its peak valuation back in 2017. The tech sector is arguably facing special challenges as the trade war continues to fester and the global economy loses momentum. The latest ECB meeting highlighted the fact that the slowdown in Europe is already here. In addition, most analysts agree that corporate earnings are likely to drift lower in 2020, with the tech sector especially vulnerable.



A survey of investors found there is relatively limited enthusiasm for ultra-long bond issuance from the US Treasury. If the Treasury seeks to issue longer maturity debt, investors prefer a 20-year security over a 50-year bond or a century bond. The strong performance of Austria's century bond in August sparked speculation in US markets that the Treasury might be interested in issuing ultra-long debt to lock in historically low interest costs. The US President has come out in favor of "refinancing" existing debt, after which Treasury Secretary Mnuchin stated that a 50-year bond was being "seriously considered" for 2020. JP Morgan analysts believe that in the end the authorities will most likely abandon the idea due to the lukewarm investor interest and because the Treasury is trying to reduce the weighted average maturity (WAM) of its debt. The Treasury Borrowing Advisory Committee (TBAC) estimates that further increasing debt maturities would increase future costs without a significant reduction in risk. The US already accounts for a major portion of the global supply of longer-dated government debt with maturities of more than ten years. Some contacts disagreed with this view, holding that pressure from the President could play a role and that investor demand for ultra-long bonds could be strong provided the volume of issuance was kept in check.

Exhibit 11: The WAM of Treasury's debt sits near multi-decade highs, and TBAC's work suggests further extension would increase interest cost without meaningfully reducing risk…

Weighted average maturities of Treasuries outstanding; months



Source: J.P. Morgan

Exhibit 12: …and Treasury is a large issuer of long-end debt

Gross issuance of >10-year bonds by various DM government issuers in 2018 ($bn) and share of total gross issuance (%)

Country	Gross issuance ($bn)	% of total issuance
Japan	237.3	23%
US	199.0	18%
France	56.2	25%
UK	39.1	41%
Spain	34.1	26%
Italy	33.0	17%
Germany	16.7	11%
Belgium	14.8	39%
Ireland	8.7	44%
Finland	5.0	45%
Portugal	4.0	20%
Austria	3.7	19%
Netherlands	2.7	10%

Source: Country debt management offices

The downgrade of Ford to high yield status (Aa10 by Moody's last week has had a limited impact on the US corporate bond market so far and analysts expect no disruption in the high yield sector. Ford's credit spreads widened as much as 25 bps after the downgrade. S&P and Fitch still have Ford two notches higher at BBB with a stable outlook, so the automaker remains comfortably within the IG market. Despite headwinds facing the auto sector worldwide, Barclays takes the view that the spread widening brings Ford bonds to a fair valuation relative to other BBB bonds. If Ford becomes a fallen angel and drops into the high yield (HY) sector, the impact is expected to be relatively minor given the large size of the current HY market. In 2005, both Ford and GM were downgraded to HY, becoming fallen angels, and the market suffered major spread widening due to the large relative size of their bonds. However, markets gradually recovered and investors were eventually able to absorb the supply. The current market would likely be more hospitable given the search for yield and the growth of passive investment vehicles. In addition, today GM is regarded as a much stronger credit than Ford, so a repeat of a 2005 double downgrade seems highly unlikely.

Fallen Angels: Ford and GM and the US High Yield Market

Source: Barclays, IMF Staff Calculations

	2005	2019
Ford	$40.8 bn	$35.3 bn
GM	$41.5 bn	$40 bn
Joint Share of HY Market	13%	5%

