GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, AUGUST 24, 2021

- **Treasury and TIPS markets diverge** (link)
- **10-year Treasury yield approaches key milestone** (link)
- **US corporate debt-to-equity ratio at record low** (link)
- **Chinese central bank signals dovish tilt** (link)
- **Shift in German polls increases election uncertainty** (link)
- **Inflation fears weigh on Brazil markets** (link)

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Markets little changed in quiet summer trading

US equity index futures are slightly higher and pointing to new all-time highs, while European stocks gave up early gains following the overnight rally in Asia to fall back into slightly negative territory. Volumes are light in the midst of the August vacation season, and volatility remains quite low. Government bond yields are slightly lower in Europe and slightly higher in the US but remain close to their lowest levels in many months. The dollar is weaker against most currencies today, while oil has resumed its rally. Attention is shifting to the US Fed's Jackson Hole meeting which starts on Thursday, but the consensus is that there will be no major surprises. Meanwhile, China's central bank signaled a shift to a more dovish policy to support the economy. In Germany, changing poll numbers ahead of the September 26 election suggested there was growing uncertainty about the outcome.

Key Global Financial Indicators

Last updated: 8/24/21 8:06 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		4480	0.9	0	2	31	19
Eurostoxx 50		4176	0.0	0	2	25	18
Nikkei 225		27732	0.9	1	1	19	1
MSCI EM		50	1.5	-2	-4	12	-3
Yields and Spreads				bps			
US 10y Yield		1.27	1.5	1	-1	61	35
Germany 10y Yield		-0.48	0.3	-1	-6	1	9
EMBIG Sovereign Spread		353	-1	0	0	-69	3
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		56.1	0.1	0	0	2	-3
Dollar index, (+) = $ appreciation		93.0	0.0	0	0	0	3
Brent Crude Oil ($/barrel)		69.9	1.7	1	-6	55	35
VIX Index (%, change in pp)		17.2	0.1	-1	0	-5	-6

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

Mature Markets

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United States

The US Treasury market and the market for Treasury Inflation Protected Securities (TIPS) have diverged significantly. Nominal Treasury yields have fallen steadily over the summer and the 10-year Treasury yield is close to its lows for the year. The flattening of the Treasury yield curve (as long rates decline and short rates hold steady) has led lowered expectations for Fed rate hikes. The Overnight Index Swap (OIS) market is pricing just two rate hikes in the two years following liftoff. However, TIPS breakeven yields (the spread between the nominal Treasury yield and the equivalent maturity TIPS yield) are close to their highest levels for the year, buoyed by higher oil prices and global equity markets near all-time highs. Meanwhile, real yields at the front end of the curve have hit record lows – the one-year real yield four years forward being an example. Some analysts think this reflects fears of stagflation. On the other hand, 5 and 10-year TIPS yields have gone up in recent weeks.

Exhibit 3: Markets are priced for very firm levels of inflation over the coming years, but also a very benign path of Fed tightening…

1Yx4Y breakeven derived from par fitted curves (bp; RHS) compared to number of 25bp hikes implied by OIS curve in 24 months following first hike (number; LHS)

Source: J.P. Morgan

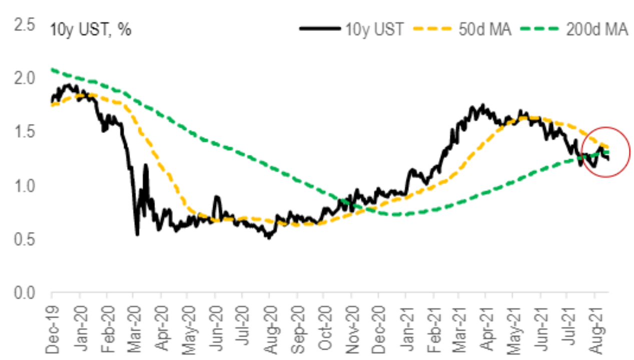
Exhibit 4: …leaving front-end real yields near all-time lows

