GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

WEDNESDAY, SEPTEMBER 18, 2019

- **Fed launches open market operations to counter funding market volatility** (link)
- **Markets await Fed meeting** (link)
- **EC president Junker says that the risk of a no-deal Brexit is now "palpable"** (link)
- **Oil prices tumble as Saudi Arabia reports some production has been restored** (link)
- **Korea removes Japan from trade white list as dispute deepens** (link)
- **Turkish banking regulator calls for reclassification of $8 bn-worth of bad loans** (link)

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

Yields edge lower ahead of FOMC decision

Sovereign bond yields continued to move lower this morning even as investors wait for signals from today's FOMC meeting. While a cut at today's meeting is fully priced by futures markets, investors will be watching for signs on the future direction of monetary policy. Additionally, given the recent turmoil in US funding markets, there is some expectation that other measures will be implemented in addition to the anticipated rate cut. Overnight US repo markets skyrocketed once again early yesterday morning, following Monday's sharp moves, before the New York Fed performed an open market operation, injecting needed liquidity. Another operation is scheduled for this morning. Equity markets meanwhile are little changed, and even moving somewhat higher in Europe. Oil prices have fallen sharply over the past day after Saudi Arabia reported that a significant proportion of their lost production has been recovered.

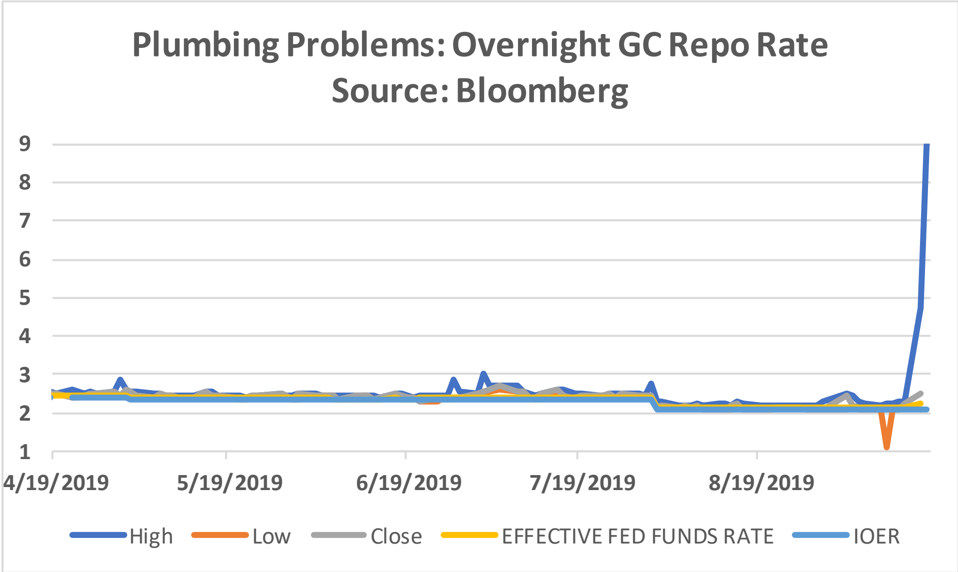
Key Global Financial Indicators

Last updated: 9/18/19 8:02 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		3006	0.3	1	4	3	20
Eurostoxx 50		3526	0.1	0	6	5	17
Nikkei 225		21961	-0.2	3	8	-6	10
MSCI EM		42	-0.2	1	6	0	7
Yields and Spreads					bps		
US 10y Yield		1.77	-4.5	3	22	-128	-91
Germany 10y Yield		-0.50	-2.7	6	18	-98	-74
EMBIG Sovereign Spread		335	-1	1	-31	-20	-79
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		61.0	0.2	0	0	0	-2
Dollar index, (+) = $ appreciation		98.4	0.2	0	0	4	2
Brent Crude Oil ($/barrel)		64.2	-0.5	6	10	-19	19
VIX Index (%, change in pp)		14.5	0.0	0	-4	2	-11

