Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Wednesday, October 3, 2018

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- **Press reports suggest Italian government may cut 2020 and 2021 deficits to 2.2% and 2.0%, respectively (link)**
- **Oil markets trade near 4-year highs on supply concerns (link)**
- **Turkish assets sell-off on higher-than-expected inflation (link)**
- **Indian rupee hits record low to US dollar amid rising oil prices (link)**
- **Indonesia weighs new measures to encourage inflows as currency and bonds remain under pressure (link)**

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

Market sentiment improves on Italy's budget deficit concessions

S&P 500 futures (+0.3%) traded higher this morning following gains in European bourses on Italy's budget deficit concessions but emerging markets remain under pressure. Italian newspapers report that the budget deficit could be reduced to 2.2% in 2020 and 2.0% in 2021, compared to 2.4% for both years previously. Even such a timid cut has been enough to spark a bout of risk-on trades, boosting US and European equities and lowering Italian sovereign yields. Emerging markets, however, remain under pressure. The Turkish lira (-1.4%) weakened after a much higher-than-expected inflation print and a new policy rate hike could be in the horizon. Elsewhere, Indian assets sold off-with the rupee hitting a record low against the dollar amid rising oil prices- and Indonesia weighs new measures to encourage inflows as currency and bonds remain under pressure.

Key Global Financial Indicators

Last updated: 10/3/18 8:08 AM	Level		Change from Market Close				
	Last 12m	Index	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		2926	0.1	1	1	15	9
Eurostoxx 50		3409	0.6	-1	0	-5	-3
Nikkei 225		24111	-0.7	0	6	17	6
MSCI EM		42	-1.3	-1	-2	-7	-10
Interest Rates					bps		
US 10y Yield		3.07	1.1	3	21	75	67
Germany 10y Yield		0.45	2.5	-8	11	-2	2
Japan 10y Yield		0.14	1.1	2	2	7	9
FX / Commodities / Volatility					%		
Dollar index, (+) = $ appreciation		95.5	0.0	1	0	2	4
Brent Crude Oil ($/barrel)		84.8	0.0	4	9	52	27
VIX Index (%, change in pp)		11.5	-0.5	-1	-1	2	0

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

United States

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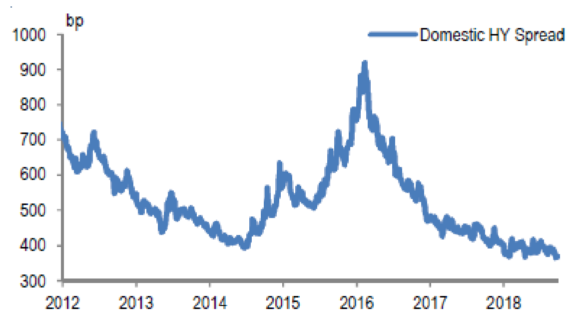
Stocks finished mixed Tuesday, with the Dow industrials rising to a record high. The Dow was paced by export-driven stocks which outperformed in the wake of the revamped NAFTA deal with Canada. Retailers were pressured by a wage hike announcement by Amazon (-1.7%). Stocks generally lost ground mid-session when the Fed's Powell remarked the US outlook was "remarkably positive" and that the "ongoing policy of gradual interest rate normalization reflects our efforts to balance the inevitable risks that come with extraordinary times." Treasury yields finished slightly lower.

This morning, **the ADP research institute reported that the US economy added 230k jobs in September (vs. +184k expected),** from a slightly upwardly revised +168k in August. US Treasury yields were slightly higher following the release as investors await Friday's non-farm payroll numbers.

High-yield bonds have been outperforming their investment-grade peers. JP Morgan finds that the spread on its investment-grade (JULI) index hit a low of 108 bps in early February in the wake of the recently announced tax breaks. The firm's high-yield index was at 379 bps at the time. However, this week, the spread on the JULI is actually 28 bps higher than it was in February, while high-yield spreads have narrowed by 14 bps. JP Morgan attributes this outperformance to a number of factors: a drop in the supply of high-yield bonds, rising oil prices (since energy companies have higher weightings in high-yield indices), recovery in the high-yield retail sector, shorter duration high-yield bonds in a flattening yield curve environment, and the widening economic performance of the US compared to its peers (since high-yield companies are more reliant on the domestic economy).

