Global Markets Monitor

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Markets poised to end week on optimistic note

Strong earnings reports in Europe pushed markets higher. Barclays surprised analysts with stronger than expected results, and upbeat numbers from Daimler and Renault gave hope that the automobile industry is turning the corner. Strong euro area manufacturing PMIs also boosted sentiment. US equity futures followed European equities higher. The market impact of the US Presidential debate was limited, with attention shifting back to last ditch efforts to reach a budget deal before the election. Zambia became the first frontier market to fall victim to the pandemic as it missed a coupon payment on a $1 bn Eurobond and was downgraded to selective default by S&P. US Treasury yields seem positioned to move higher, while oil makes small gains and the dollar holds steady.

Key Global Financial Indicators

| Last updated: 10/23/20 8:18 AM	Level		Change from Market Close				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities				%			%
S&P 500		3453	0.5	-1	7	15	7
Eurostoxx 50		3208	1.2	-1	1	-11	-14
Nikkei 225		23517	0.2	0	1	4	-1
MSCI EM		46	0.0	1	7	9	3
Yields and Spreads				bps			
US 10y Yield		0.86	0.2	11	19	-91	-106
Germany 10y Yield		-0.56	0.9	7	-5	-16	-37
EMBIG Sovereign Spread		404	0	-16	-13	68	111
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		55.2	0.3	1	2	-10	-10
Dollar index, (+) = $ appreciation		92.8	-0.2	-1	-2	-5	-4
Brent Crude Oil ($/barrel)		42.6	0.3	-1	2	-30	-35
VIX Index (%, change in pp)		27.6	-0.5	0	-1	14	14

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

United States

The US Presidential debate seemed to have little impact on financial markets, but prediction markets showed a small move in favor of Biden with his odds of victory moving about 5% higher.

RCP Betting Odds

Source: Real Clear Politics
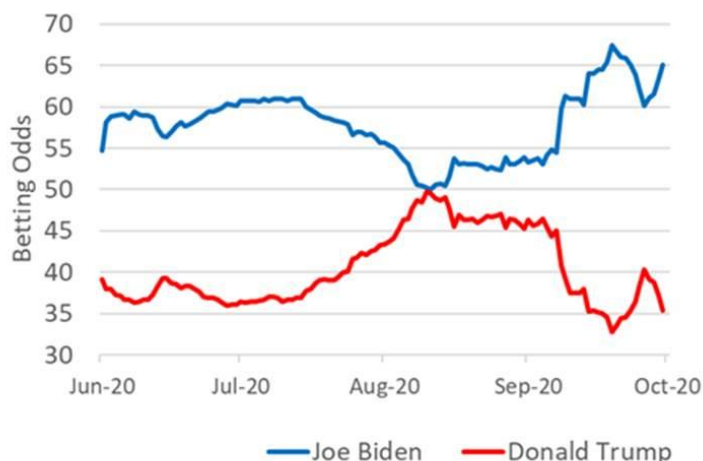
Treasury yields broke higher on Thursday, with the benchmark 10-year yield reaching 0.86%, its highest since June. The long bond yield hit 1.68%, its highest level since March. With the Fed keeping a firm hold on the short end of the curve, the overall yields curve steepened dramatically. The rise in yields and steepening curve proved to be beneficial to bank stocks, which led the market with a solid 2% gain, while the broader indexes posted more moderate gains during the session. With little new insight into how the budget talks are going, markets focused on the upcoming Presidential debate and a flurry of news stories on foreign interference in the election. With the polls narrowing slightly and talk of election interference in the air, fears of a contested election are steadily rising.

### The US Yield Curve is Steepening
Source: Bloomberg
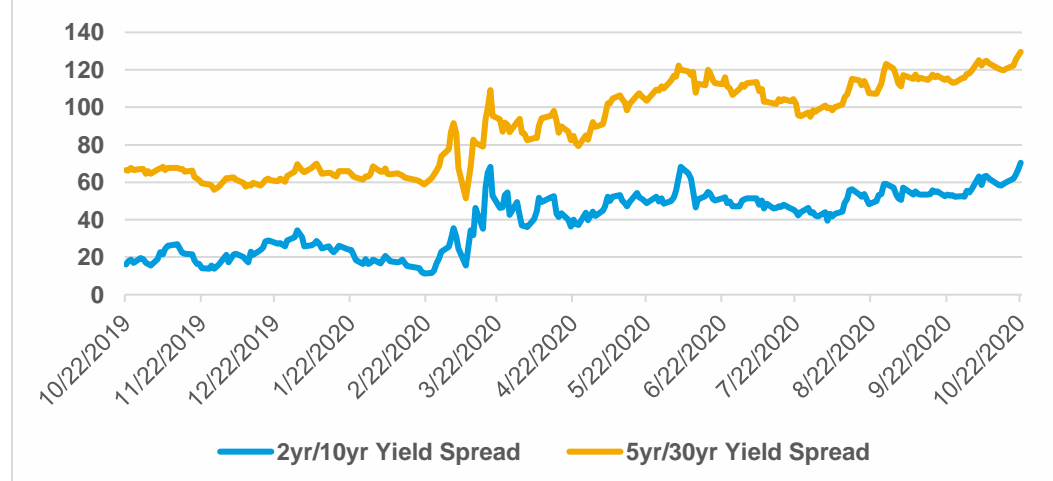
In other news, existing home sales for September came in well above forecasts (+9.4% versus +5%, 6.54 mn homes sold versus the 6.30 mn forecast), yet another strong data point showing that the US housing market continues to do very well despite the broader economic crisis. This was the strongest report since May 2006. Thursday's $17 bn Treasury Inflation Protected Securities (TIPS) auction met strong demand as five-year TIPS breakeven yields remained high on expectations of higher inflation in the weeks ahead.

