GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, AUGUST 30, 2021

- **The Fed's policy outlook appears little changed after Powell's speech** (link)
- **Euro area high risk bonds and CMBS face strong demand** (link)
- **China Huarong released its financial statement, booking losses as expected** (link)
- **EM primary issuance is expected to pick up pace as the summer lull ends** (link)
- **Foreign purchase of Turkish assets continues to recover** (link)

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Markets calm after Jackson Hole, awaiting data

Markets are fairly quiet so far today following Friday's reaction to Fed Chair Powell's statements at Jackson Hole. While the 10-year yield only declined 4bps following his speech, the breakdown of the move was significant. The real yield on the 10-year TIPS declined 8 bps while 10-year breakeven inflation rose 4 bps. The tone was overall supportive of markets, with the S&P 500 rising nearly 1% on the day. This week, investors will be awaiting a series of key economic data, highlighted by Friday's US NFP report. Global equities are overall slightly stronger today. Most Asian exchanges moved higher overnight and European stocks are rising modestly. US S&P futures meanwhile are little changed. EM currencies are largely continuing their strengthening trend from last week.

Key Global Financial Indicators

Last updated: 8/30/21 8:05 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		4509	0.9	2	3	29	20
Eurostoxx 50		4198	0.2	1	3	27	18
Nikkei 225		27789	0.5	1	2	20	1
MSCI EM		52	1.2	4	0	13	0
Yields and Spreads					bps		
US 10y Yield		1.31	0.7	6	9	59	40
Germany 10y Yield		-0.41	1.2	7	5	0	16
EMBIG Sovereign Spread		346	1	-8	-13	-71	-5
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		56.6	0.1	1	0	2	-2
Dollar index, (+) = $ appreciation		92.7	0.0	0	1	0	3
Brent Crude Oil ($/barrel)		72.8	0.1	6	-5	62	41
VIX Index (%, change in pp)		16.7	0.3	0	-2	-6	-6

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

In the last week of summer ahead of Labor Day, markets will be eyeing Friday's nonfarm payrolls report for August, with current expectations for 700k jobs and an unemployment rate of 5.2%. US ISM surveys will be released on Wednesday, with Markit PMIs on Friday. European inflation data for August will be released on Monday and Tuesday. Major emerging markets will see the release of manufacturing PMIs from both Markit and national surveys. Chile's central bank meets on Monday, with analysts expecting a 50 bps hike.

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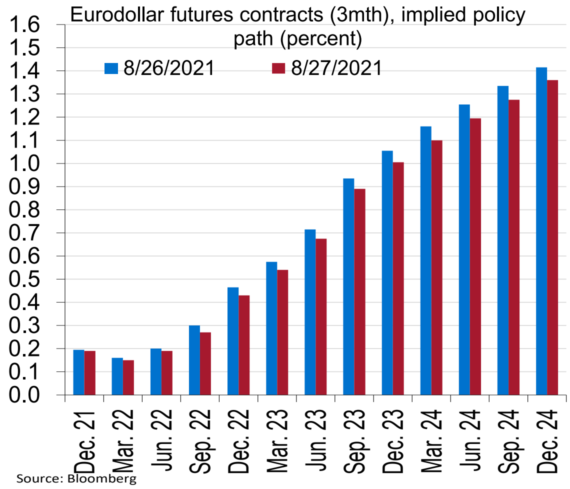
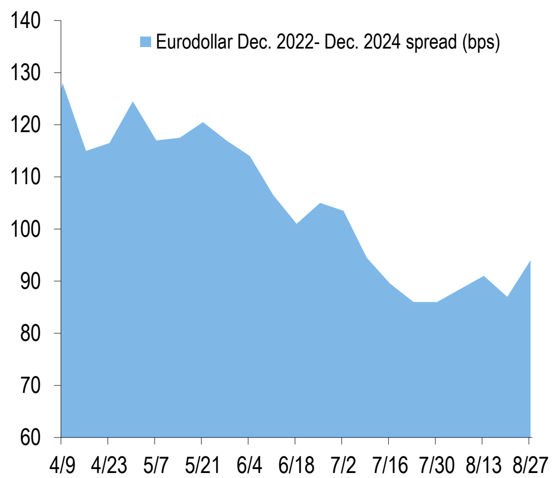
United States

