GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

THURSDAY, OCTOBER 15, 2020

- **European markets under heavy pressure as virus spreads further** (link)
- **Fading budget hopes sink US markets** (link)
- **US mulls sanctions against China's Ant Financial** (link)
- **People's Bank of China injects $74 bn of liquidity** (link)
- **Stocks in US extend outperformance versus rest of world** (link)
- **Inflation swap markets signal bullish expectations for US elections and Brexit** (link)
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Rising second wave rattles markets

Thursday is proving to be negative day across most markets. Investors are being forced to confront the reality that a rising second wave of the virus is going to lead to further shutdowns and more economic disruptions, with Europe seeing the most adverse trends. European stocks suffered heavy losses in early trading and oil markets were doing even worse. US equity futures are also sharply lower. German bund yields are breaking below US Treasuries in the longer maturities due to plunging inflation expectations, growing economic challenges to the euro area and worries about Brexit. Thailand declared a state of emergency in Bangkok in response to widespread protests against the government. The US is reported to be considering putting China's Ant Financial on a trading blacklist ahead of its IPO to deter US investors, in yet another escalation of tensions between the two nations. US Treasuries and the dollar are rallying on safe haven flows.

Key Global Financial Indicators

Last updated: 10/15/20 8:21 AM	Level: Last 12m	Level: Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		3489	-0.7	2	3	16	8
Eurostoxx 50		3190	-2.5	-2	-4	-11	-15
Nikkei 225		23507	-0.5	-1	0	6	-1
MSCI EM		46	-0.7	1	1	10	2
Yields and Spreads			bps				
US 10y Yield		0.69	-3.1	-9	2	-108	-122
Germany 10y Yield		-0.63	-5.1	-11	-15	-22	-45
EMBIG Sovereign Spread		404	0	-16	-13	68	111
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		54.4	-0.4	0	-3	-10	-11
Dollar index, (+) = $ appreciation		93.8	0.5	0	1	-5	-3
Brent Crude Oil ($/barrel)		41.8	-3.4	-3	3	-29	-37
VIX Index (%, change in pp)		28.1	1.7	0	3	15	14

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

United States

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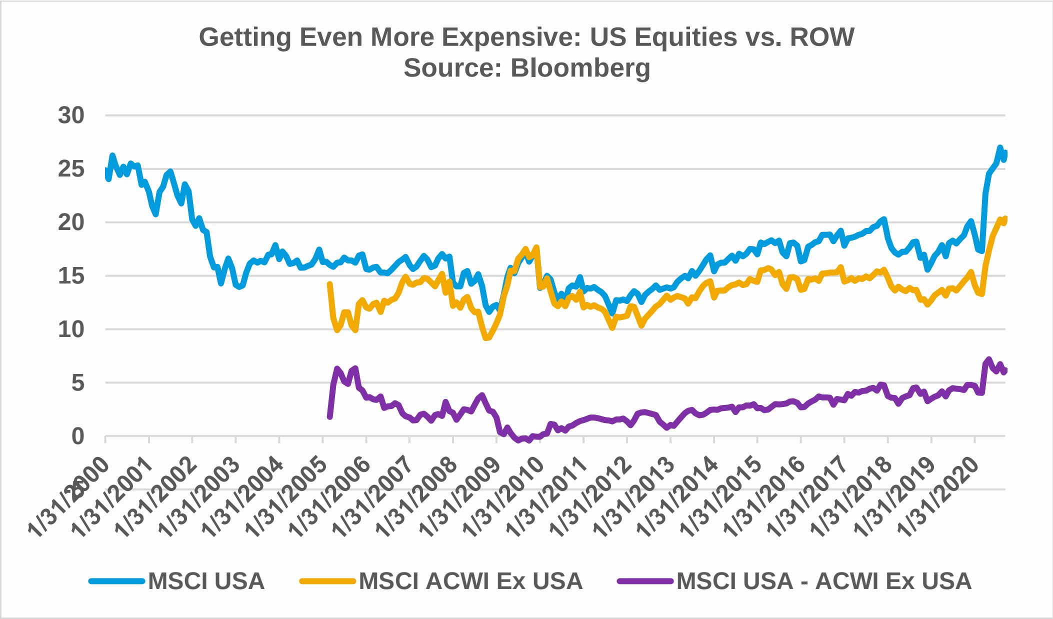
Markets fell for a second day as hopes for a budget deal before the election continued to fade. Treasury Secretary Mnuchin reported that the two sides remain too far apart on key issues. Bank stocks were an important area of weakness for the market, as Wells Fargo reported an unexpected decline in profits and Bank of America's trading revenue was well below its peers. However, Goldman's results beat forecasts. For once, energy stocks and cyclical sectors such as consumer durables did better than other sectors on the news of ConocoPhilip's proposed acquisition of Concho Resources. Treasuries rallied for most of the day as the market sold off but gave up most of their gains by the end of the session to close with only slightly lower yields.

