GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, OCTOBER 6, 2020

- **US election flagged as biggest risk for markets** (link)
- **Investors expect steeper US yield curve and moderately higher interest rates** (link)
- **Climbing TIPS breakevens show rising hopes of US fiscal stimulus** (link)
- **European banks suffer equity erosion as pandemic drags on** (link)
- **Japan output gap turns negative for first time since global financial crisis** (link)
- **Brazilian real strengthens on hopes of fiscal reform** (link)
- **Reserve Bank of India names three new members to monetary policy council** (link)

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Markets looking for direction after Monday's strong rally

Markets are quieter today after yesterday's impressive gains. US equity futures are mixed but little changed, while most European stocks are modestly higher. Treasury yields are holding steady but core euro area yields were up again. Oil prices are unwinding a part of their gains from yesterday's strong rally, but gold is higher again. Many emerging markets are also higher today in the wake of the Monday rally, with Brazil doing especially well on hopes of fiscal reform. However, this week's positive market tone is in marked contrast to the growing bad news on the virus front. In an important development, the IMF Executive Board extended debt relief for 28 low income countries for a further six months to help them in their fight against the pandemic.

Key Global Financial Indicators

Last updated: 10/6/20 8:14 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		3409	1.8	2	-1	15	6
Eurostoxx 50		3234	0.4	1	-1	-6	-14
Nikkei 225		23434	0.5	0	1	9	-1
MSCI EM		45	1.3	3	1	9	-1
Yields and Spreads				bps			
US 10y Yield		0.78	0.2	13	7	-75	-113
Germany 10y Yield		-0.50	1.0	5	-3	9	-32
EMBIG Sovereign Spread		419	-1	-18	10	71	126
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		54.9	0.1	1	-1	-10	-11
Dollar index, (+) = $ appreciation		93.4	-0.1	-1	1	-5	-3
Brent Crude Oil ($/barrel)		42.1	1.9	3	-1	-28	-36
VIX Index (%, change in pp)		28.4	0.4	2	-2	11	15

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

United States

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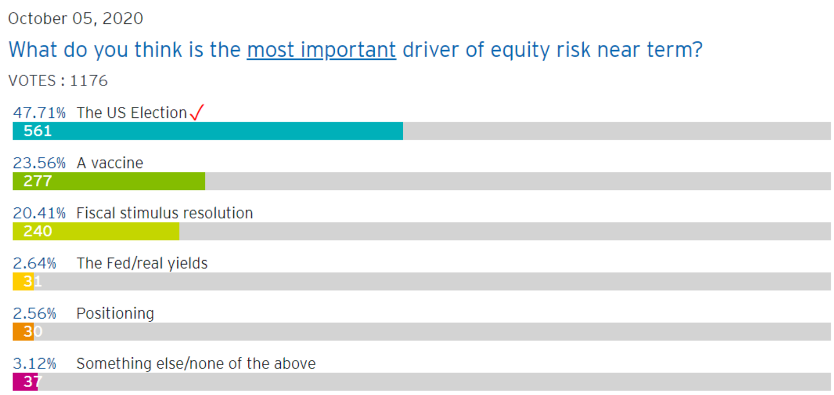
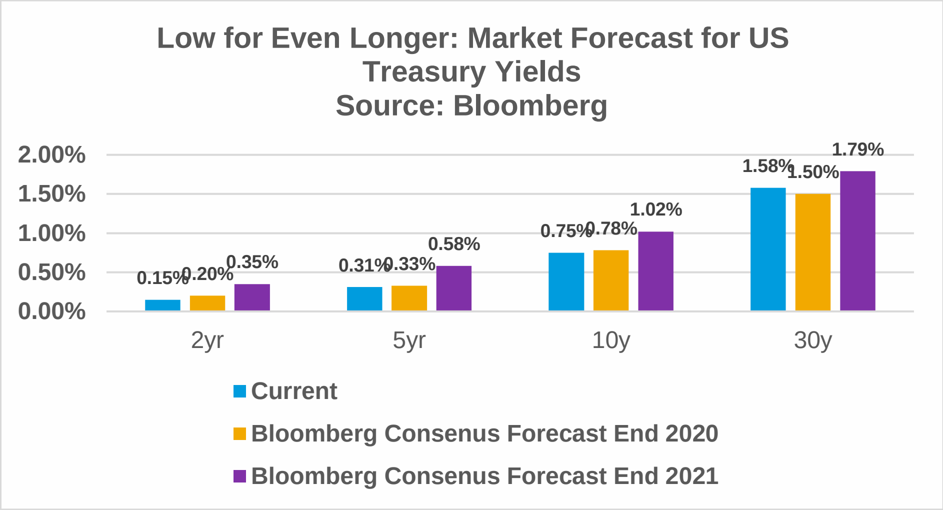
Global markets had a very good day on Monday, with US markets leading the way as optimism about the President's health rose. The S&P 500 hit its highest level since September 8. The 10-year and 30-year Treasury yields saw their biggest one-day upward moves in many weeks as the yield curve steepened noticeably. The benchmark 10-year yield is now at its highest since June. To the surprise of some investors, the VIX held steady despite the strong equity rally. Talks on a new stimulus bill dragged on without any sign of a breakthrough, even as the virus appears to be mounting a steady comeback around the country.

