










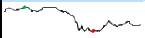


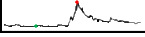
- Fed unveils dovish shift in inflation framework after policy review ([link](#))
- Tighter US lending standards may foreshadow more high yield defaults ([link](#))
- Japan's Prime Minister Abe resigns on health reasons ([link](#))
- Inflation in Lebanon accelerates to +100% as central bank announces FX plan ([link](#))
- Chinese firms raised a record amount of dollar debt between June and August ([link](#))

[US](#) | [Europe](#) | [Other Mature](#) | [Emerging Markets](#) | [Market Tables](#)

Markets mull Fed's new inflation stance

Global yield curves have steepened and the dollar is sinking as investors digest the Fed's dovish shift in its policy framework. Long-maturity government bond yields rose yesterday and overnight in the US and other major markets as the Fed adjusted its inflation target to an averaging approach that would allow greater tolerance for inflation overshoots. Investors priced in modest increases in inflation risk in long-dated breakevens after the announcement, but analysts questioned whether such a shift on its own would be enough to push price growth meaningfully higher given extraordinary monetary policy's limited impact in recent years. Equities have been mixed, with US futures pointing higher this morning, while EM currencies have broadly strengthened as the dollar has taken another leg weaker. Meanwhile, new indications of tightening credit standards in the US – both in commercial lending but also in credit cards – suggests more insolvency stress may lay ahead.

Key Global Financial Indicators

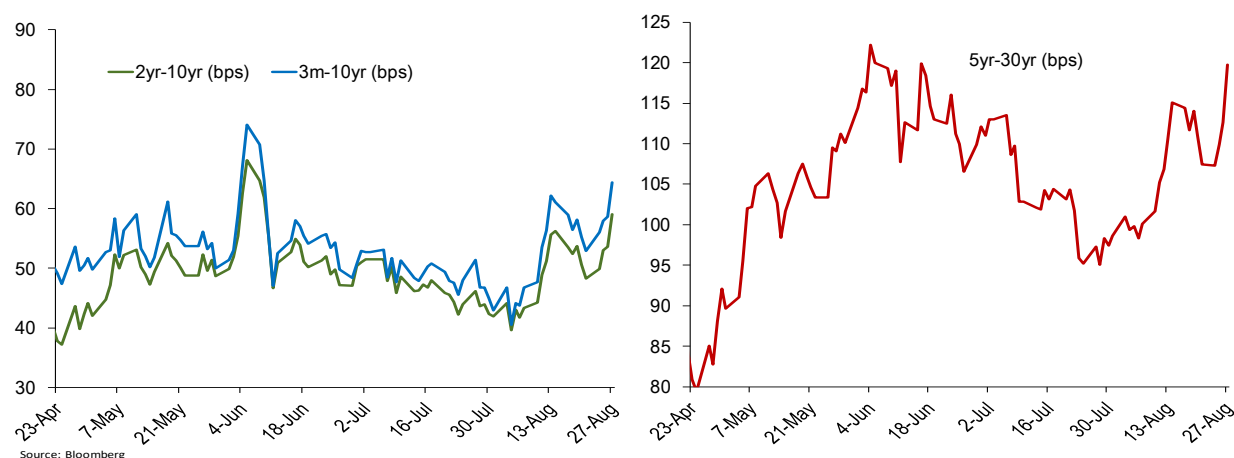
Last updated: 8/28/20 8:39 AM	Level		Change from Market Close				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		3485	0.2	3	8	21	8
Eurostoxx 50		3331	0.0	2	1	-1	-11
Nikkei 225		22883	-1.4	0	1	12	-3
MSCI EM		45	-0.8	2	3	15	0
Yields and Spreads			bps				
US 10y Yield		0.74	-1.1	11	16	-74	-118
Germany 10y Yield		-0.40	0.5	11	11	31	-22
EMBIG Sovereign Spread		421	5	-2	-26	50	128
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		55.3	0.7	1	-1	-8	-10
Dollar index, (+) = \$ appreciation		92.2	-0.8	-1	-2	-6	-4
Brent Crude Oil (\$/barrel)		45.1	0.0	2	4	-25	-32
VIX Index (% change in pp)		24.8	0.4	2	-1	5	11

