



Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Tuesday, September 11, 2018











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- **Supply disruptions widen WTI-Brent oil price discount** ([link](#))
- **US credit spreads remain tight despite heavy new supply to start the month** ([link](#))
- **Rising US cross-asset correlations cue worries about future market volatility** ([link](#))
- **Reports suggest UniCredit could consider merger with BBVA and ABN Amro** ([link](#))
- **ESRB report shows EU shadow banking sector shrunk 0.1% in 2017** ([link](#))
- **Emerging market portfolio inflows slow in August** ([link](#))
- **Increased repo usage signals rising leverage in Chinese bond markets** ([link](#))

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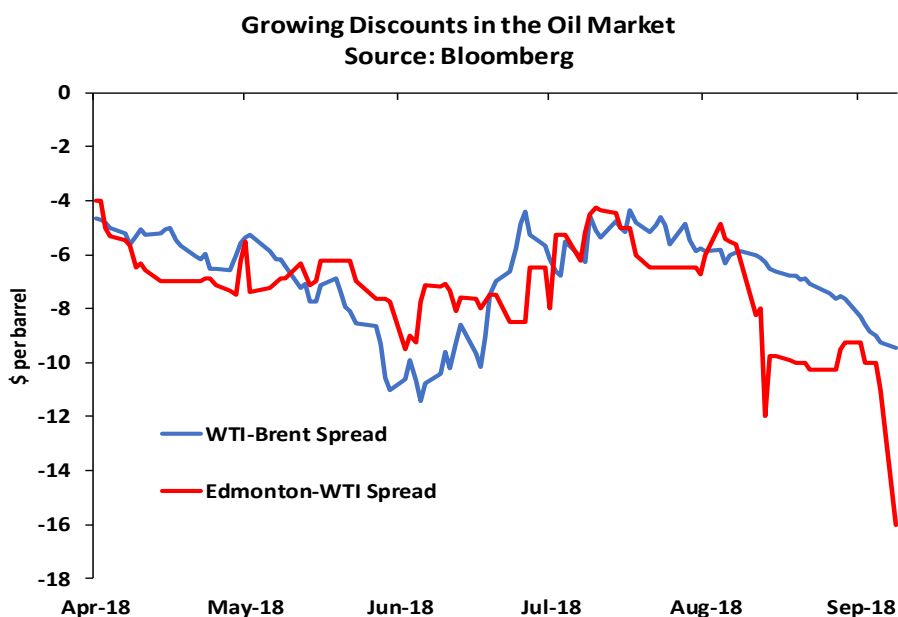
Markets mixed as investors weigh trade worries with easing policy risks in Europe

The British pound outperformed as encouraging remarks from officials have eased concerns around upcoming policy risks in Europe. This morning, Asian equities have stabilized and European bourses are marginally lower, while developed market sovereign yields are modestly higher. Investors remain anxious about the US-China trade relationship, while risks around the Italian budget process and Brexit continue to diminish. The sterling rallied close to 1% amid a more positive tone between EU and UK negotiators that has both sides emphasizing a mutually agreed Brexit is the most likely outcome, and with a potential deal by November. While Italian equities are experiencing some profit taking this morning, overall sentiment has improved following remarks over the weekend that reforms will be done within the EU budget limits. Emerging market assets have been steady more recently, but some currencies (ARS, BRL, and TRY) are partially reversing last week's gains and contacts note investors remain cautious.

Last updated: 9/11/18 8:06 AM	Level		Change from Market Close				YTD
	Last 12m	Index	1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		2876	0.0	-1	2	16	8
Eurostoxx 50		3293	-0.5	-2	-4	-6	-6
Nikkei 225		22665	1.3	0	2	16	0
MSCI EM		41	-1.0	-5	-5	-10	-13
Interest Rates			bps				
US 10y Yield		2.95	1.8	5	8	82	54
Germany 10y Yield		0.42	1.9	6	10	8	-1
Japan 10y Yield		0.12	-0.3	-1	1	11	7
FX / Commodities / Volatility			%				
Dollar index, (+) = \$ appreciation		95.2	0.1	0	-1	4	3
Brent Crude Oil (\$/barrel)		77.9	0.6	0	7	45	16
VIX Index (% change in pp)		14.5	0.4	1	1	4	3

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

Supply disruptions have caused the largest Brent-WTI oil price divergence since June. The spread between Brent oil futures contracts and the US WTI benchmark is approaching ten dollars. The decline in exports from Iran due to US sanctions has been compounded by supply disruptions in Libya due to recent fighting. In North America, the glut of supply has led to excessive inventories that have kept prices low. Canadian oil benchmarks have been especially weak as supply from oil sands projects came back online following disruptions during the summer. The Edmonton Mixed Sweet benchmark is at its largest discount to benchmark since June 2014. WTI's steep discount to Brent could persist for longer than expected as the US is set to further increase production and become the largest global producer of oil as early as next year.



