GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, OCTOBER 28, 2024
LEAD EDITOR: SANJAY HAZARIKA

- **US markets brace for higher interest rate volatility ahead of election** (link)
- **Dollar strengthens as US election draws nearer** (link)
- **People's Bank of China introduces new measure to boost liquidity** (link)
- **Japanese markets face uncertainty after ruling party election setback** (link)
- **Pension funding ratios in US at best level since 2007**
- **Central Bank of Russia delivers larger than expected rate hike** (link)

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Markets relieved as Middle East tensions appear to abate

Markets were relieved that Israeli air strikes against Iran were not as severe as some feared and left Iran's oil infrastructure untouched. Stocks in Europe were generally higher, US equity index futures pointed to a positive start and oil prices were down sharply as supply concerns dissipated in the wake of the Israeli actions. Stocks in Asia also had a mostly positive start to the week. However, US interest rates were higher again as Treasuries sold off, reminding market participants of the many risks that could lie ahead as the last full week before the US election begins. Meanwhile, five of the Magnificent Seven US technology companies are due to report their earnings this week and markets are bracing for key economic reports on inflation and employment in the US. Japan is in focus again as the ruling party lost its parliamentary majority in a surprise election result. The UK Chancellor is scheduled to present the new budget on Wednesday.

Key Global Financial Indicators

Last updated: 10/28/24 7:53 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		5808	0.0	-1	1	41	22
Eurostoxx 50		4936	-0.1	0	-3	23	9
Nikkei 225		38606	1.8	-1	-3	25	15
MSCI EM		45	-0.1	-2	-3	24	12
Yields and Spreads					bps		
US 10y Yield		4.25	1.4	6	50	-58	37
Germany 10y Yield		2.28	-1.4	-1	14	-56	25
EMBIG Sovereign Spread		337	-6	1	-31	-102	-46
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		44.9	-0.1	0	-3	-4	-7
Dollar index, (+) = $ appreciation		104.2	0.0	0	4	-2	3
Brent Crude Oil ($/barrel)		71.8	-5.6	-3	0	-21	-7
VIX Index (%, change in pp)		19.2	-1.1	1	2	-2	7

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

The final week before the US election could prove volatile as market participants make last-minute changes to their positions in anticipation of the potential outcomes. The US data calendar could also move markets, with the all-important jobs report on Friday as well as key PCE inflation and GDP reports due earlier in the week. The latest quarterly Treasury refunding announcement may also be impactful. In the euro area, reports are due on euro area CPI and consumer confidence, as well as jobs data from Germany among other releases. China is also in the spotlight, with new PMI data expected to shed light on the state of the economy. Meanwhile, the Bank of Japan is expected to stay on hold this week despite the recent weakness in the Yen.

Mature Markets

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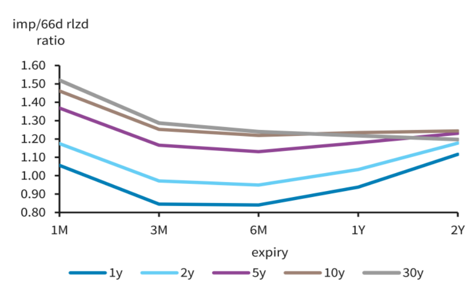
United States

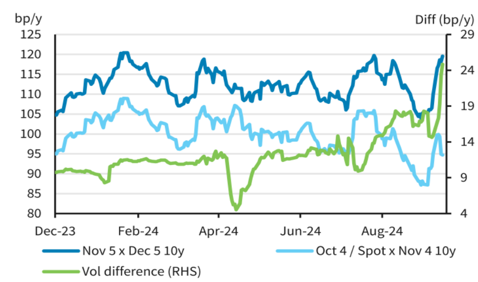
Interest rate swap markets are bracing for higher volatility as the US election draws nearer. The market for swaptions (options on interest rate swaps) is pricing higher volatility at the longer end of the curve relative to the shorter end. In addition, a surge in volatility is being predicted immediately after the election relative to the month before the election. A Trump victory is seen as increasingly likely, and markets appear to think that this outcome will lead to higher interest rates as well as inflation due to new policy measures such as tariffs. The speculation is that the Fed will be forced to halt or even reverse its rate cuts as inflation reignites, pushing rates higher across the board but with a bias towards a steeper yield curve. Bank of America's proprietary MOVE index of Treasury volatility has also risen steadily over the past few weeks.