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

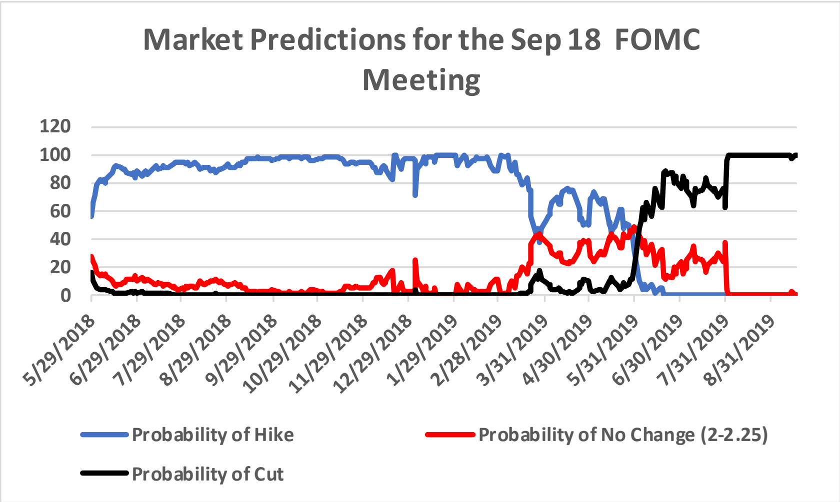
United States [back to top]

The New York Fed launched a federal open market operation (FOMO) to counter a flareup of volatility that threatened to destabilize normal operations in the US money markets. This is the first such operation in ten years. After instability from Monday spilled over into Tuesday morning trading and the benchmark overnight general collateral (GC) rate spiked up to 9%, the Fed stepped in and announced a FOMO to inject cash into the system. Technical problems caused a temporary delay, but the operation was finally launched, and the Fed offered up to $75 bn of cash in a repo auction to be secured against Treasuries, agency bonds and mortgage-backed securities, eventually attracting $53.2 bn of interest from counterparties. Overnight GC settled back down at 2.5% soon afterwards. After the market close, the Fed announced a second FOMO for this morning on the same terms as the Tuesday operation.



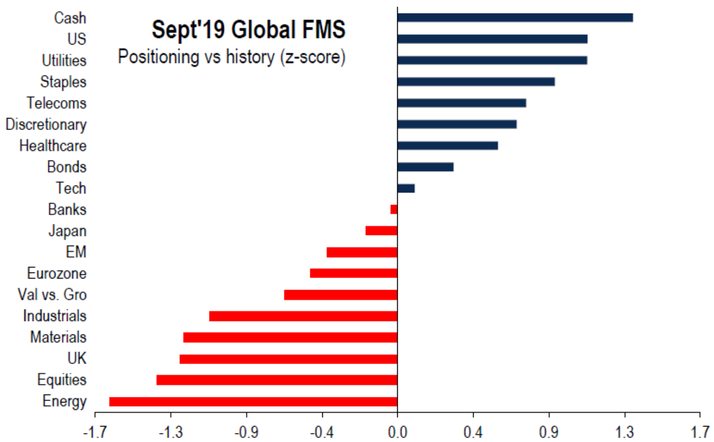
Some rise in funding costs was anticipated because Monday was a day for corporate tax payments and Treasury coupon payments and the supply of cash in the market was expected to be lower than usual. Such large moves usually occur over quarter-end or year-end, and typically not to this extent. The large moves on Monday, led to a sharp increase in the effective Fed Funds rate as funds that normally invest in that market were attracted to the much higher rates available in the O/N repo market. The fixing for Monday was 2.25%, at the upper limit of the band. In any case, the volatility forced the Fed's hand. There is active debate and no consensus on the causes of the imbalances among contacts. Some think the Fed miscalculated its estimates of how much excess reserves there were in the system and that there is actually a shortage. In addition, heavy new issuance of Treasuries has led to bloated dealer balance sheets, which also drains cash from the system. JP Morgan points out that the repo market itself has grown by one-third over the past year. Although the repo market is much safer than previous years, it is vulnerable to temporary mismatches that can cause short term problems.

Other markets were relatively quiet as everyone settled in to wait for today's FOMC meeting. Stocks were little changed although bond yields declined for a second day, with 10-year yields down 10 bps on the week as of the Tuesday close. Despite the tumult in the oil and repo markets, the VIX remained subdued, falling below 15. However, the widely followed MOVE interest rate volatility index remains close to its highest level since March 2016 as bond markets respond to geopolitical worries, ongoing trade tensions and uncertainty about Fed policy. There is broad agreement that the Fed will deliver a 25 cut today and futures markets assign a near 100% probability to the cut. Most analysts expect another 25 bps move later in the year, but there is less consensus on what will happen after that. Although the market is pricing more than 50 bps of further cuts over the next 12 months, some analysts think Fed Chair Powell's mid-cycle adjustment means the Fed will be done after this year and that the market has overestimated the Fed's dovishness. Other issues on the minds of investors include whether the Fed will adjust the Interest on Excess Reserves (IOER), whether it will discuss a standing repo facility to address future funding shortages and what are the plans for the size of the Fed's balance sheet.