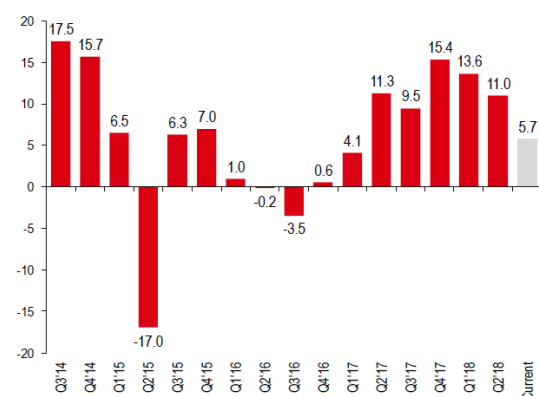
United States

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Markets were little changed in quiet holiday trading (S&P 500 +0.2%), although the prospect of trade tensions continues to lurk in the background. The continued outperformance of US markets versus Europe and emerging markets remains a key focus for investors. Most expect the performance gap to close but with little agreement on whether this will occur due to better performance overseas or US under performance due to political or economic surprises. The technology sector has faltered in recent days due to worries about the impact of trade sanctions on companies such as Apple. Volatility in both equities and rates remains very low and the dollar traded in a narrow range for most of the day. The S&P 500 closed just over 1% below the record set on August 29.

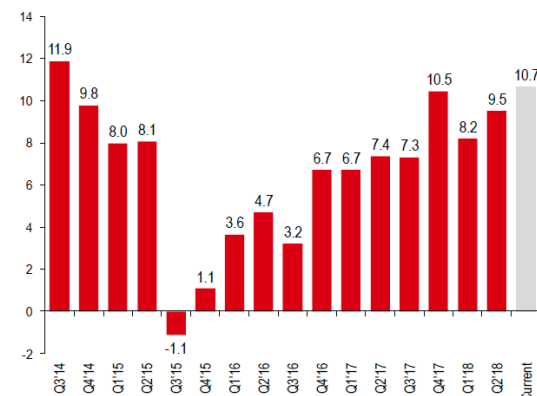
US credit spreads held steady despite the heaviest week of corporate bond issuance in 2018. New deals of over \$64 bn came to market over the past few sessions, but both investment grade and high yield spreads have tightened a few basis points. However, some investors have become worried that the long bull market in corporate bonds could be finally coming to an end. The recent downgrades of prominent issuers such as Ford and Campbell Soup have increased worries about deteriorating credit quality. Other metrics such as the slowing growth of cash balances and the increasing level of corporate debt have also worried some investors. Others are more optimistic, pointing to continued strong corporate profits and default rates that have been lower than historical averages.

Cash balance growth rate (YoY%)



Source: MSCI
Note: MSCI US Large Cap 300

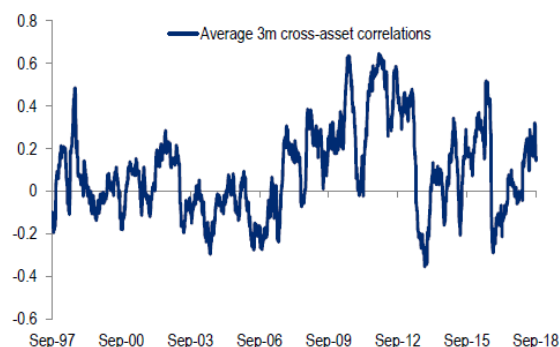
Total debt growth rate (YoY%)