With the election just eleven days away, worries about the virus, a tightening in the polls and fears of a contested election have kept equity volatility elevated, despite markets having risen in recent weeks. Option market prices seem to imply that a relatively benign post-election environment is still not the base case for investors. On the other hand, this trend appears to be contradicted by the fact that trading volumes for S&P 500 put options and VIX call options, which benefit if markets fall, are lower than they were at the same time last year. Dealers seem to be raising these option prices because they are reluctant to go short volatility ahead of the election, while investors appear to be reluctant to buy expensive insurance to hedge against potential post-election volatility. This contradiction will need to be resolved in the last few days before the election, but there is little visibility about how these trends will eventually play out.

Exhibit 1: Over the past three months expectations of late 2020/early 2021 volatility have not fallen even though the S&P 500 has rallied 6%

VIX futures curves (each future represents volatility expected in the 30 days following its expiration)
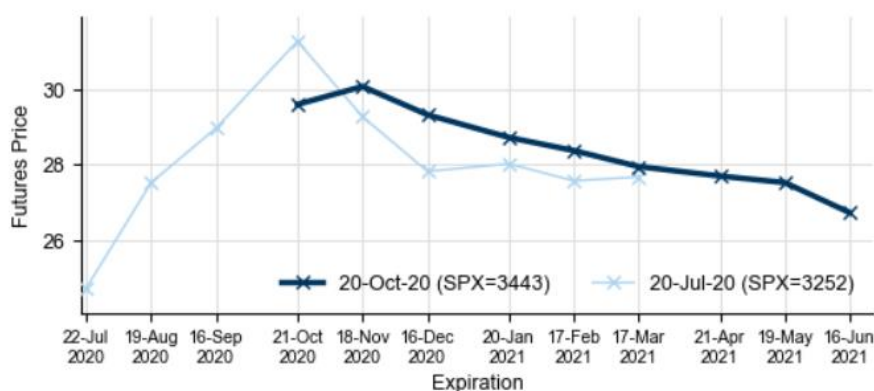
Source: Goldman Sachs Global Investment Research, Reuters

There is a growing divergence between the VIX and US investment grade (IG) credit spreads. The two usually move closely together but have diverged in recent weeks as the election draws nearer. Bank of America estimates that the current VIX level of 28 should correspond to an IG spread of 160 bps compared to the current level of 132 bps, while the equivalent VIX level at the current spread should correspond to a VIX level of 20. Uncertainties about the budget negotiations, the growing virus crisis and worries about a contested election are keeping the VIX high, but these anxieties do not appear to be manifesting themselves in the risk appetite of fixed income investors. The search for yield and a continuous trend downwards in US credit spreads has proved very attractive for investors, who have piled into the sector from all parts of the world and earned strong profits on their holdings through the summer and autumn. Some analysts are worried that the market is "priced to perfection," leaving it very vulnerable if any of the risk factors mentioned above actually materialize.

Figure 1: Decoupling between two measures of corporate uncertainty
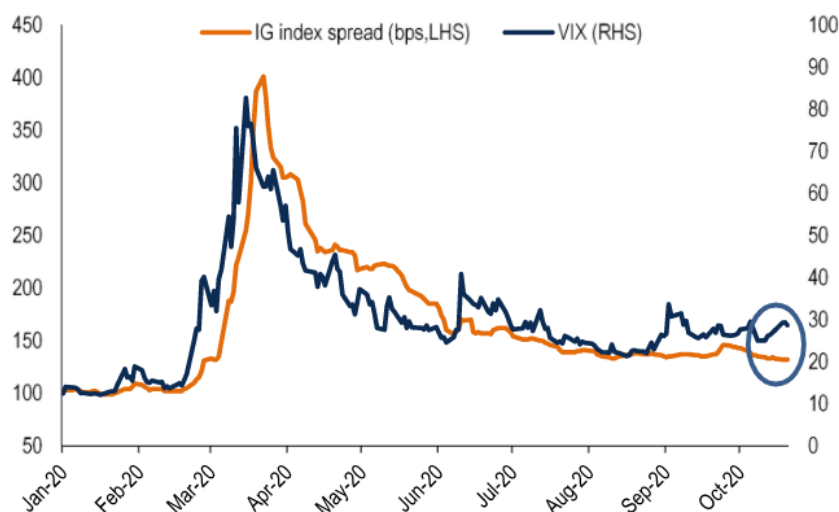
Source: Bloomberg, ICE Data Indices, LLC

