Global Markets Monitor

GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

WEDNESDAY, APRIL 21, 2021

- **Markets may be overestimating risk of Fed hikes** (link)
- **US private pension funds close to eliminating deficits** (link)
- **Japanese markets hit by growing virus worries** (link)
- **China mulls support for troubled asset management company** (link)
- **Foreign investors step back into South African markets** (link)
- **Special Feature: M&As and Special Purpose Acquisition Companies (SPACs) (attached)**

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Virus worries retake center stage

The pandemic is once again the main focus for markets today as India reported a record case count of 294K new cases yesterday and Japan ponders major lockdowns during the upcoming Golden Week holidays. European stocks are up modestly in fairly quiet trading ahead of tomorrow's ECB meeting. In Germany, the Constitutional Court ruled that participation in the European Recovery Fund is legal under the constitution, a decision that came earlier than expected. Nasdaq futures in the US are in the red due to disappointing results from Netflix, which reported its weakest quarter in eight years. The Bank of Canada is expected to announce tapering of asset purchases at today's meeting due to improvements in the economy. The BOCs assets purchases are even bigger than the Fed's as a percentage of GDP. The dollar appreciated against most major currencies for a second day, while Treasury yields held steady. Oil prices are down sharply on concerns about global demand.

Key Global Financial Indicators

Last updated: 4/21/21 8:07 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		4135	-0.7	0	6	51	10
Eurostoxx 50		3966	0.6	0	3	42	12
Nikkei 225		28509	-2.0	-4	-2	49	4
MSCI EM		54	-0.8	0	-1	54	4
Yields and Spreads					bps		
US 10y Yield		1.57	1.1	-6	-15	100	66
Germany 10y Yield		-0.26	0.1	0	3	22	31
EMBIG Sovereign Spread		340	7	-6	-5	-277	-10
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		56.8	0.0	0	-1	8	-2
Dollar index, (+) = $ appreciation		91.3	0.1	0	-1	-9	2
Brent Crude Oil ($/barrel)		65.6	-1.4	-1	2	240	27
VIX Index (%, change in pp)		18.4	-0.3	1	-3	-27	-4

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

United States

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Markets could be overestimating the risk of Fed rate hikes, according to analysis from HSBC. The bank built a scenario analysis that predicts future interest rates under a variety of Fed hiking paths. Scenarios 1-3 below envisage a hawkish Fed, scenarios 4-6 cover the Fed's current guidance and scenarios 7-9 show results under a more dovish than expected Fed. Only the most hawkish scenario 1 predicts interest rates significantly above current levels. Moreover, current market levels are well above scenario 5, which has the first rate hike in Q1 2024, suggesting that the market does not believe Fed the Fed will stay on hold until 2024 as implied by current guidance. For its part, HSBC thinks that the 10-year yield will fall to near 1% by the end of 2021 and remain there through 2022, as predicted by scenarios 7-9.

Table 1. Yields are priced to an aggressive tightening scenario versus the March dots

Scenario		1Y	2Y	3Y	5Y	10Y
	Yield curve 16 April 2021	0.06%	0.16%	0.33%	0.81%	1.56%
Early hike	1. First hike in Q1 2022 & 2Y to tighten to 3.0%	0.14%	0.57%	1.17%	1.87%	2.36%
	2. First hike in Q1 2022 & 2Y to tighten to 2.5%	0.13%	0.49%	0.98%	1.55%	1.95%
	3. First hike in Q1 2022 & 2Y to tighten to 2.0%	0.13%	0.40%	0.78%	1.23%	1.55%
Fed timing	4. First hike in Q1 2024, & 2Y to tighten to 3.0%.	0.10%	0.10%	0.10%	0.74%	1.78%
	5. First hike in Q1 2024, & 2Y to tighten to 2.5%	0.10%	0.10%	0.10%	0.63%	1.48%
	6. First hike in Q1 2024, & 2Y to tighten to 2%	0.10%	0.10%	0.10%	0.51%	1.18%
Delayed start	7. First hike in Q1 2026, & 2Y to tighten to 2.5%	0.10%	0.10%	0.10%	0.10%	1.03%
	8. First hike in Q1 2026, & 2Y to tighten to 2%	0.10%	0.10%	0.10%	0.10%	0.82%
	9. First hike in Q1 2026, & 2Y to tighten to 1.5%	0.10%	0.10%	0.10%	0.10%	0.62%
Japan	10. Stay at ZLB forever	0.10%	0.10%	0.10%	0.10%	0.10%