Source: MSCI
Note: MSCI US Large Cap 300

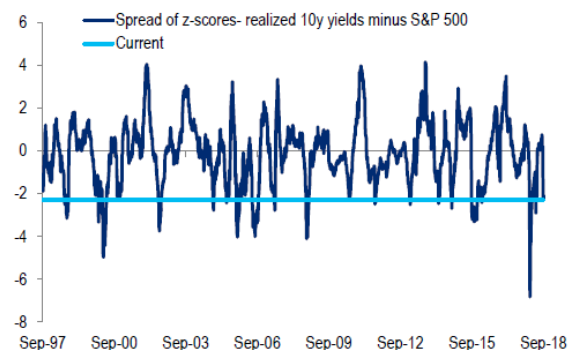
Cross-asset correlation has increased in recent weeks, a development often linked to higher market volatility down the road. Higher correlations were observed leading up to the LTCM crisis in 1998 as well as the global financial crisis of 2007-8. Correlations across US equities, Treasury rates, oil and the dollar moved higher through the summer, but interest rate volatility remains suppressed relative to equity volatility. This is viewed as a bad omen by some analysts who think that the US bond market is due for a volatility shock. Treasury yields moved in an unexpectedly narrow range over the past few months due to strong safe haven demand, but they think this could change due to potential surprises from events such as the US elections or other political events.

Figure 8. Cross asset correlations have been increasing recently which is typically a risk for higher vol...



Source: Citi Research, Bloomberg; Note: Our measure of average cross-asset correlations uses equal weights of 10s/spx, 10s/oil, 10s/dxy. Correlations are computed on a 3m rolling window.

Figure 9. ...but rates realized vol has been significantly depressed to equity vol as of late



Source: Citi Research; Note: We compute the spread between the rolling 1y z-score of realized vol of 10y yields and the S&P 500. The realized vol is computed over a 3m window.

Europe

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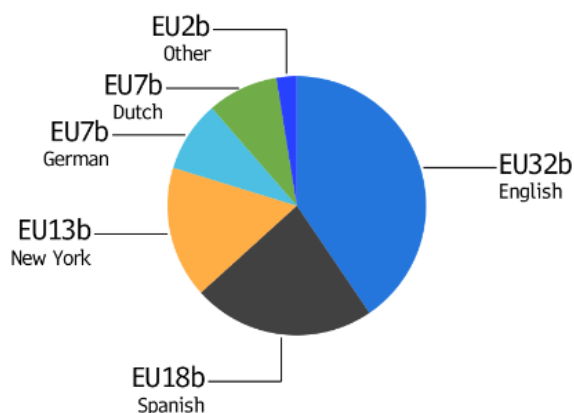
European stocks are mixed within a narrow $\pm 0.1\%$ corridor, while bank stocks are outperforming with gains of 0.5%. UK main indices are underperforming: FTSE 100 (-0.4%) and FTSE 250 (-0.2%). **Sovereign yields are 1-2 bps higher across countries:** 10-year yields at 0.42% in Germany, 0.72% in France, 2.88% in Italy, 1.45% in Spain.

Local media in Italy suggest UniCredit may be considering a merger with BBVA and ABN Amro if talks with Societe General fail. Analysts doubt, however, that a large pan-european merger may occur in the near term. Separately, UniCredit is also rumored to be planning the sale of a further €1 bn of NPLs to Cerberus and Banca Ifis in a sale dubbed 'project Torino.' The disposal comes on top of the €1 bn already underway as 'project Milano.' UniCredit stocks are 0.1% down today, underperforming the banking sector at large (+0.3%).

Bloomberg News reports an increasing use of contractual clauses allowing bond issuers to switch their governing jurisdiction away from English law in preparation for Brexit. Based on interviews with corporate lawyers, Bloomberg claims debt prospectuses are including an increasing amount of provisions regarding potential legal risks of Brexit. One area of concern according to Bloomberg is AT1 bonds, which under English law are considered bail-in debt but may not be so under EU rules, and may become 'third-country' bonds and hence lose their loss-absorbing status. As part of Brexit preparations, steps are being reportedly taken in Paris, Dublin, and Amsterdam to set up new courts able to make judgements based on English law.

English Dominance

English law governs about 40% of the 79 billion euros in outstanding AT1 bonds



Source: Bloomberg data for EU banks except U.K.