Europe

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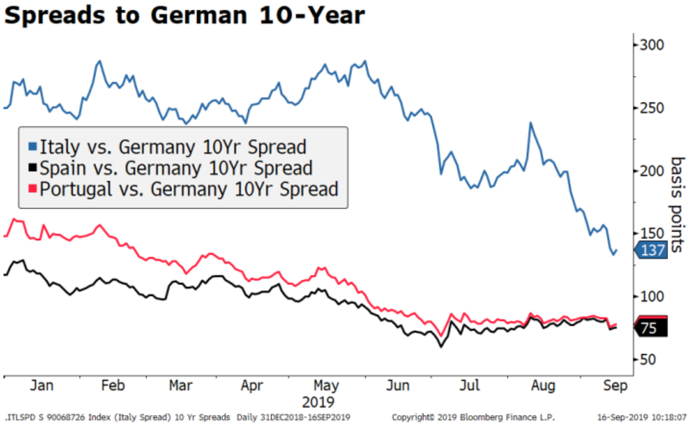
The EuroStoxx 600 is down 0.5% with big intra-sector divergences. The energy sector is up 3.2% with most other sectors down between 0.5%-1%. Yields are lower across the region with the 10-year German bund down 4 bps to -0.41% after rising nearly 20 bps last week. S&P Ratings changed its outlook on **Portugal** (BBB) from neutral to positive, meaning an upgrade could be in the cards for 2020. The agency characterised the fiscal policy as stable and praised the country's economic resilience to external threats. There was little reaction to the news with Portugal's 10-year spread to equivalent German bunds still trading around 75 bps, the same level as Spain.

Spreads to German 10-Year



In the UK, sterling is depreciating 0.5%, giving back some of Friday sharp appreciation of +1.3%. Hopes for a deal continue to build up as UK PM Johnson reinforces his commitment to negotiate a Brexit agreement. The UK is due to leave the EU in 45 days. The FTSE 100 is little changed on the day, but yields are down 5 bps, in line with the global trend.

Other Mature Markets

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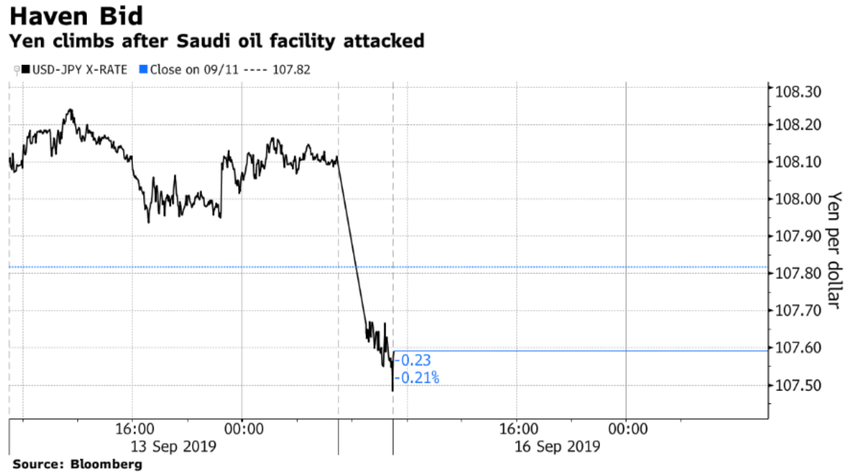
Japan

Japanese markets were closed for a holiday. The yen strengthened 0.3% on risk-off sentiment following the drone attacks on two oil facilities in Saudi Arabia on September 14.



Commodities

Brent futures are up about 10% from Friday's close to $65.5 per barrel after a major attack on Saudi Arabia's production facility cut its output in half. Yemeni rebels claimed responsibility for the attack, though the US blames Iran. The disruption will reduce global supply by about 5% and is likely to last for several weeks. Analysts at JPM drew three scenarios, with their base case (#2 in the table below), assuming a one-month disruption and Saudi Arabia depleting its inventory to meet half of the decline in supply, which would result in an $8 price increase over the period. If it takes three months to normalize production, JPM estimates a price increase of $27.