Source: HSBC, Bloomberg

Large private pension plans in the US have nearly eliminated their funding deficits and some have even moved into surplus positions, buoyed by the historic post-pandemic rally in equities. The average funding ratio of US pensions in 2016 was as low as 80%. UK defined benefit pension plans are in surplus on aggregate. JP Morgan thinks that pension plans now have an incentive to "lock in" their equity gains by reducing equity exposure and increasing exposure to the fixed income sector instead. Public pension plans are not doing as well as their funding ratios averaged under 60% at the end of 2020.

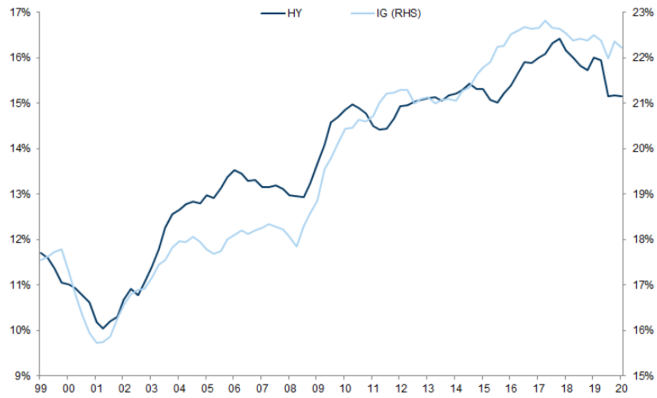
Figure 1: Pension fund deficits

For US, we show the funded status of the 100 largest US corporate defined benefit pension as reported by Millman in $bn. For UK, we show funded status of the defined benefit schemes eligible for entry to the Pension Protection Fund, in £bn. Last obs. is for March 2021.

Source: US Flow of Funds, UK Pension Protection Fund, J.P. Morgan

Investment grade (IG) and high yield (HY) companies could face pressures on profit margins in the months ahead due to rising input costs, supply chain disruptions and the inability to pass higher costs on to consumers. Companies have highlighted challenges such as shortages of computer chips in industries as diverse as airlines, technology, and automobiles. IG and HY earnings before interest, taxes, depreciation, and amortization (EBITDA) peaked in Q1 and Q3 respectively in 2018, but they remain very high by historical standards. If these margin pressures materialize, they could pose a risk to equity prices and credit spreads. However, analysts think these pressures are likely to be temporary and will dissipate as the global economy continues to reopen, and that long term prospects remain very positive.

Exhibit 3: We expect some additional near-term pressure on EBITDA margins for both HY and IG firms
4-quarter moving average EBITDA margins for the median IG and HY North American firm