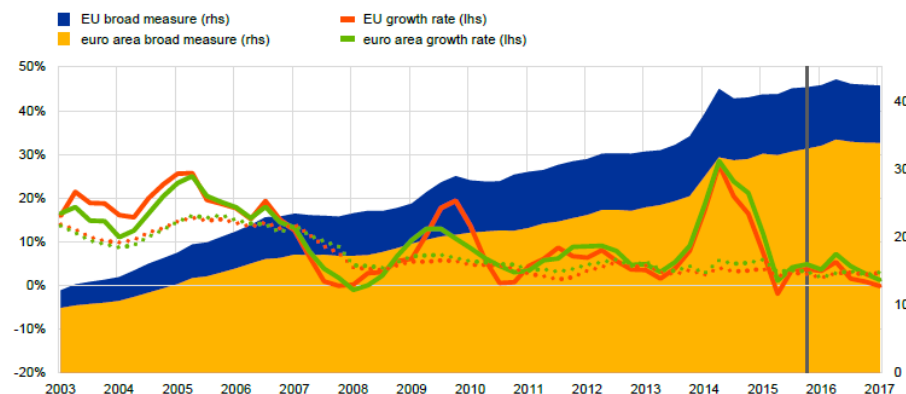
Bloomberg

The European Union's shadow banking sector shrunk 0.1% in 2017 while the banking sector continued to grow, according to the European Systemic Risk Board (ESRB). In its [latest report](#), the ESRB also underscored the need to continue monitoring shadow banks given their size and interconnections with the rest of the financial system.

Chart 2 (See Section 4.2)

Size of EU and euro area shadow banking system (investment funds and other financial institutions)

(annual growth rates and EUR trillions; last observation: Q4 2017)



Sources: ECB and ECB calculations.

Notes: The continuous lines indicate annual growth rates based on changes in outstanding amounts. The dotted lines indicate annual growth rates based on transactions – i.e. excluding the impact of FX or other revaluations and statistical reclassifications.

Table 1

Potential risks and vulnerabilities in the shadow banking system

- I. Liquidity risk and risks associated with leverage among some types of investment funds
- II. Interconnectedness and the risk of contagion across sectors and within the shadow banking system, including domestic and cross-border linkages
- III. Procyclicality, leverage, and liquidity risk created through the use of derivatives and securities financing transactions
- IV. Vulnerabilities in some parts of the other financial institutions sector, where significant data gaps prevent a definitive risk assessment

Note: The assessment presented in this report does not provide a ranking of risks and vulnerabilities in the EU shadow banking system in terms of likelihood of materialisation or impact.

European Data Releases:

- **The German ZEW Survey Current Situation for September surprised at 76 vs. 72 expected.** The survey on Economic Expectations was also stronger at -10.6 compared to -13.0 expected.
- **UK unemployment in July stood at 4.0%**, the same level as in June.







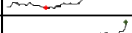
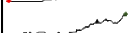


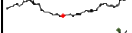

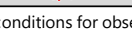

Other Mature Markets [back to top](#)

Japan

Equities gained while the yen lost ground for a third day as market sentiment stabilized. The Topix rose 0.7% and the Nikkei, +1.3%, with technology shares providing the biggest boost. Meanwhile, the yen shed 0.3% to 111.5 as safe-haven demand for the currency fell, despite lingering US trade tensions. Separately, Bloomberg reported that the **BoJ could reduce its ETF purchases.** A number of BoJ officials raised the possibility that the central bank would need to cut its ¥6 tn (\$54 bn) annual target for ETF purchases in the future as the BoJ already owns about 75% of the market. Notably, the BoJ's ETF purchases had already fallen markedly in August to ¥140.6 bn, excluding buying related to supporting investment in physical and human capital.

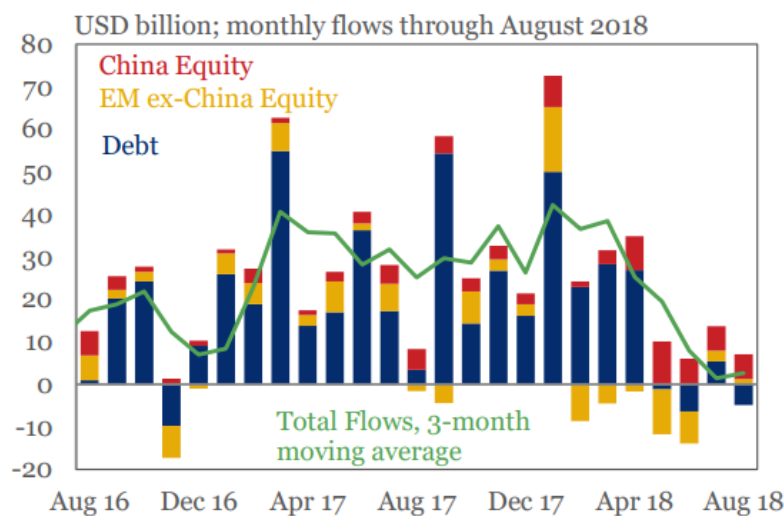
Emerging Markets [back to top](#)