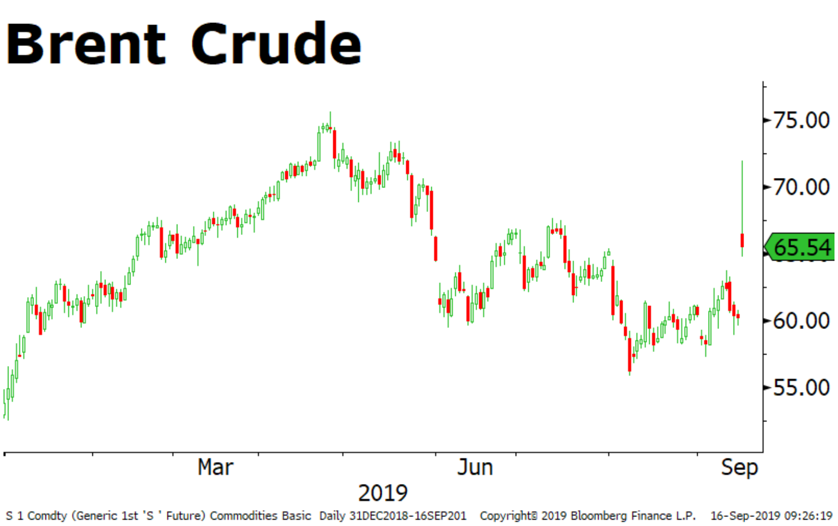


Exhibit 1: Saudi supply disruption scenario analysis

Scenarios	1	2	3
Production Impact	**50%**	**50%**	**50%**
Disruption Duration	**1w**	**30d**	**90d**
Current Output (kbd)	9,900	9,900	9,900
Supply Loss (kbbl)	34,650	148,500	445,500
Current Export (kbd)	7,000	7,000	7,000
Export Loss (kbbl)	34,650	148,500	445,500
Saudi Implied Oil Demand (kbd)	1,700	1,700	1,700
Saudi Refinery Intake (kbd)	2,600	2,600	2,600
Refinery Intake Adj. For Exports (kbd)	-900	-900	-900
Implied Saudi Stock Draw For Exports (kbbl)	-7,650	-121,500	-121,500
Current Saudi Export Forward Cover (days)	26	26	26
Oct'19 Est. Saudi Export Forward Cover (days)	**25**	**9**	**9**
Current Saudi Output Forward Cover (days)	19	19	19
Oct'19 OECD Inventories Forecast (mbbl)	**2,913**	**2,856**	**2,670***
Oil Price Shock ($/bbl, 1 Month Average)	**2**	**8**	**27***

Source: JODI, J.P. Morgan Commodities Research; Note: Exports as at Aug'19 and production as indicated by KSA for Sep'19, *90 days of Inventory and price shock over 30 days

Emerging Markets

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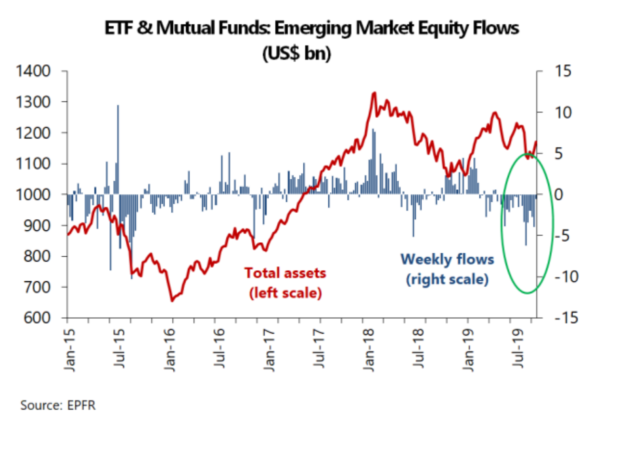
Asian equities (-0.3%) fell on net. Indonesia (-1.8%) and India (-0.8%), net oil importers with current account deficits, led losses amid risk aversion and higher oil prices following the attacks on Saudi Arabian oil facilities. Hong Kong (-0.8%) also underperformed amid disappointing Chinese data, even though Chinese equities were little changed. Regional currencies were mixed, with currencies such as the Indian rupee (-0.8%), Philippine peso and Indonesian rupiah (both -0.6%) underperforming. **EMEA** stocks were mixed, with Kuwait (-2.4%) suffering the largest losses, followed by Bahrain (-0.2%) after the attacks. However, equities in Saudi Arabia (+0.7%) and Qatar (+0.6%) were higher, while UAE was flat. Currencies were little changed. **Latin American** hard currency yields were dominated by US treasury movements on Friday, while equity and forex markets remained calm, except for gains in Argentine equities. Equity markets closed last week lower in Brazil (-0.8%) and Colombia (-0.4%), while performing positively in Argentina (+3.5%), Chile (+0.6%) and Mexico (+0.4%). Local currencies appreciated in Chile (+0.4%), depreciated in Brazil (-0.6%) and stood virtually flat in Argentina, Colombia, Mexico and Peru. Benchmark yields on sovereign local currency debt remained flat.