Source: FactSet, Goldman Sachs Global Investment Research

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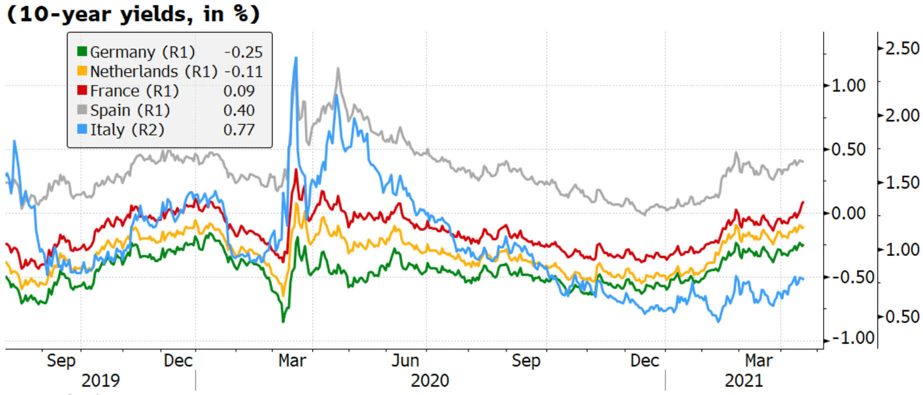
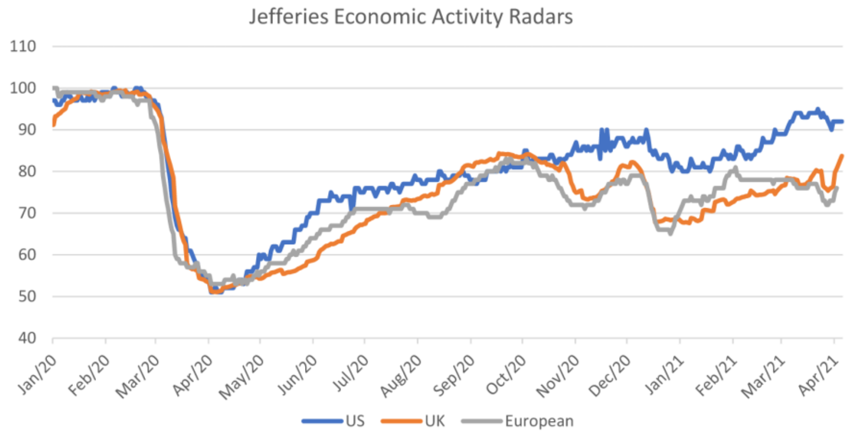
Sovereign yields remained steady. German 10-year yields at -0.25% (+2 bps); French OATs are at 0.08% (+1 bps); Italian at 0.77% (-1 bps); and Spanish at 0.4% (unchanged). Taking a multi-month perspective, however, shows that European sovereign yields have trended upwards since end-2020.

Government Bond Yields
(10-year yields, in %)



Source: Bloomberg
91282CBL Govt () FI: EZ Bond Yields Daily 02AUG2019-21APR2021 Copyright© 2021 Bloomberg Finance L.P. 21-Apr-2021 10:13:08

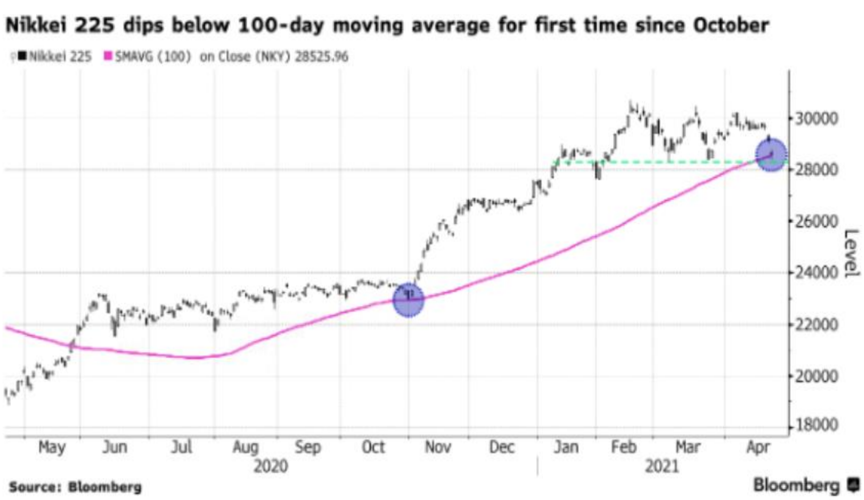
UK data released today point to a slight increase in inflation in March. Headline CPI printed at +0.7% year-on-year, compared to 0.4% in February, whereas core CPI came in 1.1% y/y in March from 0.9% in February. According to Jefferies Research, **economic activity in the UK is picking up notably following the re-opening of the economy**. European nations have also experienced a rebound, albeit smaller.



Other Mature Markets back to top

Japan

Equities fell sharply by 22%, sinking to the lowest level in more than six weeks on virus concerns. A new state of emergency in Tokyo and Osaka, which could also include Hyogo and Kyoto prefectures, could come as soon as this week, according to Bloomberg. Tokyo is looking to impose a state of emergency from April 29 through May 9 to coincide with the string of public holidays known as ‘Golden Week’. This could see the closure of departmental stores and entertainment facilities such as karaoke stores. **Separately, the Bank of Japan’s Semiannual Financial Stability Report said that the financial system has maintained stability owing to a coordinated policy response.** However, the report mentioned three key risks that warrant attention, which include: 1) increase in credit costs due to a delay in economic recovery domestically and abroad, 2) potential losses in security investments from a substantial adjustment in financial markets, 3) destabilization of foreign currency funding, mainly the US dollar.