FIGURE 1. **Vol markets are pricing a larger vol risk premium in long tenor vols**



Source: Barclays Research

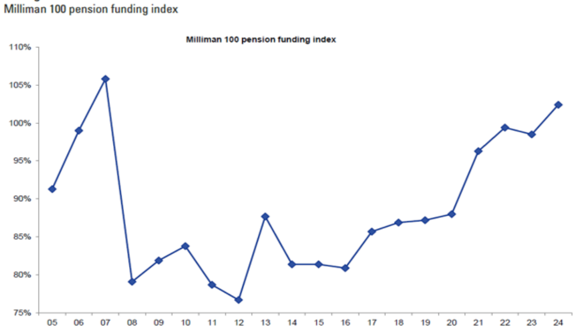
FIGURE 2. **The forward vol premium for 10y rates in the month after the election has continued to increase**



Source: Barclays Research

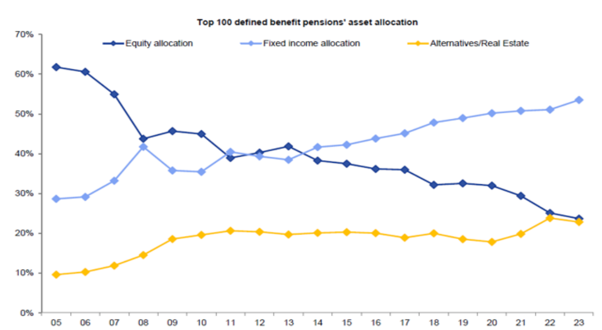
US defined benefit pension funds (DBPFs) are in robust condition, with the aggregate funding ration of 102.4% the highest since 2007. This implies that on aggregate the DBPF sector has more financial resources than it needs to fund all its obligations, in contrast to the long period after the Global Financial Crisis when funding ratios were much lower and the viability of many DBPFs was called into question. With the Fed rate cut cycle underway and with the DBPF fixed income allocation at its highest since 2005, the sector is well positioned to continue its strong performance. Its demand for fixed income instruments is likely to remain strong. Analysts noted that the sector's funding ratios have continued to improve almost all the way through the Fed's rate hike cycle.

Exhibit 4: The aggregate funding ratio for the top 100 defined benefit pensions stood at 102.4% in September, the highest level since 2007
Milliman 100 pension funding index



Source: Milliman, Goldman Sachs Global Investment Research

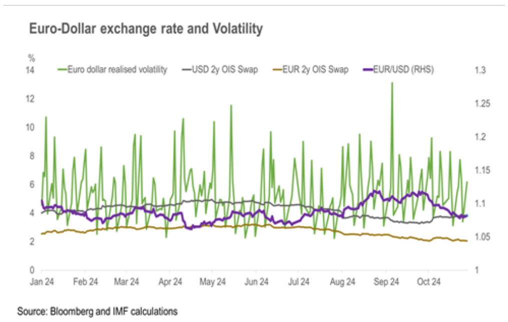
Exhibit 5: The fixed income allocation of the top 100 defined benefit pensions finished 2023 at its highest level since 2005