Chicago Fed president Evans warned against premature rate hikes from the Federal Reserve, expressing the view that the recovery has a long way to go, echoing comments from Minneapolis Fed President Kashkari last week. The Markit US services PMI for September met the consensus forecast with a 54.6 level, well into expansionary territory in contrast to most euro area economies which saw weaker PMIs earlier in the day. The report was notable for the employment component, which rose above 50 into expansion for the first time since February. The ISM services index also beat forecasts (57.8 vs. 56.2). In other news, **the most recent investor poll from Citi flagged the US election as the biggest risk in the near term.**

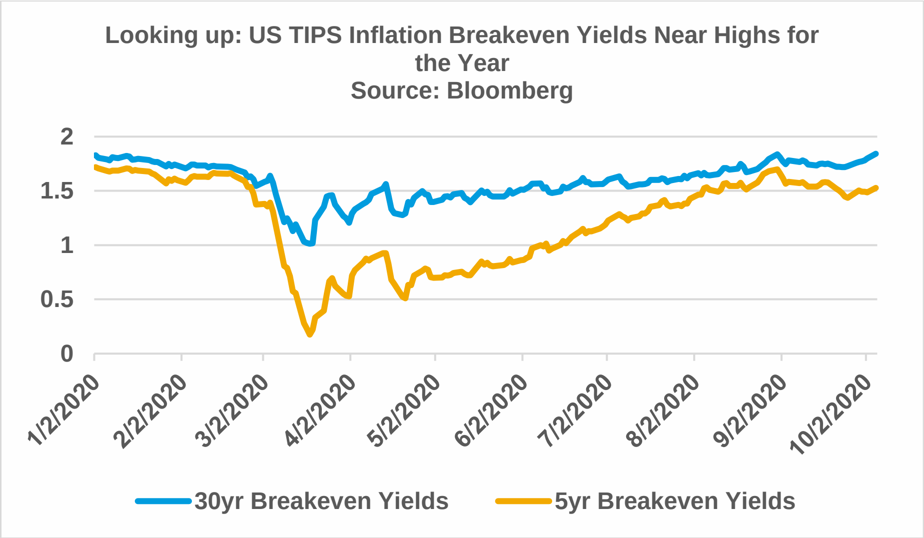


Source: Citi

In contrast, contacts reported strong interest in curve steepening trades from leveraged investors such as hedge funds, as well as outright selling of duration. Some investors seem to be positioning for higher rates and a steeper yield curve as a convincing Biden victory is becoming the consensus forecast, implying that any election dispute (if it even occurs) is likely to be brief, and that higher fiscal stimulus becomes more likely. Contacts argued that these views did not necessarily contradict the poll results as the election probably is the biggest risk, although the risk appears to be diminishing as Biden rises further in the polls. A few real money investors such as bond mutual funds are buying longer maturity Treasuries. Market forecasts for US interest rates remain very low for end-2020 and end-2021. Bloomberg's own forecast is that longer-dated yields will be 5-20 bps higher than the consensus at the end of 2021.



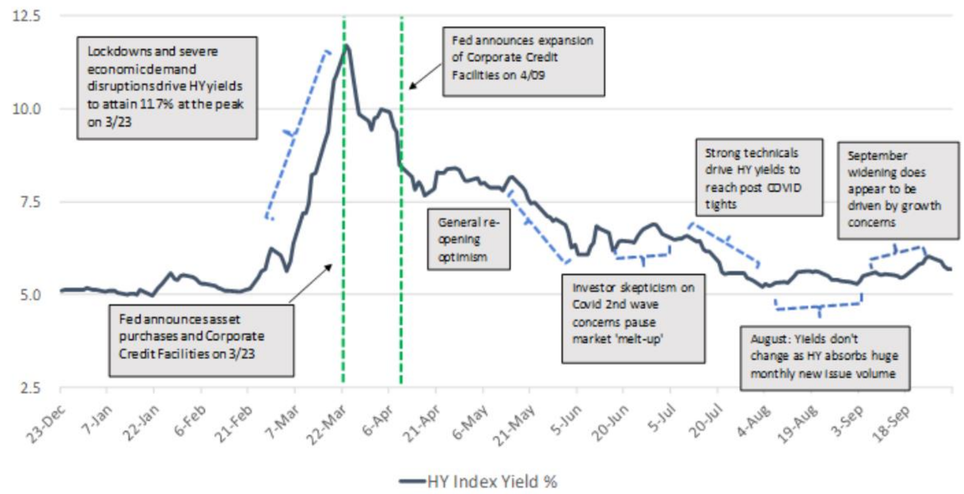
In keeping with these expectations for a steeper yield curve and higher stimulus spending if Biden wins, 30-year and five-year Treasury Inflation Security (TIPS) breakeven yields are close to their highest levels for the year. Five-year/five year forward breakevens are also moving higher. This implies that at least some investors are coming around to the view that longer term prospects for reflation are improving. However, 10-year breakeven yields remain 15 bps below their highs back in August, probably for valuation reasons as contacts said they were over-bought in September.