Key Emerging Market Financial Indicators

Last updated: 9/11/18 8:10 AM	Level		Change				YTD
	Last 12m	index	1 Day	7 Days	30 Days	12 M	
Prices/Returns of Major EM Benchmarks			%				%
MSCI EM Equities		41.14	-1.0	-5	-5	-10	-13
MSCI Frontier Equities		27.65	-0.4	-1	-4	-12	-17
Hard Currency Sovereign Debt		814.53	-0.1	0	-1	-5	-5
Local Currency Sovereign Debt		15.87	-0.1	-2	-4	-19	-16
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.87	-0.2	0	0	-5	-5
Indonesian Rupiah		14870	-0.2	1	-2	-11	-9
Indian Rupee		72.73	-0.2	-2	-4	-12	-12
Argentine Peso		37.46	0.0	4	-20	-54	-50
Brazil Real		4.16	-1.7	0	-6	-25	-20
Mexican Peso		19.34	-0.4	0	-1	-9	2
Russian Ruble		70.21	0.5	-3	-4	-19	-18
South African Rand		15.12	0.5	1	-5	-14	-18
Turkish Lira		6.47	-0.1	3	6	-47	-41
Dollar vs. Mature FX (DXY index)		95.25	0.1	0	-1	4	3

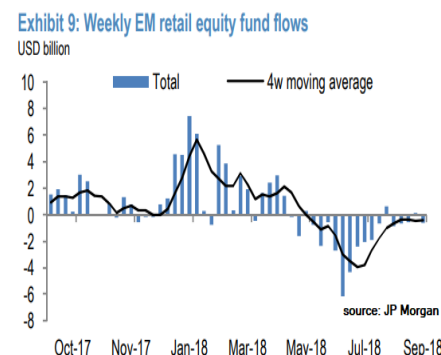
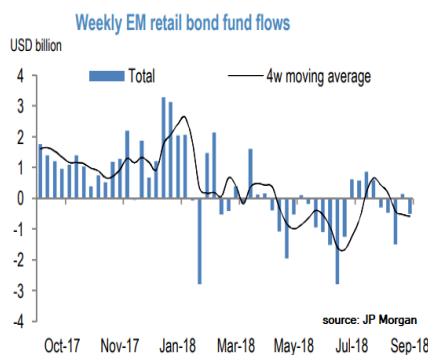
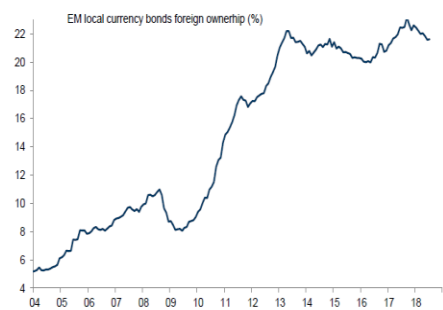
Colors denote **tightening/easing** financial conditions for observations greater than ± 1.5 standard deviations. Data source: Bloomberg.

Flows and issuance data show a slowdown of portfolio inflows to emerging markets in August, down to \$2.2 bn, from \$13.7 bn in July. Chinese equities accounted for more than 80% of total equity inflows. Additionally, debt flows turned negative for the first time since June. Net inflows were again primarily to Asia, with over \$2 bn to Thailand. For Latin America, debt outflows reached \$3.1 bn, driven by the current crisis in Argentina, and the political situation in Brazil. Meanwhile, debt outflows from EMEA reached \$3.2 bn, with a substantial portion caused by concerns related to South Africa.

