Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Thursday, October 4, 2018

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- **US yields break higher on signs of strong economy, hawkish Fed (link)**
- **Global bonds and currencies sell off after advance in US yields (link)**
- **Asian emerging market and Turkish assets decline after US rates move (link)**
- **Argentine currency and bonds strengthen on confidence in new policies (link)**

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Surging US bond yields reverberate globally

US bond yields broke decisively higher in trading yesterday, **triggering a sell-off in bond markets and equities around the world and a rally in the dollar.** After months of rangebound trading, Treasury yields have jumped by over 14 bps since yesterday's market open, reaching new multi-year highs. Traders attribute the move to a combination of strong US data, hawkish commentary from Fed Chair Powell, and outsized shifts in market positioning as prices blew through key psychological thresholds for 10- and 30-year bonds. Despite little initial reaction in US shares, global risk assets weakened overnight, with equities slipping in Europe and EM Asia, and US equities now poised to decline at the open. Emerging markets have been largely on the backfoot, particularly in EM Asia and Turkey, as rising US yields fueled selling pressure on both fixed income and equities.

Key Global Financial Indicators

Last updated: 10/4/18 8:26 AM	Level		Change from Market Close				
	Last 12m	Index	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		2922	-0.1	0	1	15	9
Eurostoxx 50		3392	-0.4	-2	1	-6	-3
Nikkei 225		23976	-0.6	1	6	16	5
MSCI EM		42	-0.8	-2	-1	-8	-11
Interest Rates				bps			
US 10y Yield		3.19	11.8	14	29	87	79
Germany 10y Yield		0.53	5.1	0	17	7	10
Japan 10y Yield		0.16	1.8	4	4	10	11
FX / Commodities / Volatility				%			
Dollar index, (+) = $ appreciation		95.8	0.1	1	0	3	4
Brent Crude Oil ($/barrel)		85.9	-0.4	5	10	54	29
VIX Index (%, change in pp)		12.9	1.3	0	0	3	2

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

United States

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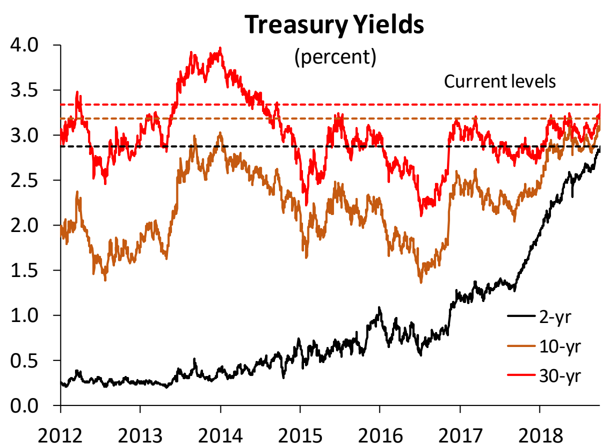
Treasury yields rose 5 to 12 bps across the 2- to 30-year maturity spectrum in an active session in US bonds markets yesterday. Wednesday's yield spike was one of the largest increases on a non-FOMC day in the past few years, comparable in size to the aftermath of the 2016 election. The uptick and bear steepening in the curve occurred amid highly elevated volumes in cash and futures markets, with major technical levels in 10s and 30s being breached, but was not accompanied by reports of mini-flash events or other disruptions.

Traders attributed the price action primarily to optimism about the US economy, but also to carryover from Europe's selloff and higher hedging costs. Key drivers included: the strong ISM non-manufacturing print (the strong employment component led analysts to upgrade estimates for this Friday's payrolls release); comments from Fed chair Powell about the "remarkably positive" economy that should see continued growth "for quite some time;" ADP data which showed companies added the most jobs in seven months; some carry-over from higher core yields in Europe on the back of Italian budget news; and reduced Treasury demand from European and other overseas investors as the increasing cross-currency basis has caused hedging costs to increase.