Q3 was a very strong quarter for the US high yield (HY) market as spreads tightened by 110 bps and a high volume of new bonds were snapped up by yield hungry investors, according to Goldman. Demand was supported by strong corporate earnings and low real yields, although news on the virus front was more mixed. In contrast to Q1 and Q2, lower rated bonds did better than higher rated bonds and cyclical sectors did better than defensive sectors. The strong summer rally in equities with a new record for the S&P 500 on September 2 also helped, and the strength of the HY sector was underlined by its continued good performance despite the subsequent equity selloff. Analysts expect issuance to slow down into year-end but think spreads will remain tight barring further lockdowns or a disputed election.

HY was 110bp tighter in 3Q20 when we saw record new issue volumes, stronger-than-expected 2Q earnings, and COVID news both on the positive and negative side

HY Index YTW Performance



Source: Bloomberg, Goldman Sachs Global Investment Research

Europe

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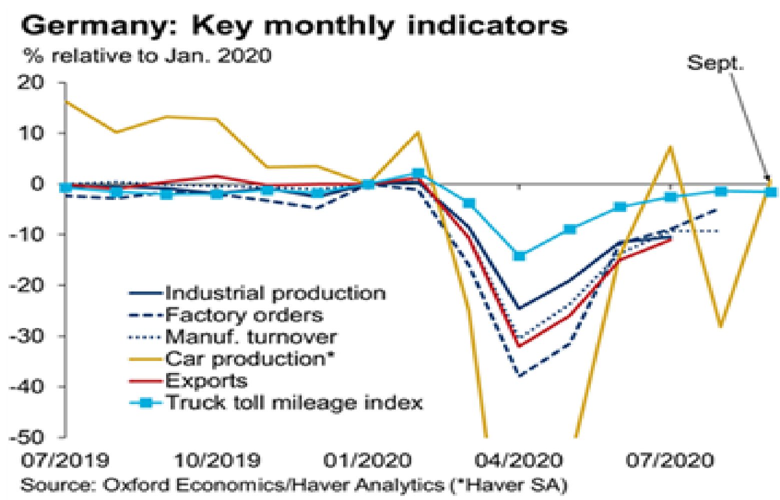
In a pre-recorded speech to the Wall Street Journal CEO Conference, ECB President Lagarde stated that "we now fear that the containment measures that have to be taken by authorities will have an impact on this recovery, so instead of that V shape that we all long for and hope for, we fear that it might have that second arm of the V a little bit more shaky."

European equities traded without clear direction today. While the DAX (-0.1%) and EuroStoxx 600 (-0.2%) posted small losses, the CAC 40 was flat and Italy's Titans 30 (+0.4%) and Spanish Ibex (+0.7%) remained in positive territory for the session. Bank stocks (+2.6%) had another day of solid gains.

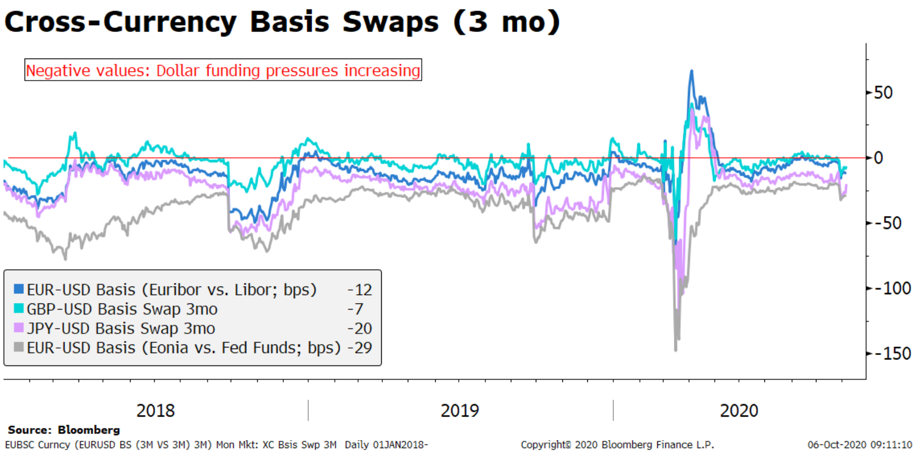
Sovereign yields were steady across countries and tenors, with most curves unchanged: German 10-year yields at -0.51%; French OATs are at -0.25%; Italian at 0.79%; and Spanish at 0.25%.