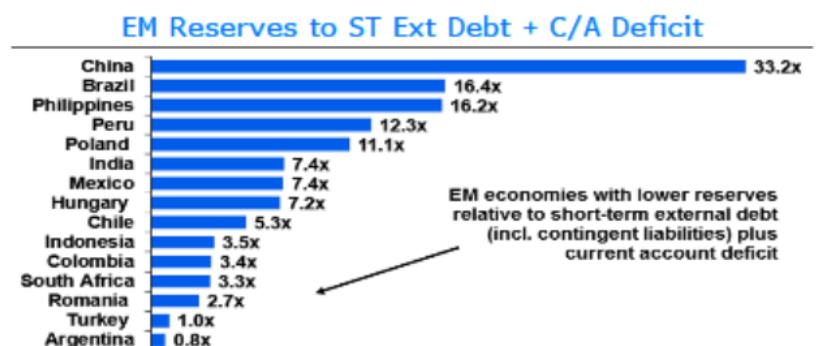
Chart 1: Net non-resident portfolio inflows to EMs

Source: National sources, IIF

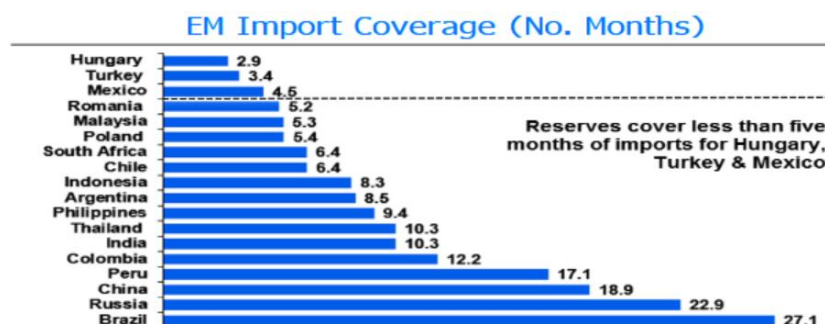
Meanwhile, emerging market bond and equity flows continued the outflow trend for the first week of September. EM bond flows were -\$492 mn, while equity fund flows were -\$592 mn, as idiosyncratic factors in EMs, tightening monetary policy in advanced economies, and trade tensions continue to cause headwinds. Data shows that there has been a slowdown in issuance of FX-denominated debt, and that foreign ownership of local currency sovereign bonds has subsided.



A report by Bloomberg that gauges the state of capital buffers in EM concluded that they remain elevated for most countries despite some recent deterioration. Argentina, Hungary and Romania stand out as having the lowest buffers when comparing FX reserves to short-term loans and current account. For number of months of import coverage, Turkey, Hungary and Mexico are the weakest countries in the sample. China and Brazil stand out as the safest against both measures.