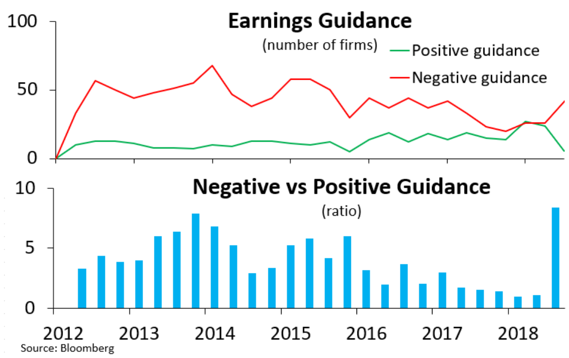
The rise in nominal yields was initially accompanied by higher real rates, but as oil prices rose, break-evens also widened. No convexity-related hedging appears to have been tied to today's move, as mortgage desks note that duration has already extended significantly. Eurodollar spreads indicating market expectations for rate hikes in 2019 moved sharply higher, and now price in an additional 10 bps of Fed hikes compared to the start of yesterday's session.

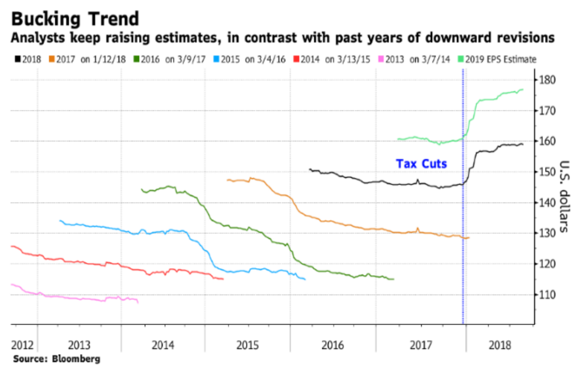


Source: Bloomberg

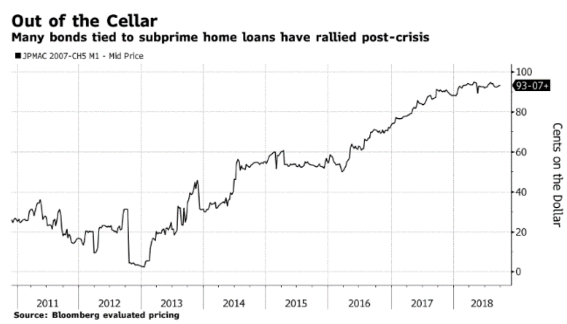
Stocks firmed yesterday as Treasury yields spiked, with the Dow posting a record close for a 15th time this year. Robust economic data helped support markets, but the sectoral picture was mixed. Financials (+0.8%) and energy (+0.8%) outperformed, while utilities (-1.2%) lagged. The S&P had surged intraday alongside rising yields but gave back most of its gains in the last hour of trading.

Companies are rushing to offer profit warnings to the market. Bloomberg data indicate that the ratio comparing the number of companies saying they will miss analyst estimates to those saying they will beat them is 8:1 currently, the most in the data going back to 2010. Some 80% of S&P 500 companies reported profits in Q2 that beat market expectations, which was a record high. Tax cuts and a strengthening economy underpinned such results. In aggregate, earnings beat forecasts by 5.2% in Q2. Earnings grew by 24% yoy in Q1 for S&P 500 firms, and by the same in Q2 according to Bloomberg. And FactSet expects Q3 growth to come in at a solid 19%.





Sub-prime mortgage bond prices have been rising over the years. Bloomberg notes that the benchmark JP Morgan bond was selling at just 2 cents on the dollar soon after the crisis. Rising home prices have underpinned the gains. But the stigma persists, and there was only $5.6 bn in sub-prime mortgage securities issued last year. And while the market stood at $2 tn in 2007, outstanding securities now total around $350 bn.



The Fed is asking for public comments on efforts to expedite the **US payments system.** There are basically two approaches: a real-time interbank settlement system available all the time, or a liquidity management tool that would support similar private-sector infrastructure. The intent is to increase the flexibility for households and businesses, and to address the recommendations of a Fed task force which advised a 24/7 solution, and similar findings from a Treasury department report on the issue.

