



- **China faces electricity crunch** ([link](#))
- **Social Democrats win German election with tight margin** ([link](#))
- **Treasuries breach key technical level** ([link](#))
- **US credit market sensitivity to volatility falls below 2007 levels** ([link](#))
- **Ethiopia may restructure debt** ([link](#))

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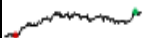






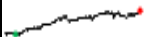

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Markets cautious as political risks loom

Markets are mixed as a potentially eventful week gets underway. US equity index futures are generally lower while European stocks are posting modest gains. Treasury, bund, and gilt yields are moving higher. The US debt ceiling and budget negotiations take center stage this week, with a key vote on the infrastructure package due later today. The prospect of a repeat of the 2011 government shutdown and default drama is growing larger. Germany's close election is expected to lead to a prolonged period of negotiation before a government is formed. In China, a shortage of electricity has led to widespread power cuts, raising fears of disruptions to the local economy as well as disturbances in the wider global trade network.

Key Global Financial Indicators

Last updated: 9/27/21 7:57 AM	Level		Change from Market Close				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		4449	0.1	1	-1	35	19
Eurostoxx 50		4172	0.3	3	0	33	17
Nikkei 225		30240	0.0	0	9	29	10
MSCI EM		51	-1.2	-1	-2	18	-2
Yields and Spreads			bps				
US 10y Yield		1.45	3.6	18	18	83	57
Germany 10y Yield		-0.23	1.8	11	21	32	36
EMBIG Sovereign Spread		350	3	9	3	-89	0
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		55.8	-0.1	0	-1	3	-4
Dollar index, (+) = \$ appreciation		93.5	0.1	0	1	-1	4
Brent Crude Oil (\$/barrel)		79.2	1.5	7	9	89	53
VIX Index (% change in pp)		18.5	0.9	-7	2	-8	-4

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

Mature Markets

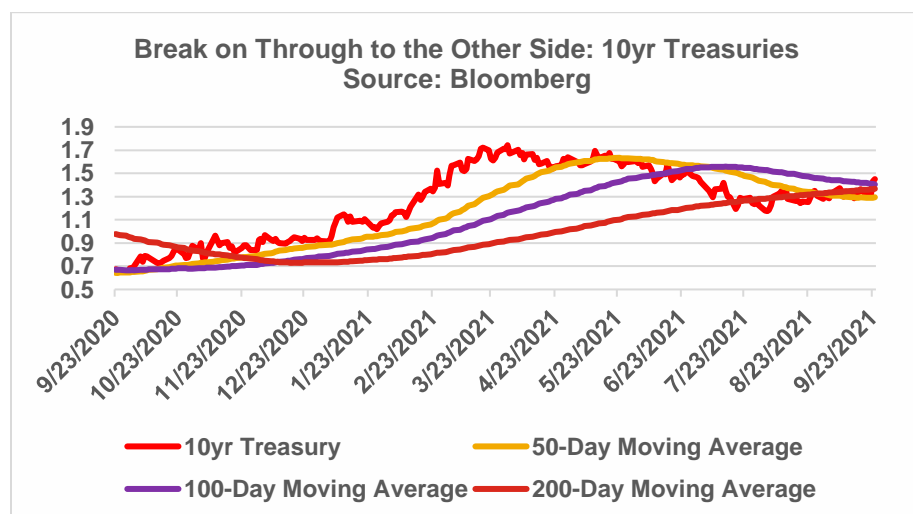
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The problems facing China's second largest property developer Evergrande continue to be an important focus for the market. Other property developers are also coming under pressure. The ongoing impact of the Chinese crackdown on cryptocurrencies will also be an important focus for markets. Fed Chair Powell and Treasury Secretary Yellen will testify before Congress tomorrow. Japan's Liberal Democratic Party will vote on a new leader, who is likely to become the new Prime Minister. On the data front, the latest PMI data from China due on Thursday has the potential to move markets, as do key US inflation data due on Friday. Euro area data include unemployment on Thursday and CPI and PMIs on Friday. We get UK GDP on Thursday, and Japan publishes its Tankan outlook surveys on the same day.

United States

This morning, US durable goods numbers were much stronger than expected at 1.8% versus the 0.7% consensus forecast. However, the widely followed ex transportation number was weaker than expected at 0.2% (vs. 0.5%), leaving markets little changed.