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

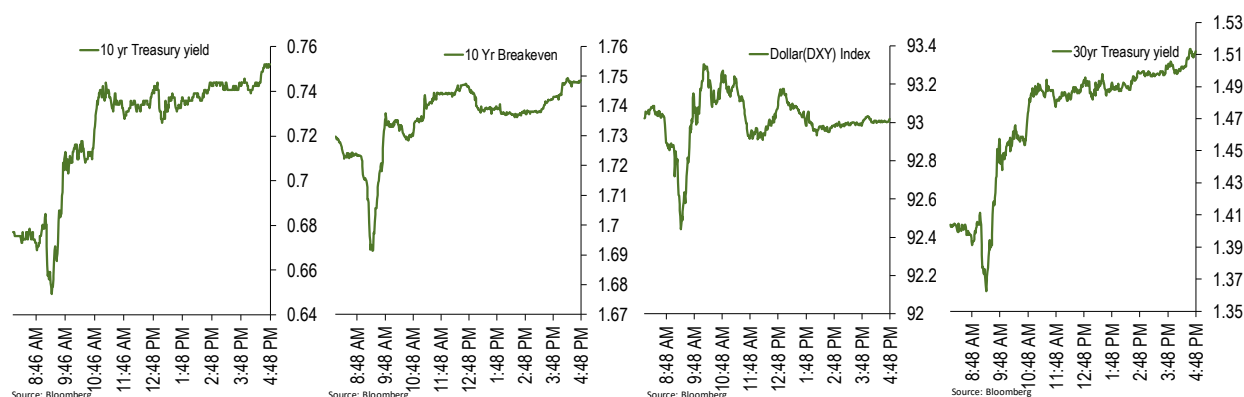
United States

[back to top](#)

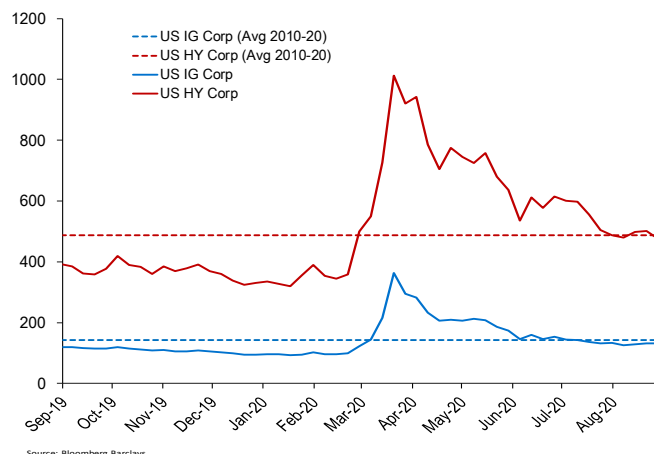
US equities closed higher after an up-and-down day in markets following Fed Chair Powell's Jackson Hole speech and the release of an updated Fed policy framework. The S&P 500 gained 0.2% to outperform the Nasdaq (-0.3%). Treasury yields saw the largest intraday swing in weeks. After initially dropping about 4 bps during Powell's speech, the 10- and 30-year yields closed 6 and 9 bps higher respectively. **The Treasury yield curve steepened to its highest level in two months.**