Europe

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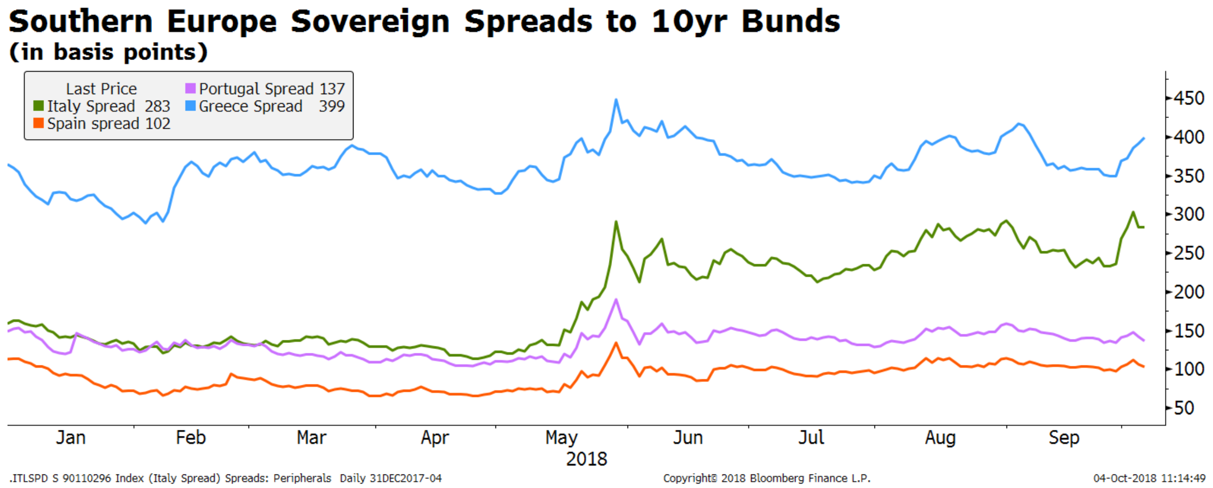
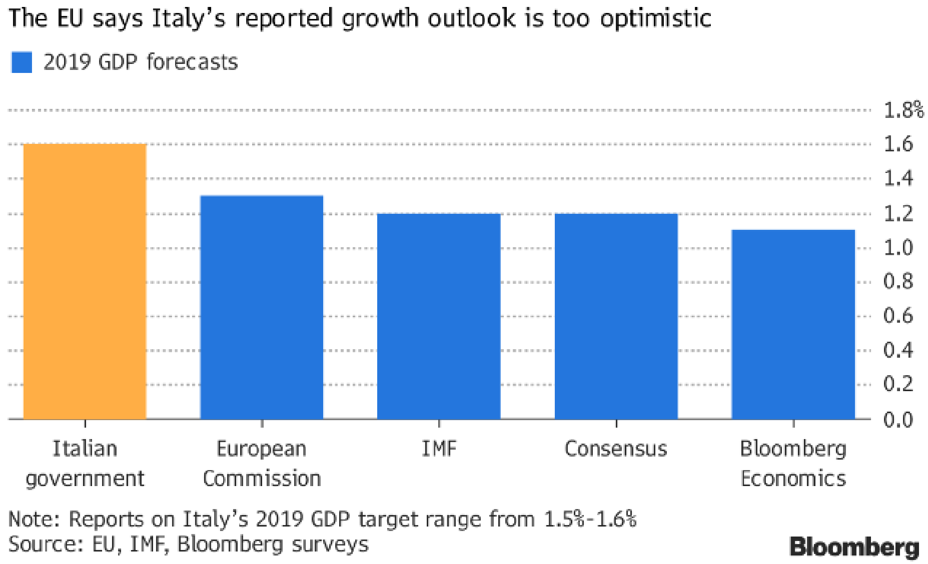
Ten-year sovereign debt yields are about 5 bps higher across markets this morning: Germany (0.53%, +5 bps); France (0.87%, +5 bps); Italy (3.35%, +5 bps); Spain (1.55%, +2 bps). Greek yields surged 15 bps to 4.52% on mounting concerns about the stability of domestic banks, which are saddled with large portfolios of NPLs (see below). Italian spreads to German bunds (currently at 283 bps) have almost doubled since end-2017.



Italian PM Conte said that the deficits have been fixed at 2.4% for 2019, 2.1% for 2020, and 1.8% for 2021. Analysts remain unconvinced about the credibility of the Italian government's growth assumptions, which well exceed those of most forecasters.