This morning's initial jobless claims data was weaker than expected, although continuing claims were slightly lower than forecasts. The widely followed Empire Manufacturing report for the New York area was also much weaker than expected, adding to the morning's gloomy tone. US equity futures are slumping and Treasuries and the dollar are rallying as global markets sello off.

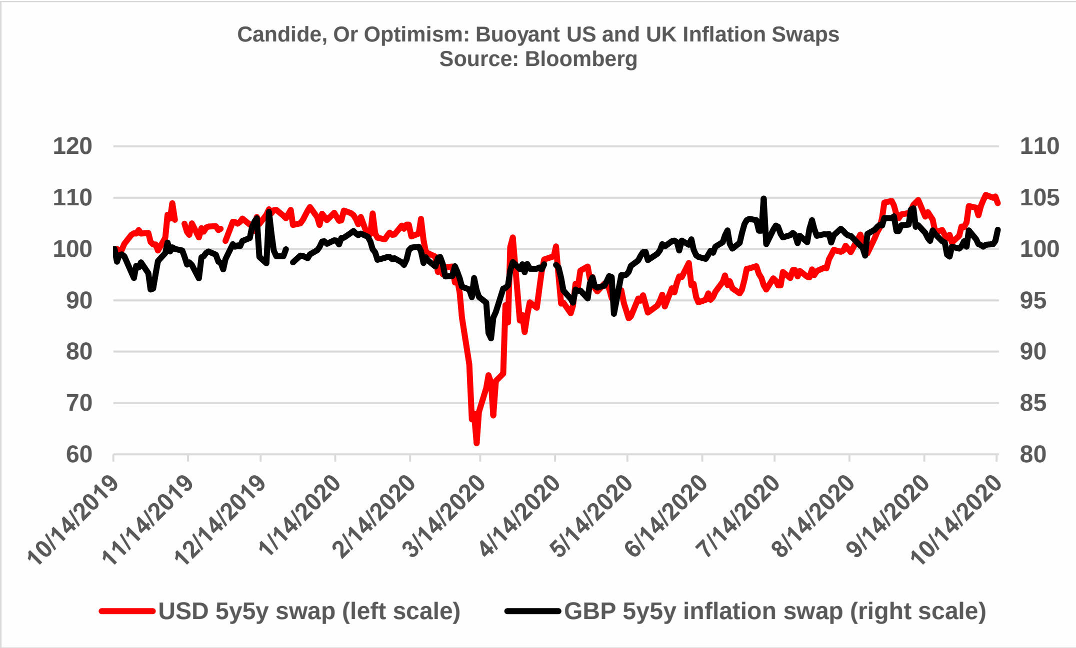
Key US Economic Data 8.30 am October 15
Source: Bloomberg

Report	Consensus Forecast	Actual Report
Jobless claims	825K	898K
Continuing claims	10550K	10018K
Empire Manufacturing	14.0	10.5

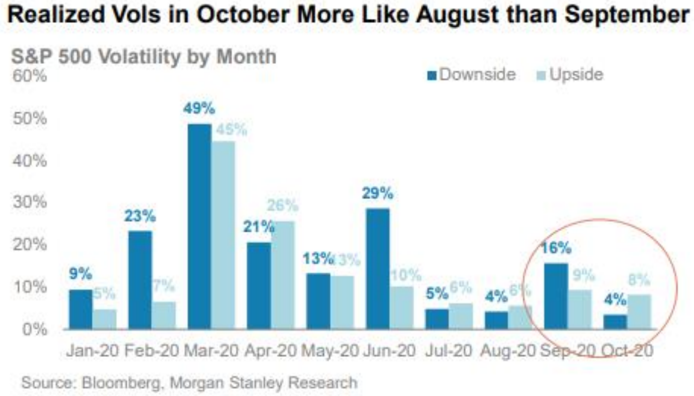
US equities continue to outperform versus the rest of the world and the outperformance has become even more pronounced in 2020. Despite the selloff and higher volatility since September 2 when the major indexes recorded new all-time highs, the Nasdaq remains just 2% below its record and the S&P 500 is within 2.5% of its record. Cyclical stocks which do better in a stronger economy have begun to recover as the market rally broadens beyond favored sectors such as technology and pharmaceuticals. Although the VIX is still high, it has fallen below September levels.