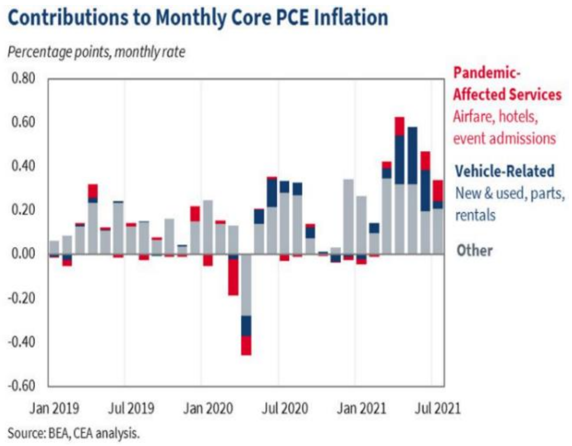
Markets rallied on Friday following Jackson Hole, with the S&P up 0.9% and Treasury yields lower by 4-5 bps. Real rates also fell, with 5- and 10-year yields down close to 9 bps, leaving breakeven rates higher. The dollar (DXY) index slipped lower by 0.4%. The speech contained few major surprises, with investors largely interpreting it as somewhat dovish, at least on rates. Powell noted that there has been clear progress toward maximum employment and current price trends are "consistent with our goal of inflation averaging 2 percent over time" while highlighting his view that higher inflation is largely the result of reopening pressures. He also noted that inflation expectations remain well anchored and brushed off the notion that a wage price cycle has begun.

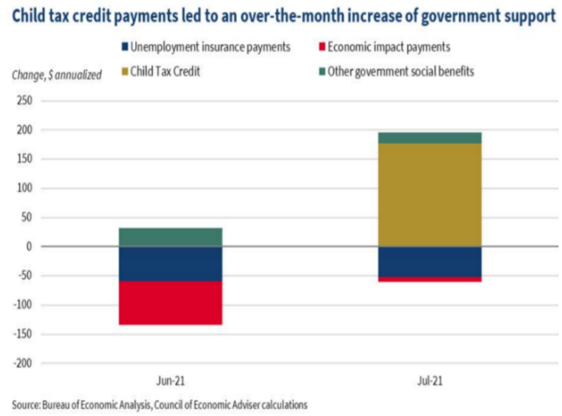
The policy outlook appears little changed after Powell speech, with tapering on track for 2021, but rate hikes a ways off. Chairman Powell also furthered efforts by Fed officials in recent months to separate the tapering decision from prospective rate hikes, noting "The timing and pace of the coming reduction in asset purchases will not be intended to carry a direct signal regarding the timing of interest rate liftoff, for which we have articulated a different and substantially more stringent test." Eurodollar contract rates fell 3-4 bps following the speech, and continue to imply that the Dec. 2022 or Jan. 2023 FOMC meetings would likely be the earliest possibilities for liftoff in rates. The pace of eventual tightening remains gradual, with under 100 bps priced between Dec. 2022 and Dec. 2024.





Core PCE inflation slowed to 0.3% m/m, while personal income surprised to the upside in July at 1.1%. Consumer prices rose at a slower place in July, with core PCE and headline PCE inflation up 0.3% m/m (3.6% y/y) and 0.4% m/m (4.2% y/y) respectively. Prices in pandemic affected services rose 6% in July (red bar in left chart), while the pace of price increases in autos dissipated somewhat. Personal income jumped 1.1% m/m (vs 0.3% consensus and 0.1% in June), bolstered by a 0.9% increase in aggregate compensation. Government support for personal income also expanded m/m for the first time since March as child tax credits were disbursed, even as unemployment payments fell. Consumer spending also came in above expectations at 0.4% (vs 0.3%) but was down from June, as spending on goods fell—led by durables-- while services spending continued to expand.