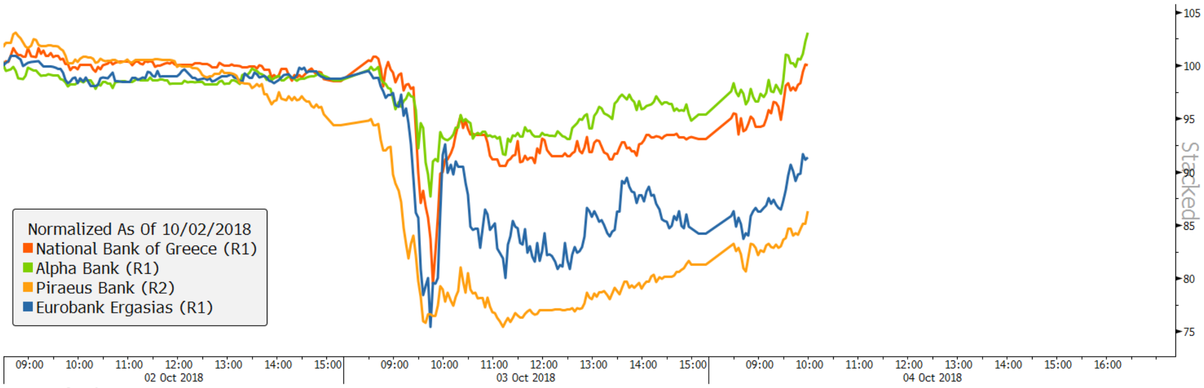
The main European stock indices are down – DAX (-0.3%), CAC 40 (-0.1%), EuroStoxx 600 (-0.8%) – **while bank stocks are up about 0.6%.**

The European Securities and Markets Authority (ESMA) plans to sign various memoranda of understanding with the UK's Financial Conduct Authority (FCA) to limit market instability in case of hard-Brexit (see here and here). Reportedly, the MoUs would cover issues ranging from transitional access of banks to clearing houses to information-sharing among regulators for financial surveillance. Mr. Maijoor, head of ESMA, said yesterday that a such agreements are "essential" to preserve financial stability, and added that added that central clearing of derivatives is "generally considered to be the securities markets area to entail the highest stability risks in the event of no deal being reached."

Monte dei Paschi is in advanced talks to sell its Belgian unit to local private equity firm Warburg Pincus, Bloomberg reports. The deal, part of MPS's rescue plan agreed with the Italian government, would be capital-neutral for MPS and would command only about €50 mn of fresh funds for the Italian lender. MPS stocks are 1.5% higher today, strongly putperforming peers.

Greek banks reversed some of their large losses from yesterday: Piraeus (+11.5%), Alpha (+8.3%), NBG (+7.7%), and Eurobank (+10.4%). Nonethless, year to date, Greek banks have underperfomed European banks by 32%. The continued poor performance of Greek lenders is linked to their high levels of non-performing exposures (NPEs), which range between 40% and 55% of total assets: Piraeus (54%), Alpha (52%), NBG (43%), and Eurobank (41%). Rumors have emerged that **the governemnt could be planning the creation of a bad-loan vehicle to unload about €15 bn worth of banks' NPEs.**

Bank Equities: Selected Greek Banks



Source: Bloomberg
SX7E Index (EURO STOXX Banks Price EUR) Bank: Greece 3 Days 3 Minutes Copyright© 2018 Bloomberg Finance L.P. 04-Oct-2018 10:16:57

Other Mature Markets

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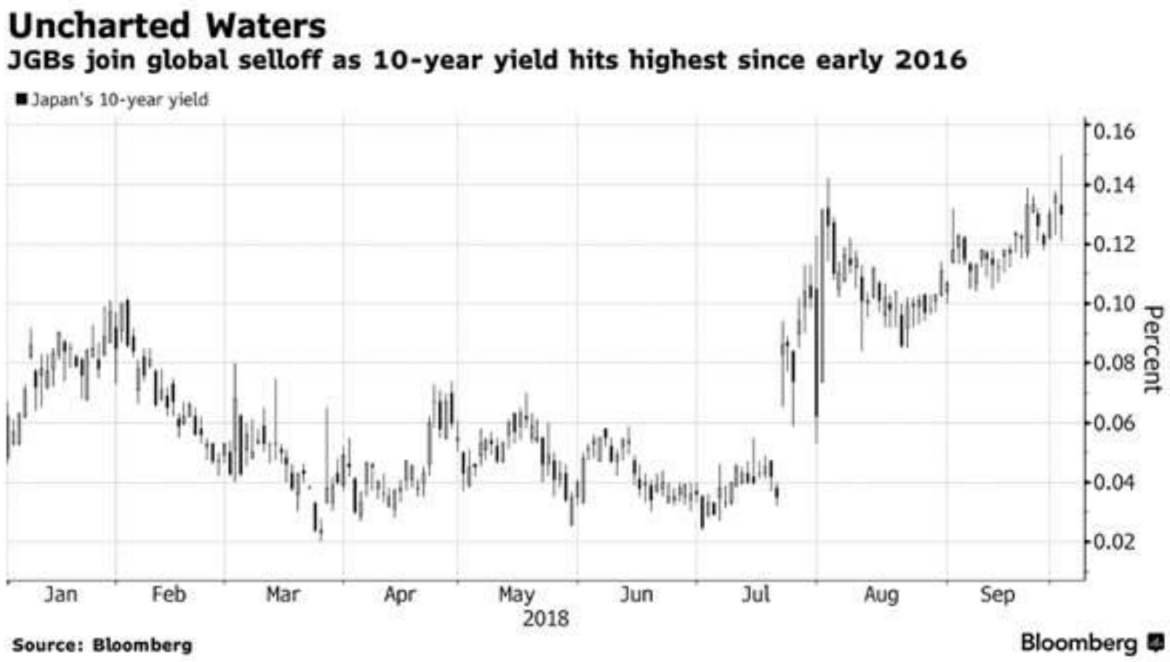
Japan