Exhibit 19: The JULI spread reached a new post-crisis low of 108bp in early February 2018 and widened to 135bp-140bp recently

Exhibit 20: Similarly, HY spread has outperformed YTD and also reached its post-crisis low of 365bp recently on September 18th



Source: J.P. Morgan

Europe

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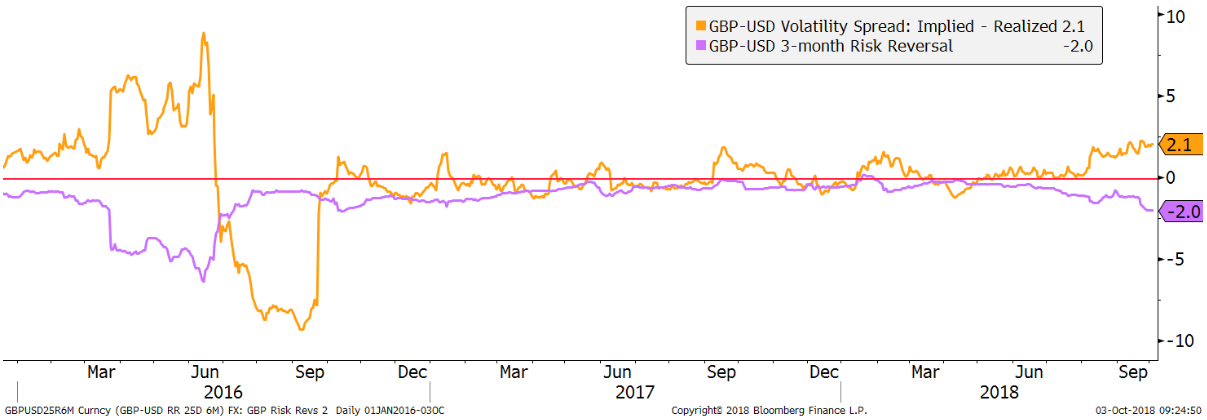
Italian newspapers report that the budget deficit could be reduced to 2.2% in 2020 and 2.0% in 2021, compared to 2.4% for both years previously. The news sparked a bout of risk-on trades, boosting Italian bonds, european equities, and the euro. The rumored cuts are not official, and market contacts continue to worry that the growth assumptions in the Italian budget are overly optimistic.

The Italian sovereign debt market reversed recent moves after news emerged that the government may reduce its planned deficit for 2020 and 2021. The yield on **2-year bonds dropped 13 bps to 1.35%** and the 10-year 6 bps to 3.39%. Core yields were unchanged at 0.43% for Germany and 0.78% for France.

Equities are up through most of Europe: EuroStoxx (+0.2%), Titans 30 (+0.6%), FTSE 100 (+0.2%). Bank stocks (+0.5%) performance is line with major indices, including for Italain lenders: Unicredit (+0.4%), Intesa (+0.6%), and MPS (+0.5%).