In another sign of optimism in the markets, five-year/five-year US inflation swap spreads have rebounded from the March lows and continue to remain wide in expectation of a Democratic sweep in the election and a subsequent fiscal stimulus to boost the economy. Some analysts are concerned that these expectations have gone too far and fear a correction if the Republicans retain the Senate. There is also the strong possibility of a contested election that is not resolved for several weeks or months, as in 2000 when the contest did not end until January. The consensus seems to be that a Democratic sweep or a Trump victory will be bullish for markets, while a divided government will be bearish. The five-year/five-year spreads in the UK have remained at wide levels for the past year and remain wide on hopes that a hard Brexit will be avoided, and that pandemic-related fiscal spending will support the economy and be bullish for risk assets and inflation. That makes the coming EU summit of even more interest than usual as EU leaders debate their Brexit options.



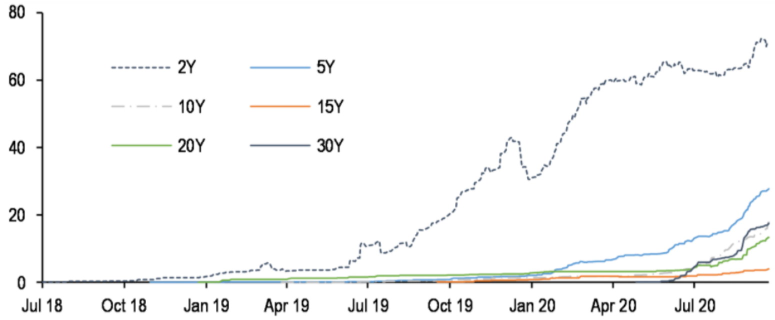
In October, realized volatility in the S&P 500 went back to summer level as the turbulence of the September selloff abated and markets traded within a relatively narrow range not far from the recent market records. This was observed not just in equities but across most asset classes. Implied volatilities in the options markets also declined, but not as much as realized volatility in most cases. The election month premium is also starting to fade as markets begin to price in a decisive victory for the Democrats, although equity volatility does remain more elevated relative to other asset classes. For current markets, US interest rate volatility is in the 10th decile, while volatility in the dollar-yen currency pair is in the bottom 20% of the historical range. However, volatility in the GBP-USD pair remains high due to uncertainty about Brexit.



Although liquidity in the market for derivatives linked to the new money market benchmark Secured Overnight Funding Rate (SOFR) has improved, activity in the crucial longer maturities remains muted. Most hedging and trading in the US interest rate derivative markets are concentrated in maturities five years and longer, and volumes for these maturities have not picked up much as regulators had originally hoped. This is a major concern because Friday's "Big Bang" transition from Libor-based discounting to SOFR-based discounting in the valuation of derivatives contracts is one of the final steps before the abolishing of the Libor benchmark at the end of the year. Despite the imminent deadline, hundreds of billions of Libor-based long maturity trades continue to be made every week, making the final transition even more problematic.

Exhibit 3: Most of the open interest in SOFR OTC derivatives trades remains clustered at shorter maturities, even on a risk-adjusted basis

Outstanding stock of SOFR OTC derivative trades by current tenor; $mn/bp



Note: We capture trade unwinds by matching new trades with identical maturity and notional terms to existing trades, while assuming passive roll-off of existing trades after they mature.