In its latest Risk Dashboard, **the European Banking Authority (EBA) found that the pandemic is starting to have a negative impact on banks' asset quality.** The Dashboard is based on a sample of 147 banks covering over 80% of the EU banking sector by total assets. Among the major trends in banking, the EBA highlighted that (i) banks' Core Tier 1 Equity Ratios (CET1 ratios) have increased by 30 bps to 14.7% (on average) due in part to regulatory measures that have reduced risk-weighted assets; (ii) Non-performing loans (NPLs) stopped their multi-year declining trend in Q2-2020; (iii) banks' return on equity more than halved to 0.5% from 1.3% in Q1; and that (iv) revenues are expected to remain under pressure. The study also finds a wide country dispersion of some key risk parameters.

German factory data for August came in above expectations, with factory orders increasing 4.5% m/m from 2.8% the month prior. The August figure amounts to a year-on-year contraction of 2.2%, much better than the -3.8% expected or the -7.3% y/y contraction seen in July.



In **European credit markets**, corporate spreads for investment grade and high yield continued to trend lower. IG spreads stood at 57 bps and HY at 333 bps. Spreads have declined markedly from the highs reached in March but remain above the average level of 2019. In **money markets**, the cross-currency basis has widened for the euro-dollar, pound-dollar and dollar-yen pairs. A widening into negative territory typically reflects increased demand for dollar funding in money markets, a development that tends to happen towards the end of each calendar year as institutions rebalance portfolios to meet regulatory requirements.



FinTech

The UK's Financial Conduct Authority has opened applications for two sandboxes for FinTech firms tackling challenges for the pandemic. According to the FCA, the [regulatory sandboxes] will help FinTech firms to innovate in three key areas: (i) improving small and medium enterprise (SME) access to finance; (ii) enhance the financial resilience of vulnerable consumers; and (iii) combat fraud and scams.

Other Mature Markets

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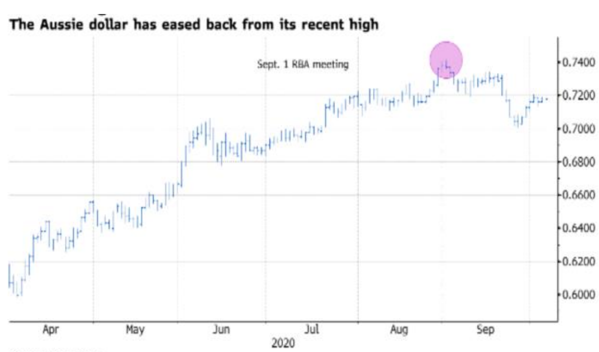
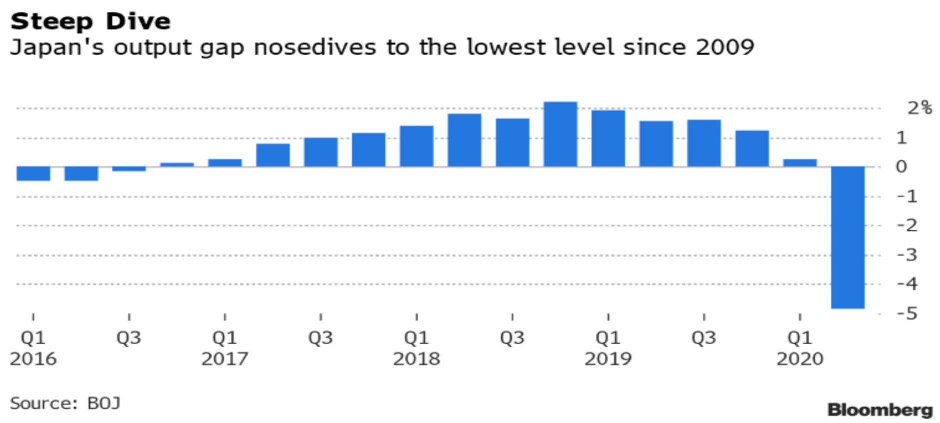
Australia

The Reserve Bank of Australia (RBA) left its cash rate and 3-year government bond yield target unchanged at 0.25% as expected. The central bank said that it bought a further AUD2 bn of government securities in September in support of the yield target, bringing the total amount purchased since March to AUD63 bn ($45.1 bn). It added that 3-year yields have fallen to 18bps as markets price in some probability of further monetary easing. **The RBA also maintained unchanged the Term Funding Facility that was expanded last month.** The facility provides additional funding of AUD120 bn to authorized deposit taking institutions. The RBA increased its emphasis on the labor market, noting that addressing the high unemployment rate is 'an important national priority' and that it is 'considering how additional monetary easing could support jobs as the economy opens up further'. **The Australian dollar weakened -0.3%, 10-year bond yields rose +5.2bps and equities rose +0.4%.**



Japan

The output gap, a key measure of the strength of the economy, turned negative for the first time since the global financial crisis. This is a warning bell for policymakers at the central bank, who have already shifted their focus from their 2% inflation target to pumping credit into the economy. Meanwhile, the Nikkei posted modest gains while the yen was marginally stronger against the dollar.