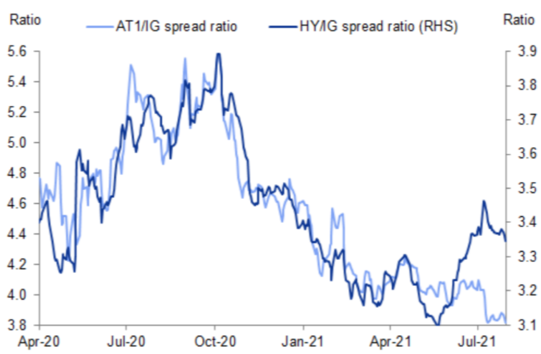




Euro Area

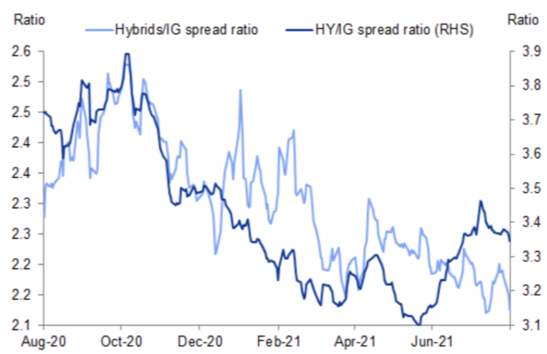
There is strong demand for euro area higher risk bonds, such as the high yield sector, the alternative Tier 1 (AT1) perpetual bonds issued by banks, as well as hybrids. As a result, AT1 bonds and hybrids have outperformed their investment grade (IG) counterparts. Very low levels of implied volatility in the bond market have also supported these sectors, which underperform when volatility picks up. These bonds also have higher coupons than IG bonds, making them more attractive in the search for yield environment.

Exhibit 8 : AT1 bonds have outperformed their beta to EUR IG, even as EUR HY slightly underperformed



Source: iBoxx, Goldman Sachs Global Investment Research

Exhibit 9 : The same has been true for hybrids

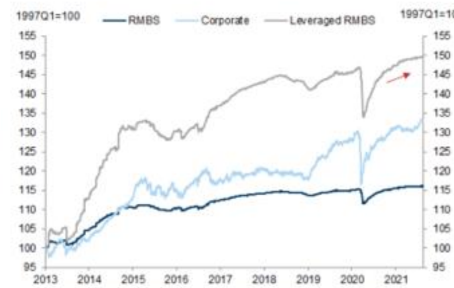


Source: iBoxx, Goldman Sachs Global Investment Research

Euro area commercial mortgage backed securities (CMBS) and mortgage backed securities (MBS) are also favored by investors for similar reasons, such as low volatility and higher coupons. In addition, euro area CMBS have much lower prepayments than US MBS. US MBS are prepaying at a constant prepayment rate (CPR) of 50, meaning that half of the principle would be paid off over a one year time horizon. In contrast, Spanish and UK RMBS have prepayments in the 5-25 CPR range. In addition, euro area MBS have much less convexity risk than US MBS because features such as prepayment penalties keep their cash flows much more stable. Compared to euro area IG bonds, these CMBS have delivered much better risk adjusted returns.