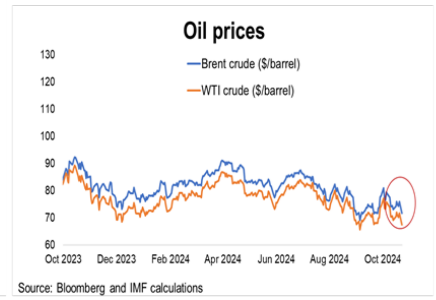


Source: Milliman, Goldman Sachs Global Investment Research

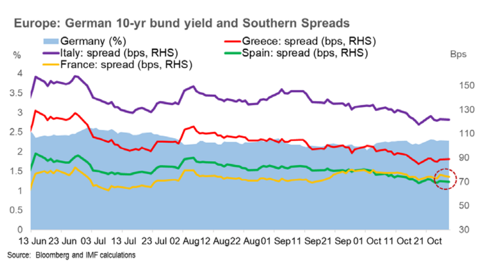
Euro Area

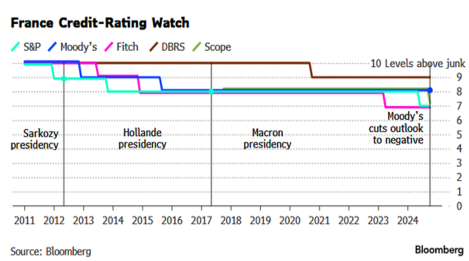
European equities traded mostly sideways this morning. The Stoxx 600 index was little changed, with gains from consumer goods (0.5%), real estate (0.4%) and banking (0.3%) offsetting losses in the energy sector (-1.9%) on the backdrop of lower oil prices (Brent -6% at $71.58 per barrel). Bourses were in the green across the region, with France (CAC 40 index +0.4%) and Spain (IBEX 35 index +0.5%) outperforming. The euro was firmer (+0.2%) against the dollar this morning, trading at around &1.0815/€. Analysts at ING note that lower oil prices are good news for the euro but continue to expect the currency to return to levels in the range of 1.0765–1.0850 as the two-year EUR-USD swap rate differential has reached 158bps, the widest since April this year, and as result of developments linked to the US elections.





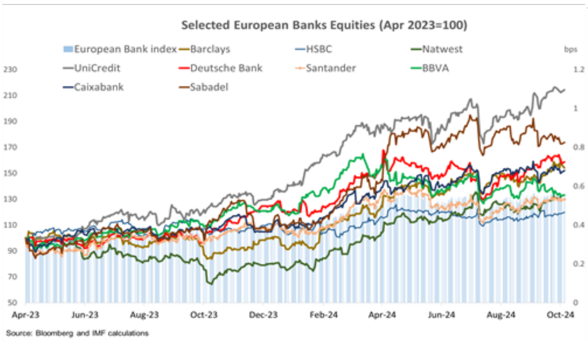
This morning, **German government bond yields edged lower on shorter tenors**, with the 2Y Bund yield at 2.07% (-3bps) while the 10y Bund yield was at 2.27%, relatively unchanged (-1bp) since last Friday, as the yield curve continues to bull steepen. The spread between the 10y Italian BTP and the 10y Bund was little changed at 121 bps, while the **differential between the French 10y OAT and the 10y Bund yields closed marginally (-1bp) to 74bps** despite Moody's having changed the outlook for France from stable to negative last Friday.

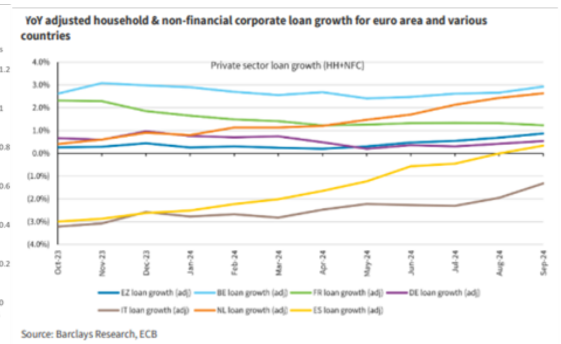




European banking sector

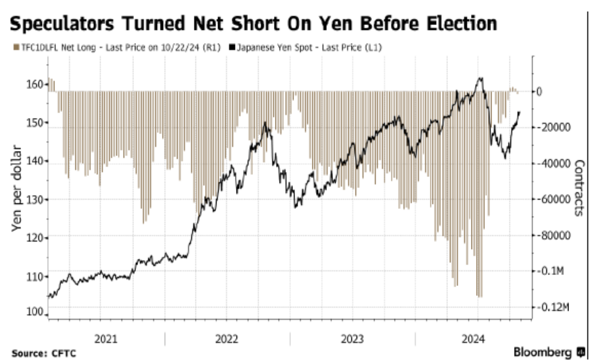
The European banking sector was down by -1.5% last week, largely in line with the market, but **opened this week in the green, with the Stoxx 600 Banks index higher by +0.3% this morning.** The Q3 earnings season has been positive so far. According to Jefferies, European banks' profits before tax were on average 12% higher than expected, driven by higher revenues from fees and commissions businesses (non-interest income +5%y/y), lower costs and lower loan provisions (11% better than expected according to Barclays, with Deutsche Bank the most notable exception). The Core Tier 1 (CET1) ratio of European banks was +10bps above expectations. The European banks earnings season will continue with investors focus on Spanish and French banks this week (in addition to HSBC and ING). Analysts at Bloomberg see Spanish banks mostly meeting consensus net interest income (NII) in Q3, but with a weaker 2025 NII outlook.