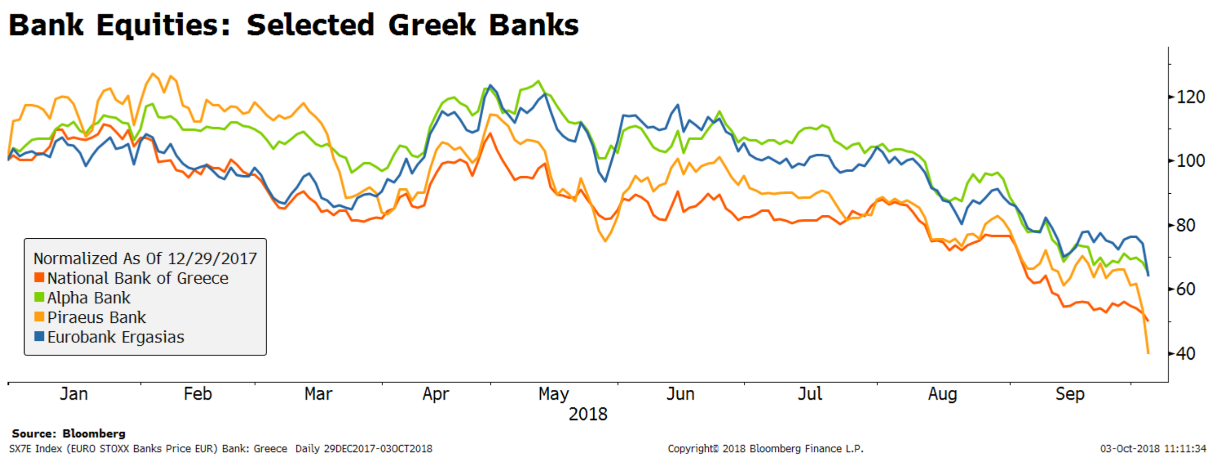
The euro (+0.2%) and the pound (+0.2%) strengthened today to the dollar. The euro strengthened on news of a lower planned deficit in Italy. Looking ahead, markets expect a further weakening and volatility of sterling, as measured by the 3-month pound-dollar risk reversal and the volatility spread. Both measures seem to have breached their trading corridor of over the last 2 years. The trend is motivated by growing fears of a no-deal Brexit, which could plunge the pound to as low as $1.20, according to some forecasters.

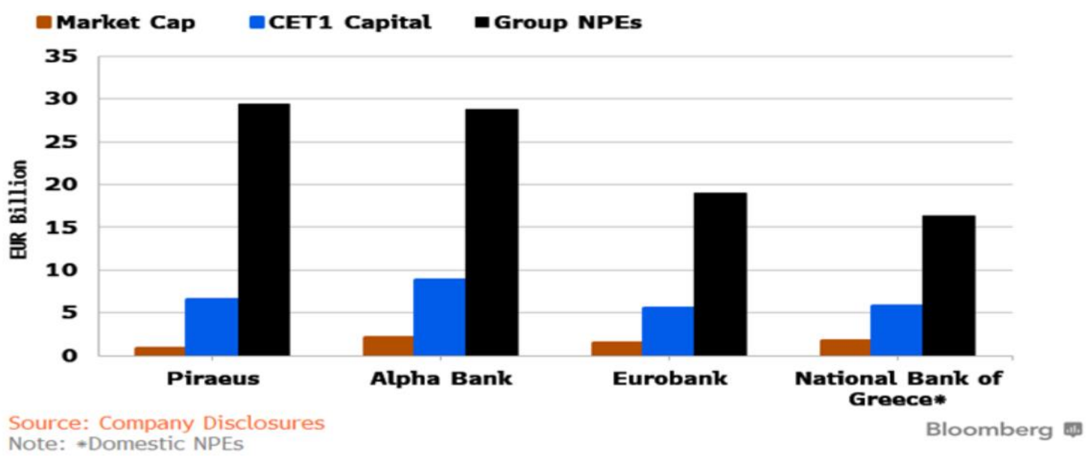
British Pound: Risk Reversals and Volatility



The Greek FM Tsakalotos announced that Greece plans to repay its IMF and ECB loans before they mature. In a televised interview, Mr. Tsakalotos said that the Greek government has “plans to pay the IMF and the ECB earlier and, you know, this is a kind of restructuring because we swap expensive debt for cheap debt.” He added that the government could use part of its €24 bn cash buffer in exchange for Greek bonds held by the IMF (€10 bn) and the ECB (€12 bn). **The yield on 5-year Greek debt fell 3 bps to 3.27% today; the 10-year bond is flat at 4.28%.**

Piraeus Bank (-26.8%) stocks plummeted on concerns that the lender wil not be able to raise €500 in capital. Piraeus’ capital raising exercise has been prompted by the ECB’s SSM, who reportedly has requested Piraeus to raise the funds this year. The bank plans to issue Tier 2 bonds to fulfill the requirement. Other Greek banks also performed poorly today, pushing the FTSE/Athex Bank Index 10.4% lower: National Bank of Greece (-7.5%), Alpha (-5.3%), Eurobank (-14.1%). Analysts concur that Greek banks remain severely undercapitalized given their backlog of non-performing assets.