Global investors remain cautious despite the recent rally in risk assets. The latest Bank of America global fund manager survey finds that investors favor assets that do better in a low growth environment where low interest rates prevail. They have rotated out of value stocks and other assets that do better when the economy is strong and rates are rising. Overall, they are underweight equities in favor of bonds and remain convinced that there is a limited chance of a pickup in global growth. They also think 2019 US corporate earnings will decline by 3.1% overall in 2019.

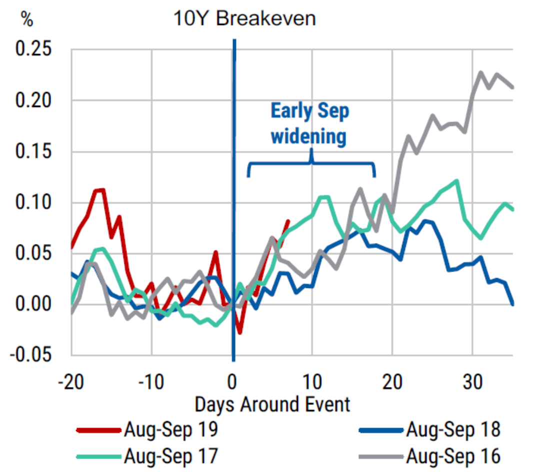
Exhibit 3: FMS investor asset allocation remains risk-off



Source: BofA Merrill Lynch Global Fund Manager Survey

Inflation linked securities showed a strong performance in recent days, both in the US and the euro area. The de-escalation in trade tensions helped Treasury Inflation Protection Securities (TIPS) breakeven yields (a measure of inflation expectations) move higher by 12 bps for five-year TIPS and 11 bps for ten-year TIPS over the past two weeks, a fairly significant move. Euro area equivalent bonds benefited from the ECB's strong forward guidance linked to inflation. If the US authorities decide on a more sustained de-escalation of the trade war, it could trigger a significant rally in risk assets that could drive breakevens even higher. The Fed keeps a close eye on breakevens as an important signal of market inflation expectations. A significant rally could affect the Fed's calculations about future rate hikes.

Exhibit 23: Moves in 10-year TIPS breakeven from August to September over the last four years



Source: Bloomberg, Morgan Stanley Research

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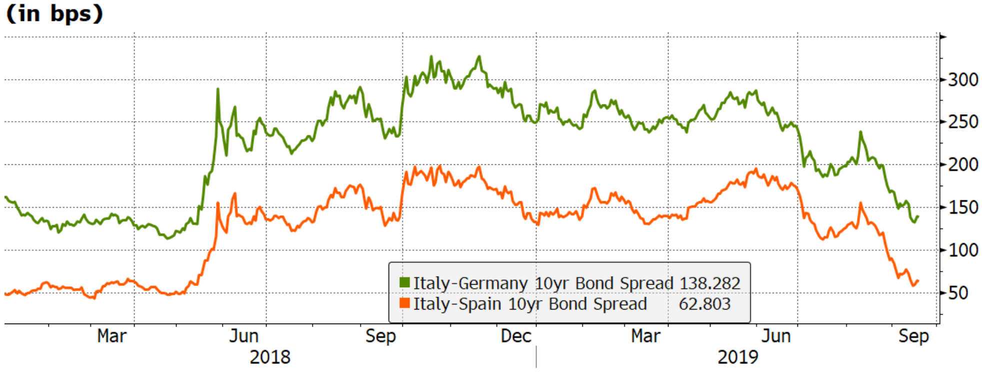
European stocks inched up today, with most major indices gaining 0.1%. Bank stocks (+0.3%) slightly outperformed. **Core sovereign debt yields dropped 2-3 bps:** German 10-year bunds at -0.49% (-2 bps) and French OATs at -0.20% (-3 bps). Italian 10-year yields are at 0.88% (-4 bps). The Italian spread to other sovereigns has come down noticeably since early last summer.