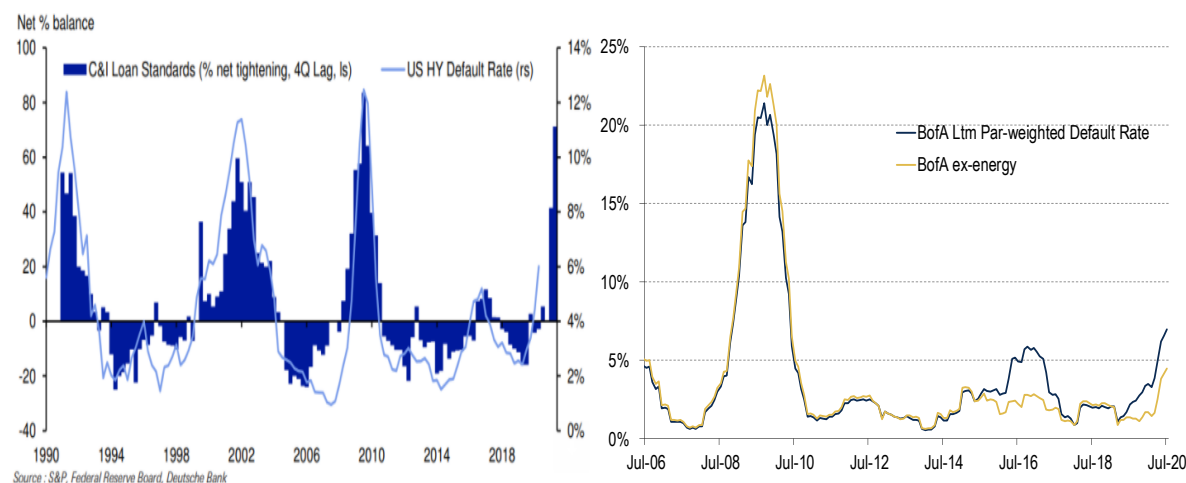
The Federal Reserve formalized a dovish shift in its inflation and employment policy mandates. The Fed released a statement titled 'Longer-Run Goals and Monetary Policy Strategy' alongside Chairman Powell's Jackson Hole speech Thursday morning. **On inflation**, the Fed will target average inflation of 2% going forward, which Fed watchers had largely expected. However, the statement did not commit the Fed to any kind of formula or time horizon for calculating this average, which some independent market commentators noted could limit its efficacy. **On full employment**, the Fed's framework shifted from targeting "deviations from its maximum level", to "assessments of the *shortfalls* of employment from its maximum level"; a dovish shift indicating the Fed's view that a strong job market can be sustained without causing inflation. The Fed will also now conduct regular policy reviews every five years. Powell also highlighted the challenges for monetary policy with interest rates near the effective lower bound. **Price action was volatile following Powell's remarks, but markets eventually came around to the prospect of somewhat higher inflation.**



Corporate spreads have moved sideways over the last month and remain above pre-Covid levels, but in line with long-term averages. High yield spreads have narrowed by about 20 bps in the last week, but are virtually unchanged over the last month, around 150 bps higher than pre-pandemic. Investment grade spreads are little changed over the last week.



Tightening lending standards could foreshadow higher default rates in the high yield sector. The net percentage of bank loan officers tightening lending standards for both large and small companies topped 70 in the Fed's Q3 survey, up from near 40 in the Q2 iteration, and 0 in Q1. Notably, the net percentage of respondents reporting stronger demand for C&I loans turned negative to -23.3 and -28.6 for large and small firms in Q3 as well. Historically, tightening standards have been a strong leading indicator of higher high yield default rates, though if past patterns hold, the default rate would remain below 2009.

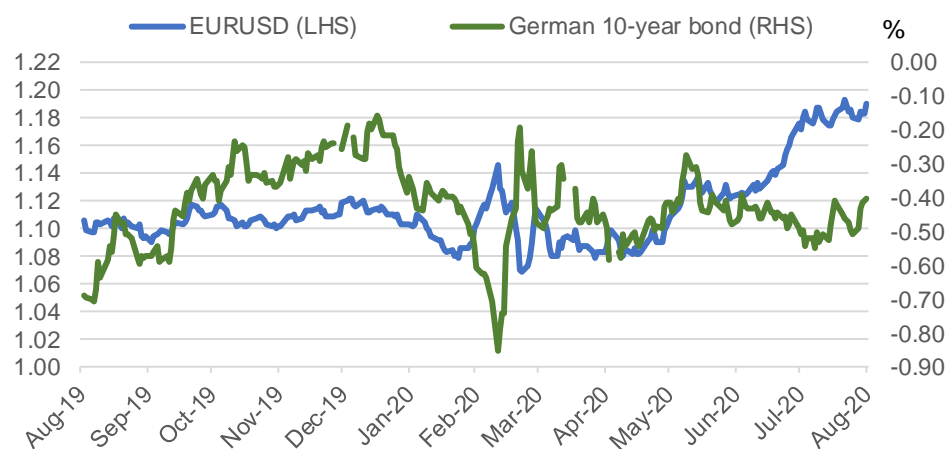


Europe [back to top](#)

Equities in Europe are trading mixed with stock indices up in Spain (+0.4%), but down in Germany (-0.6%) and France (-0.4%).