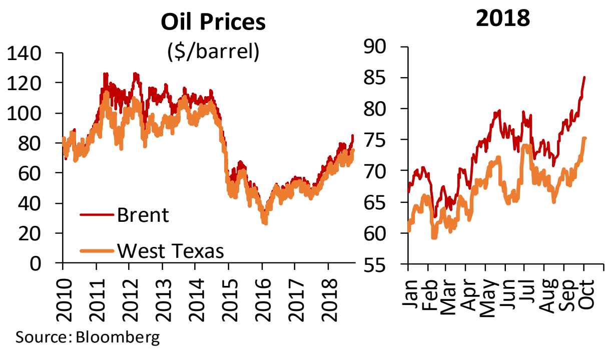
Other Mature Markets back to top

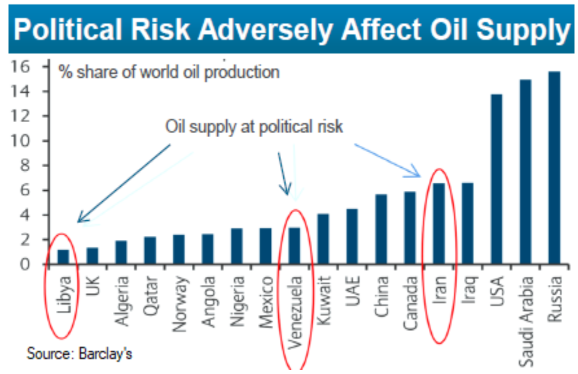
Japan

Equities fell, while the yen depreciated (-0.2%). The Topix fell 1.2%, and the Nikkei closed 0.7% lower, as shares of automakers strongly underperformed after their latest data for US new car sales showed a sharp decline. Financial stocks likewise dipped on profit-taking, as the Nikkei index continues to hover near a 27-year high. **Ten-year bond yields rose 0.5 bps to 0.13%.** The BoJ kept the amount of debt purchases unchanged at its regular operation today. Meanwhile, a BoJ paper found that JGB buying has reduced term premiums mostly through stock effects, while flow effects appear to have contributed little.

Commodities

Oil prices have been accelerating lately. West Texas futures (WTI) broke above $75/barrel yesterday and Brent over $85. This morning, both WTI and Brent traded marginally higher. These are the highest levels in nearly four years, as supply concerns weigh on markets. Investors are worried about US sanctions on Iranian oil exports set to come into effect November 4th. Production shortfalls in Venezuela are also roiling markets, and there is some concern about protests in Iraqi oil-producing regions, an opposition win in Nigerian elections, and further disruptions in Libya. Precious metals also rallied yesterday, with gold topping $1,200/oz.





Emerging Markets

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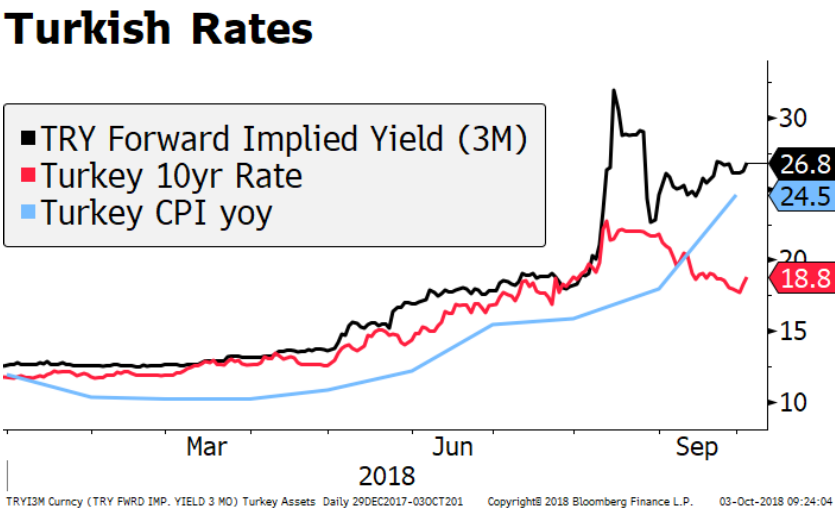
Key Emerging Market Financial Indicators