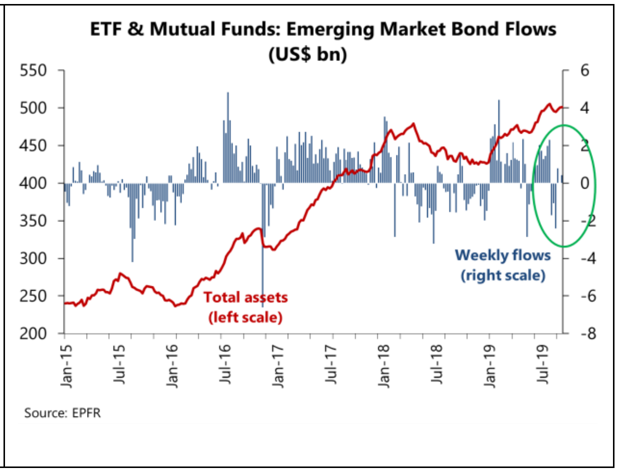
Key Emerging Market Financial Indicators

Last updated:	Level		Change				
9/16/19 8:12 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		**%**
MSCI EM Equities		42.24	-1.0	2	7	1	8
MSCI Frontier Equities		28.20	0.5	-1	-3	2	8
EMBIG Sovereign Spread (in bps)		335	6	1	-31	-23	-79
EM FX vs. USD		60.99	-0.3	1	0	0	-2
Major EM FX vs. USD				**%, (+) = EM currency appreciation**			
China Renminbi		7.07	0.1	1	0	-3	-3
Indonesian Rupiah		14042	-0.5	0	1	6	2
Indian Rupee		71.60	-0.9	0	-1	1	-3
Argentine Peso		56.12	0.0	-1	-1	-29	-33
Brazil Real		4.09	-0.1	0	-2	1	-5
Mexican Peso		19.42	-0.1	1	1	-3	1
Russian Ruble		64.03	0.5	2	4	6	8
South African Rand		14.64	-0.4	1	5	2	-2
Turkish Lira		5.72	-0.5	1	-2	10	-7
EM FX volatility		8.16	0.4	-0.1	-0.6	-3.7	-1.6

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

Investors remained cautious on EM equity funds and neutral on EM bond funds. EM equity funds registered modest outflows of $ 0.57 bn, compared to $ 4bn the week before, while bond funds realized inflows of $ 0.44 bn over the week. YTD inflows were positive for bond funds ($ +32 bn) and negative for equity funds ($ -28 bn). In the last week, investors rotated from hard currency bond ETFs ($ -525 mn) to their mutual fund peers ($ +449 mn), generating net outflows of $ 77 mn for the entire sector. Local currency bond funds saw inflows of $ 494 mn: US$ 142 mn for ETFs and $ 353mn for mutual funds. In the equity segment, the rotation pattern from ETFs to mutual funds reversed: mutual funds saw $ 675mn leaving, while ETFs enjoyed inflows of $ 105 mn.