Emerging Markets

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EMEA equities are trading with a positive tone with the main indices up in Saudi Arabia (+0.8%), Poland (+0.5%) and Turkey (+0.5%). **EMEA currencies are trading little changed** except for the Russian ruble (-0.3%) and the Turkish lira (-0.3%) that are weaker against the dollar. **Asian equities rose +0.8% on net with most markets in the green.** India (+1.4%) and Taiwan Province of China (+1.2%) outperformed. **Regional currencies broadly appreciated, led by gains in the Thai baht (+0.6%) and the Indonesian rupiah (+0.5%).** On COVID-19, India reported the lowest levels of cases in a month of around 61,000. Singapore is reviewing proposals by stakeholders and the public to safely reopen its borders. In **Latin America**, the **Mexican** peso appreciated by 1%, posting its largest four day rally since April (+5%). In **Brazil**, the real outperformed all EM currencies strengthening by 2% on the back of increased optimism that the government and congress might find some common ground on fiscal issues. The **Chilean** peso was the only underperformer in the region, depreciating by 1.1%. Headlines flagged a decrease in domestic risk appetite heading into this month's constitutional reform plebiscite, a decline in copper prices and impact from pension funds' repositioning following recommendations by a local research company.

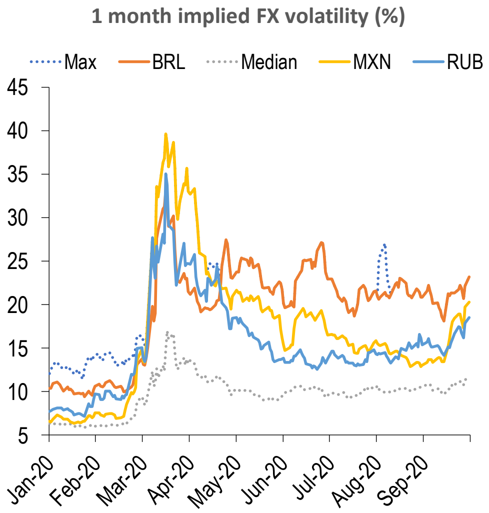
Key Emerging Market Financial Indicators

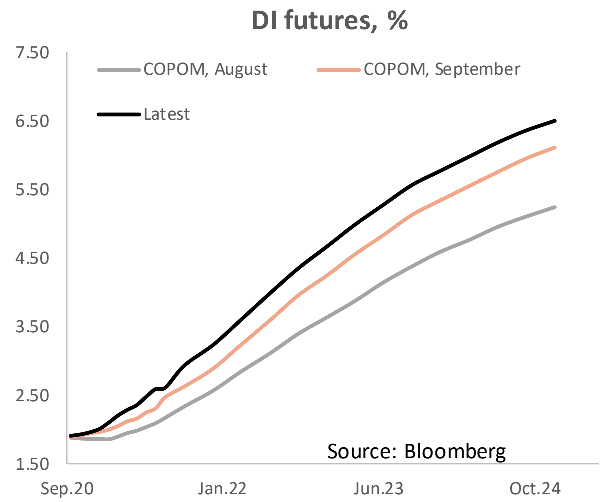
Last updated:	Level		Change				
10/6/20 8:17 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		44.58	0.2	3	1	9	-1
MSCI Frontier Equities		26.27	2.2	2	3	-7	-13
EMBIG Sovereign Spread (in bps)		419	-1	-18	10	71	126
EM FX vs. USD		54.86	0.1	1	-1	-10	-11
Major EM FX vs. USD				**%, (+) = EM currency appreciation**			
China Renminbi		6.79	0.4	0	1	5	3
Indonesian Rupiah		14735	0.4	1	0	-4	-6
Indian Rupee		73.46	-0.2	1	0	-3	-3
Argentine Peso		77.02	-0.1	-1	-3	-25	-22
Brazil Real		5.54	0.6	2	-4	-26	-27
Mexican Peso		21.33	0.3	5	1	-8	-11
Russian Ruble		77.76	0.4	2	-3	-16	-20
South African Rand		16.49	0.5	3	1	-8	-15
Turkish Lira		7.77	-0.1	1	-4	-25	-23
EM FX volatility		11.72	0.0	-0.3	0.4	3.7	5.1