US 10-year Treasuries broke above a key technical level, raising the prospect of higher rates. Market strategists had identified the 1.42%-1.43% yield level as key for the market, as it represented a breach of the 100-day moving average for the 10-year. The note had already breached the 200-day and 50-day levels in earlier weeks. The yield is now at 1.50%, the highest level in three months, following a downtrend in the spring and summer after hitting its high for the year on March 30 at 1.76%. Some analysts are speculating that the market may retest that level in the days ahead. There are rumors that Commodity Trend Advisors (CTAs) and other fast money players lost a lot of money this week as they were long the market and stop losses may have come into play as rates kept rising. The increase in yields is occurring against the backdrop of a global step upwards in rates. There was a surge in UK gilt yields after the hawkish BOE meeting, which in turn pushed bund yields to their highest level since June.

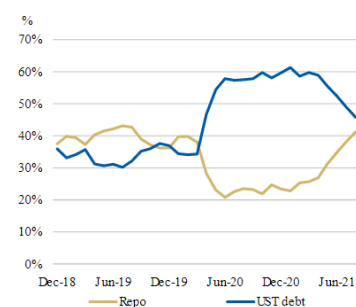


Money market fund (MMF) holdings in the Fed's Reverse Repo (RRP) facility are expected to decline. MMFs have been forced to increase their use of the RRP facility due to the scarcity of T-Bills as the US Treasury tamped down on supply. Analysts expect this to change when the debt ceiling is lifted and Treasury starts to issue higher volumes of T-Bills. When this occurs, usage of the RRP facility could decline sharply, relieving some of the pressure on the facility. MMF holdings in the Fed's RRP facility have ballooned over the past few months. The Fed's move to double the individual counterparty limit from 80 bn to \$160 bn was timely because two MMFs have already reached holdings of \$60 bn and there are several more with holdings of around \$50 bn.

Exhibit 4: MMFs with the top 10 largest RRP holdings as of the end of August

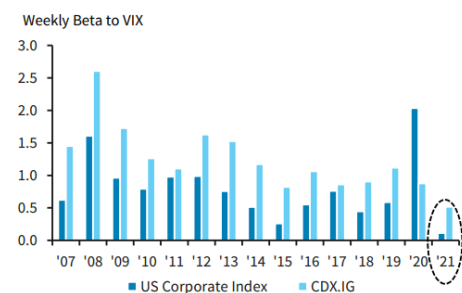
Top 10 Largest Holders	Fed RRP Holdings as of End of August	1m Change in R
MVROXX	65.9	15.9
QGVXX	60.0	14.2
SPAXX	50.7	-3.5
FDRXX	50.5	-5.3
FDDT	50.4	-7.5
GOVXX	49.7	5.7
TFDXX	48.5	22.5
FIGXX	43.9	-5.6
DGCIXX	40.1	3.8
TSTXX	36.0	24.0
Total	495.7	64.3

Source: Crane Data, Morgan Stanley Research

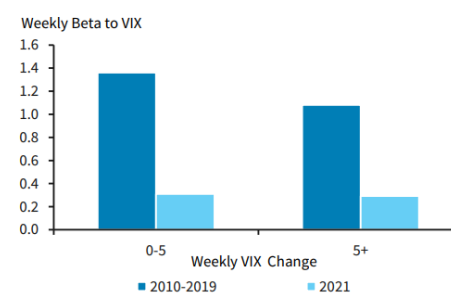
Exhibit 5: Government MMF holdings of repo vs. UST debt

Source: Crane Data, Morgan Stanley Research

Credit market sensitivity to market volatility has declined significantly in 2021 and is well below 2007 levels. The reaction to last Monday's Evergrande scare was very limited and spreads tightened through the rest of the week. For cash bonds, the sensitivity to volatility (using the VIX index as a proxy) is miniscule. The CDX investment grade (IG) credit default swap index shows more sensitivity to the VIX as it is a vehicle for taking macro bets on the sector and cash bonds take more time to respond, but even the CDX IG index sensitivity has fallen below 2007 levels. With both IG and high yield at their tightest levels in years, some investors are growing concerned that the credit market is "priced to perfection." In their view, the market has become so stable that it is now vulnerable to a major selloff if volatility picks up, or interest rates rise sharply, or the economy stumbles.