1Yx4Y forward real yields, from J.P. Morgan seasonally-adjusted par fitted TIPS curve; %

Source: J.P. Morgan

The sustained decline in the 10-year Treasury yield this year has caused its 50-day moving average approach its 200-day moving average. If the 50-day falls below the 200 day, the event is known as a "death cross" in market jargon. As of Monday, the 10-year was just 3 bps away from this key milestone. Analysis by Citi shows that Treasury yields usually register major further declines after a death cross occurs. Specifically, the average move following a death cross is a further decline of 30 bps over six months. Furthermore, significant declines occurred in 75% of all occurrences. With the 10-year currently trading near 1.25%, if history repeats itself the market could be confronted by a sub-1% yield in the months ahead.

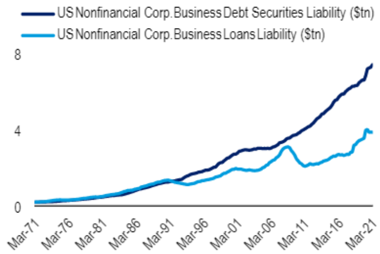
Figure 10. 10y UST nearing its death (cross)



Source: Citi Research, Bloomberg

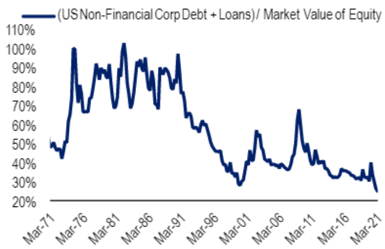
Despite steadily rising debt levels over the past decades, US investment grade non-financial corporations (NFCs) have very low debt-to-equity ratios. Currently, financial debt as a proportion of market equity value stands at 25%, well below the historical range of 25-60% that has prevailed over the previous 25 years. This is in spite of NFC debt reaching a record $11.2 tn outstanding. Companies closely manage their balance sheets and capital structure, and the massive increase in equity prices over the past decade has given them a lot more flexibility.

Figure 1: Growth in US non-financial sector financial debt
Debt securities for US nonfinancial business ($7.4tr) exceed loans ($3.8tr).



Note: Companies have significant additional liabilities including trade payables.
Source: Federal Reserve, BofA Global Research
BofA GLOBAL RESEARCH

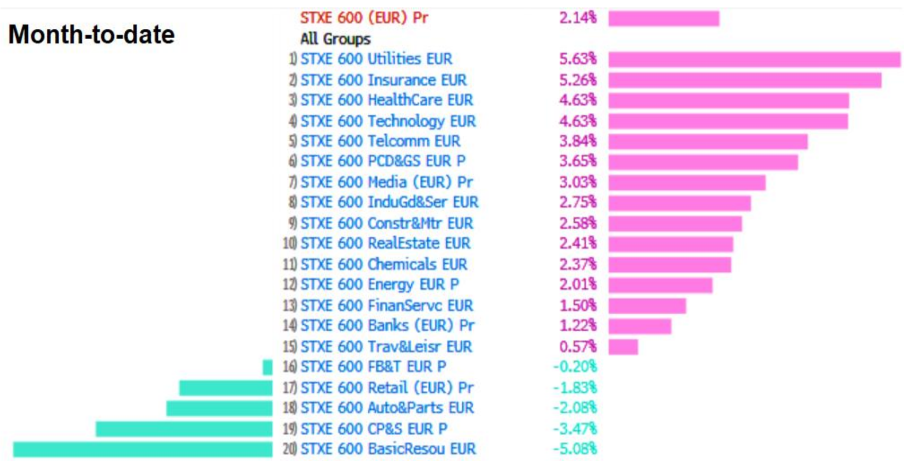
Figure 2: US corporate debt to equity is currently very low
Non-financial debt as a share of equity (25%) is currently at the low end of historical range.