Source: Bloomberg Intelligence



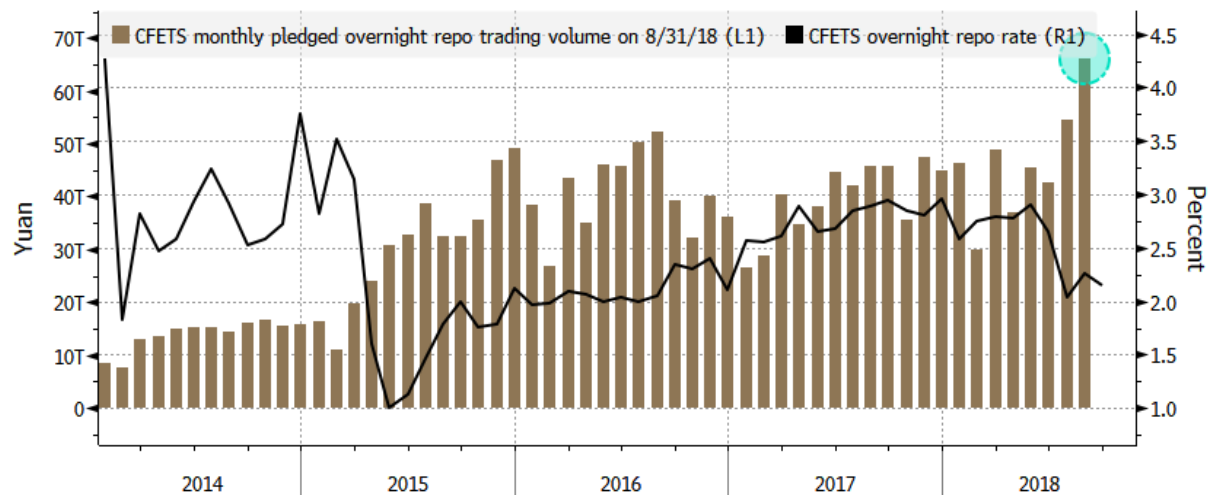
Source: Bloomberg Intelligence

China

Bond market leverage reached a record high amid recent declines in funding rates. Based on official data, the turnover of overnight repo transactions, a gauge for market leverage, increased for a third month to reach RMB 66.1 tn (\$9.6 tn). Although funding costs have edged higher more recently, interbank rates remain well below levels seen in June. The overnight rate, at 2.67%, is roughly 140 bps below the highest level seen in June; the 1-month rate, at 3.2%, is about 200 bps lower. Amid this decline in funding rates, the yield spread between the overnight rate and longer-dated debt have widened, making leveraged borrowing attractive. For example, the spread between overnight repo and a 6-month AA+ rated NCDs is currently about 107 bps, a sizable return. Market observers noted that this increased use of leverage is presenting challenges to the PBC as it looks to stabilize investor sentiment while pressing ahead with its deleveraging campaign. **Amid stabilized market sentiment, the RMB softened a touch while equities held steady.** Both the onshore CNY and the offshore CNH lost 0.2% to 6.87 and 6.88, respectively. Meanwhile, the Shanghai Composite was little changed while the high-tech Shenzhen Compositd edged higher (+0.2%), though it remains near its weakest level in more than 3 ½ years.

Borrowing Binge

Trading of overnight pledged repos surges to a new high in August



Source: CFETS, Bloomberg

CFEBYV1D Index (CFETS Monthly Pledged Repo R001 Trading Volume) pledged repo Mo Copyright© 2018 Bloomberg Finance L.P. 11-Sep-2018 14:45:10






























Brazil

Bolsonaro leads the latest opinion poll for the presidential election, but the election outcome remains uncertain. Brazil's datafolha poll, the first major poll since the assassination attempt of Bolsonaro, showed the far-right candidate as still leading the field. However, the poll also showed that left-wing candidates had made the most significant gains in the presidential race, with candidate Ciro Gomez up from 9% to 13%, and Fernando Haddad (replacement of former president Lula da Silva), up from 4% to 9%. Bolsonaro's numbers increased only marginally, from 22% to 24%. This falls short of analysts' expectations, who had speculated that the assassination attempt would significantly boost his popularity. Market participants view that while it is increasingly likely that Bolsonaro will make it to the second round, he would be likely to struggle in the run-off. The *real* depreciated over 1%, while local equities were little changed on the day.

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Global Financial Indicators

Last updated: 9/11/18 8:08 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		2876	0.0	-1	2	16	8
Europe		3293	-0.5	-2	-4	-6	-6
Japan		22665	1.3	0	2	16	0
China		2665	-0.2	-3	-5	-21	-19
Asia Ex Japan		68	-1.0	-5	-5	-7	-11
Emerging Markets		41	-1.0	-5	-5	-10	-13
Interest Rates			basis points				
US 10y Yield		2.95	1.8	5	8	82	54
Germany 10y Yield		0.42	1.9	6	10	8	-1
Japan 10y Yield		0.12	-0.3	-1	1	11	7
UK 10y Yield		1.49	2.1	6	25	45	30
Credit Spreads			basis points				
US Investment Grade		103	-0.6	0	1	-9	12
US High Yield		344	-0.8	0	-3	-60	-31
Europe IG		62	1.1	-6	-8	10	17
Europe HY		283	3.0	-14	-25	55	50
EMBIG Sovereign Spread		373	0.0	2	18	82	88
Exchange Rates			%				
Dollar Index (DXY)		95.20	0.1	0	-1	4	3
USDEUR		1.16	-0.2	0	1	-3	-4
USDJPY		111.4	-0.2	0	-1	-2	1
EM FX vs. USD		60.2	-0.1	0	-3	-15	-13
Commodities			%				
Brent Crude Oil (\$/barrel)		78	0.6	0	7	45	16
Industrials Metals (index)		115	-0.9	0	-6	-11	-17
Agriculture (index)		43	-0.4	0	-3	-13	-10
Implied Volatility			%				
VIX Index (% change in pp)		14.5	0.4	1.4	1.4	3.8	3.5
10y Treasury Volatility Index		3.6	0.0	-0.1	-0.3	-0.7	0.1
Global FX Volatility		9.1	0.0	0.0	0.1	0.8	1.7
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		410	-10.2	-47	-13	-137	-2
Italy		289	-2.5	-13	-11	92	87
Portugal		187	-1.1	0	9	-95	-7
Spain		145	-0.8	2	4	-12	-12