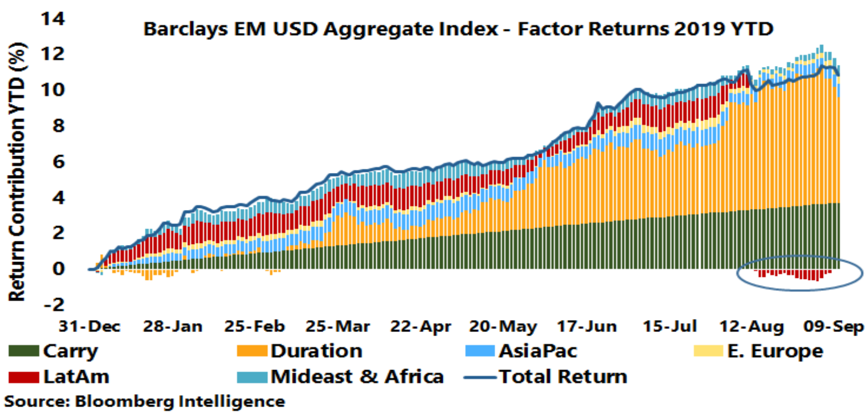




China

Equities were little changed despite economic activity data for August missing expectations. Industrial output weakened to 4.4% y/y, the lowest for a single month since 2002, while fixed asset investment and retail sales softened to 5.5% y/y ytd and 7.5% y/y, disappointing expectations of 5.7% and 7.9%. Some analysts saw the data underlining the need for policymakers to step up monetary and fiscal support. Meanwhile, Premier Li Keqiang stated in an interview that it is 'very difficult' for China's economy to maintain 6% growth, according to Reuters. **The onshore RMB appreciated 0.2% while the offshore RMB depreciated 0.2%.**

Latin America contributed YTD negatively to global EM US dollar debt performance. According to Bloomberg analysts deteriorating credit fundamentals, mainly in Argentina, rendered the contribution of Latin American credit spreads to the performance of global EM US dollar debt negatively since mid-August. Similarly, YTD EM local debt returns were weakened by a trend to depreciation in EM currencies, including major currencies in Latin America.



The Central Bank of Azerbaijan cut its main policy rate on Friday by 25 bps to 8.0%, as expected. The CBA also narrowed the interest rate corridor from 6.25%-10.25% to 6.25%-9.75%. This is the sixth reduction in policy rates in 2019, which the CBA defended as it sees inflation risks diminishing. For 2019, the central bank expects inflation to be at 4±2%.

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Global Financial Indicators

Last updated: 9/16/19 8:08 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		3007	-0.1	1	4	4	20
Europe		3531	-0.5	1	6	6	18
Japan		21988	1.1	4	8	-5	10
China		3031	0.0	1	8	13	22
Asia Ex Japan		69	0.7	3	7	-1	8
Emerging Markets		42	-1.0	2	7	1	8
Interest Rates					basis points		
US 10y Yield		1.84	12.4	20	29	-116	-84
Germany 10y Yield		-0.48	-2.8	11	21	-93	-72
Japan 10y Yield		-0.15	0.0	10	8	-27	-16
UK 10y Yield		0.72	-4.1	13	26	-81	-56
Credit Spreads					basis points		
US Investment Grade		130	0.0	-3	-5	30	-17
US High Yield		444	2.7	-16	-61	113	-77
Europe IG		46	1.1	-2	-7	-14	-41
Europe HY		242	4.0	3	-37	-40	-111
EMBIG Sovereign Spread		335	6.0	1	-31	-23	-79
Exchange Rates					%		
USD/Majors		98.45	0.2	0	0	4	2
EUR/USD		1.10	-0.4	0	-1	-6	-4
USD/JPY		107.8	0.3	-1	-1	4	2
EM/USD		61.0	-0.3	1	0	0	-2
Commodities					%		
Brent Crude Oil ($/barrel)		67	10.8	7	14	-15	24
Industrials Metals (index)		118	-1.0	0	4	3	8
Agriculture (index)		38	0.4	4	0	-8	-8
Implied Volatility					%		
VIX Index (%, change in pp)		15.1	1.3	-0.2	-3.4	3.0	-10.4
10y Treasury Volatility Index		5.9	0.7	1.1	-0.1	2.7	1.3
Global FX Volatility		7.1	0.0	0.0	-1.0	-1.5	-1.8
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		202	-1.2	-17	-63	-162	-213
Italy		135	2.3	-18	-73	-118	-115
Portugal		75	-2.1	-8	-5	-66	-73
Spain		73	-2.0	-7	-3	-30	-44