Emerging Markets back to top

Most emerging markets were lower, although Latin America stood out with some gains. The Turkish lira weakened on comments from President Erdogan that the central bank could intervene to support the currency. Investors are worried about the low level of FX reserves in Turkey.

Key Emerging Market Financial Indicators

Last updated:	Level		Change				
4/21/21 8:09 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		53.71	-0.5	0	-1	54	4
MSCI Frontier Equities		30.81	0.2	0	4	44	9
EMBIG Sovereign Spread (in bps)		340	7	-6	-5	-277	-10
EM FX vs. USD		56.84	0.0	0	-1	8	-2
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.50	0.0	1	0	9	0
Indonesian Rupiah		14530	-0.2	1	-1	6	-3
Indian Rupee		75.46	-0.8	0	-4	2	-3
Argentine Peso		92.97	-0.1	0	-2	-29	-9
Brazil Real		5.57	0.0	2	-1	-5	-7
Mexican Peso		19.90	0.3	1	3	23	0
Russian Ruble		76.66	0.3	-1	-2	1	-3
South African Rand		14.28	0.2	1	3	33	3
Turkish Lira		8.18	-0.7	-1	-5	-15	-9
EM FX volatility		9.93	0.0	-0.1	-0.4	-1.7	-0.8

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

Brazil

The federal government and the Congress are reported to have reached an agreement on the budget before the April 22 deadline. As per local media reports, the Senate passed the 2021 budget bill on Monday with an understanding that proposed expenditure of BRL10 bn. would be vetoed by the government. At the same time, the senate agreed to allow the government to keep pandemic emergency spending outside the set spending cap, keeping the primary deficit performance/target for the year unaffected. This emergency spending is estimated at $22.6 bn (~1.6% of GDP), as per a Bloomberg report. However, analysts believe the government would have to take additional measures to meet its fiscal targets. Yields on Brazil's 10-year sovereign bonds were up 20bps yesterday.

Table 3: Possible correction to the 2021 budget

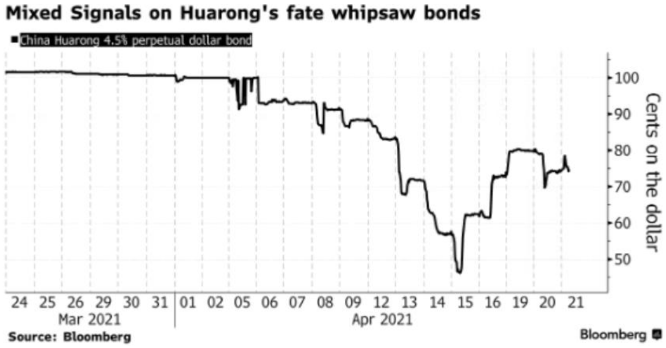
BRL billion

Items	Amount
Amendments cancelled	10.5
Reduction in discretionary expenditure	9.5
Excess in Bolsa Familia	8.0
Adjustment in sickness benefit	4.0
Total	**32.0**
Gap	**4.6**