Italy: Spreads to Other Sovereigns
(in bps)



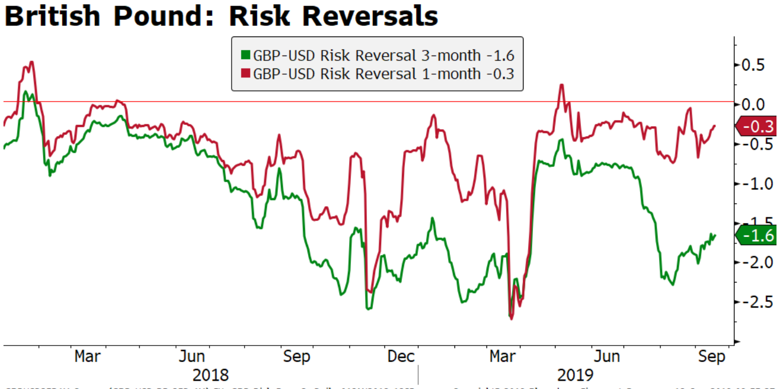
Source: Bloomberg
CFRTR1U5 Curncy (FRANCE CDS USD SR 5Y D14) FI: Ita-Periph Spreads Daily 02JAN20 Copyright© 2019 Bloomberg Finance L.P. 18-Sep-2019 10:44:05

Spain seems headed for another general election as acting president Sánchez fails to secure support to form a government. Analysts note that the new elections—likely to be held around Nov. 10th—would leave a similar parliamentary composition and hence will be unlikely to facilitate the formation of a new government. The Spanish 10-year yield was little changed at 0.26% (-2 bps) this morning.

On the Brexit front, PM Johnson's government is reportedly about to overhaul a previously-planned schedule of tariffs to be applied under a no-deal Brexit. According to news outlets, the changes include increases in various industries (e.g., textiles and biofuels) and reductions in others (e.g., heavy vehicles). The UK government claims, however, that the overall thrust of the its tariff schedule will remain unchanged and that about 87% of imports to the UK will still be eligible for a tariff-free access for one year while a new permanent tariff agreement is negotiated with the EU.

EC president Jean-Claude Junker said yesterday that the risk of a no-deal Brexit is now "palpable". The remarks come after Mr. Junker met with PM Johnson on Monday to discuss a potential new Brexit deal. The Irish backstop seems to remain the main issue of contention between both parties. **The British pound (-0.4%) is trading at $1.24** and 3-month GBP-USD risk reversals are trading well into negative territory—indicating relatively high demand for put options on sterling.

British Pound: Risk Reversals



In central banking news, **the European Parliament voted in favor of Christine Lagarde's candidacy to the presidency of the ECB.** Mme. Lagarde secured 394 votes in favor, while there were 206 against her and 49 abstentions. She is expected to take the helm of the institution on Nov. 1, 2019. Separately, **BoE governor Mark Carney could be asked to extend his term due to the political uncertainty in the UK**, according to the FT.

Other Mature Markets

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Japan

Equities (-0.5%) fell, led by energy (-3.6%) following the retreat in oil prices. Separately, Japan's trade dispute with South Korea deepened as Korea removed Japan from its list of most trusted trading partners. Korea also plans to terminate a US-endorsed intelligence-sharing pact with Japan, according to Bloomberg. Japanese exports to Korea fell 9.4% y/y in August, larger than the overall decline of 8.2% y/y in Japanese exports. Food exports, including beer, which has been boycotted by some South Koreans, collapsed 41%. **The yen was little changed while 10-year JGB yields fell 3bps to -0.19%.**

Commodities

Oil traded at $64.1/barrel for Brent (-0.7%) and $58.9/barrel (-0.7%) for WTI as Saudi authorities announced that half of the pre-attack production capacity has been restored. According to analysts, concerns over Saudi Arabia's production capacity will linger as the Kingdom needs to rely on reserves to honor supply commitments and it will take more time to repair the damaged facilities.