Japan

The yen weakened amid increased political uncertainty as the ruling Liberal Democratic Party (LDP) and its coalition partner lost their parliamentary majority in a snap election. The yen extended its recent depreciation to its weakest level in about three months against the dollar (-0.6%) to 152.25. Although Prime Minister Ishiba indicated he does not intend to step down, analysts expect sizable political uncertainty given the LDP's losses and PM Ishiba's compromised standing. **CFTC data suggest short yen positions had been building ahead of the snap election.** According to CFTC data for the week to October 22, hedge funds turned bearish on the yen ahead of the snap election, switching to a net short position on the yen for the first time in October. Asset managers were similarly bearish and flipped to a net short of 17,226 contracts during the same week—the first time since mid-August. The yen has depreciated nearly 7% against the dollar this month and has given up all its gains since the Bank of Japan tightened policy in late July, making it the worst performer among its G10 peers.

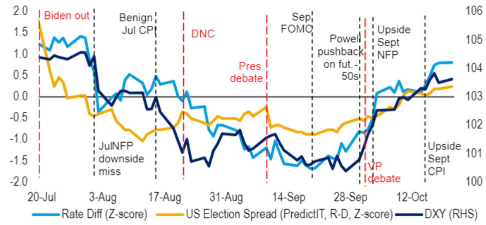


Foreign Exchange Markets

Analysts point to a strengthening dollar as another sign that markets expect higher US interest rates in the event of a victory for the Republican presidential candidate. Bank of America tracked the movements in the DXY dollar index versus the interest rate differentials between the US and other major markets as well as the movement in the "PredictIt" betting market of the odds of a Republican victory relative to a Democratic victory in the presidential election. The dollar index and the interest rate differential measure have both risen along with the rising expectation of a Republican victory. However, other analysts warn against drawing firm conclusions. They point out that US interest rates have been rising for fundamental reasons such as the growing strength of the economy. They also note that multiple press outlets have published reports about the very limited liquidity in the betting markets and their manipulation by a few large transactions.

Exhibit 4: DXY vs. Rate Differentials* (Z-score) and Pres. Betting mkt spread (Z-Score)**

DXY and IRD's track with key fundamental developments; Pres. odds shifts appear more coincidental



Source: Bloomberg; BofA Global Research; *IRD Z score =2y Sov. DXY weighted; Betting spread Z-score = PredictIT Republican - Democratic

BofA GLOBAL RESEARCH

Emerging Markets

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EMEA equities and currencies were mixed, while local currency bond yields were mostly higher this morning. On the central bank front Ukraine is expected to keep rates unchanged at 13% on Thursday. **Chinese shares edged lower for much of the day before posting modest gains (+0.7%) following the release of a steep decline in industrial profits for September (-27%, y/y).** Most Asian currencies also weakened. **Latin American currencies underperformed last Friday.** Brazilian yields continue to hover near the highest levels for this year (12.7%) ahead of the BCB's meeting next week where investors are expecting a hike as inflation is near the upper band of the central bank's target. Mexican yields have risen by 100bps in less than 90 days as markets are increasingly pricing the possibility of tariffs following the US election along with spillovers from rising US yields due to the US economy's strong momentum.

Emerging Market Fund Flows

EM bond funds saw outflows for the second week whereas the pace of inflows into equities moderated. The pace of outflows from bond funds picked up modestly from last week (-$0.6bn, -$0.1bn prior). Despite the start of cutting cycles by EM central banks, bond funds are in their third straight year of outflows (-$13.9bn YTD). The majority of outflows from the asset class have been from local currency funds (-$8.5bn YTD) rather than hard currency funds (-$5.4bn YTD). Inflows into EM equity funds have remained positive but the pace has moderated in the last two weeks (+$0.4bn, +$8.3bn YTD).