US prime money market funds (MMFs) face tough challenges, according to JP Morgan. Inflows into prime MMFs have been very weak compared to the strong inflows into government MMFs this year. Moreover, the yield differential between prime and government MMFs has fallen to just two basis points, giving investors little incentive to take on the credit risk associated with prime MMFs relative to government MMFs. Another challenge is that the very low level of interest rates makes the gross yield on prime MMFs of 0.25% too low to cover the costs of operating many of these funds. In this context, JP Morgan cites Crane data's finding that 70% of prime MMFs offer some form of waiver of their fees to keep customers engaged. Retail funds typically have higher costs and face an especially heavy burden. The prospect of tougher regulations for the industry is yet another headwind after the sector's poor performance at the height of the virus crisis, as highlighted on multiple occasions by Fed Vice Chair Quarles. Northern Trust and Fidelity have already closed their prime institutional MMFs and Vanguard has closed its retail prime MMF.

Exhibit 1: Prime funds have experienced lackluster flows this year versus the surge in government funds
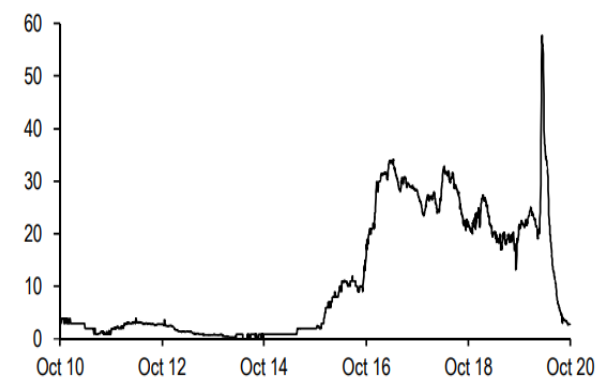AUM of prime and government funds ($bn)
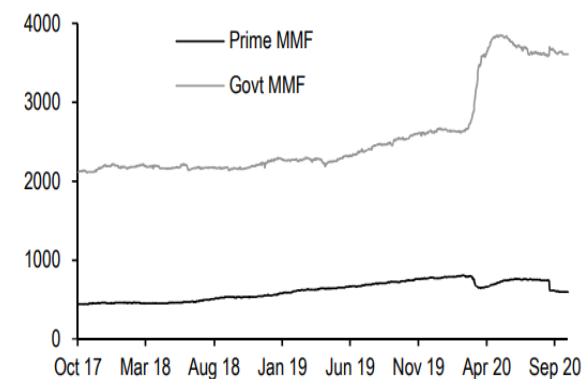
Source: iMoneyNet

Exhibit 2: The net yield between prime and government funds has cratered and has fallen to 2bp
Net yield spread differential between prime and government funds (bp)

Source: iMoneyNet

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European stocks rallied this morning on the back of strong earnings reports. Most stock indices were around 1-1.5% higher with particular strong performance by banks (+3%) after Barclays earnings report as well as the automobile sector (+1.5%) with Daimler and Renault beating analyst estimates.

The euro (+0.2%) benefited from stronger Eurozone manufacturing PMI's while the sterling (-0.1%) was little changed following the UK data. Bunds were mostly unchanged while Southern European spreads tightened by 2-4 bps with Italy outperforming.

The Eurozone preliminary October composite PMI fell into contraction territory on the back of the service sector but surprised on the upside with strong manufacturing activity. The composite reading declined slightly less than expected to 49.4 from 50.4 in September (49.2 consensus). There was a notable divergence on both country and industry level. German aggregate PMI surprised to the upside, remaining almost unchanged at 54.5 against the 53.3 consensus, supported by **surprisingly strong activity in the manufacturing sector (58 reading against 55 consensus) through new export orders**. Manufacturing also did well in France. By contrast, service PMI's were weaker than expected, falling deeper into contractionary territory as restriction measures impacted business sentiment and analysts expected further downside as new measures continue to be rolled out. **Markets reacted positively to the data, focusing on strong manufacturing surveys, with equities gaining 0.7% and the euro appreciating 0.4% following the release.**

Table 1: Eurozone flash PMI*

		12M Trend	Oct-20	Sep-20	12M Avg.
Eurozone					
	Composite	⬇	49.4	50.4	44.6
	Manufacturing	⬆	54.4	53.7	47.2
	Services	⬇	46.2	48.0	43.9
Germany					
	Composite	⬇	54.5	54.7	46.0
	Manufacturing	⬆	58.0	56.4	46.7
	Services	⬇	48.9	50.6	45.6
France					
	Composite	⬇	47.3	48.5	44.7
	Manufacturing	⬇	51.0	51.2	47.9
	Services	⬇	46.5	47.5	44.2

Source: IHS Markit. *Key: If below 50, text is highlighted in red. Arrows correspond to the change on the previous month