Equities fell, while the yen appreciated against the dollar. The Topix index closed 0.1% lower, while the Nikkei fell 0.6%. Healthcare and real estate stocks led losses. The yen appreciated 0.2% against the dollar, after sliding to an 11-month low. **Ten-year bond yields jumped 2bps to 0.149%, the highest since the introduction of the BOJ's negative interest policy in January 2016.** Markets are watching closely when the BoJ will step into the market. The central bank said on July 31 that it would allow the 10-year yield to deviate as much as 0.2 ppt from zero. However, it intervened in the market on Aug 2 when yields reached 0.145%.



Emerging Markets

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Key Emerging Market Financial Indicators

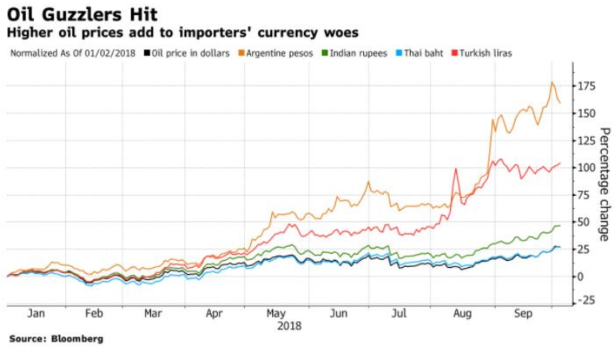
Last updated: 10/4/18 8:30 AM	Level: Last 12m	Level: index	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Prices/Returns of Major EM Benchmarks					%		%
MSCI EM Equities		42.04	-0.8	-2	-1	-8	-11
MSCI Frontier Equities		28.57	-0.6	-1	4	-10	-14
Hard Currency Sovereign Debt		829.58	-0.1	0	1	-2	-3
Local Currency Sovereign Debt		16.27	-0.7	-1	3	-15	-14
Major EM FX vs. USD					%, (+) = EM currency appreciation		
China Renminbi		6.87	0.0	0	0	-3	-5
Indonesian Rupiah		15194	-0.1	-2	-1	-11	-11
Indian Rupee		73.74	0.3	-2	-3	-12	-13
Argentine Peso		37.75	0.0	5	3	-54	-51
Brazil Real		3.92	-0.3	2	6	-20	-15
Mexican Peso		19.08	-0.2	-2	2	-4	3
Russian Ruble		66.77	-1.3	-2	2	-14	-14
South African Rand		14.71	-0.4	-4	4	-8	-16
Turkish Lira		6.15	-1.7	-2	9	-42	-38
Dollar vs. Mature FX (DXY index)		95.83	0.1	1	0	3	4