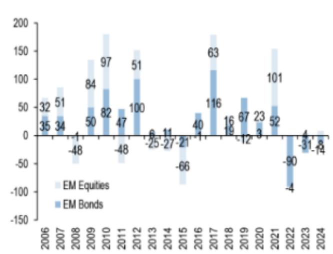
Figure 1: Weekly cross-asset flows

USD billion

	Asset	8w flows (8w ago → current)	This wk	YTD
Fund Flows	**EM Bonds and Equities**		-0.3	-5.6
	EM Bonds		-0.6	-13.9
	Hard Ccy		-0.4	-5.4
	Local Ccy^		-0.3	-8.5
	o.w. EM ex-China		-0.3	-7.4
	o.w. China		0.1	-1.5
	EM Equities		0.4	8.3
	US HG		2.4	311.0
	US HY		-0.1	26.7
	Global Equities		5.8	185.9
	EM Bond and Equity ETFs		7.4	46.3
	EM Bond ETFs		-0.1	-1.0
	EM Equity ETFs		7.5	47.2
	Non-resident EM flows*		0.0	2.1

Figure 2: EM bond and equity fund flows

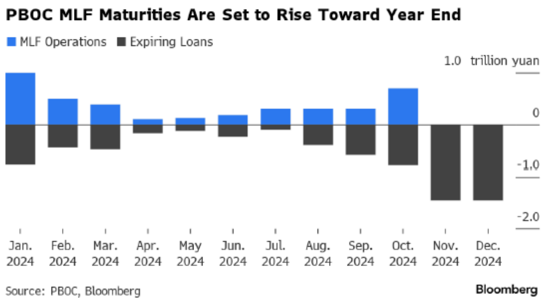
USD billion



*High-frequency non-resident EM portfolio flow data where available. ^Local ccy split is retail only. *Source for all charts and data in this report: J.P. Morgan, EPFR Global, Bloomberg Finance L.P.*

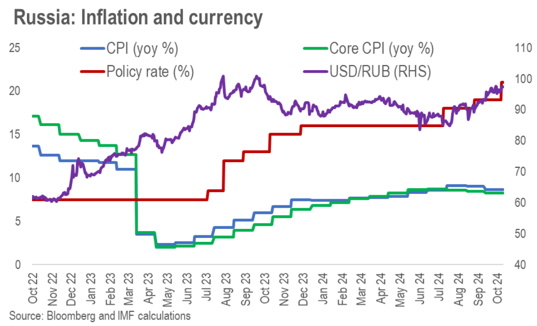
China

The People's Bank of China (PBC) announced a new policy operating tool to help maintain market liquidity. According to a PBC statement released before the market open, PBC will conduct outright reverse repurchase agreements with primary dealers monthly for tenors of up to one year. The move is aimed at maintaining a reasonable level of banking system liquidity and expanding its policy toolkit. Analysts noted that the new tool would help mitigate liquidity pressure near year end. A record amount of Medium Term Lending Facility loans are coming due, including RMB1.45tn (or about USD 200bn) due in November and December each, or roughly 40% of the total balance outstanding. The new measures would also help ease interbank liquidity pressure that could arise from possible freezes of pledged repo collateral trades. Moreover, Standard Chartered expects the new tool to provide a longer-term liquidity injection to the interbank market amid an expected increase in bond issuance.



Russia

The central bank of Russia (CBR) last Friday surprised with a larger than expected rate hike and contacts expect another rate hike in December. Last Friday the CBR increased its policy rate by 200bps to 21%, while consensus had expected a 100bps rate hike, with the governor noting that price growth had accelerated since September while inflation expectations also increased. The governor also noted that the CBR saw the need for a higher rate path than previously assumed, with the key rate at an average of 17.5% this year and between 17% and 20% in 2025. JPMorgan analysts see the central bank's signaling as hawkish, and also argue that the regulator seemed uneasy regarding the effectiveness of policy transmission in this cycle. The analysts expect a final 100bps rate hike in December and see higher risks of a recession in 2025. Deutsche Bank analysts also expect a 100bps rate hike in December, with only modest easing seen as likely in 2025.