The UK data was also mixed this morning with the October preliminary composite PMI pointing to slowdown in the recovery momentum amid a stronger than expected September retail sales growth. The UK aggregate PMI fell to 52.9 in October from 56.5 in September (54 consensuses) but remained in expansionary territory. The downside surprise came predominantly on the back of the service sector that 52.3 from 56.1 in September. By contrast, September retails sales growth beat consensus expanding at 4.7% yoy, up from 2.7% in August and was above the 3.7% consensus estimate. Analysts point out that

the strong expansion of retails sales in the third quarter leaves upside room for GDP. That said, there is limited optimism as the GfK's consumer confidence fell sharply in October to a five-month low of -31, also pointing to downside risk into the year-end. **UK equities were trading 1.5% higher this morning, while the sterling reaction was muted.**

U.K. retail sales post their best quarter on record in lockdown recovery

■ Retail sales (3m/3m)

Source: Office for National Statistics

Bloomberg
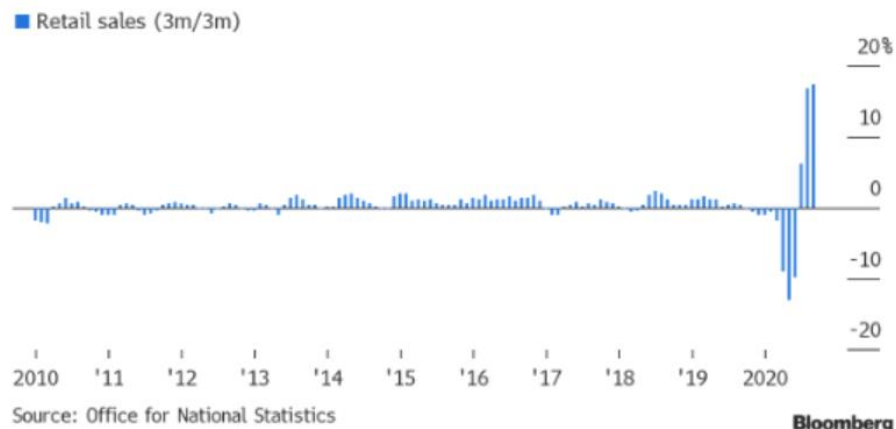
The UK Chancellor launched a new stimulus package to counter the recent tightening virus-related restrictions. The total package could be worth £13 bn (0.7% of GDP) with measures primarily focused on the labor market and the hospitality sector. The Job Support Scheme was modified by reducing the minimum qualifying working hours from 33% to 20% as well as cutting the proportion of business contribution to wages from 33% to 5%. The government's contribution will double its contribution to the regular wage for the part-time workers, capped at £1540. In areas with full lockdown, the state will pay two-thirds of normal wages. Furthermore, business in high risk areas (includes London) will receive government support grants. **Contacts suggest that the new measures should help to reduce unemployment by 1-1.5% into the year end, which some expected to reach 8-9% previously.**


WAGE SUPPORT FOR WORKERS

● Government pays   ● Employer must pay   ● Pay falls

Original furlough scheme
60%   20%   20%

Lockdown Job Support Scheme (Tier 3)
67%   33%

Original part-time Job Support Scheme (working at least 33% hours)
33%   33%   33%
% of UNWORKED hours paid

New part-time Job Support Scheme (working at least 20% hours)
Work one day a week and get 73% of pay
61.67%   5%   33%
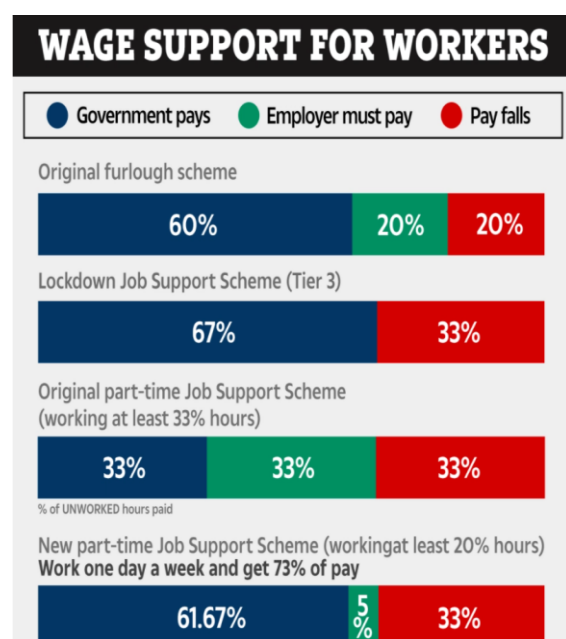
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Japan
Equities rose (+0.3%), driven by financials outperformance. Preliminary figures for October showed that the manufacturing purchasing managers index (PMI) improved by 0.3 points to 48; the services PMI worsened, dropping 0.3 points to 46.6. Headline consumer price inflation (CPI) came in at 0% y/y in September, falling from 0.2% y/y in August, largely reflecting the impact from the government's travel subsidies. Excluding fresh food, the decline in CPI moderated to -0.3% y/y from -0.4% y/y over the same period. Separately, **Japan has signed a trade deal with the UK that was reached in principle in September.** It is the UK's first deal with a major economy since Brexit. The deal improves access to the UK market for Japanese train cars and some auto parts. The agreement is set to be approved by Japan's parliament next week and expected to come into effect on January 1. **The yen appreciated +0.2% while 10-year JGB yield rose +0.3bps.**