Last updated:	Level		Change				
10/3/18 8:10 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Prices/Returns of Major EM Benchmarks			%				%
MSCI EM Equities		42.39	-1.3	-1	-2	-7	-10
MSCI Frontier Equities		28.73	0.8	-1	3	-9	-13
Hard Currency Sovereign Debt		831.24	0.0	1	1	-2	-3
Local Currency Sovereign Debt		16.38	-0.1	0	1	-14	-14
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.87	0.0	0	-1	-3	-5
Indonesian Rupiah		15069	-0.1	-1	-1	-10	-10
Indian Rupee		73.34	-0.1	-1	-3	-11	-13
Argentine Peso		38.07	0.0	1	0	-54	-51
Brazil Real		3.90	1.0	3	7	-19	-15
Mexican Peso		18.77	0.1	0	2	-3	5
Russian Ruble		65.60	-0.2	0	4	-12	-12
South African Rand		14.37	0.0	-2	3	-5	-14
Turkish Lira		6.06	-1.3	1	9	-41	-37
Dollar vs. Mature FX (DXY index)		95.52	0.0	1	0	2	4

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

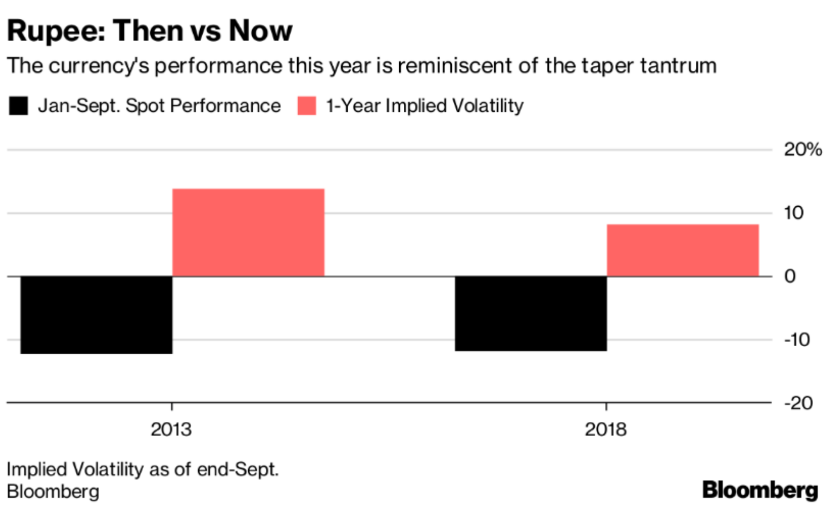
Turkey

The Turkish Lira depreciated 1.4% this morning as the inflation rate shot up to near 25% yoy in September, reinforcing the view that the Turkish economy is overheating. Markets expected a rate of 21% yoy, up from 18% in the previous month. Transportation costs and food prices rose 37% and 28%, respectively, in part due to the weaker currency and higher oil prices. Analysts commented that the data increases the odds of another rate hike in the next meeting, even though official comments still suggest otherwise. FM Albayrak said he will announce a new plan to fight inflation next week, but no details were provided. Swap rates are up as much as 100 bps following the release.