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

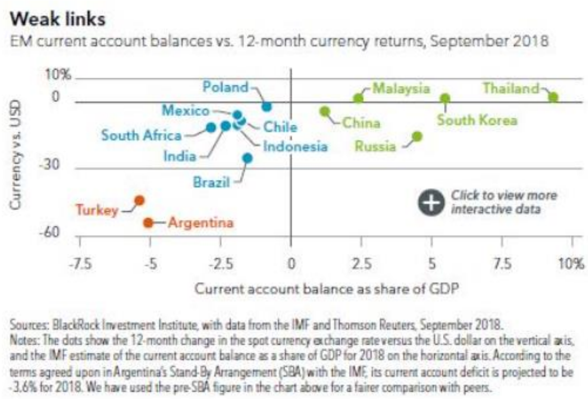
The Argentine peso appreciated further yesterday, up 1.0%, as commentators increasingly acknowledge that the new monetary policy regime is working well. Brazilian markets continued to rally for a second day, with equities up 1.7% and the real 1.3% stronger, as hopes for the right-wing candidate increased and some even contemplate his first-round victory. EMEA assets are under pressure with equities and currencies down in most countries in the region. Turkey is the clear underperformer with the lira depreciating 2.0% against the dollar and rates spiking by as much as 200 bps. EM Asian equities are also broadly lower with losses between 1.5%-2.0% in India, Korea and Taiwan. In FX, the Korean won and the Thai baht were underperforming, depreciating nearly 1.0%.

Emerging Markets

Rising oil prices renew pressures on emerging markets. Analysts are focusing on the implications of surging oil prices for EM oil importers. Oil futures prices have breached the $85 mark in the fourth session over the last five days. Oil is now up 26% year-to-date, as worries about falling exports from Iran are outweighing the supply reflected in higher US stockpiles. Analysts note that a basket of Asian currencies incurred the largest three-day loss in a month. The Indian rupee has been the worst performing currency in the region based on this metric—in contrast with the Thai baht which has been steady against the dollar (figure). Observers also single out Turkey and South Africa as oil-importing high-beta EMs under additional pressure from oil.



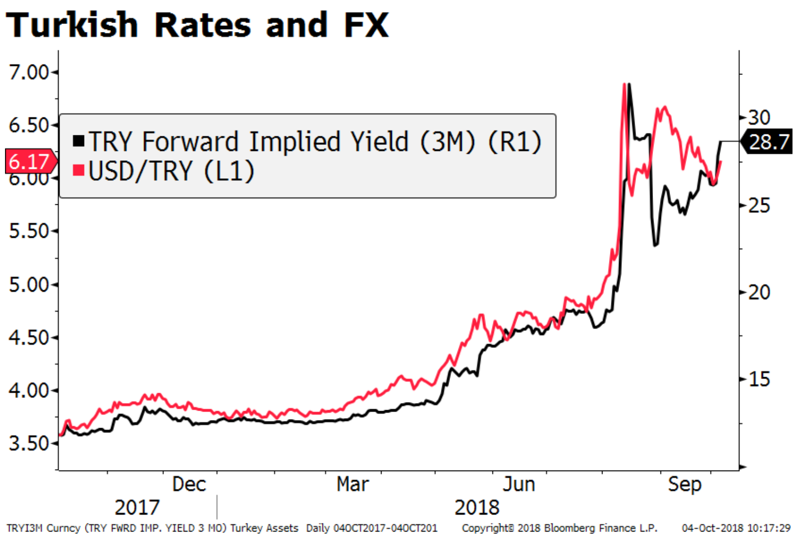
BlackRock sees EMs as approaching a turning point and advises to avoid countries with external vulnerabilities. In a publicly available note, global strategists at the $6 tn investment manager said that while there are still uncertainty and negative factors like higher interest rates affecting EMs, the asset class may soon pass the worst of its troubles, including the end of high political risks after the Brazilian elections. Blackrock advised to be selective across emerging markets and to avoid countries with large external debt and high current account deficits (figure).



Turkey

The lira is under strong pressure again this morning, weakening for the third consecutive session. Contacts have not noted any specific catalyst for today's underperformance. Instead, the move seems to be driven by continued negative sentiment following yesterday's higher-than-expected CPI print, along with a confluence of negative external factors: stronger dollar, higher Treasury yields, and gradual move higher in oil prices. Swap rates are as much as 200 bps higher and the lira is down 2.0% against the dollar (chart). Despite the moves, the lira is still about 10% stronger compared to its weakest level seen in mid-August.

A leaked draft of the proposed presidential decree banning FX and FX-indexed contracts for several sectors has been leaked to the media, and it is less punitive than some had feared. The draft reportedly contains exceptions to foreign-owned businesses in Turkey, exporters, leasing and aviation firms. This was seen as positive since it would minimize the law's potential repercussions on doing business in Turkey. The news didn't seem to elicit any market reaction.