Exhibit 2 : European RMBS have lower and more stable prepayment rates compared with US RMBS
Annualized conditional prepayment rates, 2016-2020 vintage prime non-agency RMBS

Exhibit 3 : European RMBS have delivered high returns on a risk-adjusted basis compared with European corporate bonds
Total returns, Bloomberg-Barclays pan-European corporate bond index vs. pan-European floating rate RMBS index*

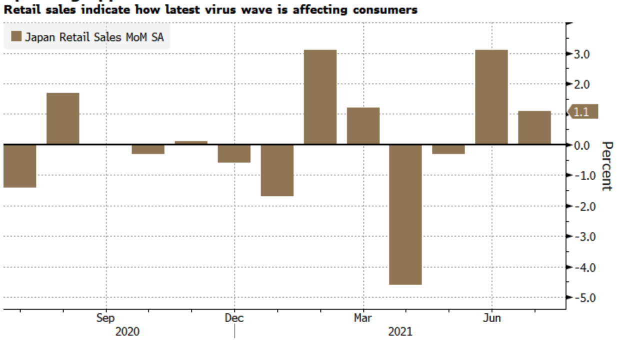


*Leverage ratio for RMBS index chosen to match the unlevered return volatility of the corporate bond index.

Japan

Retail sales increased stronger than expected in July. In m/m terms, retail sales grew 1.1% (consensus: +0.4%) after a 3.1% expansion in June, underpinned by spending on fuel and general merchandise. Analysts had split opinions about the impact of the COVID-19 situation on consumption. As illustrated by strong retail sales, some viewed that Japanese consumers are shrugging off ongoing pandemic restrictions and that the government's call for voluntary cooperation no longer has much impact. Others viewed that services consumption will likely remain sluggish. Japan is still facing the worst COVID-19 outbreak, and the government expanded the latest state of emergency to cover areas that account for 80% of the economy. **Equities gained (NIKKEI: +0.5%); the Japanese yen was little changed. Long-end JGB yields declined** (10-year: -0.5 bp; 30-year: -0.2 bp), following the decline in U.S. treasury yields.

Spending Appetite
Retail sales indicate how latest virus wave is affecting consumers



Sources: Bloomberg, based on data from Japan's trade ministry.

Emerging Markets

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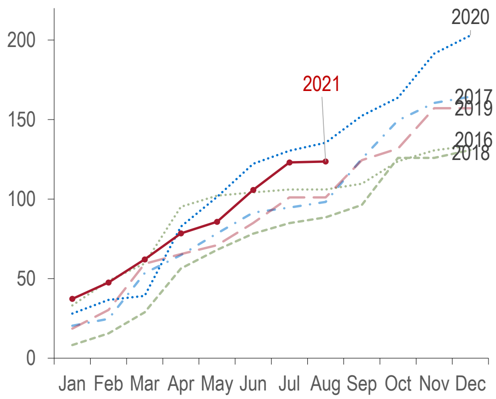
Asian markets rallied on the dovish tone of Fed Chair Jerome Powell's speech at Jackson Hole. Asian equities gained, +0.7% on net, led by Indonesian (+1.7%), Thai (+1.3%), and Indian (+1.2%) equities. Meanwhile, share prices dropped in China (CSI 300: -0.3%). Asian currencies appreciated, led by the Malaysian ringgit (+0.8%), Taiwan dollar (+0.6%), Thai baht (+0.5%) and Indian rupee (+0.5%). Long-end government bond yields edged down, with 10-year yields falling in Indonesia (-5 bps) and India (-3 bps), following the decline in U.S. treasury yields. In Thailand, the government plans to relax some of its quasi-lockdown restrictions on September 1. The cabinet also approved a plan to increase compensation for individuals affected by pandemic-related restrictions. In Singapore, Prime Minister Lee Hsien Loong on Sunday announced measures to boost income of lower-wage workers and adjustments to the foreign manpower policy. In Sri Lanka, S&P last Friday revised the sovereign rating outlook from stable to negative, citing that the country may face a more difficult financing environment over the next 12 months; the long-term foreign-currency debt rating was affirmed at CCC+. Government bond yields rose (10-year: +16 bps). In **Latin America Friday**, regional currencies were the biggest gainers in EM on the back of Chair Powell's

Jackson Hole Speech and a rally in commodity prices. The Colombian peso and the Brazilian real led gains appreciating by 1.1%. In Peru, local bonds rallied with the 10 year rate declining by more than 70 bps on the week to 6.1% as markets are pricing-in reduced political uncertainty. After the market close a newly formed cabinet led by Prime Minister Bellido won an inaugural vote of confidence in congress.