Topix erases loss following Trump–Biden debate
Source: Bloomberg
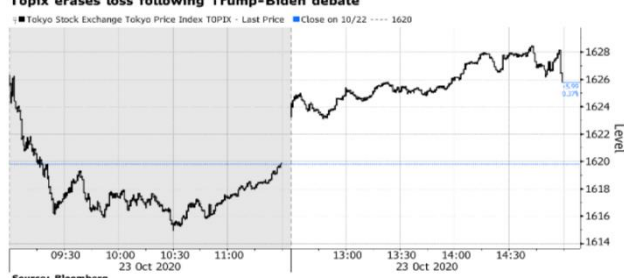
Activity in manufacturing, service sectors continues to contract
Source: IHS Markit
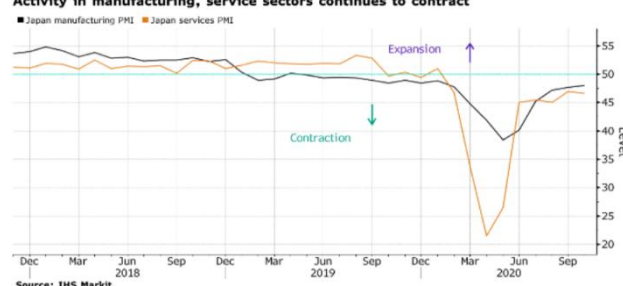
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EMEA equities are trading mixed, with indices up in South Africa (+1.1%) and Russia (+0.5%) but down in Turkey (-0.2%). Currencies were little changed, except for the Turkish lira (-0.4%). Asian equities were flat on net. Dispersion was wide, with China (Shanghai -1%; Shenzhen -1.9%) lagging while Philippines (+2.2%) outperformed for the fifth straight day. Asian currencies were mixed. The RMB (+0.2%) strengthened following a stronger-than-expected fixing while the Malaysian ringgit (-0.3%) weakened following news of a special cabinet meeting that could see a proclamation of emergency. Latin America's equities were mostly higher, currencies appreciated and sovereign debt yield curves moved up. Equities were strongest in Argentina (+3.2%) and declined in Peru (-0.5%).

Key Emerging Market Financial Indicators

Last updated:	Level		Change				YTD
10/23/20 8:21 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		**%**
MSCI EM Equities		46.05	0.3	1	7	9	3
MSCI Frontier Equities		26.99	0.9	1	5	-4	-11
EMBIG Sovereign Spread (in bps)		404	0	-16	-13	68	111
EM FX vs. USD		55.21	0.3	1	2	-10	-10
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.68	0.1	0	2	6	4
Indonesian Rupiah		14660	0.0	0	1	-4	-5
Indian Rupee		73.60	-0.1	0	0	-4	-3
Argentine Peso		78.07	-0.4	-1	-3	-25	-23
Brazil Real		5.57	0.4	1	0	-28	-28
Mexican Peso		20.88	0.5	1	7	-8	-9
Russian Ruble		76.44	0.2	2	1	-16	-19
South African Rand		16.18	0.2	2	6	-9	-13
Turkish Lira		7.96	-0.4	-1	-3	-28	-25
EM FX volatility		10.95	0.0	-0.1	-1.1	3.4	4.4

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

China

China's $157 bn exchange-traded fund (ETF) market became directly accessible to foreign investors. Regulators in Hong Kong SAR have wanted to include ETFs to broaden trading links with China since at least 2016 but the initiative was delayed partly due to complex clearance and settlement issues, according to Bloomberg. Four so-called 'feeder' ETFs began trading in Shenzhen and Hong Kong SAR and is the first batch in a project to connecting both markets. Equities (Shanghai -1%; Shenzhen -1.9%) fell on broad-based losses. The RMB appreciated +0.2%.

Colombia

Recent growth in the client base of Colombian banks may promote financial inclusion and banks' future business volume. According to S&P reports the penetration rate of banking services in the Colombian population increased during the COVID-19 pandemic: the number of individuals with a bank account rose by 6.7% over the two first quarters of 2020. The increase was mostly motivated by the need to receive welfare benefits but is expected to expand banks' client base permanently. While the percentage of Colombians currently using credit services actually declined by 1.2 ppt in the same time, the large increase in banks' client base is still be expected to have a positive impact on future profits, as banks can use the information gathered from the new bank clients to assess their credit quality, eventually targeting them with credit products once the recovery takes hold and employment grows again.