FIGURE 1. Credit Beta to VIX Is the Lowest since at Least 2007

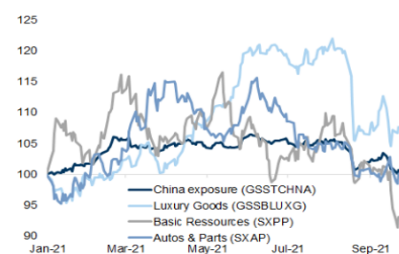
Source: Bloomberg, Barclays Research

FIGURE 2. Beta Is Also Lower for the Largest Spikes in Volatility

Source: Bloomberg, Barclays Research

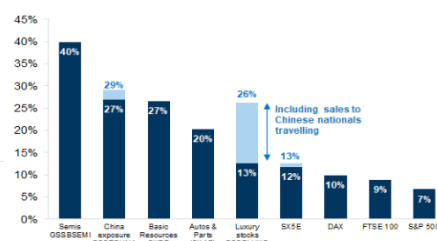
Euro Area

European equities were trading higher this morning with Spain's IBEX (+1.40%) outperforming. Energy shares (+2.8%) and banks (+2.2%) delivered strong gains while consumer goods, including the luxury good segment struggled to recover as investors remain concerned about a slowdown in China.

Relative performance vs. STOXX 600

Source: Bloomberg, STOXX, Goldman Sachs Global Investment Research

Estimated sales exposure to China (as a % of total). For Autos, we use volumes exposure. Based on FY19.

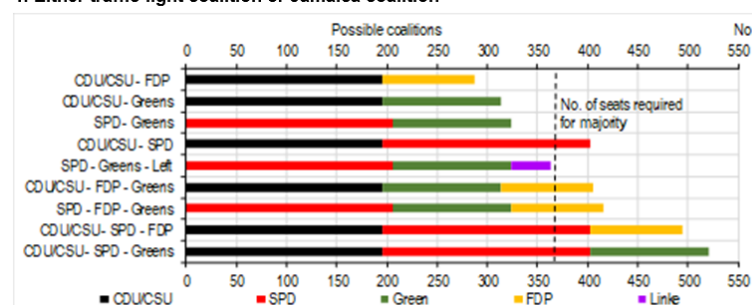


Source: FactSet, Datastream, Goldman Sachs Global Investment Research

European bond yields continued to climb with 10-year bunds gaining 2 bps and now approaching 0.2%. Southern European spread were steady, except for Italy (+2 bps). The euro (-0.2%) traded around 1.17 dollars per euro.

The Social Democrats (SPD) won a narrow victory in the German parliamentary election. The provisional results suggest that the SPD got 25.7% of the votes, while outgoing Chancellor Merkel's CDU/CSU block gained 24.1% with the gap narrower than suggested by the pre-election opinion polls. Furthermore, the “left-wing” coalition between SPD, the Greens and the Linke, which could have resulted in markets uncertainty, did not achieve a majority. **Most analysts now expect lengthy coalition negotiations** with both the SPD and CDU/CSU block trying to reach an agreement with the Greens and the FDP to form a government.

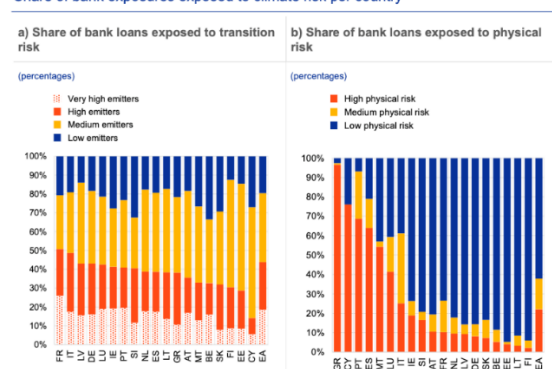
4: Either traffic-light coalition or Jamaica coalition



Source: Bundeswahlleiter, HSBC

The ECB climate stress test results highlight the systemic risk climate change poses to the financial sector. The economy-wide stress tests reveal large potential losses to the corporate and the banking sector from physical risk factors in the absence of mitigating climate policy action. The two main sources of physical risk and floods and wildfires with notable geographic differentiation in terms of resulting exposure. A delayed and disorderly transition policy is also outlined as a risk scenario. However, **the ECB analysis shows that an early adoption of green policies can help to greatly reduce both physical and transition risks.**