European yields are unchanged after increasing yesterday by 8 bps following similar moves in the U.S. yield curve. The euro (+0.6%) and the sterling (+0.6%) continue to benefit from the dollar weakness.

German 10-year Bond Yield and the Euro

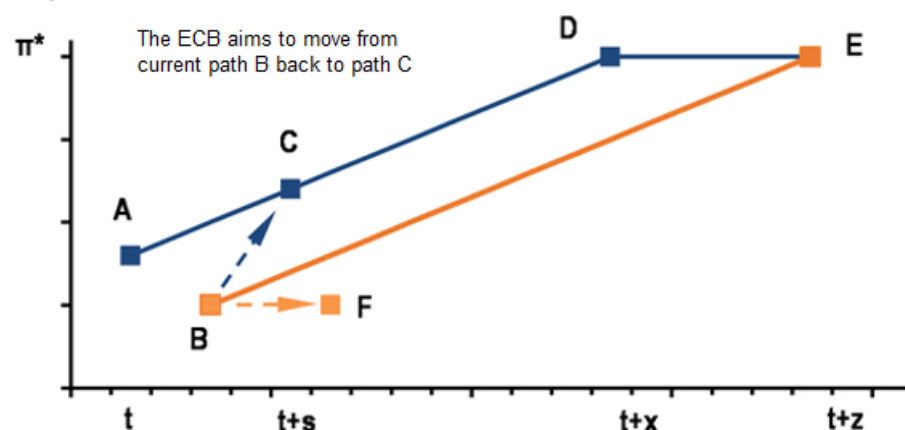


Source: Bloomberg, IMF

Speaking in Jackson Hole, the **ECB Chief Economist Philip Lane stressed the need to bring inflation dynamics closer to pre-pandemic projections**. The speech highlighted that the central bank was generally satisfied with the stabilization of the European sovereign yields as well as ongoing provision of credit to the economy. Inflation normalization remained as the last but most important goal in focus. **The ECB plans to use the Pandemic Emergency Purchase Program (PEPP) as the primary tool to achieve its inflation target**. As such, the PEPP could be both increased in size and extended in duration beyond the immediate needs of the COVID-19 response. Some sell-side analysts now also expect the ECB to follow the Fed in redefining its inflation target as the ECB reviews its strategy.

ECB inflation strategy in response to COVID-19 (Lane speech)

%oya inflation



Source: ECB, J.P. Morgan

The ECB's money supply report confirms a healthy pace of bank lending to the economy. Banks provided €34 bn of loans in July, split equally between households and corporates. That said, the data continues to diverge on the country level with higher corporate lending observed in France and Italy.

Euro area bank lending to real economy

€bn, monthly flows, adj. for loan sales/securitizations



Source: ECB, J.P. Morgan

Pressure continues to grow ahead of the next round of Brexit talks starting on the 7th of September.

According to media reports, the EU officials have warned the UK that there is less than two weeks to salvage the trade and security negotiations. This comes after Germany removes Brexit from next week's EU ambassadors meeting agenda, citing lack of tangible progress. The sides plan three rounds of talks concluding on the 2nd of October, just ahead of the EU leaders summit taking place on the 15-16 October. A UK government emergency dossier was leaked to the media warning of shortages, price hikes and public disorder due to a no-deal Brexit.