Source: Brazil's economy ministry; and JP morgan

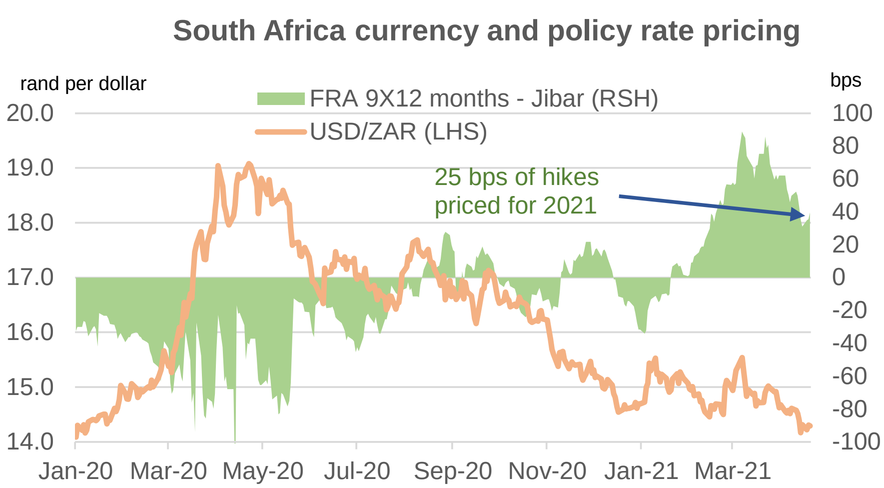
China

China is reported to be considering support for China Huarong Asset Management using central bank funds. According to Bloomberg, a unit of the People's Bank of China (PBOC) would assume more than RMB100 bn ($15 bn) of assets from some of Huarong's unprofitable operations, with the aim of helping the state-owned company clean up its balance sheet and refocus on its core business of managing distressed debt. Separately, China Huarong International Holdings Ltd., the offshore unit that issues or guarantees most of Huarong's dollar bonds, is in the process of transferring distressed assets to a separate offshore entity called China Huarong Overseas Investment Holding Co. The transfer would be to improve the financial health of the offshore unit, the group's main link to overseas funding. The company's offshore bond prices have been volatile over the past few days.



South Africa

Inflation pressures remained subdued in March as core inflation slowed down to 2.5% yoy (2.7% expected). Headline inflation picked up to below expected 3.2% mostly on the back of food and administrative prices. Market reaction was somewhat muted although contacts point out that interest rate forward agreements have already priced in a more benign inflationary environment. **Markets are currently pricing just one 25 bps increase by year-end as compared 3 hikes being priced in the middle of March**. Contacts also note return of foreign investors' interest in both primary and secondary local bond markets. **The 10-year local bond yield has declined about 45 bps while the South African rand has appreciated by 3.5% since the start of April** to the strongest level since the start of the pandemic.



Source: Bloomberg, IMF

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Global Financial Indicators

Last updated: 4/21/21 8:08 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
United States		4131	-0.7	0	6	51	10
Europe		3966	0.6	0	3	42	12
Japan		28509	-2.0	-4	-2	49	4
China		3473	0.0	2	1	22	0
Asia Ex Japan		93	-0.7	0	-1	52	4
Emerging Markets		54	-0.8	0	-1	54	4
Interest Rates				basis points			
US 10y Yield		1.57	1.1	-6	-15	100	66
Germany 10y Yield		-0.26	0.1	0	3	22	31
Japan 10y Yield		0.08	-0.9	-1	-3	6	6
UK 10y Yield		0.74	0.9	-6	-10	44	54
Credit Spreads				basis points			
US Investment Grade		95	-0.6	4	-2	-102	0
US High Yield		341	-0.6	5	-22	-422	-39
Europe IG		51	-0.1	0	-4	-40	3
Europe HY		253	-0.5	6	-19	-294	12
Exchange Rates				%			
USD/Majors		91.34	0.1	0	-1	-9	2
EUR/USD		1.20	-0.2	0	1	11	-2
USD/JPY		108.1	0.0	-1	-1	0	5
EM/USD		56.8	0.0	0	-1	8	-2
Commodities				%			
Brent Crude Oil ($/barrel)		66	-1.4	-1	2	240	27
Industrials Metals (index)		148	0.8	1	2	58	12
Agriculture (index)		54	0.4	3	5	55	13
Implied Volatility				%			
VIX Index (%, change in pp)		18.4	-0.3	1.4	-2.5	-27.0	-4.3
US 10y Swaption Volatility		80.9	-0.1	5.1	-3.5	1.4	20.7
Global FX Volatility		7.3	0.0	0.0	-0.4	-2.5	-0.8
EA Sovereign Spreads				10-Year spread vs. Germany (bps)			
Greece		117	-1.4	-2	-5	-188	-3
Italy		101	-2.8	-4	5	-162	-10
Portugal		66	-1.3	-3	13	-98	6
Spain		65	-1.5	-2	1	-83	4