EM hard currency issuance

In line with seasonal patterns, sovereign issuance was subdued in August with only Rwanda coming to the market for $0.6 bn. Year-to-date sovereign supply remains the second-highest behind 2020. **Analysts expect issuance to pick up in the coming months given the low interest rate environment and strong risk appetite for EM credit.** Analysts at JP Morgan estimate that sovereigns have completed less than 60% of their expected issuance in 2021. Morgan Stanley highlights that the issuance pipeline in the near term potentially includes Romania, Egypt Bahrain, Ghana, Gabon, Nigeria, Ivory Coast, China, Colombia, Panama, Peru, and Chile.

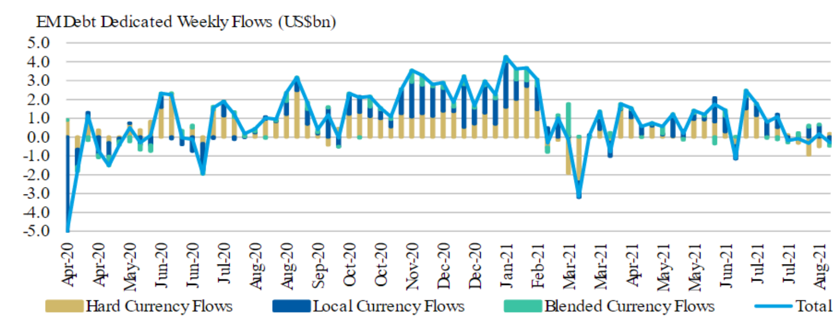
EM hard currency YTD issuance



Source: Bondradar

EM fund flows

EM debt fund flow continued to be weak in the last full week of August, with overall outflows amounting to just $0.2 bn. Year-to-date totals stand at 0.1% and -4.5% for hard currency and local currency debt, respectively, while year-to-date fund flows stand at $12.6 bn and $16.4 bn respectively.

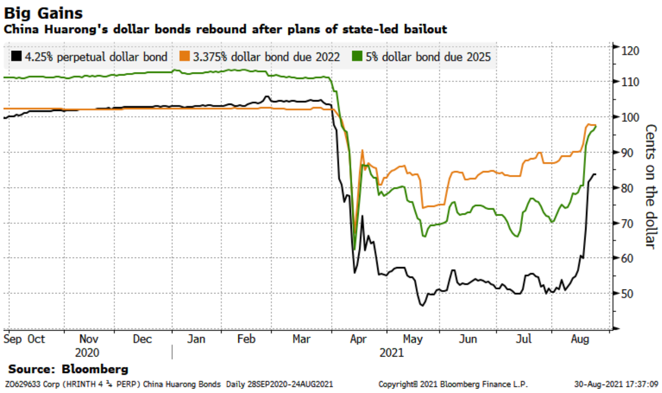


Source: EPFR, Morgan Stanley Research; Note: The EPFR data and charts displayed here must not be extracted and republished (whether internally or externally). Such use will violate the terms of Morgan Stanley's contract with EPFR which only covers named users.

China

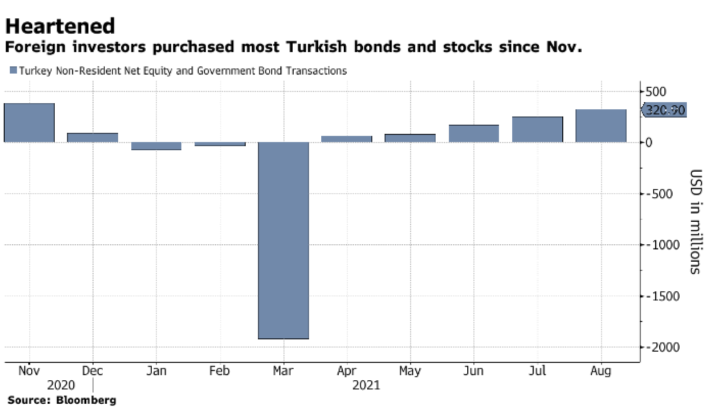
China Huarong released its 2020 financial statement, booking losses as previously announced. Huarong recorded a loss of $15.9 bn for 2020 while returning to a small profit in the first half of 2021.