Other Mature Markets

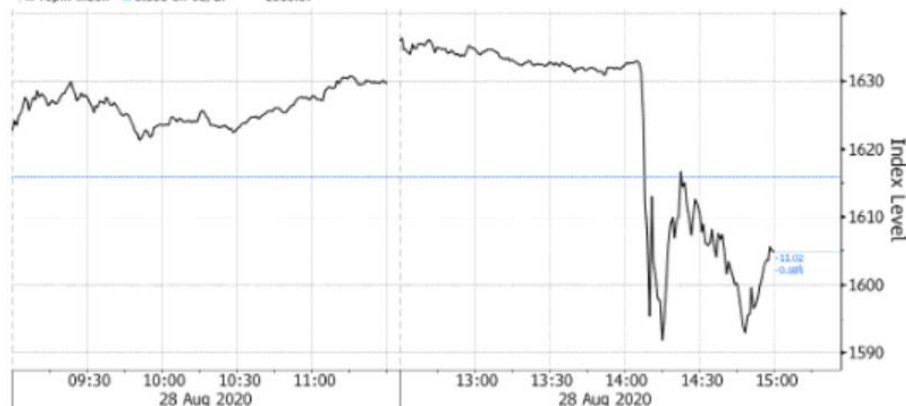
[back to top](#)

Japan

Equities dropped -0.7%, erasing an earlier gain of as much as +1.3% after Prime Minister Abe's resignation. Abe will resign after eight years in office due to health reasons. His current term was not due to end until 2021. Abe said that he would fulfil his duties as prime minister until the next leader is appointed. His successor would be picked by an election within the ruling Liberal Democratic Party according to lawmaker Hiroshige Seko. Separately, consumer price inflation (excluding fresh food) in Tokyo dropped -0.3% y/y in August, the steepest fall since 2017, due to plunging hotel accommodation fees. **The yen appreciated +0.7% while 10-year JGB yields rose +2bps.**

Japan stocks plunge after reports Abe will resign

■ Topix Index ■ Close on 08/27 ---- 1615.89



Source: Tokyo Stock Exchange

Emerging Markets

[back to top](#)

In EMEA this morning, currencies gained in line with the theme of broader U.S. dollar weakness. South African rand (+2%), Russian ruble (+0.8%) and Turkish lira (+0.5%) all appreciated against the U.S. dollar. Equities traded with a cautious tone. Shares traded lower in South Africa (-1.1%), Hungary (-0.7%) and Russia (-0.6%). **In Asia overnight, equity markets closed with wide dispersion for a net gain of 0.2%.** China (Shanghai +1.6%; Shenzhen +2%) outperformed while Malaysia (-1.9%) was the biggest laggard. Regional currencies were broadly stronger against the US dollar. On COVID-19, South Korea tightened social distancing measures in Seoul but kept the alert level at 2 for another week. Restaurants will not be allowed to serve diners after 9pm and cafes will only be allowed to do deliveries and pickups. **Yesterday, Latin American equity and currency markets were quiet with the exception of Argentina**, where equities decreased (-3.4%). The Inter-American Development Bank (IDB) purchased \$100 mn of gender equality bonds, where the funds are designated for programs to advance women's equality, in Colombia this week; and is looking for other opportunities in the region for "socially responsible" lending. The IDB also plans similar operations this year in Peru and Brazil.

Key Emerging Market Financial Indicators

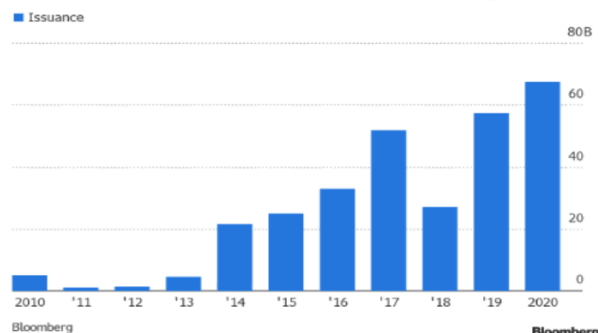
Last updated: 8/28/20 8:41 AM	Level		Change				
	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		44.96	0.9	2	3	15	0
MSCI Frontier Equities		25.18	0.0	2	5	-13	-17
EMBIG Sovereign Spread (in bps)		421	5	-2	-26	50	128
EM FX vs. USD		55.28	0.7	1	-1	-8	-10
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.86	0.4	1	2	4	1
Indonesian Rupiah		14632	0.2	1	-1	-3	-5
Indian Rupee		73.40	0.6	2	2	-2	-3
Argentina Peso		73.94	-0.1	-1	-3	-24	-19
Brazil Real		5.50	1.3	2	-6	-24	-27
Mexican Peso		21.88	1.2	0	0	-8	-13
Russian Ruble		74.46	0.6	0	-3	-10	-17
South African Rand		16.70	2.0	3	-1	-8	-16
Turkish Lira		7.34	0.2	0	-6	-21	-19
EM FX volatility		11.10	0.0	-0.1	1.1	2.1	4.5