Source: J.P. Morgan, Bloomberg SDR, DTCC

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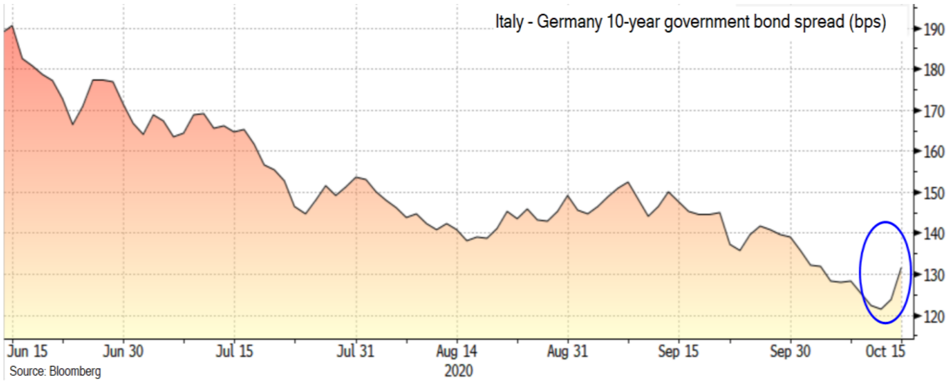
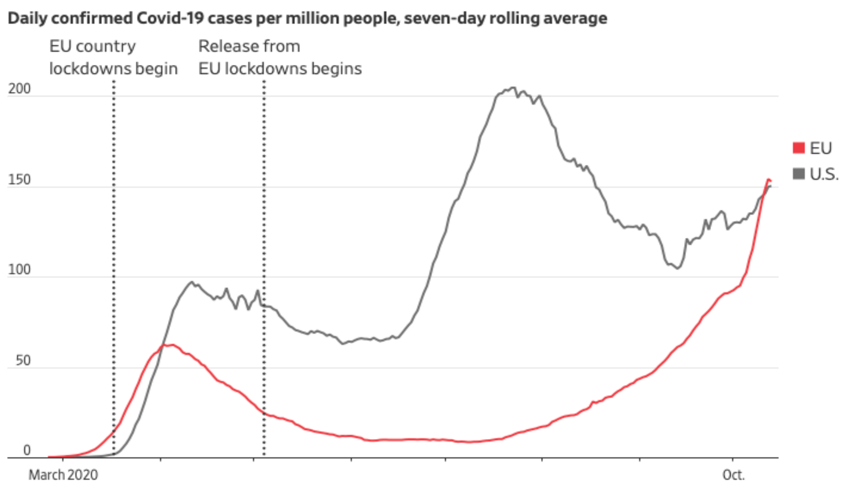
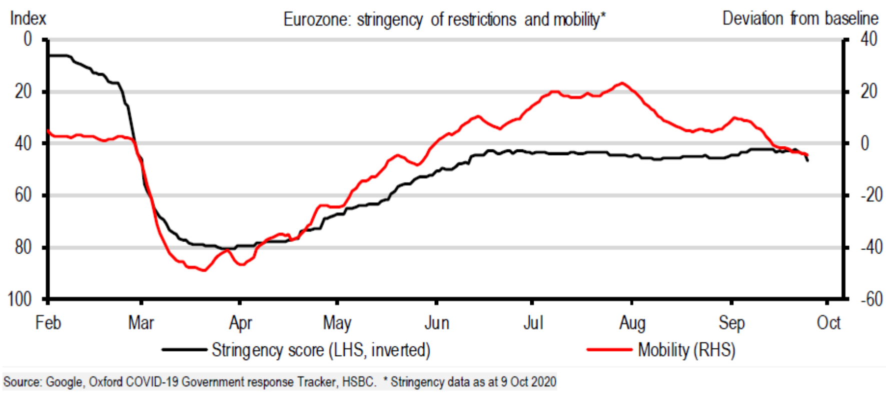
European equity markets are under heavy pressure this morning with most indices down around 2.5%. The sell-off is relatively broad based with most sectors lower except for the healthcare industry. **The euro (-0.2%)** and **the sterling (-0.4%) are lower against the dollar on the broader risk-off tone.**

European bond markets are also trading in risk-off mode with German 10-year bund yield lower by 5 bps and Southern European spreads under pressure. Italian bonds are most affected with 10-year credit spreads widening by 10-bps in the last 24 hours. While contacts suggest the move is amplified by profit taking, the market is also bracing for the start of the EC summit as the prospects of further progress on the EU recovery fund remain unclear. The Deputy PM of Poland threatened to veto the deal due to the rule-of-law dispute. Multiple analysts have warned that disbursements under the EU recovery fund could be delayed if no agreement is reached.



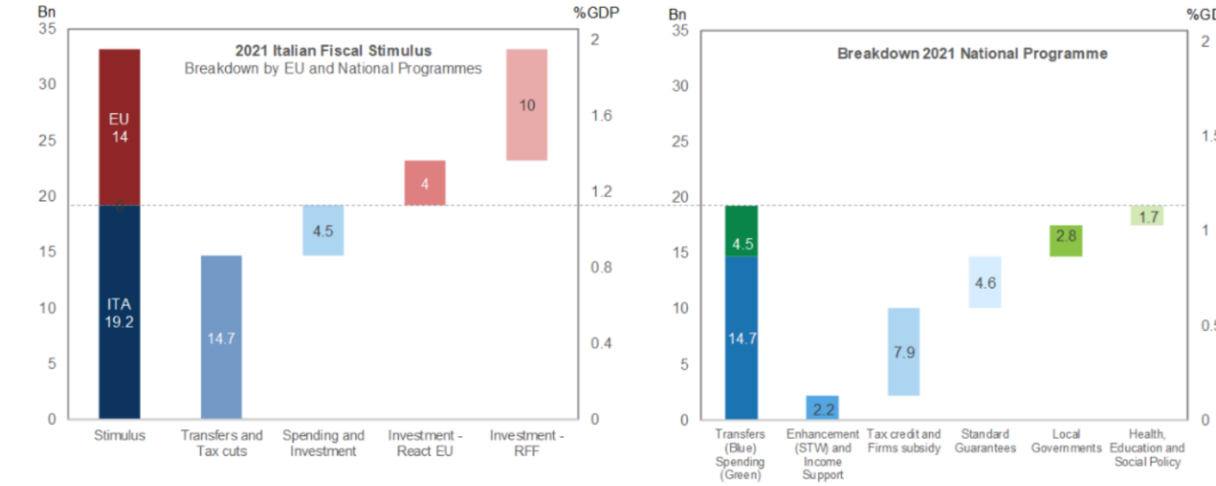
The second wave in Europe shows no signs of easing as the number of new cases per capita now overtake those in the U.S. After days of consecutive record cases, **France announces a curfew affecting 9 largest cities** at least for the next four weeks. The virus situation is also rapidly deteriorating in Italy, Germany and the UK with governments mulling tighter restriction as early as the coming weekend. According to media reports, London will most likely migrate to the “high-risk” category on the UK scale with mixing between households prohibited indoors. Furthermore, there is also a growing debate around a “circuit-breaker” blanket two-week lockdown in the UK. The idea faces strong opposition from Chancellor Sunak due to fears of its disproportionate economic impact in regions with fewer infections.