This monitor is prepared under the guidance of Jason Wu (Assistant Director), Charles Cohen (Advisor), Nassira Abbas (Deputy Division Chief), Caio Ferreira (Deputy Division Chief) and Sheheryar Malik (Deputy Division Chief). Fabio Cortes (Senior Economist), Sanjay Hazarika (Senior Financial Sector Expert), Esti Kemp (Financial Sector Expert-London Representative), Johannes S Kramer (Senior Financial Sector Expert-New York Representative), Benjamin Mosk (Senior Financial Sector Expert), Patrick Schneider (Financial Sector Expert), and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Mustafa Oguz Caylan (Research Officer), Yingyuan Chen (Financial Sector Expert), Andrew Ferrante (Research Assistant), Deepali Gautam (Senior Research Officer), Harrison Kraus (Research Assistant), Yiran Li (Research Assistant), Xiang-Li Lim (Financial Sector Expert), Corrado Macchiarelli (Economist), Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), Sonal Patel (Senior Financial Sector Expert-London Representative), Silvia Ramirez (Senior Financial Sector Expert), Francesco de Rossi (Senior Financial Sector Expert-London Representative), Dmitry Yakovlev (Senior Research Officer), and Akihiko Yokoyama (Senior Financial Sector Expert). Javier Chang (Senior Administrative Coordinator), Lauren Kao (Administrative Coordinator), and Srujana Tyler (Administrative Coordinator) are responsible for the word processing and production of this monitor.

Global Financial Indicators

10/28/24 7:57 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		5,808	0.0	-1.0	1.2	41.1	22
Europe		4,936	-0.1	-0.1	-2.6	23.0	9
Japan		38,606	1.8	-0.9	-3.1	24.6	15
China		3,964	0.2	0.7	7.0	11.3	16
Asia Ex Japan		77	0.1	-1.8	-3.1	26.0	16
Emerging Markets		45	-0.1	-1.7	-3.2	23.5	12
Interest Rates					basis points		
US 10y Yield		4.3	1	6	50	-58	37
Germany 10y Yield		2.3	-1	-1	14	-56	25
Japan 10y Yield		1.0	3	2	13	10	37
UK 10y Yield		4.2	-2	8	24	-33	68
Credit Spreads					basis points		
US Investment Grade		123	0	2	-7	-36	-11
US High Yield		336	-2	0	-27	-127	-49
Exchange Rates					%		
USD/Majors		104.2	0.0	0.2	3.8	-2.2	3
EUR/USD		1.1	0.2	0.0	-2.9	1.9	-2
USD/JPY		152.7	0.3	1.2	6.3	2.4	8
EM/USD		44.9	-0.1	-0.3	-2.9	-4.0	-7
Commodities					%		
Brent Crude Oil ($/barrel)		71.8	-5.6	-3.4	0.3	-13.4	-4
Industrials Metals (index)		149.0	-0.8	-0.3	-3.4	7.9	4
Agriculture (index)		55.6	-0.3	0.0	-4.2	-14.8	-11
Implied Volatility					%		
VIX Index (%, change in pp)		19.2	-1.1	0.8	2.3	-2.1	6.8
Global FX Volatility		9.0	0.1	0.3	0.5	1.0	0.9
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		89	0	0	-8	-45	-15
Italy		122	0	-1	-10	-75	-46
Portugal		44	-1	-2	-13	-29	-19
Spain		70	-1	-2	-9	-40	-27