Colombian adults with deposit products
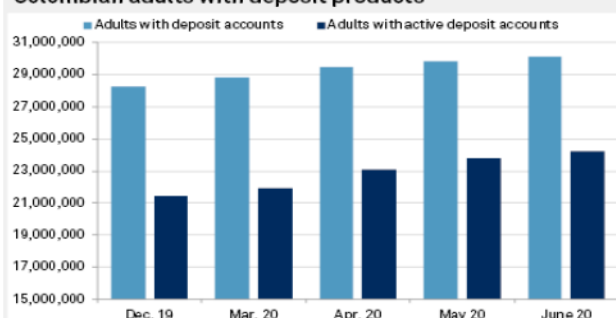
Data compiled Oct. 19, 2020.
Accounts are categorized as active when they have registered any form of transaction within the last six months.
Source: S&P Global Market Intelligence

Percentage of Colombian adults with credit products
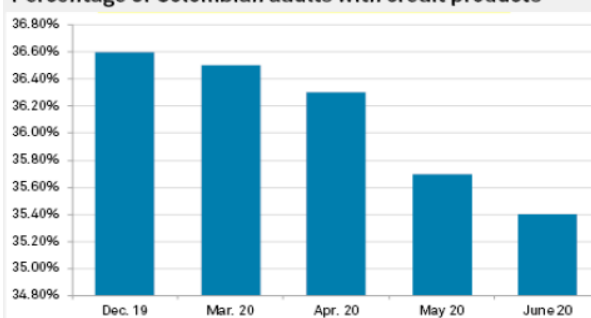
Data compiled Oct. 19, 2020.
Source: S&P Global Market Intelligence

India

The benchmark 10-year sovereign bond yield fell 7bps to 5.85% on Friday, the lowest since mid-August. The previous day, the average yield of 10-year Indian state bonds fell to 6.47% following the central bank's first state bond purchase. The Reserve Bank of India (RBI) received 154.8 billion rupees ($2.1 billion) of offers from investors to sell state government bonds maturing between 2029 and 2031, compared with its plan to purchase 100 billion rupees of the notes. **The Indian rupee was little changed while equities rose +0.4%.**


State borrowing costs have eased after the RBI's support measures
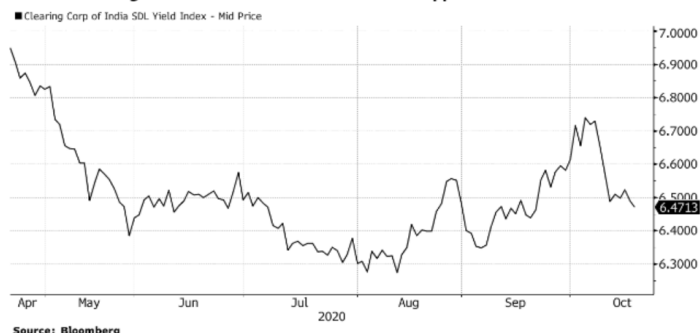
Source: Bloomberg

Mexico

Above target inflation reduced expectations of additional rate cuts and supported the peso. The bi-weekly CPI inflation figure for the first half of October printed at 4.09% y/y, 9 bps above consensus expectations and 0.2 ppt higher than a fortnight before. Core inflation came in at 4% y/y, virtually unchanged from two weeks ago. Inflation is now at the upper margin of the central bank's 3% inflation target, which allows for a deviation of one percentage point, making a November rate cut less likely. The peso reacted with an appreciation of 0.6%, while the peso sovereign debt yield curve moved higher.

Source: Bloomberg.
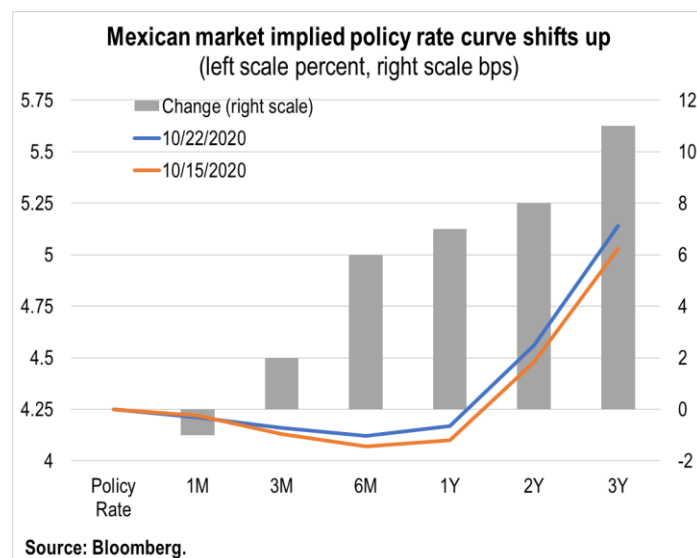
Russia

The central bank kept its policy rate unchanged at 4.25% while signaling room for easing. The overall stance remained cautious but acknowledged downside risks from the second wave of COVID- and pointed to room for further easing in upcoming meetings. Analyst consensus remains split with regards to further interest rate cuts, with most concerned with the performance of Russian assets following the U.S. elections. Market reaction was muted with interest rate forwards continuing to price tighter policy in 2021.