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

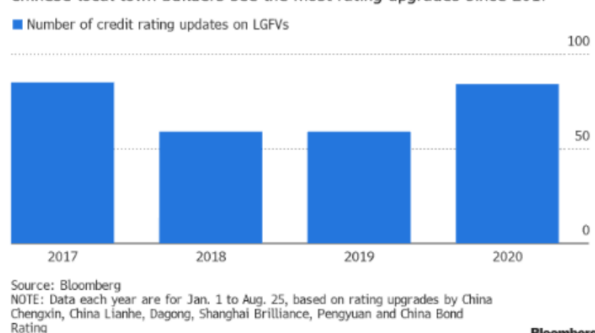
China

Chinese firms raised a record amount of dollar debt between June and August. According to Bloomberg, companies issued \$67.5 bn of debt including convertible bonds, asset-backed securities and certificates of deposits. Separately, China's local government financing vehicles (LGFVs) saw at least 84 upgrades by six Chinese rating agencies year-to-date, an increase of 42% y/y and the most since 2017. The rating firms issued three downgrades in the same period. **Equities (Shanghai +1.6%; Shenzhen +2%) gained and the RMB appreciated +0.4% to its strongest level since January.**

Chinese firms have raised \$67.5 billion between June and August

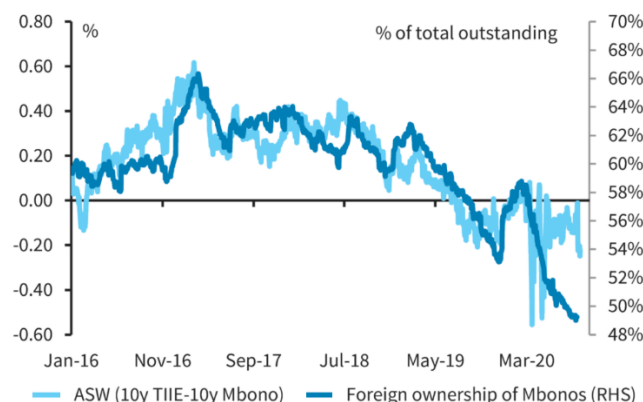


Chinese local town builders see the most rating upgrades since 2017



Mexico

Banxico's August 13 MPC meeting minutes highlighted uncertainty and fiscal concerns. The committee had cut the policy rate by 50 bps to 4.50% in the meeting, in a split 4-1 decision. This was the fifth cut of 50 bps since March. Members emphasized the possibility for a prolonged and uncertain recovery path, given uncertainties about the containment of the pandemic and developments for a vaccine, and noted concerns on the fiscal outlook. Since the series of rate cuts during the COVID-19 shock, the foreign ownership of Mbonos has been decreasing. It is now at 49% of total outstanding, which is a multi-year low. Some analysts view the currency as likely to be increasingly sensitive to additional rate cuts given the lower yield on the policy rate.