Share of bank exposures exposed to climate risk per country



Japan

Governor Kuroda said that continued large-scale monetary easing is still necessary. In his speech, he noted that Japan's inflation is weaker than in the United State and Europe. Hence, it is necessary for the Bank of Japan (BOJ) to continue with its large-scale monetary easing to achieve the 2% inflation target. Japan's economy also faces a high degree of uncertainty due to the Delta variant, and the BOJ will keep providing strong support for corporate financing. **Equities were little changed**, retreating from earlier gains driven by the expectation that the state of emergency will end soon.

Emerging Markets

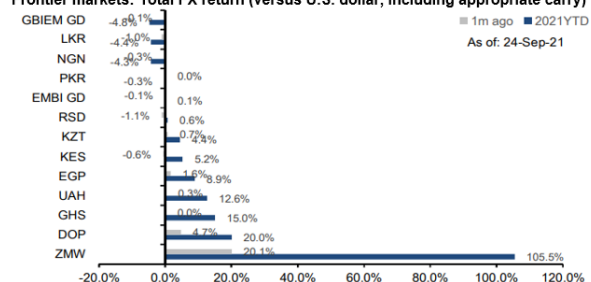
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EMEA countries were doing well on higher commodity prices, although the South African rand depreciated on worries about the terms of trade. Asian stocks were mixed and currencies were little changed. Latin American markets were relatively quiet, although government bond spreads were generally wider. Rising inflation in Brazil is causing markets to price substantial further rate hikes.

Frontier Markets

Analysts at JP Morgan warn that the recent outperformance of local debt markets in frontier economies may not last. A combination of easy global liquidity, rising commodity prices, and positive IMF engagement and SDR allocations, have led to strong year-to-date returns for local markets (led by a +100% return in Zambia). JP Morgan warns that this outperformance may not last given that commodity prices may not rise much further, inflationary pressures are persistent, a Fed taper lies ahead, foreign investor positioning has increased, and the pace of vaccinations against covid-19 remains relatively slow.

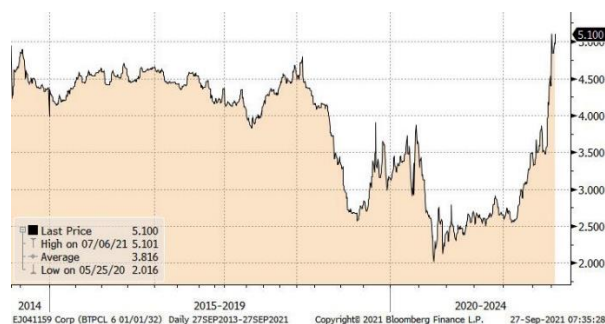
Frontier markets: Total FX return (versus U.S. dollar, including appropriate carry)



Note: 12-m OMO used for NGN, 12m T-bill for PKR, Jul-23s for EGP, Jul-24s for GHS, Dec-27s for ZMW, Jan-33 KENIBs for KES, 12m NDF mid for KZT and UAH; Feb-28s for RSD, Jul-23s for LKR and GBI-EM GD index for DOP.
Source: JP Morgan

Chile

Borrowing costs for Chile are at their highest level in more than 7 years, making Chile lose its status as an investment haven in a neighborhood of problem economies. Yields on the government's 10-year local currency bonds have surged from 2% in May 2020 to more than 5.5% this month. On one hand, pressure from the street protests has pushed Congress into populist measures, including three successive early withdrawals of savings from the private pension system. On the other hand, consumer prices in Chile rose 4.8% in the year to August, well above the central bank's 3% target. The central bank has raised its policy rate twice this year, most recently by 75 basis points (0.75 percentage points) to 1.5% on August 31.