Source: Bloomberg, IMF
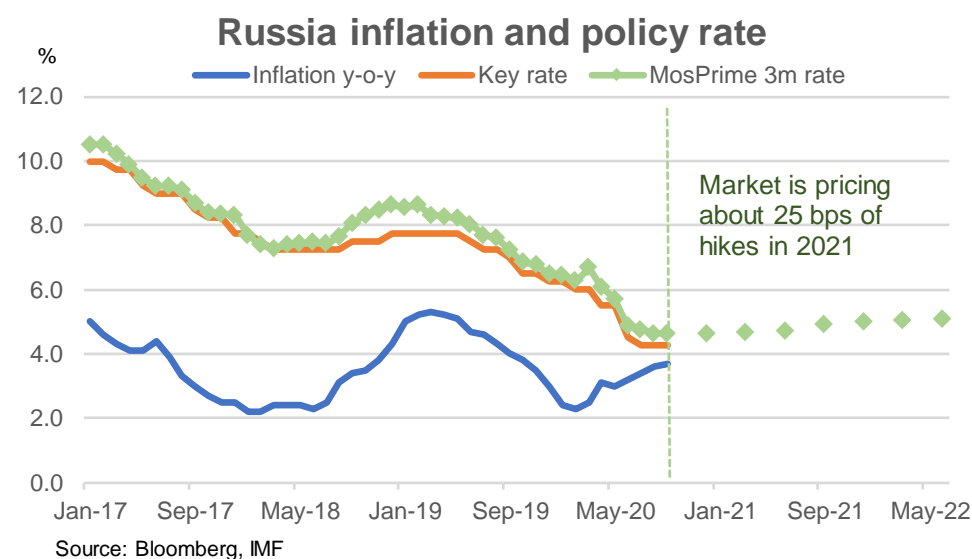
Zambia

S&P cut Zambia's debt rating to selective default after the country missed a coupon payment on $1 bn securities due 2024 last week, based on Bloomberg reporting. (S&P's "selective default" means a borrower is not paying a specific loan or bond but is meeting its other obligations). The credit rating agency did not wait for the expiration of a 30-day grace period after the missed payment and predicted that Zambia would remain in default for the next six months. Zambia is now negotiating with bondholders to get an interest-payment holiday for six months, so that it can work out a debt restructuring plan. The next meeting of Zambia's Eurobond holders is now slated for November 13, and if the country does not make the payment by that date, it will go into full technical default. Zambia's 2024 Eurobonds continued to slide yesterday, down 1.1% by mid-day. Moody's still has Zambia at Ca and Fitch at C.

Key Zambian Market Variables
Source: Bloomberg

— Benchmark 2024 Eurobond Yield
— Zambian Kwacha Spot (right scale)
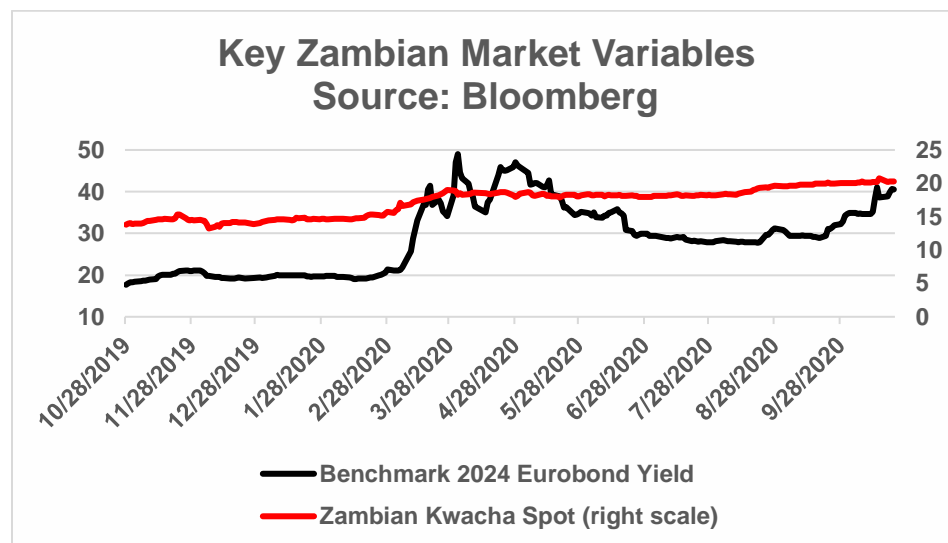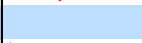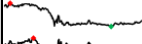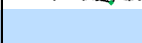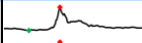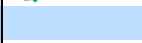
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Global Financial Indicators