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: 4/21/2021 8:16 AM	Exchange Rates Level Last 12m	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Local Currency Bond Yields (GBI EM) Level Last 12m	Latest	Change (in basis points) 1 Day	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.					
China		6.50	0.0	0.5	0	9	0		3.2	-1.1	-3	-11	76	-4
Indonesia		14530	-0.2	0.5	-1	6	-3		6.5	-1.6	-11	-31	-120	45
India		75	-0.8	-0.4	-4	2	-3		6.4	-0.1	3	-11	0	43
Philippines		48	-0.3	0.1	0	5	-1		4.1	2.3	-4	29	-95	43
Thailand		31	-0.2	-0.2	-2	4	-4		1.9	-2.1	-4	-15	38	56
Malaysia		4.12	-0.1	0.2	0	7	-2		3.2	0.8	-3	-10	33	65
Argentina		93	-0.1	-0.4	-2	-29	-9		46.5	3.9	58	78	-235	-962
Brazil		5.57	0.0	1.5	-1	-5	-7		8.1	14.2	-35	37	255	250
Chile		697	0.7	1.7	3	23	2		3.4	3.0	-1	21	32	68
Colombia		3640	-0.7	0.8	-2	9	-6		6.2	1.8	-9	-1	-30	110
Mexico		19.90	0.3	0.8	3	23	0		6.7	12.3	3	15	-40	107
Peru		3.7	-0.5	-1.6	1	-8	-2		4.9	2.1	19	37	35	126
Uruguay		44	-0.1	0.0	0	-2	-4		7.4	-0.8	-5	2	-492	11
Hungary		302	-0.5	-0.9	2	8	-2		2.0	1.3	-10	-9	24	45
Poland		3.79	-0.3	0.2	2	10	-2		0.9	3.4	4	4	-17	27
Romania		4.1	-0.2	0.2	0	9	-3		2.6	0.0	0	-4	-153	-11
Russia		76.7	0.3	-1.1	-2	1	-3		6.8	2.5	-17	4	81	107
South Africa		14.3	0.2	0.8	3	33	3		9.9	0.6	-21	-33	-79	21
Turkey		8.18	-0.7	-1.1	-5	-15	-9		17.6	15.0	-22	298	611	445
US (DXY; 5y UST)		91	0.1	-0.4	-1	-9	2		0.80	0.7	-6	-8	46	44

	Equity Markets Level Last 12m	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Bond Spreads on USD Debt (EMBIG) Level Last 12m	Latest	Change (in basis points) 1 Day	7 Days	30 Days	12 M	YTD
									basis points					
China		5099	0.3	2	1	33	-2		199	0	-2	-9	30	-9
Indonesia		5993	-0.7	-1	-5	31	0		158	0	-9	-25	-5	-29
India		47706	0.0	0	-4	56	0		168	4	-1	14	-152	17
Philippines		6439	-0.9	-1	1	16	-10		83	0	-9	-17	13	-22
Malaysia		1597	-0.7	0	-1	16	-2		113	0	-2	-3	9	3
Argentina		46894	0.0	-2	-4	55	-8		1459	0	19	8	-570	91
Brazil		120062	0.0	1	3	52	1		253	0	0	-16	58	3
Chile		4976	0.0	1	2	36	19		126	0	-6	-16	-14	-18
Colombia		1311	0.0	-1	-1	16	-9		207	0	-4	-15	44	2
Mexico		48529	0.0	2	3	43	10		348	0	-9	-34	55	-12
Peru		19534	0.0	-9	-12	37	-6		133	0	-4	-3	22	1
Hungary		42727	0.3	0	-3	35	2		65	0	-6	-15	-42	-31
Poland		59135	-0.4	-2	3	35	4		-22	0	-4	-11	-54	-21
Romania		11139	0.0	0	2	44	14		189	5	-1	-1	-162	-14
Russia		3559	0.2	-1	2	43	8		159	0	-5	-3	19	-7
South Africa		66675	-0.2	-2	1	40	12		357	0	-4	-35	25	-23
Turkey		1349	-1.2	-4	-12	38	-9		421	0	-5	-47	34	-24
Ukraine		527	0.0	0	2	5	6		479	0	12	-21	127	-12
EM total		54	-0.5	0	-1	54	4		421	0	17	-10	97	128

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

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