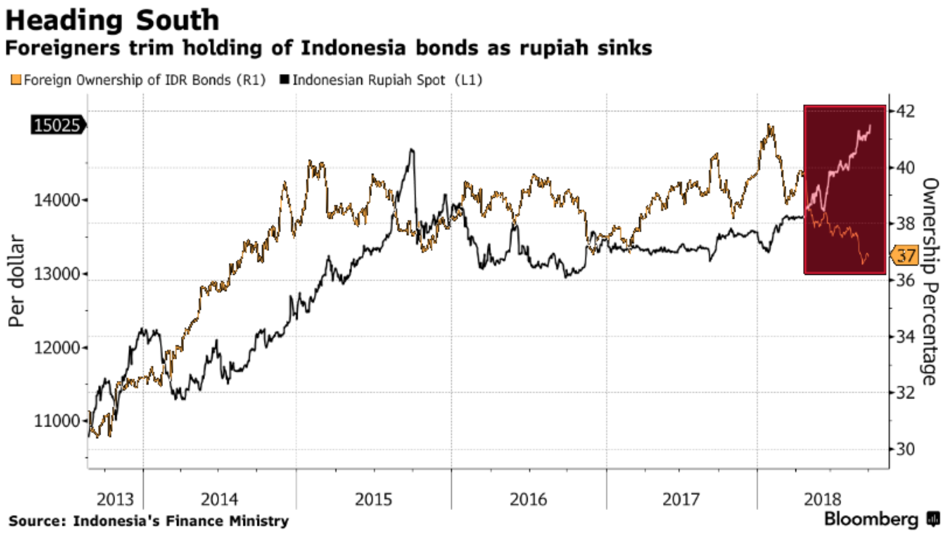
India

The rupee depreciated 0.6%, hitting a record low against the dollar amid rising oil prices. Ten-year bond yields rose 11 bps to 8.09% on the day. Meanwhile, **liquidity remains tight although the government take-over of troubled infrastructure lender IL&FS on Monday was welcomed by investors.** In its meeting tomorrow, most economists expect the RBI to hike interest rates by 25 bps to 6.75% as the inflation outlook deteriorates and external pressures persist. Equities fell 1% on the day, but on a ytd basis the Indian stock markets remains Asia's best performing market (+6%).



Indonesia

Pressures on Indonesian asset continued as the rupiah depreciated (-0.2%) and bond yields rose 10 bps. In a statement, Bank Indonesia's governor pledged that the central bank will maintain its "pre-emptive and ahead of the curve" monetary policy stance to deal with external pressures. He also said that BI is continuing to intervene in support of the currency. Meanwhile, **Indonesia is considering a tax reduction on gains from its sovereign bonds, and an extension of tax breaks to exporters who deposit their dollar earnings in domestic banks**, possibly beyond the six-month timeframe. Details have yet to be announced but new rules could take effect soon**.** Equities were little changed on the day.

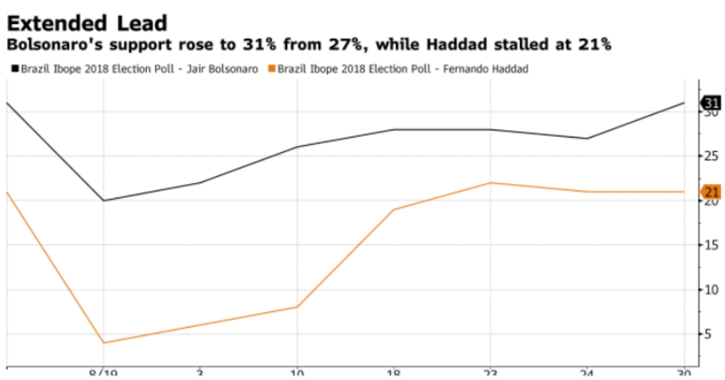


Argentina

Markets continued to broadly rally during the second day of the new monetary policy and FX framework. The peso strengthened 3.8% against the US dollar to 38.06. Dollar bonds rallied modestly, reversing yesterday's slight weakening. Yields on the 2019 bond slid 12 bps to 8.645%. During this morning's operation, ARS 52.8 bn in 7-day LELIQs were sold (slightly fewer than yesterday) at an average rate of 69.465% (slightly higher than yesterday). Demand for LELIQs has been fairly strong during the first 2 days of the monetary framework, due in part LELIQs' attractive yield relative to other ARS paper, but also to satisfy the recently raised reserve requirements.