Note: Companies have significant additional liabilities including trade payables.
Source: Federal Reserve, BofA Global Research
BofA GLOBAL RESEARCH

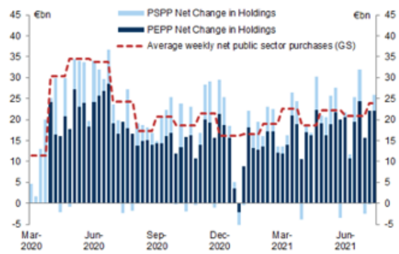
Euro Area

European equities mostly lost ground with only the German DAX (+0.3%) managing to hold on to gains. Travel and leisure firms (+1.8%) were notably outperforming today, while banks (-0.6%) and food retailers (-0.6%) underperformed. Despite last week's set-back, European equities are on track for the best month since March, aided by broad-based earnings surprises and record income margin revision among firms.



German bund yields were steady with Southern European spreads tightening by 1-2 bps. ECB's pandemic purchases stood at €16.6 bn in the last reporting week with analysts noting resilience in purchases despite low issuance and liquidity.

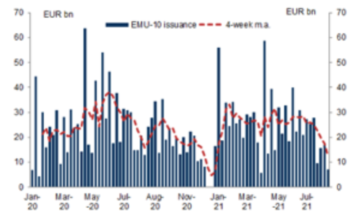
Exhibit 1 : The PEPP pace observed last week is in line with recent releases



Source: Haver Analytics, ECB, Goldman Sachs Global Investment Research

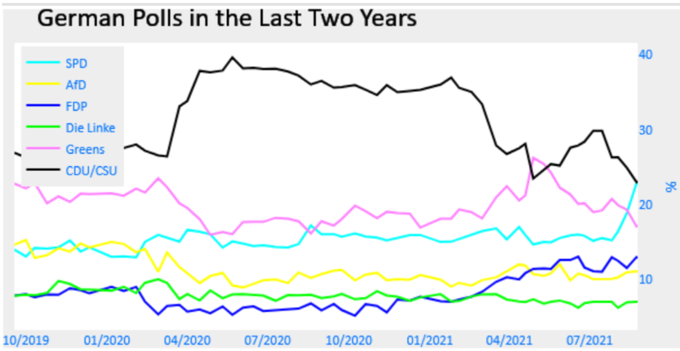
Exhibit 3 : While issuance activity has been particularly subdued

Gross bond issuance. Weekly issuance sums are computed from Thursdays to Wednesdays to match ECB purchase timing.



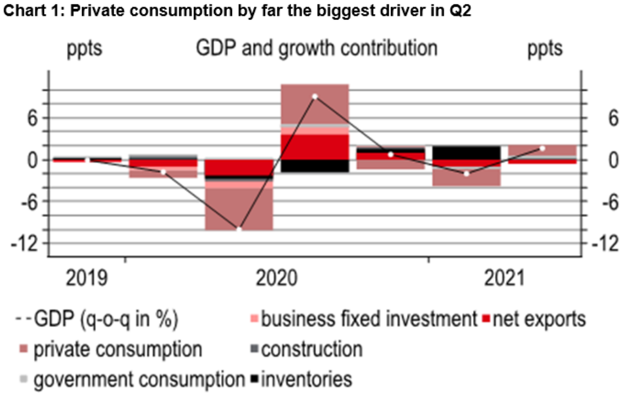
Source: Reuters, Goldman Sachs Global Investment Research

German Federal election in gaining analysts attention as the recent shift in polls has further increased the uncertainty around the potential composition of the new government. The support for CDU/CSU has seen a large decline since the July floods, while that of SPD has risen, driven by the popularity of the current Finance Minister Olaf Scholz. With 5 weeks left until the 26th September vote, analysts at Deutsche Bank note that a coalition between Conservatives (CDU/CSU and FDP) and Greens remains the most likely scenario and could result in a push towards more fiscal conservativism and opposition to making the NGEU more permanent. On the other hand, an SPD-led government is seen to result in more easy fiscal policies.