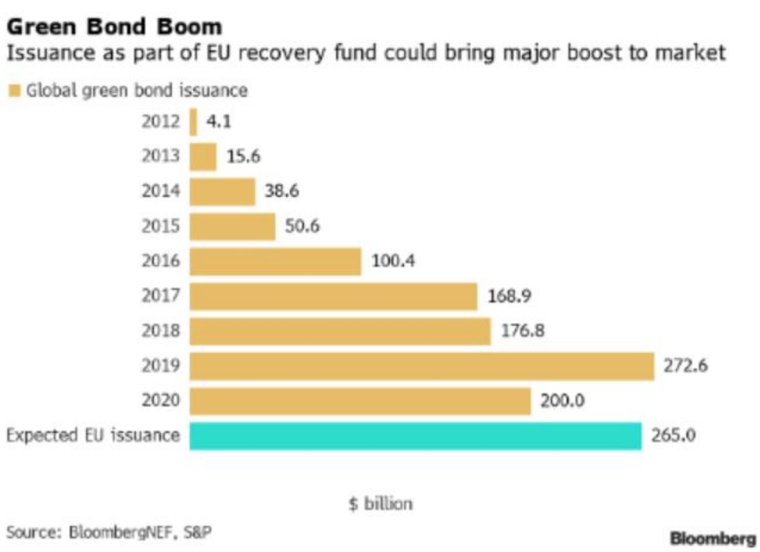
The Italian government 2021 budget projects a fiscal stimulus of EUR 33bn (2% of GDP) with a total budget deficit expected at 7% of GDP. Analysts point out that there is a stark difference in the composition of nationally funded and the EU funded programs. The national government financed programs are skewed towards tax cuts and transfers while the EU funded programs focus on structural spending and investment. As such, European initiatives are critical for Italy not only from the overall financing perspective but also in achieving higher effectiveness of the overall stimulus package.

Exhibit 2: Zooming in on 2021 Fiscal Response



Source: Goldman Sachs Global Investment Research, Italian Ministry of Economics and Finance

The ECB President Lagarde suggested that the central bank will consider favoring green corporate bonds in its asset purchase operations. Moving away from its current "market neutrality" principle could help to offset the underpricing of climate risk by financial markets. The measures will be discussed as part of the ECB's strategic review. Contacts have pointed out that market pricing of ESG bonds relative to the conventional issuance is still at the early stages of development, especially for government bonds. The overall pricing remains also heavily influenced by scarcity and lower liquidity of ESG bonds. With green bond issuance expected to increase dramatically over the next few years, a shift in ECB policy would help to support a more consistent pricing.



Other Mature Markets

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Australia

Reserve Bank of Australia (RBA) Governor Lowe that signaled further monetary policy easing may be imminent. He said that interest rates could be cut more and noted that 10-year government bond yields

were higher in Australia than in other major economies. Some market participants estimated that the RBA could buy up to 100 bn Australian dollar ($70.7 bn) of bonds with maturities between 5 and 10 years.

Equities rose (+0.5%) amidst falling share prices across Asian markets; the Australian dollar depreciated (-1.2%); government bond yields declined (10-year: -7 bps).

Japan

Equities declined (NIKKEI: -0.5%) in line with market movements in the region; Japanese yen (-0.1%).

Emerging Markets

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Most EMEA bourses traded lower, led by Central and Eastern Europe, on growing fears about the virus and stricter counter measures. Currencies weakened against the dollar, with the largest moves seen in Central European currencies and the South African rand (-1.0%). **Asian stock markets were mostly lower today.** Share prices declined the most in Hong Kong SAR (-2.1%), Thailand (-1.6%) and Singapore (-1.4%). **Asian currencies were mixed. Government bond yields declined across many Asian countries,** led by Indonesian (-8.3 bps) and Malaysian (5 bps) 10-year bonds. **In Thailand,** the government declared a statement of emergency in Bangkok to handle protestors who called for the resignation of the Prime Minister and a reform of the monarchy. **Latin American equity markets** were generally higher on Wednesday. Argentina outperformed as the Merval rose 2.7%, followed by Brazil (+1%), while the Mexican Bolsa was slightly lower.