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

Brazil

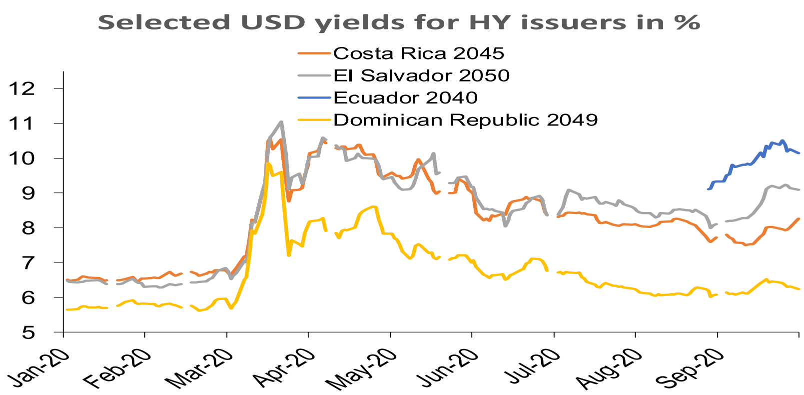
The Brazilian real outperformed all EM currencies yesterday, strengthening by 2% after press reports fueled hopes that the government and congress might find some common ground on fiscal issues. The key headline was that the Economy Minister is set to have a meeting with the Lower House President. This followed local media reports stating that the Lower House President met with President Bolsonaro and agreed to work with the government to solve fiscal issues. Relatedly, a key senator told reporters that the new social program "Renda Cidada" will respect the spending cap rule - a key market concern - and legislation will only move forward after the Economy Minister's approval. Amid the uncertainty regarding fiscal issues, the real continues to be the most volatile EM currency, with one-month implied volatility at 23%. Fiscal uncertainty has also led to local curve steepening over the last few months. Following the news, swap rates with maturities from late 2021 and beyond declined by 15-20bps. Late last week Reuters reported that the central bank president said that BCB will withdraw its forward guidance of not raising rates if the spending cap is not respected.





Costa Rica

Costa Rica 10y USD yields rose by 30bps to 7.3% after President Alvarado said he would withdraw a draft proposal for an IMF program and launch a national dialog before submitting a new one. This decision followed social demonstrations against austerity measures and calls against government's plans from political parties in the national assembly. Analysts highlighted that following this news, investors will be concerned around potential delays on this "national dialog" which might increase liquidity/rollover risks given relatively high gross financing needs in 2021.

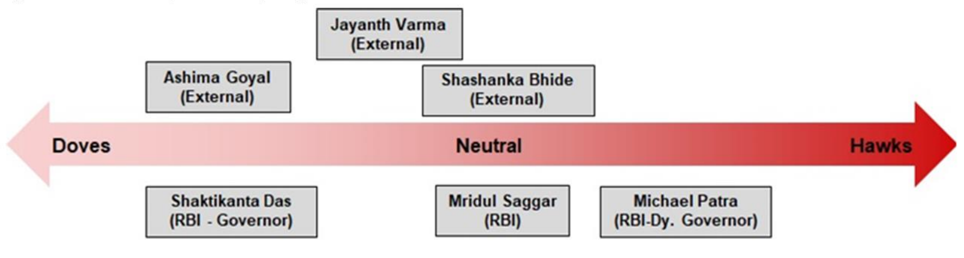


Source: Bloomberg

India

The Reserve Bank of India (RBI) appointed new members to its monetary policy committee (MPC). Three new external members from academia/ think tanks have been appointed to the MPC for a four-year term to replace those whose terms expired in August, according to the Ministry of Finance. The MPC will meet Oct 7-9, more than a week later than originally planned. Analysts view the three new MPC members as holding neutral-to-dovish policy stances which will tilt the overall MPC in a dovish direction. That said, most analysts expect the RBI to remain on hold on October 9, in line with market pricing, given the current high levels of inflation. **The rupee and bond yield were little changed.**

Fig. 1: Nomura's interpretation of policy stance of MPC members: Hawk vs Dove



Source: Nomura Global Economics

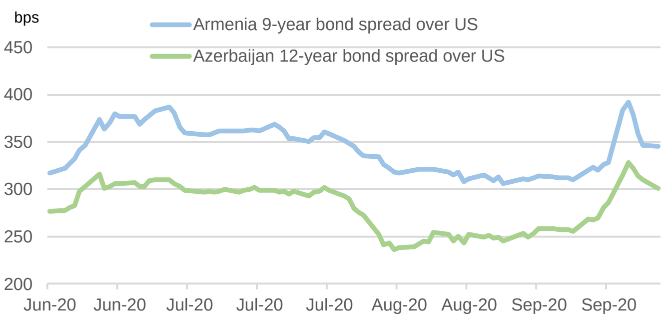
Indonesia

Indonesian assets rose following the earlier than expected passage of a job creation omnibus bill aimed at improving the business and investment environment. The bill is expected to attract foreign direct investment and create jobs by cutting regulations on businesses, speeding approvals of projects, eliminating many permit requirements and adjusting labor laws, particularly by reducing the corporate severance payment liability.

Nagorno-Karabakh

The military conflict in the Caucasus region of Nagorno-Karabakh shows no signs of deescalation. Fighting intensified over the weekend with the leaders of Azerbaijan and Armenia unable to reach a diplomatic compromise. The members of the Organization for Stability and Cooperation in Europe (OSCE) Minsk-group (the U.S., France and Russia) issued a join-statement condemning the violence, while Turkish Foreign Minister Cavasouglu traveled to Azerbaijan to show solidarity. Russian Prime Minister Mishustin is also reported to have traveled to Armenia but the details of the visit remain unclear. **Despite the build-up in tension, the international bonds of both Armenia and Azerbaijan have stabilized over the last few days**.