Emerging Markets

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Asian equities were little changed (+0.1%) ahead of the Fed meeting. Indonesia (+0.6%) and Taiwan Province of China (+0.5%) led gains. Other South East Asian bourses posted small losses. Regional currencies were broadly unchanged, except for the Indian rupee (+0.7%), which outperformed as oil prices retreated. Local sovereign bond yields were slightly lower, with the Indian 10-year bond yields falling the most by 10bps to 6.6%, the largest decline in three weeks. In **EMEA markets**, stocks rallied in Qatar (+0.7%) and Saudi Arabia (+0.6%) while they dropped notably in other commodity-exporting bourses such as Kuwait (-2.2%), South Africa (-1.0%), and UAE (-0.9%). Other bourses in the region traded within a ±0.3% range. Currencies were steady. In **Latin America**, stock markets posted gains in Brazil (+0.9%) and Mexico (+1.4%) and trended lower in Argentina (-1.3%). Currencies depreciated in Argentina (-0.4%), Chile (-0.8%) and Colombia (-0.6%). 10-year benchmark rates decreased in Brazil by 11 bps, while at the short end of the term curve yields reduced for US$ sovereign 2-year debt in Argentina (-161 bps) and for local currency sovereign 2-year debt in Brazil (-6 bps).

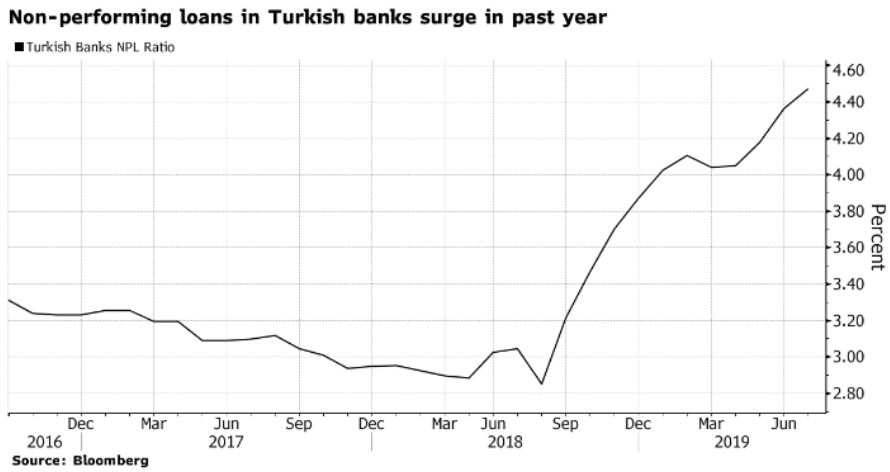
Key Emerging Market Financial Indicators

Last updated:	Level		Change				
9/18/19 8:07 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		41.91	-0.2	1	6	0	7
MSCI Frontier Equities		28.29	0.7	0	-3	1	8
EMBIG Sovereign Spread (in bps)		335	-1	1	-31	-20	-79
EM FX vs. USD		61.05	0.2	0	0	0	-2
Major EM FX vs. USD			**%, (+) = EM currency appreciation**				
China Renminbi		7.09	0.1	0	-1	-3	-3
Indonesian Rupiah		14067	0.2	0	1	6	2
Indian Rupee		71.24	0.8	1	0	2	-2
Argentine Peso		56.50	-0.4	-1	-3	-30	-33
Brazil Real		4.08	-0.1	0	0	2	-5
Mexican Peso		19.34	0.1	1	3	-3	2
Russian Ruble		64.17	0.4	2	4	5	8
South African Rand		14.61	0.7	0	6	2	-2
Turkish Lira		5.67	0.5	1	0	13	-7
EM FX volatility		8.18	0.0	-0.1	-0.6	-3.6	-1.6