Key Emerging Market Financial Indicators

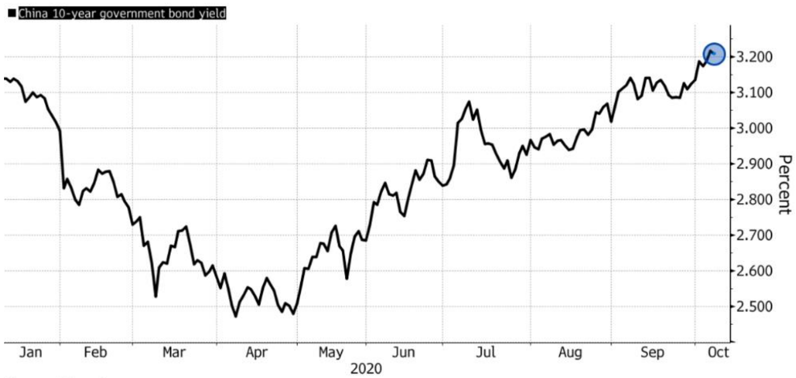
Last updated:	Level		Change				
10/15/20 8:25 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		45.73	-2.1	1	1	10	2
MSCI Frontier Equities		26.52	-0.8	0	3	-6	-13
EMBIG Sovereign Spread (in bps)		404	0	-16	-13	68	111
EM FX vs. USD		54.41	-0.4	0	-3	-10	-11
Major EM FX vs. USD				%, (+) = EM currency appreciation			
China Renminbi		6.73	-0.2	1	1	5	3
Indonesian Rupiah		14690	0.2	0	1	-4	-6
Indian Rupee		73.38	-0.1	0	0	-3	-3
Argentine Peso		77.46	-0.1	0	-3	-25	-23
Brazil Real		5.63	-0.6	-1	-6	-26	-28
Mexican Peso		21.48	-0.8	0	-2	-10	-12
Russian Ruble		78.14	-0.5	-1	-4	-18	-21
South African Rand		16.68	-0.9	-1	-1	-11	-16
Turkish Lira		7.94	-0.4	0	-6	-25	-25
EM FX volatility		11.14	0.0	-0.5	-0.1	3.2	4.5

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

China

The People's Bank of China (PBOC) injected liquidity of 500 bn yuan ($74.3 bn) through its medium-term lending facility (MLF). The funding has a one-year maturity at an unchanged interest rate of 2.95%. For this month, the net liquidity injection through the MLF would amount to 300 bn yuan ($44.6 bn). The PBOC also injected liquidity of 50 bn yuan ($7.4 bn) through its 7-day reverse repo operations. Reportedly, the liquidity injections are aimed at ensuring system-wide liquidity ahead of tax payments due next week. The PBOC earlier said that it looks to normalize monetary policy as the economy recovers but will continue maintaining sufficient liquidity. While price-based financial conditions may have tightened due to rising bond yields, credit growth remains strong.

Rising Yields
Yield on Chinese sovereign bonds due in a decade near highest of year

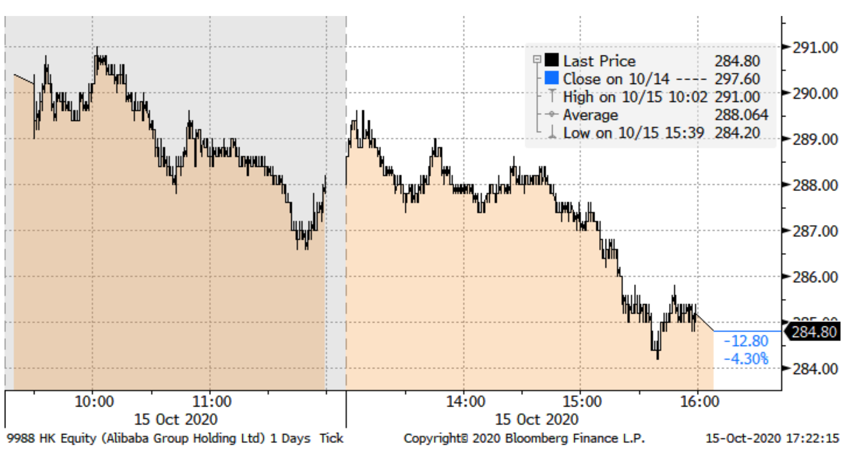


Source: Bloomberg

China's CPI inflation decelerated to 1.7% y/y in September, lower than expected (the consensus forecast was 1.9%). This is down from 2.4% in August, driven by cooling food prices and sluggish core inflation. Core inflation remained soft but steady at 0.5% y/y, suggesting weak household demand. **PPI inflation decelerated to -2.1% y/y in September (versus the 1.8% expected decline),** down from -2.0% in August.