On the data front, **Germany released its final Q2 GDP reading** at 1.6% qoq (1.5% earlier release). Analysts pointed out that growth composition was skewed towards private consumption and government spending, while capital investment and exports expanded less than expected. This was attributed mostly to supply chain headwinds, as corporate surveys have remained optimistic on overall export perspectives.

Chart 1: Private consumption by far the biggest driver in Q2



Source: Macrobond, HSBC

Emerging Markets back to top

EMEA stocks were little changed, although its local markets are seeing rising inflows. The forint appreciated ahead of the Hungarian central bank's meeting, at which it is expected to hike its policy rate by 30 bps to 1.50%. The rally in Asian equities continued, led by Chinese tech stocks. Moody's affirmed Thailand's Baa1 rating with a stable outlook. The Bank of Indonesia extended its burden sharing arrangement for government debt purchases. Most Latin American markets followed the US higher, with Brazil the notable exception, where inflation concerns have pressured local markets for several weeks. Weakening retail sales in Mexico weighed on the economic outlook.

EM bond issuance

EM bond issuance hit $25 bn over the last 4 weeks, with non-financial corporates ($12.9 bn) and financial corporates ($10.5 bn) dominating in volume. Issuance was concentrated on the Asia-Pacific region: $9.8 bn were placed in China, $5.4 bn in Singapore and $3 bn in India. Rwanda tapped the hard-currency market for the first time since 2013, issuing a $0.6 bn dollar bond.

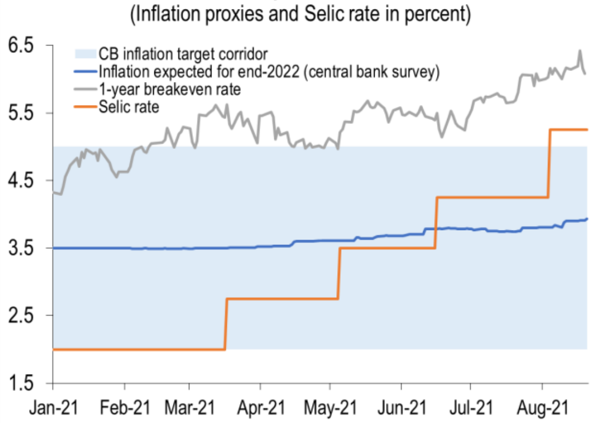
Sector	Last 4 weeks	The week before	YTD
	USD bn	USD bn	USD bn
Corporate	12.9	8.7	262.2
Sovereign	0.6	8.5	139.8
Financial	10.5	1.8	96.5
Agency	-	-	22.4
Muni/Local Gov't	0.8	0.6	8.9
Supra	0.2	-	9.3
Total	**25.0**	**19.6**	**539.1**

Source: Bond Radar, Bloomberg.

Brazil

Rising inflation expectations weigh on local markets. Despite several rate hikes in the last six months and another expected for September, market expectations for end-of-2022 inflation as surveyed by Brazil's central bank ventured deeper into the upper half of the central bank's 2022 inflation target range of 2 to 5 percent. The one-year breakeven rate, a market-implied proxy for inflation expected over the next 12 months, has been even higher, above the 2022 target range for several months. Rising inflationary expectations were also visible in upwards shifts of the local-currency treasury yield curve and may have been weighing on Brazil's stock markets which are among the weakest in the globe with a 6.1% decline over the past four weeks.

Brazil's inflation expectations are on the rise
(Inflation proxies and Selic rate in percent)



Source: Bloomberg.