Huarong stated that it is still working with strategic investors on the recapitalization plan; more investors could join the original group led by CITIC. Reportedly, these strategic investors would provide $7.7 bn for capital, making CITIC the major shareholder instead of the Ministry of Finance. Given the loss, Huarong's capital ratio stood at 6.3% as of June 2021, below the regulatory requirement at 12.5%. Moody's last week lowered Huarong's credit rating to Baa2, citing deterioration of its capital and profitability. Huarong's USD bond prices have recovered since the earlier announcement on the recapitalization plan. Some analysts noted that Huarong is just at the beginning of a long, bumpy journey to a full recovery. **The China Securities Regulatory Commission (CSRC) asked brokers to step up oversight of their margin financing business.** Reportedly, some brokers were told to rectify violations such the use of margin loans for purchasing ineligible stocks. China's outstanding margin loans has risen to 1.7 tn yuan ($262 bn), still well below its 2015 peak. **Equities declined (CSI 300: -0.3%). RMB appreciated (+0.1%);** RMB's fixing was 19 pips weaker than expected. The People's Bank of China continued providing liquidity of 40 bn yuan ($6.2 bn) to ease interbank liquidity pressures at month end.



Turkey

Foreign purchases of Turkish assets continue to recover as the lira is set to close its first back-to-back monthly gain since January. Foreign investors have purchased a net $321 mn of Turkish stocks and bonds this month through Aug 20, already the largest inflow in 9 months. The policy rate has been on hold for 5 months, easing investor concerns that the new central bank governor would revert to rate cuts despite accelerating inflation. Still, Turkish risk assets are among the worst performing EM assets. The stock index trades at a 60% discount to the MSCI EM and the lira is down 11% against the dollar this year.



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Global Financial Indicators

Last updated: 8/30/21 8:05 AM	Level Last 12m	Latest	Change 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		4512	0.9	1	3	29	20
Europe		4198	0.2	1	3	27	18
Japan		27789	0.5	1	2	20	1
China		3528	0.2	1	4	4	2
Asia Ex Japan		87	1.1	4	-1	10	-3
Emerging Markets		52	1.2	4	0	13	0
Interest Rates					basis points		
US 10y Yield		1.31	0.7	6	9	59	40
Germany 10y Yield		-0.41	1.2	7	5	0	16
Japan 10y Yield		0.02	-0.5	0	0	-4	0
UK 10y Yield		0.58	-2.2	6	2	24	38
Credit Spreads					basis points		
US Investment Grade		91	0.0	-3	2	-38	-4
US High Yield		324	0.1	-18	-9	-181	-55
Europe IG		45	0.0	-1	-1	-9	-3
Europe HY		229	0.0	-4	-8	-95	-14
Exchange Rates					%		
USD/Majors		92.69	0.0	0	1	0	3
EUR/USD		1.18	0.1	0	-1	-1	-3
USD/JPY		109.9	0.0	0	0	4	6
EM/USD		56.6	0.1	1	0	2	-2
Commodities					%		
Brent Crude Oil ($/barrel)		73	0.1	6	-5	62	41
Industrials Metals (index)		161	0.5	2	-1	35	21
Agriculture (index)		58	0.1	3	2	53	21
Implied Volatility					%		
VIX Index (%, change in pp)		16.7	0.3	-0.5	-1.6	-6.3	-6.1
US 10y Swaption Volatility		73.1	2.2	-2.7	-3.1	16.0	13.0
Global FX Volatility		6.6	0.0	-0.2	-0.1	-2.5	-1.4
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		111	-1.3	5	4	-40	-8
Italy		106	0.8	0	-2	-39	-5
Portugal		59	-0.7	-2	-4	-22	-1
Spain		71	-0.6	0	-2	-8	10