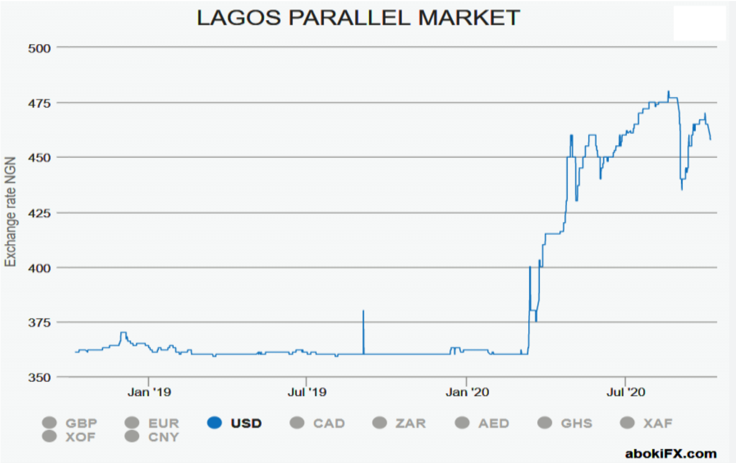
Armenia and Azerbaijan credit spread



Source: Bloomberg, IMF

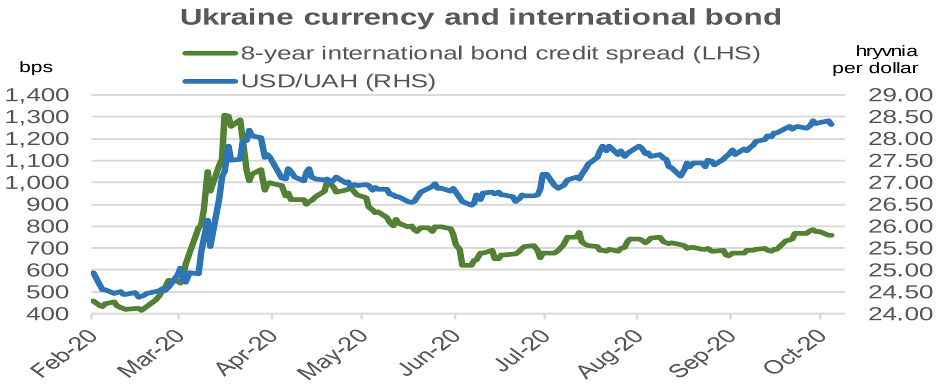
Nigeria

The balance of payment dynamics improved in the second quarter, but concerns remain around medium-term sustainability. The Q2 current account deficit narrowed to $3.2 bn (3% of GDP) from $5.6 bn in Q1 (5% of GDP). The improvement comes despite the drop in hydrocarbon export revenues and is driven by a sharp contraction of imports due to pandemic related lockdown measures as well administrative measures restricting imports and access to foreign currency. Portfolio flows were flat with the financial account supported by borrowing from official creditors. Contacts remain skeptical that the import compression can be sustained as the economy re-opens while the central bank pursues easing of monetary policy. **Contacts anticipate that the official naira exchange rate could weaken by another 15-20% from current rate of 385 naira per dollar towards the parallel market rate of 450-475 naira per dollar**.



Ukraine

The supervisory body of the National Bank of Ukraine (NBU) reprimanded two deputy governors, raising renewed concerns around the central bank's independence. The NBU council expressed a lack of confidence in the first deputy head Kateryna Rozhkova and deputy head Dmytro Solohub, the two remaining members of the board under the previous governor Yakiv Smoly who resigned abruptly in July. The council cited violation of ethics and internal procedures, with exact details remaining unclear. **While both board members remain on duty, contacts now see increased risk of their dismissal**. The NBU policy under the new governor has been on the hawkish side, surprising the market twice by keeping the key rate unchanged at 6%. That said, given the broader market concerns around the appointments to the anti-corruption agency, **contacts are concerned that another reshuffle at the NBU could lead to further delays in discussion with the official creditors**. Ukraine international bond credit spreads have widened 80-100 bps in September while the hryvna depreciated by 3% against the dollar.