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: 9/16/2019 8:13 AM	Exchange Rates: Level – Last 12m	Level – Latest (vs. USD)	Change (in %) (+) = EM appreciation – 1 Day	7 Days	30 Days	12 M	YTD	Local Currency Bond Yields (GBI EM): Level – Last 12m	Level – Latest (% p.a.)	Change (in basis points) – 1 Day	7 Days	30 Days	12 M	YTD
China		7.07	0.1	0.7	0	-3	-3		3.1	0.0	2	1	-55	-9
Indonesia		14042	-0.5	0.0	1	6	2		7.3	-8.5	-16	-25	-141	-88
India		72	-0.9	0.2	-1	1	-3		6.7	-0.5	3	4	-155	-70
Philippines		52	-0.5	-0.8	0	4	1		4.4	2.7	1	-22	-184	-192
Thailand		31	-0.1	0.4	1	7	6		1.7	-0.5	6	3	-126	-98
Malaysia		4.17	0.0	0.3	1	0	-1		3.4	1.4	3	-5	-73	-71
Argentina		56	0.0	-0.5	-1	-29	-33		71.5	118.0	593	3055	4662	4854
Brazil		4.09	-0.1	0.1	-2	1	-5		6.7	8.5	4	13	-387	-142
Chile		711	-0.5	0.6	0	-3	-2		2.8	8.1	18	5	-198	-167
Colombia		3364	0.1	-0.2	1	-10	-3		5.7	2.9	5	3	-87	-79
Mexico		19.42	-0.1	0.8	1	-3	1		7.3	6.9	24	2	-65	-138
Peru		3.3	0.2	0.7	2	0	1		4.4	5.0	7	2	-127	-138
Uruguay		36	0.0	-0.1	-2	-10	-11		10.8	7.1	-16	28		13
Hungary		301	-0.6	-0.7	-3	-8	-7		1.1	3.4	-7	18	-146	-107
Poland		3.92	-0.4	0.1	0	-6	-5		1.9	10.0	11	21	-67	-34
Romania		4.3	-0.4	-0.3	-1	-7	-5		3.7	6.0	-2	7	-62	-54
Russia		64.0	0.5	2.4	4	6	8		6.8	1.2	-2	-29	-164	-156
South Africa		14.6	-0.4	0.9	5	2	-2		9.3	4.0	-4	-25	-44	-33
Turkey		5.72	-0.5	0.6	-2	10	-7		14.6	1.2	-66	-21	-701	-232
US (DXY; 5y UST)		98	0.2	0.2	0	4	2		1.70	-5.5	20	28	-121	-82

	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 (basis points)	Change (in basis points) – 1 Day	7 Days	30 Days	12 M	YTD
China		3031	0.0	1	8	13	22		184	0	-2	1	0	-10
Indonesia		6219	-1.8	-2	-1	5	0		169	7	-2	-19	-32	-67
India		37123	-0.7	0	-1	-3	3		127	-5	-13	-11	-43	-69
Philippines		7997	0.1	0	3	8	7		65	6	-3	-14	-38	-56
Malaysia		1601	0.0	0	0	-11	-5		121	0	-2	-2	-13	-41
Argentina		30136	3.5	9	-1	0	-1		2179	7	119	521	1523	1364
Brazil		103501	-0.8	1	4	37	18		220	3	-7	-21	-109	-53
Chile		5004	0.6	3	4	-7	-2		128	2	0	-8	-5	-38
Colombia		1581	-0.4	1	2	5	19		175	3	1	-14	1	-53
Mexico		42841	0.4	0	9	-14	3		314	2	-13	-35	47	-40
Peru		19416	0.0	0	3	3	0		115	3	4	-13	-25	-53
Hungary		40456	0.4	0	1	12	3		81	12	-6	-29	-29	-67
Poland		58342	0.3	1	6	1	1		19	18	-6	-20	-31	-66
Romania		9279	0.5	0	3	14	26		174	-2	-24	-20	-5	-47
Russia		2822	1.1	1	8	20	19		180	3	-10	-33	-56	-72
South Africa		57634	0.9	4	7	2	9		299	5	-7	-30	-30	-66
Turkey		102433	-0.6	2	7	8	12		488	6	-16	-26	13	59
Ukraine		515	0.0	-2	-4	-3	-8		449	6	-6	-107	-98	-338
EM total		42	-1.0	2	7	1	8		335	6	1	-31	-23	-79

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

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