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

Emerging Market Financial Indicators

Last updated:	Exchange Rates							Local Currency Bond Yields (GBI EM)					
8/30/2021	Level		Change (in %)					Level		Change (in basis points)			
8:07 AM	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.				
China		6.47	0.0	0.2	0	6	1		3.0	2	-2	-21	-25
Indonesia		14370	0.3	0.3	1	1	-2		6.1	-12	-16	-60	7
India		73	0.6	1.3	2	0	0		6.4	-2	-4	14	47
Philippines		50	0.2	0.8	0	-3	-4		4.3	1	-6	72	67
Thailand		32	0.3	2.5	1	-4	-8		1.7	5	2	16	34
Malaysia		4.16	0.9	1.7	2	0	-3		3.3	-2	8	83	75
Argentina		98	0.0	-0.3	-1	-24	-14		45.9	33	121	88	-1027
Brazil		5.21	-0.1	3.3	0	5	0		9.5	-13	93	394	397
Chile		783	0.5	0.4	-2	0	-9		4.7	1	30	221	195
Colombia		3835	0.9	0.9	2	0	-11		6.8	-8	-1	152	176
Mexico		20.20	0.0	0.6	-2	8	-1		7.0	-3	-5	93	140
Peru		4.1	0.0	0.8	-4	-13	-11		6.2	-55	71	206	257
Uruguay		43	0.2	1.5	3	0	-1		7.9	-9	-2	-33	64
Hungary		295	0.3	0.9	2	1	1		2.5	20	26	82	97
Poland		3.87	0.2	0.8	-1	-5	-4		1.1	8	13	31	51
Romania		4.2	0.1	0.3	-1	-3	-5		3.3	13	31	-21	57
Russia		73.5	-0.1	0.6	-1	1	1		6.9	5	12	117	119
South Africa		14.6	0.6	3.4	0	16	0		9.6	-14	-11	-52	-4
Turkey		8.38	-0.4	0.5	1	-12	-11		17.2	-27	-45	366	405
US (DXY; 5y UST)		93	0.0	-0.3	1	0	3		0.80	3	11	53	44

	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	7 Days	30 Days	12 M	YTD
								basis points					
China		4813	-0.3	0	0	0	-8		217	-1	3	-13	-12
Indonesia		6145	1.7	1	1	17	3		183	0	-7	-42	-17
India		56890	1.4	2	8	47	19		148	3	-11	-68	-3
Philippines		6787	0.0	2	8	15	-5		113	0	-7	-19	1
Malaysia		1601	0.7	5	7	5	-2		135	-1	-9	-35	0
Argentina		73204	2.3	8	11	58	43		1523	-60	-62	-577	167
Brazil		120678	1.6	2	-1	18	1		291	-10	6	-38	32
Chile		4459	0.0	2	5	15	7		143	-4	-17	-41	-13
Colombia		1326	0.9	-1	7	8	-8		274	-15	-12	10	59
Mexico		52426	0.3	2	3	39	19		352	-12	-11	-108	-5
Peru		17444	3.3	12	-1	-5	-16		174	-8	-2	12	45
Hungary		51356	0.6	-1	6	47	22		132	0	-11	-26	-17
Poland		70258	0.7	2	4	34	23		36	0	-2	9	8
Romania		12466	0.6	2	5	41	27		185	-1	-13	-78	-18
Russia		3922	0.9	1	4	32	19		169	-2	-15	-40	-10
South Africa		67334	-0.5	1	-2	20	13		351	-8	-2	-142	-33
Turkey		1458	0.0	1	5	33	-1		459	-17	-21	-148	12
Ukraine		526	0.0	0	0	5	5		495	-20	-35	-135	2
EM total		52	0.0	4	0	13	0		356	-10	-18	-39	18

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

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