Last updated: 10/23/20 8:20 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		3455	0.5	-1	7	15	7
Europe		3208	1.2	-1	1	-11	-14
Japan		23517	0.2	0	1	4	-1
China		3278	-1.0	-2	0	11	7
Asia Ex Japan		80	-0.2	1	6	17	9
Emerging Markets		46	0.0	1	7	9	3
Interest Rates			basis points				
US 10y Yield		0.86	0.2	11	19	-91	-106
Germany 10y Yield		-0.56	0.9	7	-5	-16	-37
Japan 10y Yield		0.04	0.6	2	3	18	5
UK 10y Yield		0.31	2.1	12	9	-38	-52
Credit Spreads			basis points				
US Investment Grade		124	-0.4	-1	-8	4	27
US High Yield		501	-1.3	-6	-50	49	108
Europe IG		55	-1.5	1	-3	4	11
Europe HY		325	-7.5	-3	-6	98	119
EMBIG Sovereign Spread		404	0.0	-16	-13	68	111
Exchange Rates			%				
USD/Majors		92.76	-0.2	-1	-2	-5	-4
EUR/USD		1.19	0.3	1	2	7	6
USD/JPY		104.7	0.1	1	1	4	4
EM/USD		55.2	0.3	1	2	-10	-10
Commodities			%				
Brent Crude Oil ($/barrel)		43	0.3	-1	2	-30	-35
Industrials Metals (index)		123	0.0	2	6	5	7
Agriculture (index)		42	0.2	2	9	7	2
Implied Volatility			%				
VIX Index (%, change in pp)		27.6	-0.5	0.2	-1.0	13.6	13.8
US 10y Swaption Volatility		72.4	0.2	2.1	27.2	-2.5	10.4
Global FX Volatility		8.5	0.0	0.2	-1.2	2.1	2.5
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		149	-1.7	8	-4	-18	-17
Italy		133	-3.7	6	-2	0	-27
Portugal		74	-2.4	1	-1	15	12
Spain		77	-2.3	2	4	12	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:	Exchange Rates							Local Currency Bond Yields (GBI EM)						
10/23/2020	Level		Change (in %)					Level		Change (in basis points)				
8:22 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		6.68	0.1	0.3	2	6	4		3.3	-2.2	-4	9	8	18
Indonesia		14660	0.0	0.3	1	-4	-5		6.6	-0.3	-11	-17	-57	-51
India		74	-0.1	-0.3	0	-4	-3		6.0	0.0	0	-13	-79	-83
Philippines		48	0.2	0.3	0	5	4		3.6	-1.0	-1	-7	-76	-74
Thailand		31	0.2	-0.2	1	-3	-5		1.5	-0.7	1	2	-11	-13
Malaysia		4.16	-0.3	-0.1	0	1	-2		2.5	-0.2	0	-9	-95	-89
Argentina		78	-0.4	-0.8	-3	-25	-23		46.6	17.6	235	707	-952	-1604
Brazil		5.57	0.4	1.4	0	-28	-28		6.2	7.1	-9	33	29	-6
Chile		776	0.3	2.5	1	-6	-3		2.7	-1.7	-6	10	-55	-60
Colombia		3785	-0.4	1.7	1	-9	-13		5.3	1.4	12	15	-53	-69
Mexico		20.88	0.5	1.2	7	-8	-9		6.1	4.7	6	20	-83	-81
Peru		3.6	-0.1	-0.6	-1	-7	-8		4.2	-1.7	10	4	-5	-29
Uruguay		43	0.0	0.1	-1	-12	-12		7.4	-0.2	-4	-20	-360	-351
Hungary		307	0.3	1.3	2	-4	-4		1.8	0.8	7	-1	68	56
Poland		3.87	0.2	0.4	0	-1	-2		0.7	0.5	1	-11	-112	-123
Romania		4.1	0.3	1.2	2	4	4		3.2	-1.0	-2	-13	-61	-79
Russia		76.4	0.2	1.8	1	-16	-19		5.7	0.7	-4	-19	-70	-47
South Africa		16.2	0.2	2.4	6	-9	-13		10.1	-5.0	-16	-10	81	60
Turkey		7.96	-0.4	-0.5	-3	-28	-25		13.4	31.3	7	-6	-40	175
US (DXY; 5y UST)		93	-0.2	-1.0	-2	-5	-4		0.38	0.3	6	11	-121	-131

	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		4718	-1.2	-2	1	22	15		214	-1	-1	-3	27	38
Indonesia		5112	0.4	0	4	-18	-19		207	1	-2	-26	31	51
India		40686	0.3	2	8	4	-1		206	1	-2	-21	72	81
Philippines		6484	2.2	10	10	-18	-17		121	2	2	-20	43	55
Malaysia		1495	-0.3	-1	0	-5	-6		145	1	3	-13	22	33
Argentina		51672	3.2	7	26	58	24		1441	-2	45	50	-702	-328
Brazil		101918	1.4	3	6	-5	-12		299	0	1	-41	69	84
Chile		3811	0.8	5	8	-22	-18		161	0	2	-27	27	28
Colombia		1178	0.0	1	0	-27	-29		239	1	12	-35	64	76
Mexico		38652	0.0	2	8	-11	-11		477	-1	3	-49	179	185
Peru		18067	-0.5	2	3	-7	-12		148	1	8	-37	23	41
Hungary		33655	0.0	2	4	-20	-27		102	-3	-12	-22	8	16
Poland		47908	0.0	-1	-1	-17	-17		14	-2	-6	-14	-18	-4
Romania		8803	0.5	-1	-3	-8	-12		232	0	-9	-28	45	59
Russia		2822	0.7	1	-3	0	-7		191	0	-6	-22	9	60
South Africa		55414	1.1	1	2	0	-3		476	-1	-17	-51	159	156
Turkey		1194	-0.4	0	8	20	4		607	0	-10	-47	144	206
Ukraine		502	0.0	-2	0	-4	-2		719	-3	22	20	252	299
EM total		46	0.3	1	7	9	3		404	0	-16	-13	68	111

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