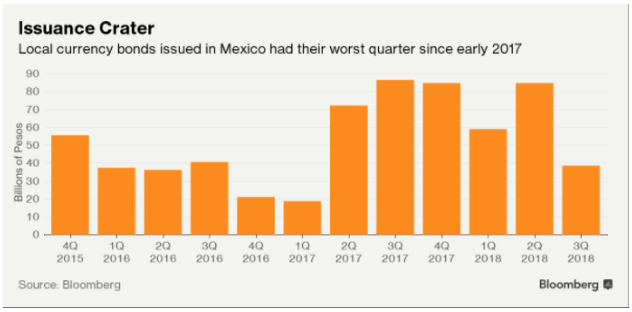
Brazil

Equities surged on a rise of the conservative candidate ahead of the election this weekend. Brazilian equities jumped 3.8% yesterday, after the latest poll showed the right-wing candidate Bolsonaro advanced his lead over the left-wing candidate Haddad. Bolsonaro garnered 31% of votes in the poll released Monday evening, up from 27% in the prior survey (figure). Support for Hadded remained unchanged at 21%. The real jumped 2.0% and EMBIG spreads fell 10 bps. Commentators noted that Bolsonaro has remained the favorite candidate for markets, and some expect a market rally if he wins. Analysts expect that a left-wing government would not proceed urgently with fiscal reform which is viewed as the key issue for Brazil.



Mexico

Corporate bond issuance dropped in the third quarter on political and policy uncertainty. Bloomberg data showed that the issuance of local currency corporate bonds slumped 54% from the previous quarter, compared with a 6 percent drop in the total for emerging markets. The drop is in contrast with the peso's outperformance during this period. The Q3 issuance amounted to $2.1 bn which was the lowest number since 2017Q1 (figure).



Analysts attributed the slowdown in issuance to the rise in political and policy uncertainty related to the election of the left-leaning Lopez Obrador on July. In particular, the concerns reportedly centered on his promise to conserve the national protection of the energy sector and to abandon plans to massively invest in the Mexico City airport. Since the election, he backtracked on the rolling back of the oil reform and the new airport project is still undecided. With Lopez Obrador's assuming office only on December 1, the uncertainty will reportedly continue to linger.

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Global Financial Indicators

Last updated: 10/3/18 8:08 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		2926	0.1	1	1	15	9
Europe		3409	0.6	-1	0	-5	-3
Japan		24111	-0.7	0	6	17	6
China		2821	1.1	3	4	-16	-15
Asia Ex Japan		69	-1.7	-2	-3	-6	-9
Emerging Markets		42	-1.3	-1	-2	-7	-10
Interest Rates					basis points		
US 10y Yield		3.07	1.1	3	21	75	67
Germany 10y Yield		0.45	2.5	-8	11	-2	2
Japan 10y Yield		0.14	1.1	2	2	7	9
UK 10y Yield		1.54	0.8	-6	13	18	35
Credit Spreads					basis points		
US Investment Grade		97	0.0	-1	-6	-2	5
US High Yield		322	-1.2	-8	-22	-47	-53
Europe IG		68	-1.2	0	0	13	23
Europe HY		273	-6.0	4	-25	26	40
EMBIG Sovereign Spread		337	0.0	-10	-34	52	52
Exchange Rates					%		
Dollar Index (DXY)		95.55	0.0	1	0	2	4
USDEUR		1.16	0.0	-2	-1	-2	-4
USDJPY		113.8	-0.2	-1	-2	-1	-1
EM FX vs. USD		62.1	-0.1	0	2	-11	-11
Commodities					%		
Brent Crude Oil ($/barrel)		85	0.0	4	9	52	27
Industrials Metals (index)		122	0.8	2	4	-4	-12
Agriculture (index)		43	0.5	3	1	-10	-9
Implied Volatility					%		
VIX Index (%, change in pp)		11.5	-0.5	-1.4	-1.3	2.0	0.5
10y Treasury Volatility Index		3.5	0.0	-0.3	-0.2	-0.8	-0.1
Global FX Volatility		8.2	0.0	-0.2	-0.7	0.2	0.8
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		390	1.0	37	-22	21	21
Italy		289	-13.5	56	7	131	131
Portugal		144	-4.3	6	-14	-8	-8
Spain		108	-3.3	9	-3	-6	-6