China

The People's Bank of China (PBOC) is likely to boost credit support after both credit and economic growth slowed in July. On Monday, the PBOC hosted a meeting chaired by Governor Yi Gang to urge financial institutions to stabilize the supply of credit and boost the amount of money supporting smaller businesses and the real economy. The PBOC stated it would keep monetary policy stable with a good cross-cyclical design and would support high-quality economic expansion with "appropriate money growth," according to Bloomberg. It also repeated the Politburo's late July request to "coordinate macro policies for this year and next year." The meeting comes after new credit expanded in July at the slowest pace since February 2020, driven by a sharp slowdown in shadow banking, government bond issuance and tighter rules for property developers' financing, while the economy decelerated below expectations in the same month. Analysts viewed this meeting as an indication of a policy shift towards easing on the back of an uneven economic recovery. **Chinese technology stocks rallied for a second day (Shanghai +1.1%, Shenzhen +0.8%), 10-year bond yield and the renminbi were little changed.**

This monitor is prepared under the guidance of Nassira Abbas (Deputy Division Chief), Antonio Garcia-Pascual (Deputy Division Chief) and Evan Papageorgiou (Deputy Division Chief). Fabio Cortes (Senior Economist), Reinout De Bock (Economist-London representative), Sanjay Hazarika (Senior Financial Sector Expert), Henry Hoyle (Financial Sector Expert), Tom Piontek (Financial Sector Expert) and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Sergei Antoshin (Senior Economist), John Caparusso (Senior Financial Sector Expert), Liumin Chen (Research Assistant), Yingyuan Chen (Financial Sector Expert), Han Teng Chua (Economic Analyst), Mohamed Diaby (Economist, EP), Dimitris Drakopoulos (Financial Sector Expert), Deepali Gautam (Research Officer), Frank Hespeler (Senior Financial Sector Expert), Shoko Ikarashi (Externally Financed Appointee), Phakawa Jeasakul (Senior Economist), Esti Kemp (Senior financial Sector Expert), Sonia Meskin (Financial Sector Expert), Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), Dmitry Petrov (Financial Sector Expert), Patrick Schneider (Research Officer), Juan Solé (Senior London Representative), Dmitry Yakovlev (Senior Research Officer), Akihiko Yokoyama (Senior Financial Sector Expert), and Xingmi Zheng (Research Assistant). Magally Bernal (Senior Administrative Assistant) and Andre Vasquez (Staff Assistant) are responsible for word processing and production of this monitor.

Global Financial Indicators

Last updated: 8/24/21 8:07 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities				%			%
United States		4482	0.9	1	2	31	19
Europe		4176	0.0	0	2	25	18
Japan		27732	0.9	1	1	19	1
China		3514	1.1	2	-1	4	1
Asia Ex Japan		85	1.5	-2	-5	9	-5
Emerging Markets		50	1.5	-2	-4	12	-3
Interest Rates				basis points			
US 10y Yield		1.27	1.5	1	-1	61	35
Germany 10y Yield		-0.48	0.3	-1	-6	1	9
Japan 10y Yield		0.02	-0.3	0	0	-1	0
UK 10y Yield		0.54	0.1	-3	-5	32	34
Credit Spreads				basis points			
US Investment Grade		95	-0.2	1	3	-35	0
US High Yield		341	-1.4	-3	10	-183	-39
Europe IG		46	-0.1	0	0	-8	-2
Europe HY		233	-0.2	-2	-1	-95	-8
Exchange Rates				%			
USD/Majors		93.00	0.0	0	0	0	3
EUR/USD		1.17	-0.1	0	-1	0	-4
USD/JPY		109.7	0.0	0	-1	4	6
EM/USD		56.1	0.1	0	0	2	-3
Commodities				%			
Brent Crude Oil ($/barrel)		70	1.7	1	-6	55	35
Industrials Metals (index)		159	1.1	1	0	37	20
Agriculture (index)		57	0.3	-3	-1	55	19
Implied Volatility				%			
VIX Index (%, change in pp)		17.2	0.1	-0.7	0.0	-5.1	-5.5
US 10y Swaption Volatility		73.3	0.0	0.7	-9.3	19.5	13.1
Global FX Volatility		6.8	0.0	0.1	0.1	-2.3	-1.2
EA Sovereign Spreads				10-Year spread vs. Germany (bps)			
Greece		106	-0.6	4	-2	-51	-13
Italy		106	-0.5	1	2	-38	-6
Portugal		60	-0.3	1	-1	-24	0
Spain		71	-0.5	1	2	-11	9