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

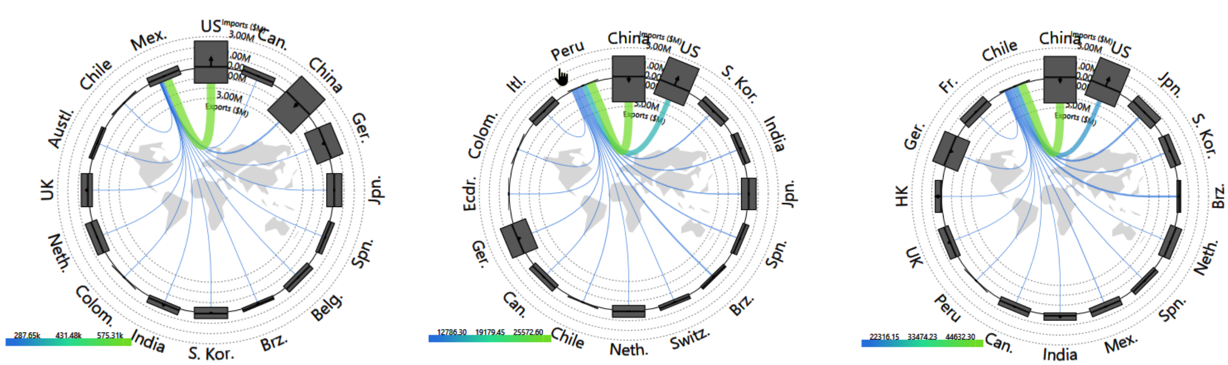
Turkey

The Turkish banking regulator has asked banks to reclassify around $8.1 bn loans as non-performing by end-2019. According to a statement released yesterday by the Banking Regulation and Supervision Agency (BDDK), the measure will bring the NPL ratio of the banking sector to about 6.3% for 2019, and will have a negative impact on banks' capital ratios, bringing them from 18.2% to 17.7%. Market contacts have welcomed the decision, as they have often complained of the unrealistically low measurement of bad loans in Turkey. **The lira strengthened 0.3% this morning to the USD while stocks dropped 0.2%.**



Latin America

Several Latin American economies appear particularly exposed to trade tensions. S&P analysts cite a Moody's report that Chile, Peru and Mexico may be vulnerable to rising trade tensions between China and the US. 34% of Chilean and 25% of Peruvian exports are destined for China, imposing vulnerabilities for government revenues and economic growth if China's aggregate demand moderates. According to Bloomberg data 72% of Mexican exports were heading to the US in 2018, implying similar vulnerabilities for the country in case of a trade shock. Moody's anticipates a potential reduction in Mexican GDP growth to 1.3% in case of an adverse trade shock. In this context, the 2% GDP growth expected in Mexico's 2020 budget proposal is assessed skeptically by Fitch, which according to S&P analysts perceives risks around the country's primary surplus target of 0.7% of GDP due to overly optimistic assumptions regarding macroeconomic developments and oil production.



Source: Bloomberg

Colombia

Increases in industrial production went along with modest increases in expected inflation. According to yesterday's data release industrial production increased in July y/y by 3.1%, up from -0.2% in June, indicating some promise for positive growth for the third quarter of 2019. With no other market reaction than a mild depreciation of the Colombian peso observable, markets may expect the additional supply to fuel income, internal demand and imports. This ties in with modest increases in expected end-of-2019 inflation reported last week by JP Morgan, which climbed in between June and September by 30bps from 3.4% to 3.7%.

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Global Financial Indicators

Last updated: 9/18/19 8:02 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		3006	0.3	1	4	3	20
Europe		3526	0.1	0	6	5	17
Japan		21961	-0.2	3	8	-6	10
China		2986	0.3	-1	6	11	20
Asia Ex Japan		68	-0.1	1	6	-2	7
Emerging Markets		42	-0.2	1	6	0	7
Interest Rates					basis points		
US 10y Yield		1.77	-4.5	3	22	-128	-91
Germany 10y Yield		-0.50	-2.7	6	18	-98	-74
Japan 10y Yield		-0.18	-3.0	2	5	-30	-19
UK 10y Yield		0.66	-4.1	2	19	-91	-62
Credit Spreads					basis points		
US Investment Grade		131	-0.4	-2	-5	30	-16
US High Yield		444	1.1	-9	-61	116	-77
Europe IG		48	-0.5	-1	-3	-12	-40
Europe HY		248	-1.1	1	-22	-31	-104
EMBIG Sovereign Spread		335	-1.0	1	-31	-20	-79
Exchange Rates					%		
USD/Majors		98.42	0.2	0	0	4	2
EUR/USD		1.11	-0.2	0	0	-5	-4
USD/JPY		108.2	0.0	0	-1	4	1
EM/USD		61.0	0.2	0	0	0	-2
Commodities					%		
Brent Crude Oil ($/barrel)		64	-0.5	6	10	-19	19
Industrials Metals (index)		116	-0.5	-2	2	0	6
Agriculture (index)		38	0.0	2	0	-7	-8
Implied Volatility					%		
VIX Index (%, change in pp)		14.5	0.0	-0.1	-4.0	1.7	-10.9
10y Treasury Volatility Index		5.8	-0.1	0.7	-0.1	2.5	1.3
Global FX Volatility		7.2	0.0	0.1	-0.9	-1.4	-1.8
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		196	-1.2	-26	-69	-164	-219
Italy		138	-1.1	-15	-70	-93	-112
Portugal		77	-1.7	-6	-3	-61	-71
Spain		75	-0.9	-7	-1	-27	-42