Indonesia

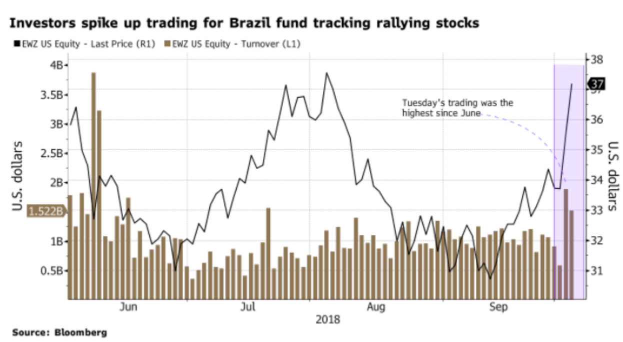
Bond yields rose in sync with the large move in US yields, while the rupiah depreciated 0.7%. Indonesian IDR sovereign bond yields rose 12bps, while those denominated in USD rose 14bps. Implied volatilities of USD-IDR options spiked but remain below levels in September. Currency options are widely used by Indonesian corporates with foreign exchange exposures to hedge. Meanwhile, the government is considering tax breaks to incentivize exporters to convert export earnings into rupiahs. The conversion of export receipts has been only around 16% recently.

Thailand

The Thai baht depreciated after the Bank of Thailand stated that it will step in should there be irregular moves. The baht depreciated 0.8% on the day, after reaching its highest level since June 15 on Monday. **The Bank of Thailand (BoT) has expressed concerns over baht strength in recent weeks**. A BoT official stated today that while the central bank has not seen irregular capital flows, nor has the strength of the currency taken a toll on the economy, the Thai baht cannot go against the trend in the currency market. Separately, **the BoT will tighten mortgage lending rules starting from Jan 1, to curb an underpricing of risks in mortgage markets**. Specifically, the loan-to-value (LTV) ratio will be capped at 80% for second homes and houses exceeding THB 10 mn. Before this tightening measure, LTV rules were not binding, and banks granted mortgage loans at more than 90% of the property value for those properties. Bond yields rose 6 bps. Equities fell 0.8%.

Brazil

Global investors are becoming more upbeat on Brazil, as evidenced by strong ETF volumes. Blackrock's iShares MSCI Brazil ETF or EWZ—the biggest fund tracking the country's equities—has reportedly swelled by 10% this week on brightened prospects for the right-wing candidate Bolsonaro. Trading volumes on the $6 bn fund spiked to $1.9 bn Tuesday and about $2 bn Wednesday, reaching the highest levels since June. Bolsonaro appeals to the market by his pledging to privatize state-own companies, among other market-friendly measures. Separately, some local analysts started to contemplate his win in the first



round, which was perceived as a very unlikely event until recently. A candidate needs 50+% votes to claim victory in the first round. Brazilian equities rose 1.7% and the real strengthened 1.3%, outperforming all other major currencies yesterday.