Source: Bloomberg, IMF

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Global Financial Indicators

Last updated: 10/6/20 8:16 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		3405	1.8	2	-1	15	5
Europe		3234	0.4	1	-1	-6	-14
Japan		23434	0.5	0	1	9	-1
China		3218	-0.2	-2	-6	11	6
Asia Ex Japan		78	1.1	3	1	18	6
Emerging Markets		45	1.3	3	1	9	-1
Interest Rates					basis points		
US 10y Yield		0.78	0.2	13	7	-75	-113
Germany 10y Yield		-0.50	1.0	5	-3	9	-32
Japan 10y Yield		0.04	1.2	2	0	25	5
UK 10y Yield		0.29	0.5	11	3	-15	-53
Credit Spreads					basis points		
US Investment Grade		133	0.3	-2	4	4	35
US High Yield		527	0.2	-27	20	34	133
Europe IG		56	-1.2	-5	3	-2	11
Europe HY		329	-4.5	-19	5	76	122
EMBIG Sovereign Spread		419	-1.0	-18	10	71	126
Exchange Rates					%		
USD/Majors		93.41	-0.1	-1	1	-5	-3
EUR/USD		1.18	0.1	0	0	8	5
USD/JPY		105.6	0.1	0	1	2	3
EM/USD		54.9	0.1	1	-1	-10	-11
Commodities					%		
Brent Crude Oil ($/barrel)		42	1.9	3	-1	-28	-36
Industrials Metals (index)		115	0.5	-1	-3	0	1
Agriculture (index)		40	0.8	4	4	3	-4
Implied Volatility					%		
VIX Index (%, change in pp)		28.4	0.4	2.1	-2.4	11.3	14.6
US 10y Swaption Volatility		61.5	-5.7	18.0	4.8	-19.8	-0.5
Global FX Volatility		9.0	0.0	-0.4	-0.2	2.0	3.0
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		148	-0.8	-8	-13	-46	-17
Italy		131	-0.6	-8	-18	-11	-29
Portugal		75	-1.0	-4	-10	2	12
Spain		76	-1.0	-1	-6	4	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: 10/6/2020 8:19 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		6.79	0.4	0.3	1	5	3		3.3	0.0	1	-1	9	13
Indonesia		14735	0.4	1.1	0	-4	-6		6.8	-3.0	2	8	-48	-29
India		73	-0.2	0.5	0	-3	-3		6.1	-0.8	-6	7	-61	-73
Philippines		48	0.0	0.2	1	7	5		3.6	-1.9	-3	-2	-72	-69
Thailand		31	0.4	1.3	1	-2	-5		1.5	0.0	0	-7	-5	-15
Malaysia		4.15	0.0	0.1	0	1	-2		2.5	-1.3	-9	8	-87	-84
Argentina		77	-0.1	-1.2	-3	-25	-22		41.3	46.1	-38	-328	-2365	-2135
Brazil		5.54	0.6	1.7	-4	-26	-27		6.2	-16.9	5	79	-14	-9
Chile		799	-0.2	-1.6	-3	-10	-6		2.7	1.9	-8	15	-9	-61
Colombia		3829	1.1	1.1	-3	-10	-14		5.3	1.8	19	27	-37	-69
Mexico		21.33	0.3	5.3	1	-8	-11		6.1	0.4	15	13	-76	-84
Peru		3.6	0.8	0.0	-1	-6	-8		4.2	-5.4	1	4	-19	-34
Uruguay		42	0.1	0.0	0	-12	-12		7.3	-5.5	-6	-62	-345	-353
Hungary		305	0.4	2.0	0	0	-3		1.8	1.3	-2	6	74	57
Poland		3.80	0.3	1.4	-1	4	0		0.8	2.5	1	-9	-96	-114
Romania		4.1	0.1	0.3	-1	5	3		3.3	-1.0	-2	-7	-51	-75
Russia		77.8	0.4	1.7	-3	-16	-20		5.8	-0.4	-12	5	-100	-33
South Africa		16.5	0.5	2.7	1	-8	-15		10.4	6.8	7	30	107	83
Turkey		7.77	-0.1	0.5	-4	-25	-23		12.7	-6.5	-29	-57	-61	99
US (DXY; 5y UST)		93	-0.1	-0.5	1	-5	-3		0.33	-0.6	7	3	-102	-136

	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		4587	0.0	-1	-5	20	12		217	0	-2	6	27	41
Indonesia		4999	0.8	2	-5	-18	-21		221	3	-14	2	31	65
India		39575	1.5	4	3	5	-4		225	-7	-8	13	88	100
Philippines		5911	-0.5	1	2	-23	-24		129	2	-14	-9	45	63
Malaysia		1509	-0.2	0	0	-3	-5		160	-3	-6	12	33	48
Argentina		44273	1.4	5	-2	39	6		1362	16	42	-789	-801	-407
Brazil		96089	2.2	2	-5	-6	-17		318	-2	-26	15	64	103
Chile		3676	0.3	3	-4	-27	-21		168	0	-19	2	26	35
Colombia		1168	0.3	0	-6	-27	-30		252	0	-17	8	64	89
Mexico		36740	0.3	-1	1	-15	-16		487	-4	-29	28	163	195
Peru		17953	0.2	0	-1	-7	-13		161	2	-13	16	31	54
Hungary		33528	0.2	3	-4	-16	-27		117	6	-9	0	2	31
Poland		50396	0.8	2	0	-10	-13		22	1	-6	0	-24	4
Romania		8904	0.4	-1	-1	-6	-11		244	-8	-12	-3	38	70
Russia		2903	0.7	0	-1	8	-5		201	3	-15	1	-5	70
South Africa		54383	-0.3	0	1	1	-5		513	-3	-26	29	170	193
Turkey		1168	0.6	4	8	13	2		592	-5	-53	-6	115	191
Ukraine		500	0.0	0	0	-5	-2		723	10	-9	102	198	303
EM total		45	0.2	3	1	9	-1		419	-1	-18	10	71	126

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