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

Emerging Market Financial Indicators

Last updated: 10/28/2024 7:58 AM	Exchange Rates: Level		Exchange Rates: Change (in %)					Local Currency Bond Yields (GBI EM): 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		7.13	-0.1	-0.1	-1.5	2.6	-0.4		2.0	0	4	1	-73	-53
Indonesia		15724	-0.5	-1.4	-3.7	1.1	-2.1		6.8	7	18	35	-41	34
India		84	0.0	0.0	-0.3	-1.0	-1.0		7.2	7	9	29	-53	2
Philippines		58	0.1	-1.2	-3.8	-2.4	-4.9		4.9	6	11	26	-96	-71
Thailand		34	-0.4	-0.9	-4.1	6.3	1.3		2.4	1	4	3	-89	-27
Malaysia		4.36	-0.4	-1.3	-5.5	9.2	5.3		3.9	0	8	15	-26	14
Argentina		985	0.0	-0.4	-1.7	-64.5	-17.9		37.6	-142	-147	-378	-6918	-4875
Brazil		5.71	-0.7	-0.3	-4.1	-12.5	-15.0		12.6	6	-20	45	77	217
Chile		945	0.3	0.8	-4.9	-4.0	-6.8		5.2	1	7	43	-89	25
Colombia		4333	-0.8	-1.5	-3.1	-3.0	-10.6		8.6	12	32	91	-84	96
Mexico		20.07	-0.4	-0.5	-1.9	-10.1	-15.4		9.5	2	25	90	-25	108
Peru		3.8	-0.4	-0.4	-0.5	2.8	-1.7		6.6	1	19	37	-107	-5
Uruguay		42	0.2	0.1	1.1	-4.1	-6.4		9.5	-5	-10	-38	-33	2
Hungary		374	0.1	-0.8	-4.7	-3.6	-7.2		6.9	14	23	112	-67	113
Poland		4.02	0.1	-0.7	-4.3	4.2	-2.1		5.0	1	0	58	1	55
Romania		4.6	0.2	0.0	-2.8	1.7	-2.0		6.6	0	4	14	-23	44
Russia		97.2	0.0	-0.7	-4.3	-4.7	-8.0							
South Africa		17.7	-0.2	-0.5	-2.4	6.5	3.7		8.9	3	-1	47	-100	-22
Türkiye		34.28	0.0	-0.1	-0.2	-17.5	-13.9		30.3	-2	43	181	82	351
US (DXY; 5y UST)		104	-0.1	0.2	3.8	-2.2	2.8		4.08	1	9	57	-69	23

	Equity Markets: Level		Change (in %)					Bond Spreads on USD Debt (EMBIG): Level		Change (in basis points)			
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	7 Days	30 Days	12 M	YTD
								basis points					
China		3,964	0.2	0.7	7.0	11.3	15.5		110	-4	-14	-58	-48
Indonesia		7,635	-0.8	-1.8	-0.8	13.0	5.0		89	-4	-10	-31	-7
India		80,005	0.8	-1.4	-6.5	25.4	10.7		91	-2	-16	-44	-25
Philippines		7,343	0.4	-0.9	-1.1	23.2	13.8		75	-4	-7	-21	-5
Thailand		1,453	-0.7	-2.5	0.2	4.7	2.6		0	0	0	0	0
Malaysia		1,610	-0.5	-2.1	-3.0	11.7	10.7		68	-1	-14	-25	-17
Argentina		1,872,785	1.2	2.7	8.4	185.7	101.4		971	-129	-332	-1508	-942
Brazil		129,893	-0.1	-0.5	-2.1	14.6	-3.2		205	-2	-17	-8	-10
Chile		6,755	0.4	1.3	3.4	21.3	9.0		110	0	-8	-30	-15
Colombia		1,334	-0.2	-1.6	1.0	22.0	11.7		319	17	4	-19	48
Mexico		51,784	0.0	-2.3	-1.9	5.7	-9.8		299	2	-13	-63	-35
Peru		30,960	0.4	0.6	2.2	41.1	19.3		135	1	-1	-23	-9
Hungary		74,235	0.0	0.0	-0.4	31.8	22.5		146	3	-6	-48	-3
Poland		80,738	0.0	-1.6	-5.0	14.9	2.9		102	-4	-8	-10	5
Romania		17,428	-0.3	-0.1	-1.5	22.2	13.4		189	5	-5	-23	-11
South Africa		87,119	0.1	0.0	-0.5	25.4	13.3		275	4	1	-115	-33
Türkiye		8,946	0.4	3.4	-8.5	16.1	19.8		270	-5	-11	-117	-44
EM total		45	0.1	-1.7	-3.2	23.5	12.2		380	-2	-16	-19	34

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

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