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: 9/18/2019 8:07 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		7.09	0.1	0.4	-1	-3	-3		3.1	0.0	3	4	-52	-8
Indonesia		14067	0.2	0.0	1	6	2		7.3	-2.5	-4	-12	-126	-83
India		71	0.8	0.6	0	2	-2		6.8	2.3	12	7	-144	-63
Philippines		52	0.2	0.0	0	4	1		4.4	-1.5	1	-18	-192	-192
Thailand		31	0.0	0.2	1	7	6		1.6	-3.2	-9	7	-132	-105
Malaysia		4.19	-0.1	-0.2	0	-1	-1		3.4	0.3	2	11	-72	-71
Argentina		56	-0.4	-0.8	-3	-30	-33		71.8	16.1	186	2680	4697	4878
Brazil		4.08	-0.1	-0.3	0	2	-5		6.5	-11.7	-16	-8	-388	-162
Chile		715	-0.1	0.0	0	-4	-3		2.8	1.0	13	10	-198	-167
Colombia		3385	-0.6	-0.7	2	-11	-4		5.7	0.0	-7	10	-90	-82
Mexico		19.34	0.1	0.9	3	-3	2		7.3	-6.3	3	19	-76	-144
Peru		3.3	-0.2	0.1	1	-1	1		4.4	2.4	8	7	-122	-134
Uruguay		37	-0.2	-0.4	-1	-10	-12		10.6	-16.3	-30	-25		-9
Hungary		301	0.0	0.3	-2	-8	-7		1.1	0.3	-13	24	-154	-109
Poland		3.92	-0.2	0.4	0	-6	-5		1.9	-0.6	-5	28	-71	-38
Romania		4.3	-0.2	0.4	0	-7	-5		3.7	2.0	-1	19	-56	-51
Russia		64.2	0.4	2.1	4	5	8		6.9	2.8	0	-26	-168	-153
South Africa		14.6	0.7	0.4	6	2	-2		9.4	5.3	8	-14	-47	-23
Turkey		5.67	0.5	1.3	0	13	-7		14.6	-2.5	-70	-52	-657	-223
US (DXY; 5y UST)		98	0.2	-0.2	0	4	2		1.63	-2.7	4	21	-131	-88

	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		2986	0.3	-1	6	11	20		184	0	-1	1	2	-10
Indonesia		6277	0.6	-2	0	8	1		167	-4	-6	-21	-27	-69
India		36564	0.2	-2	-2	-2	1		135	0	2	-5	-32	-61
Philippines		7915	-0.2	-1	2	9	6		65	-3	-3	-14	-31	-56
Malaysia		1599	-0.3	0	0	-11	-5		121	0	-1	-2	-6	-41
Argentina		30151	-1.3	6	-1	-6	0		2064	-55	-12	406	1409	1249
Brazil		104617	0.9	2	5	34	19		222	1	0	-19	-105	-51
Chile		5073	0.1	4	6	-5	-1		132	1	4	-4	2	-34
Colombia		1598	-0.2	2	4	6	21		179	2	5	-10	4	-49
Mexico		43449	1.4	2	10	-13	4		321	2	-1	-28	56	-33
Peru		19485	0.1	1	3	3	1		118	1	7	-10	-19	-50
Hungary		40809	0.5	2	2	13	4		87	1	1	-23	-22	-61
Poland		58170	0.3	0	5	1	1		25	4	5	-14	-21	-60
Romania		9316	0.5	1	3	12	26		183	1	-1	-20	5	-38
Russia		2812	-0.3	0	8	17	19		183	0	-4	-30	-47	-69
South Africa		56199	-1.2	0	4	0	7		305	1	-1	-24	-22	-60
Turkey		101419	0.0	0	6	7	11		490	1	-18	-24	20	61
Ukraine		516	0.0	-1	-4	-4	-8		464	-3	8	-92	-87	-323
EM total		42	-0.2	1	6	0	7		335	-1	1	-31	-20	-79

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

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