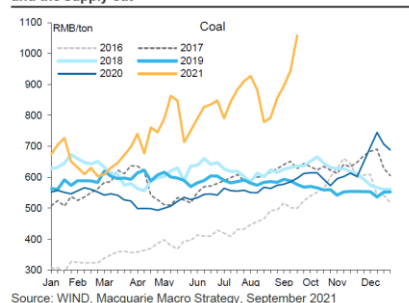


China

China is facing an electricity crunch. A handful of provinces across China are enduring an electricity supply squeeze that has prompted local governments to impose power cuts and rationing on industrial users and households. Analysts noted that the main reasons are low coal inventories and high coal prices. The former resulted from combined measures to limit domestic coal production on the back of de-carbonization efforts and to impose a ban on imported coal from Australia. High coal prices have led many power plants to reduce electricity generation to minimize their losses as electricity prices are regulated in

China. Reportedly, the power supply squeeze worsened sharply over the weekend, driving the Baidu search of “power outage” to a new high. Some analysts noted that China’s power crunch could significantly disrupt the global supply chain, with production of various products being cut and/or delayed. **The People’s Bank of China injected net liquidity of 150 bn yuan (\$23.2 bn) over the past two days.** Interbank repo rates declined, with the benchmark seven-day rate at 1.92% (today: -15.2 bps). **Markets’ concerns about China’s property developers extended to Sunac, another large developer,** with its share price falling (-9.4%), after the firm requested help from a local government to ease pressure on sales. Evergrande’s share price rose (+8%).

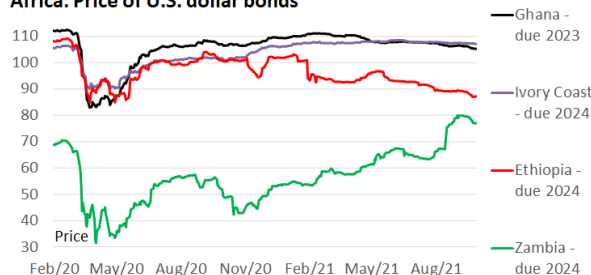
Fig 2 Coal price has been surging on the strong demand and the supply cut



Ethiopia

U.S. dollar bond prices edged 1-2 points lower in September as a committee was set up to restructure external debt. Major creditors, including France and China, form part of the committee. Last week, the Finance Ministry said that the committee may ask private creditors to extend their payment-due dates by 1 or 2 years. Armed conflict within the country has put a major strain on the fiscal resources of the government.


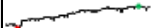
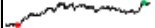


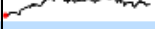

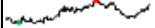

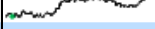


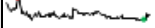


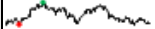





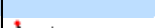


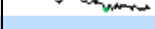
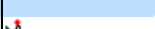
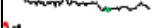

Africa: Price of U.S. dollar bonds



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Global Financial Indicators

Last updated: 9/27/21 7:58 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		4455	0.1	1	-1	35	19
Europe		4172	0.3	3	0	33	17
Japan		30240	0.0	0	9	29	10
China		3583	-0.8	-1	2	11	3
Asia Ex Japan		86	-1.4	-2	-2	14	-5
Emerging Markets		51	-1.2	-1	-2	18	-2
Interest Rates			basis points				
US 10y Yield		1.45	3.6	18	18	83	57
Germany 10y Yield		-0.23	1.8	11	21	32	36
Japan 10y Yield		0.06	0.1	1	3	5	4
UK 10y Yield		0.96	3.8	17	39	77	77
Credit Spreads			basis points				
US Investment Grade		88	-4.0	1	-6	-47	-7
US High Yield		311	-0.6	2	-23	-250	-68
Europe IG		49	-0.1	-3	3	-11	1
Europe HY		243	0.8	-10	13	-104	2
Exchange Rates			%				
USD/Majors		93.46	0.1	0	1	-1	4
EUR/USD		1.17	-0.2	0	-1	0	-4
USD/JPY		111.0	0.3	1	1	5	8
EM/USD		55.8	-0.1	0	-1	3	-4
Commodities			%				
Brent Crude Oil (\$/barrel)		79	1.5	7	9	89	53
Industrials Metals (index)		165	-0.9	2	3	44	24
Agriculture (index)		57	-0.1	3	-3	47	18
Implied Volatility			%				
VIX Index (%, change in pp)		18.5	0.9	-7.0	2.3	-7.7	-4.1
US 10y Swaption Volatility		70.0	-0.2	-0.6	-3.1	25.8	9.9
Global FX Volatility		6.7	0.0	-0.2	0.1	-3.0	-1.4
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		105	-1.3	-9	-7	-50	-14
Italy		102	0.8	-2	-4	-40	-10
Portugal		55	0.3	-1	-5	-25	-5
Spain		64	0.4	-1	-8	-14	3