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: 9/11/2018 8:11 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	-0.2	-0.4	0	-5	-5		3.6	1.3	6	13	-11	-35
Indonesia		14870	-0.2	0.7	-2	-11	-9		8.7	9.5	32	84	197	206
India		73	-0.2	-1.9	-4	-12	-12		8.3	8.3	15	32	136	81
Philippines		54	-0.4	-0.7	-1	-6	-7		6.2	8.8	26	27	135	134
Thailand		33	-0.1	-0.1	2	1	-1		2.8	1.7	3	6	64	53
Malaysia		4.15	0.0	-0.2	-1	1	-2		4.1	0.0	5	7	30	22
Argentina		37	0.0	4.1	-20	-54	-50		24.8	17.8	9	351	911	878
Brazil		4.16	-1.7	0.1	-6	-25	-20		10.5	-9.1	-9	43	181	145
Chile		699	-0.4	-1.0	-5	-11	-12		4.8	0.3	3	1	44	2
Colombia		3088	-0.1	0.2	-3	-5	-3		6.7	6.0	15	18	30	43
Mexico		19.34	-0.4	0.3	-1	-9	2		8.1	1.7	12	28	118	40
Peru		3.3	0.0	-0.4	-1	-3	-3		5.6	-0.6	9	12	14	37
Uruguay		33	-0.6	-0.1	-4	-12	-12		11.7	-16.7	26	137		310
Hungary		281	-0.2	0.8	1	-9	-8		2.5	0.6	4	-3	85	128
Poland		3.73	-0.1	-0.2	1	-5	-7		2.6	-0.3	5	10	8	-5
Romania		4.0	-0.3	-0.1	2	-4	-3		4.3	-2.0	-4	-3	149	48
Russia		70.2	0.5	-3.0	-4	-19	-18		8.9	3.3	48	80	140	159
South Africa		15.1	0.5	1.5	-5	-14	-18		9.8	9.2	25	38	62	50
Turkey		6.47	-0.1	3.1	6	-47	-41		22.5	38.7	-84	21	1194	1056
US (DXY; 5y UST)		95	0.1	-0.2	-1	4	3		2.84	2.0	7	10	113	64

	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		2665	-0.2	-3	-5	-21	-19		186	0	4	-4	39	34
Indonesia		5831	-0.3	-2	-4	-1	-8		211	2	23	21	37	45
India		37413	-1.3	-2	-1	17	10		170	6	13	14	35	60
Philippines		7518	-1.0	-5	-4	-7	-12		107	-2	2	-2	16	12
Malaysia		1799	0.0	-1	0	1	0		135	-2	3	-4	6	25
Argentina		29455	-1.2	2	10	22	-2		750	3	-34	49	355	400
Brazil		76436	0.0	0	0	3	0		332	7	-11	39	79	98
Chile		5204	0.0	1	-1	1	-6		139	0	-2	-3	11	20
Colombia		1472	-0.3	-4	-3	-2	-3		186	1	0	-7	-4	12
Mexico		48849	-0.2	-1	1	-3	-1		282	0	-5	-7	39	37
Peru		18897	0.0	-3	-6	5	-5		148	-1	0	-11	3	11
Hungary		36723	-1.3	-1	2	-3	-7		115	-2	-6	-11	22	27
Poland		57599	-0.4	-3	-2	-11	-10		54	-1	-5	-14	2	7
Romania		8305	-0.3	0	2	3	7		186	3	2	6	51	73
Russia		2322	-0.6	-1	2	14	10		250	9	19	11	79	72
South Africa		55797	-1.6	-4	-3	0	-6		354	5	16	60	102	100
Turkey		92473	0.8	-1	-3	-16	-20		547	6	-54	57	274	258
Ukraine		530	-0.2	1	5	82	68		597	11	-4	52	133	142
EM total		25	-0.7	-4	-3	-4	-7		373	0	2	18	82	88

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