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 Schmittmann
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: 10/4/18 8:26 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		2922	-0.1	0	1	15	9
Europe		3392	-0.4	-2	1	-6	-3
Japan		23976	-0.6	1	6	16	5
China		2821	1.1	3	4	-16	-15
Asia Ex Japan		69	-0.9	-3	-3	-6	-10
Emerging Markets		42	-0.8	-2	-1	-8	-11
Interest Rates					basis points		
US 10y Yield		3.19	11..8	14	29	87	79
Germany 10y Yield		0.53	5.1	0	17	7	10
Japan 10y Yield		0.16	1.8	4	4	10	11
UK 10y Yield		1.65	7.3	5	22	27	46
Credit Spreads					basis points		
US Investment Grade		98	1.1	1	-6	1	6
US High Yield		317	-0.2	-12	-27	-51	-58
Europe IG		68	0.8	1	0	11	23
Europe HY		277	6.0	11	-20	29	44
EMBIG Sovereign Spread		329	3.0	-16	-42	44	44
Exchange Rates					%		
Dollar Index (DXY)		95.83	0.1	1	0	3	4
USDEUR		1.15	0.2	-1	-1	-2	-4
USDJPY		114.1	0.4	-1	-2	-1	-1
EM FX vs. USD		61.5	-0.3	-1	2	-12	-12
Commodities					%		
Brent Crude Oil ($/barrel)		86	-0.4	5	10	54	29
Industrials Metals (index)		125	0.9	5	9	-2	-10
Agriculture (index)		43	0.2	2	1	-11	-10
Implied Volatility					%		
VIX Index (%, change in pp)		12.9	1.3	0.5	-0.3	3.2	1.8
10y Treasury Volatility Index		4.4	0.5	1.1	0.6	0.2	0.9
Global FX Volatility		8.2	0.0	-0.1	-0.9	0.3	0.8
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		398	5.3	47	-22	30	30
Italy		283	-0.7	47	17	124	124
Portugal		138	-4.4	4	-14	-14	-14
Spain		103	-2.8	6	-4	-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: 10/4/2018 8:30 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	0.0	0.3	0	-3	-5		3.6	0.0	-2	7	-10	-34
Indonesia		15194	-0.1	-1.8	-1	-11	-11		8.3	2.6	-3	-5	149	170
India		74	0.3	-1.5	-3	-12	-13		8.2	8.5	1	8	118	74
Philippines		54	-0.1	-0.5	-1	-6	-8		6.4	-0.5	-2	51	159	159
Thailand		33	-0.4	-0.7	0	2	0		2.8	-0.7	-2	4	60	54
Malaysia		4.14	0.0	-0.1	0	2	-2		4.1	-0.2	0	0	20	18
Argentina		38	0.0	5.2	3	-54	-51		22.9	-73.1	-33	-182	786	687
Brazil		3.92	-0.3	2.4	6	-20	-15		9.8	-6.1	-25	-78	118	76
Chile		668	-0.5	-1.3	4	-5	-8		4.8	-1.0	-3	3	29	2
Colombia		3016	0.0	-1.0	3	-3	-1		6.6	3.0	4	10	31	39
Mexico		19.08	-0.2	-1.6	2	-4	3		8.0	1.8	-2	1	98	29
Peru		3.3	0.1	-0.6	0	-2	-2		5.7	6.9	4	21	34	49
Uruguay		33	-0.2	0.2	0	-12	-13		10.4	0.1	-7	-100		185
Hungary		282	-0.3	-1.5	0	-6	-8		2.6	-0.5	-2	13	111	137
Poland		3.75	0.1	-2.1	-1	-2	-7		2.6	1.7	3	2	-17	-7
Romania		4.1	0.0	-1.4	-2	-4	-4		4.3	0.0	-1	-4	126	48
Russia		66.8	-1.3	-1.8	2	-14	-14		8.2	4.0	-11	-16	68	94
South Africa		14.7	-0.4	-4.0	4	-8	-16		9.7	2.7	6	16	38	42
Turkey		6.15	-1.7	-2.3	9	-42	-38		20.8	77.0	4	-258	985	882
US (DXY; 5y UST)		96	0.1	1.0	0	3	4		3.05	0.2	9	27	113	84

	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		2821	1.1	3	4	-16	-15		176	6	-10	-6	29	24
Indonesia		5757	-1.9	-3	-3	-3	-9		175	-1	-15	-13	7	9
India		35169	-2.2	-4	-8	11	3		156	-5	-7	-1	30	46
Philippines		7093	-1.6	-3	-10	-15	-17		85	1	-13	-20	-7	-10
Malaysia		1790	-0.3	0	-1	2	0		113	-4	-17	-19	-13	3
Argentina		32201	-1.6	-5	17	22	7		638	13	48	-146	267	288
Brazil		83273	2.0	6	11	9	9		275	7	-12	-68	38	41
Chile		5343	0.0	0	3	-2	-4		115	8	-17	-26	-12	-4
Colombia		1525	0.0	2	0	3	1		171	7	3	-15	-13	-3
Mexico		49005	-0.8	-1	0	-3	-1		256	5	1	-31	24	11
Peru		19823	0.7	1	3	2	-1		126	5	-7	-22	-15	-11
Hungary		37155	-0.2	2	1	-2	-6		101	0	-11	-20	11	13
Poland		58952	-0.4	-1	-1	-8	-8		42	4	-3	-17	-9	-5
Romania		8510	0.2	1	2	8	10		161	-9	-12	-23	30	47
Russia		2479	-0.6	0	6	19	18		197	0	-35	-34	9	19
South Africa		54972	-0.4	-2	-5	-3	-8		286	1	-36	-52	24	32
Turkey		95658	-1.6	-5	3	-9	-17		424	2	-30	-177	141	135
Ukraine		544	0.1	1	3	84	73		545	1	-5	-56	80	90
EM total		25	-0.7	-2	-1	-4	-6		329	3	-16	-42	44	44

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