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:	Exchange Rates								Local Currency Bond Yields (GBI EM)						
10/3/2018	Level		Change (in %)						Level		Change (in basis points)				
8:10 AM	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	0.1	-1	-3	-5		3.6	0.0	-3	7	-10	-34
Indonesia		15069	-0.1	-1.0	-1	-10	-10		8.3	15.1	-8	7	150	167
India		73	-0.1	-1.3	-3	-11	-13		8.1	0.0	-11	0	108	65
Philippines		54	0.0	-0.1	-1	-6	-8		6.4	1.1	6	52	160	159
Thailand		32	-0.1	0.2	1	3	1		2.9	-1.3	-3	4	59	55
Malaysia		4.14	0.0	0.0	0	2	-2		4.1	0.5	0	2	21	18
Argentina		38	0.0	1.2	0	-54	-51		23.6	-56.8	5	-109	837	760
Brazil		3.90	1.0	3.4	7	-19	-15		9.8	-15.0	-32	-58	130	82
Chile		659	0.4	0.6	4	-4	-7		4.8	1.0	-1	4	33	3
Colombia		3018	0.0	-0.6	1	-2	-1		6.6	1.1	0	7	24	36
Mexico		18.77	0.1	0.4	2	-3	5		7.9	0.0	-11	2	98	27
Peru		3.3	0.0	-0.3	0	-1	-2		5.7	-0.1	-4	14	29	42
Uruguay		33	0.0	0.5	-1	-11	-13		10.4	-4.0	-14	-100		185
Hungary		280	0.1	-1.4	1	-5	-7		2.6	0.0	-2	13	112	137
Poland		3.72	0.0	-2.2	-1	-1	-6		2.6	0.9	-2	3	-18	-9
Romania		4.0	0.1	-1.7	-1	-3	-4		4.3	-1.0	-1	0	122	48
Russia		65.6	-0.2	0.4	4	-12	-12		8.2	-2.4	-13	-21	65	90
South Africa		14.4	0.0	-1.6	3	-5	-14		9.7	4.4	-5	15	41	39
Turkey		6.06	-1.3	0.8	9	-41	-37		20.0	32.9	-90	-397	912	805
US (DXY; 5y UST)		96	0.0	1.4	0	2	4		2.96	0.7	1	22	104	75

	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		180	-3	-9	-5	34	28
Indonesia		5868	-0.1	0	-2	-1	-8		188	4	-4	-2	19	22
India		35976	-1.5	-2	-7	15	6		161	-2	-6	4	36	51
Philippines		7211	1.1	-1	-8	-13	-16		97	2	-1	-11	3	2
Malaysia		1796	-0.1	0	-1	2	0		128	-1	-3	-8	1	18
Argentina		32730	0.4	-4	14	23	9		619	-11	8	-152	245	269
Brazil		81612	3.8	4	7	6	7		272	-10	-23	-66	35	38
Chile		5323	0.0	0	2	-2	-4		121	-2	-10	-19	-8	2
Colombia		1512	-0.1	2	-2	2	0		167	-1	-7	-17	-16	-7
Mexico		49377	-0.9	-1	0	-2	0		256	-1	-1	-25	23	11
Peru		19694	0.6	1	1	3	-1		132	-1	-4	-16	-9	-5
Hungary		37255	1.0	3	1	-2	-5		111	-1	-1	-13	19	23
Poland		59190	0.6	0	-2	-8	-7		49	1	4	-13	-5	2
Romania		8553	0.5	2	3	8	10		170	2	1	-14	40	56
Russia		2492	1.7	3	6	20	18		209	-1	-22	-26	21	31
South Africa		55362	-0.2	-2	-6	-2	-7		296	-1	-27	-40	33	42
Turkey		97809	-0.4	-1	4	-6	-15		434	-1	-20	-164	150	145
Ukraine		540	0.6	1	2	83	72		556	0	6	-48	85	101
EM total		25	-0.8	-1	-2	-4	-5		336	-1	-11	-35	51	51

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