The U.S. administration reportedly seeks to place Ant Financial in a trade blacklist. It remains unclear when the decision will be made. According to Reuters, the U.S. administration wanted to send a message to deter U.S. investors from taking part in the IPO for Ant Financial. The dual listing in Shanghai and Hong Kong could be worth up to a record $35 billion. Share prices of Alibaba (an Ant Financial affiliate) fell 1.5% in New York yesterday and 4.3% in Hong Kong today, the latter driving the decline in the Heng Seng index (-2.1%).

Alibaba Share Price Traded in Hong Kong Exchange



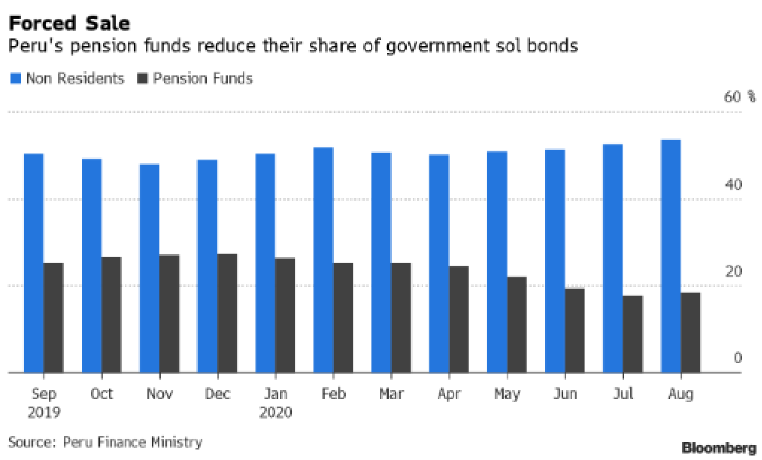
Source: Bloomberg.

Nigeria

Nigerian inflation surprised on the upside. Consumer prices rose 13.7% y/y in September, above the 13.4% expected, on the back of surging food costs. Against a deteriorating inflation outlook, analysts question the central bank's surprise decision last month to cut rates 100 bps. Price inflation has remained above the central bank's 9% upper target since 2015.

Peru

On Tuesday, the congressional committee approved a second pension withdrawal bill with a 7-4 vote. The bill allows individuals who didn't contribute to the pension system in the last 12 months to withdraw up to PEN17,200 (about US$4,780). The estimated total withdrawal would amount to PEN14.4 bn (about US$4 bn). The first pension withdrawal bill was approved in April, which amounted to around US$6.7 bn and caused the pension funds to sell part of their holdings of local government bonds. The central bank warned that further withdrawals would push up borrowing costs, harm the exchange rate, and increase the risk perception among foreign investors because of the reducing local investor base. Foreign investors now hold around 55% of the total debt, while the private pension system holds less than 20%. The bill will be sent to the floor of Congress for a vote as early as Thursday.