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

Emerging Market Financial Indicators

Last updated: 9/27/2021 8:02 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)						
	Level		Change (in %)				YTD	Level		Change (in basis points)				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		Last 12m	Latest	7 Days	30 Days	12 M		
	vs. USD		(+) = EM appreciation					% p.a.						
China		6.46	0.0	0.0	0	5	1		3.0	-2	0	-22	-26	
Indonesia		14253	0.0	-0.1	1	5	-1		6.2	9	-3	-65	11	
India		74	-0.2	-0.1	0	0	-1		6.3	0	-12	14	36	
Philippines		51	-0.7	-1.5	-2	-5	-6		4.3	0	-6	62	61	
Thailand		34	-0.4	-0.6	-3	-6	-11		1.8	-1	16	35	49	
Malaysia		4.19	0.0	0.1	0	0	-4		3.4	8	12	86	88	
Argentina		99	0.0	-0.2	-1	-23	-15		49.1	102	351	818	-704	
Brazil		5.33	0.2	0.0	-2	6	-3		10.1	-15	43	434	455	
Chile		796	-0.4	-1.0	-2	-1	-11		5.2	6	48	249	244	
Colombia		3837	-0.1	-0.2	1	0	-11		7.4	19	50	228	228	
Mexico		20.09	-0.2	0.3	1	12	-1		7.2	15	23	132	164	
Peru		4.1	-0.1	0.0	0	-13	-12		6.4	-7	-6	217	280	
Uruguay		43	-0.3	-0.2	0	-1	-1		7.9	0	2	38	66	
Hungary		306	-0.6	-1.4	-3	3	-3		2.7	-1	38	94	122	
Poland		3.93	0.0	0.0	-1	0	-5		1.4	0	28	63	75	
Romania		4.2	-0.2	-0.2	-1	-1	-6		3.6	8	37	28	85	
Russia		72.6	0.4	1.2	1	9	2		7.2	19	30	131	147	
South Africa		15.1	-0.7	-1.9	-2	13	-2		9.9	13	24	-34	27	
Turkey		8.84	0.5	-1.9	-6	-12	-16		17.8	99	58	476	474	
US (DXY; 5y UST)		93	0.1	0.2	1	-1	4		0.98	15	18	71	62	

	Equity Markets							Bond Spreads on USD Debt (EMBIG)						
	Level		Change (in %)				YTD	Level		Change (in basis points)				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		Last 12m	Latest	7 Days	30 Days	12 M		
								basis points						
China		4877	0.6	1	1	6	-6		209	0	-9	-32	-20	
Indonesia		6122	-0.4	1	1	25	2		173	0	-8	-79	-27	
India		60078	0.0	3	7	58	26		147	1	-1	-82	-4	
Philippines		6956	0.1	1	2	19	-3		108	1	-3	-45	-4	
Malaysia		1533	0.1	0	-4	1	-6		131	1	-5	-55	-4	
Argentina		74180	-0.8	-6	1	76	45		1602	105	70	250	246	
Brazil		113283	-0.7	2	-6	17	-5		297	7	1	-51	38	
Chile		4377	0.0	2	-2	22	5		146	-1	4	-54	-10	
Colombia		1309	-0.2	0	-1	12	-9		291	10	6	9	76	
Mexico		51106	-0.7	0	-3	40	16		349	11	-8	-167	-8	
Peru		18309	0.6	2	5	3	-12		166	0	-10	-27	37	
Hungary		51376	-0.2	1	1	61	22		129	-4	-2	-31	-20	
Poland		70102	-0.1	1	0	45	23		24	4	-9	-7	-4	
Romania		12519	0.6	2	1	40	28		191	2	8	-77	-12	
Russia		4073	0.9	3	5	41	24		155	0	-13	-79	-24	
South Africa		64306	0.4	2	-5	19	8		356	6	3	-189	-28	
Turkey		1390	0.4	0	-5	24	-6		502	21	36	-150	55	
Ukraine		526	0.0	0	0	5	5		501	32	-5	-226	8	
EM total		51	0.0	-1	-2	18	-2		367	13	7	-59	28	

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

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