Lebanon

Inflation accelerated to 112.4% yoy in July (from 90% yoy in June) after the currency depreciated sharply on the black market. The local currency is reportedly trading at around 7000 to the U.S. dollar in parallel markets, compared with a fixed official exchange rate of 1507.5. The central bank has been using FX reserves to subsidize purchases of fuel, wheat and medicine at the original peg and other essential food items at 3500 pounds per dollar. Governor Salameh said that the central bank is looking for new ways to support trade given required FX cash reserves of banks. Under a new plan announced yesterday, the central bank has asked lenders to encourage clients who transferred at least \$500,000 abroad from July 2017 until now to deposit 15% of the amount in a fixed-rate account for five years. "Politically exposed persons" should deposit 30% of the money taken out of Lebanon. The central bank also asked lenders to conduct a fair valuation of their assets and liabilities to restructure or increase capital by the first quarter of 2021. Eurobonds continue to be marked at highly distressed levels following the government's default in March.

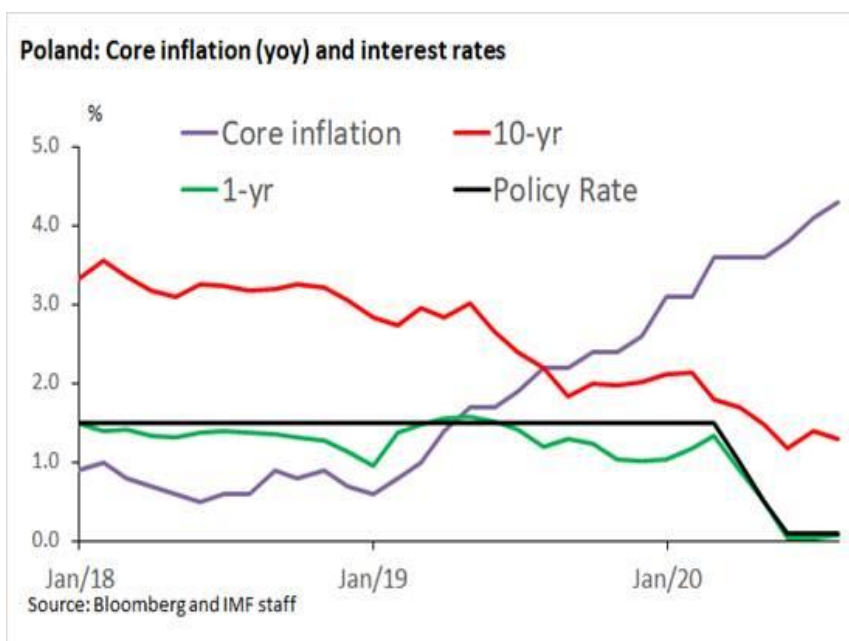
Lebanon: Cash Prices on USD bonds



Source: Bloomberg and IMF

Poland

10-yr yields are 5 bps higher at 1.42% as analysts at Citi estimate that the general government deficit will reach 11.4% of GDP in 2020 and 5.2% of GDP in 2021. Citi thinks that budget plans announced yesterday show that next year's fiscal policy will be somewhat more accommodative than previously thought and suggests that the central bank will continue its asset purchase program beyond 2020. **10-yr yields traded 13 bps higher in August as core inflation accelerated to 4.3% in July** (from 4.1% in June).