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Global Financial Indicators

Last updated: 10/15/20 8:23 AM	Level Last 12m	Level Latest	Change 1 Day	Change 7 Days	Change 30 Days	Change 12 M	YTD
Equities					%		%
United States		3471	-0.7	1	2	16	7
Europe		3188	-2.6	-2	-4	-11	-15
Japan		23507	-0.5	-1	0	6	-1
China		3332	-0.3	4	1	11	9
Asia Ex Japan		80	-0.7	1	2	17	9
Emerging Markets		46	-0.7	1	1	10	2
Interest Rates					basis points		
US 10y Yield		0.70	-3.0	-9	2	-108	-122
Germany 10y Yield		-0.63	-4.9	-11	-15	-21	-45
Japan 10y Yield		0.02	-0.9	-2	0	19	3
UK 10y Yield		0.16	-6.0	-13	-6	-53	-66
Credit Spreads					basis points		
US Investment Grade		127	1.3	-1	-2	4	29
US High Yield		507	3.7	-1	-11	55	114
Europe IG		57	3.6	3	3	4	13
Europe HY		345	17.6	24	30	107	138
EMBIG Sovereign Spread		404	0.0	-16	-13	68	111
Exchange Rates					%		
USD/Majors		93.82	0.5	0	1	-5	-3
EUR/USD		1.17	-0.3	0	-1	6	4
USD/JPY		105.2	-0.1	1	0	3	3
EM/USD		54.4	-0.4	0	-3	-10	-11
Commodities					%		
Brent Crude Oil ($/barrel)		42	-3.4	-3	3	-29	-37
Industrials Metals (index)		119	-0.3	2	0	2	4
Agriculture (index)		41	-0.6	0	6	4	-1
Implied Volatility					%		
VIX Index (%, change in pp)		28.2	1.8	0.1	2.6	14.6	14.4
US 10y Swaption Volatility		64.9	-0.3	-3.1	13.6	-16.8	2.9
Global FX Volatility		8.5	0.0	-0.3	-1.0	1.6	2.5
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		142	6.7	0	-15	-41	-23
Italy		133	9.3	5	-15	-2	-27
Portugal		77	5.4	4	-1	17	14
Spain		77	5.8	5	2	13	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: 10/15/2020 8:24 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		6.73	-0.2	0.9	1	5	3		3.4	0.7	7	4	13	21
Indonesia		14690	0.2	0.1	1	-4	-6		6.8	-1.4	-5	-1	-52	-34
India		73	-0.1	-0.2	0	-3	-3		6.1	0.4	-10	-14	-75	-82
Philippines		49	-0.1	-0.6	-1	6	4		3.6	-0.6	-3	-9	-73	-72
Thailand		31	-0.3	-0.1	0	-3	-5		1.5	-0.8	0	4	-7	-14
Malaysia		4.15	-0.1	0.0	0	1	-2		2.5	-2.8	-3	-6	-94	-89
Argentina		77	-0.1	-0.5	-3	-25	-23		42.7	30.5	130	-9	-1483	-1985
Brazil		5.63	-0.6	-0.5	-6	-26	-28		6.1	-1.7	-19	54	20	-12
Chile		801	-0.3	-0.3	-5	-11	-6		2.7	-1.5	-1	17	-8	-55
Colombia		3837	0.7	0.0	-4	-11	-14		5.2	-1.4	-13	24	-53	-79
Mexico		21.48	-0.8	-0.4	-2	-10	-12		6.0	-0.5	-8	14	-81	-90
Peru		3.6	0.0	-0.5	-1	-6	-8		4.1	-1.2	-1	0	-10	-41
Uruguay		43	-0.1	-0.2	0	-13	-12		7.4	1.8	6	-36	-343	-349
Hungary		312	-0.7	-2.4	-3	-3	-5		1.7	1.4	-11	-3	58	49
Poland		3.89	-1.1	-1.8	-3	0	-2		0.7	-0.7	-7	-14	-113	-123
Romania		4.2	-0.3	-0.5	-2	3	2		3.2	-3.0	-4	-7	-58	-78
Russia		78.1	-0.5	-1.0	-4	-18	-21		5.7	1.7	-7	-12	-88	-47
South Africa		16.7	-0.9	-0.5	-1	-11	-16		10.3	1.2	-13	20	95	76
Turkey		7.94	-0.4	0.1	-6	-25	-25		13.3	7.7	29	39	-215	158
US (DXY; 5y UST)		94	0.5	0.2	1	-5	-3		0.29	-1.4	-5	2	-131	-140

	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		4799	-0.2	5	2	22	17		215	0	-1	-2	27	39
Indonesia		5105	-1.4	1	0	-17	-19		214	3	2	-11	42	58
India		39728	-2.6	-1	2	3	-4		204	0	-13	-16	71	79
Philippines		5938	0.2	0	-1	-24	-24		124	2	0	-9	55	58
Malaysia		1514	-0.6	0	-1	-3	-5		142	-2	-13	-10	16	30
Argentina		47295	2.8	6	6	51	13		1434	32	77	312	-505	-335
Brazil		99334	0.8	4	-1	-5	-14		307	6	4	6	76	92
Chile		3664	0.3	2	-2	-29	-22		166	2	2	-5	33	33
Colombia		1171	0.1	0	-2	-26	-30		235	4	-1	-9	59	72
Mexico		38026	-0.3	2	4	-12	-13		482	8	11	13	175	190
Peru		17835	0.1	-1	-1	-8	-13		148	3	0	-9	22	41
Hungary		33052	-1.3	-2	-3	-19	-28		119	2	2	-4	27	33
Poland		47627	-2.0	-4	-5	-16	-18		23	0	1	-5	-4	5
Romania		8791	-1.0	-1	-6	-8	-12		237	1	-7	-17	51	63
Russia		2820	-1.3	-1	-5	4	-7		205	4	6	-4	20	74
South Africa		54458	-1.7	0	-3	-2	-5		502	9	7	8	182	182
Turkey		1179	-0.8	2	6	24	3		620	3	-2	20	122	219
Ukraine		510	0.0	2	2	-3	0		714	17	28	74	225	294
EM total		46	-2.1	1	1	10	2		404	0	-16	-13	68	111

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