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

Emerging Market Financial Indicators

Last updated: 8/24/2021 8:09 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	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.				
China		6.48	0.1	0.1	0	7	1		3.0	-3	-4	-16	-26
Indonesia		14393	0.1	-0.1	1	2	-2		6.3	0	-1	-38	21
India		74	0.0	0.2	0	0	-2		6.4	-4	-2	29	48
Philippines		50	0.3	0.6	0	-3	-4		4.3	-2	-4	70	67
Thailand		33	1.1	1.5	0	-4	-9		1.6	3	-3	17	31
Malaysia		4.22	0.2	0.5	0	-1	-5		3.3	0	10	91	77
Argentina		97	-0.1	-0.3	-1	-24	-14		45.5	60	97	83	-1061
Brazil		5.35	0.6	-1.0	-3	5	-3		9.8	18	131	440	426
Chile		785	0.2	0.4	-3	0	-9		4.7	6	37	220	195
Colombia		3878	-0.2	-0.7	0	-1	-12		6.9	2	14	167	180
Mexico		20.34	-0.1	-1.6	-1	8	-2		7.0	-9	-7	102	139
Peru		4.1	0.3	-0.5	-4	-13	-12		6.6	22	115	247	304
Uruguay		43	0.4	0.8	2	-1	-2		7.9	-1	-1	-28	65
Hungary		298	0.0	0.9	3	0	0		2.3	4	11	65	81
Poland		3.90	0.0	-0.1	0	-4	-4		1.1	-2	5	30	46
Romania		4.2	0.0	0.2	-1	-2	-5		3.2	-4	17	-56	44
Russia		73.9	0.1	-0.4	0	1	0		6.9	4	4	110	116
South Africa		15.1	0.4	-1.1	-2	13	-2		9.7	-4	-17	-41	5
Turkey		8.42	0.1	0.2	2	-12	-12		17.3	14	-22	373	424
US (DXY; 5y UST)		93	0.1	-0.1	0	0	3		0.78	1	6	49	41

	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		4888	1.1	1	-4	3	-6		219	-3	8	-11	-10
Indonesia		6089	-0.3	0	0	14	2		185	0	2	-48	-15
India		55959	0.7	1	6	44	17		148	-3	-8	-69	-3
Philippines		6679	1.3	2	2	12	-6		114	-3	1	-20	2
Malaysia		1553	2.0	2	2	0	-5		136	-1	-3	-35	1
Argentina		69050	1.8	-1	6	48	35		1557	-17	-8	-552	201
Brazil		117472	-0.5	-1	-6	15	-1		300	9	22	-34	41
Chile		4393	0.0	2	5	11	5		146	-2	-9	-40	-10
Colombia		1334	0.6	3	6	11	-7		289	4	13	32	74
Mexico		52055	1.2	1	4	37	18		362	4	8	-105	5
Peru		16211	4.4	-3	-13	-11	-22		182	-4	13	19	53
Hungary		51635	-0.7	3	9	43	23		132	-4	-9	-24	-17
Poland		68778	0.0	-1	2	31	21		36	0	-1	1	8
Romania		12238	0.6	1	3	40	25		187	2	-4	-79	-16
Russia		3879	-0.1	-2	4	28	18		173	-1	-7	-42	-6
South Africa		67453	0.9	-2	-1	19	14		360	10	13	-146	-24
Turkey		1470	0.8	1	9	33	0		478	4	2	-147	31
Ukraine		526	0.0	0	0	5	5		515	2	1	-119	22
EM total		50	1.8	-2	-4	12	-3		366	1	-1	-34	27

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

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