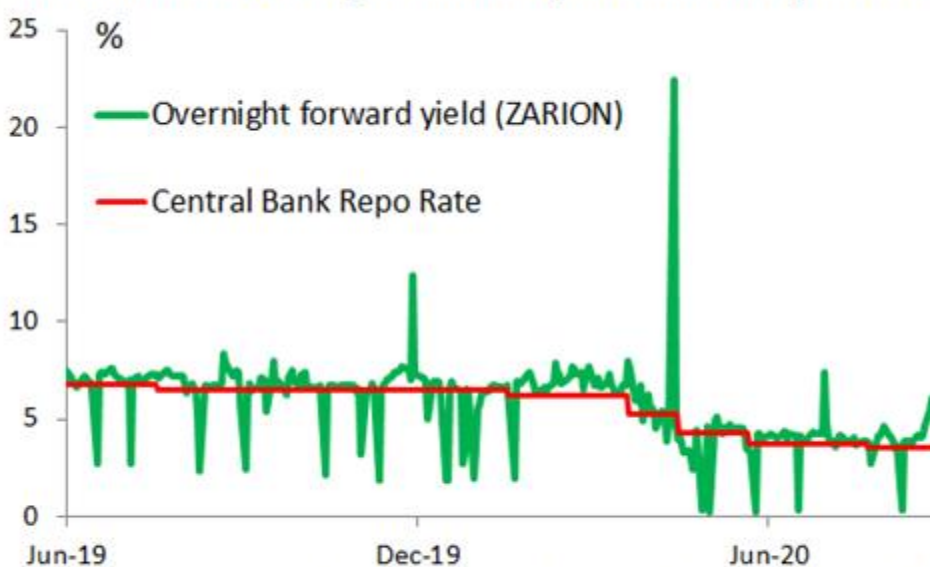


Source: Bloomberg and IMF staff

South Africa

Overnight yields implied by FX closed lower yesterday (at 4.68%) but yields remain volatile, rising 52 bps today (to 5.20%). Traders are closely following local funding markets after overnight forward yields rose to +6% in August (compared to the central bank's repo rate at 3.5%). **Contacts believe that local banks have plenty of liquidity, so the higher yield appears to be driven by offshore demand for rand exposure.** Interestingly, locals have reportedly been unwilling or unable to deploy cash in the FX funding market. Meanwhile, **BNP** argues that the upside surprise in July CPI (at 3.2% compared to expectations of 3.0%) lessens but does not completely remove the chances of a rate cut of 25 bps in September.

South Africa: Overnight forward yield and rand per USD



Note: ZARION is the overnight yield implied by forwards with U.S. dollar collateral.

Source: Bloomberg and IMF staff

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Global Financial Indicators





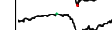
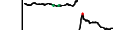

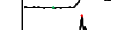





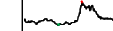















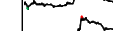

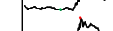

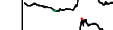

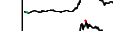

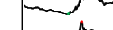
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	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities							
			%				%
United States		3488	0.2	3	8	21	8
Europe		3331	0.0	2	1	-1	-11
Japan		22883	-1.4	0	1	12	-3
China		3404	1.6	1	5	18	12
Asia Ex Japan		78	-0.8	3	5	22	7
Emerging Markets		45	-0.8	2	3	15	0
Interest Rates							
			basis points				
US 10y Yield		0.74	-1.1	11	16	-74	-118
Germany 10y Yield		-0.40	0.5	11	11	31	-22
Japan 10y Yield		0.06	1.6	3	4	33	7
UK 10y Yield		0.33	-0.7	12	22	-11	-49
Credit Spreads							
			basis points				
US Investment Grade		130	0.0	0	-2	-4	32
US High Yield		508	1.3	-22	-40	22	114
Europe IG		54	0.2	-1	-6	5	10
Europe HY		320	0.0	-12	-46	59	113
EMBIG Sovereign Spread		421	5.0	-2	-26	50	128
Exchange Rates							
			%				
USD/Majors		92.22	-0.8	-1	-2	-6	-4
EUR/USD		1.19	0.6	1	2	7	6
USD/JPY		105.5	1.0	0	0	1	3
EM/USD		55.3	0.7	1	-1	-8	-10
Commodities							
			%				
Brent Crude Oil (\$/barrel)		45	0.0	2	4	-25	-32
Industrials Metals (index)		120	1.7	3	7	6	4
Agriculture (index)		38	0.3	4	7	1	-8
Implied Volatility							
			%				
VIX Index (%, change in pp)		24.8	0.4	2.3	-0.6	5.5	11.0
US 10y Swaption Volatility		58.2	0.4	3.3	8.5	-29.6	-3.8
Global FX Volatility		8.9	0.0	-0.2	0.6	0.8	2.9
EA Sovereign Spreads							
			10-Year spread vs. Germany (bps)				
Greece		151	-0.3	-10	-8	-94	-15
Italy		145	2.0	0	-7	-31	-15
Portugal		81	-0.8	-3	-7	0	18
Spain		79	-1.1	-2	-8	1	13

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

[back to top](#)

Emerging Market Financial Indicators

Last updated: 8/28/2020 8:41 AM	Exchange Rates						YTD	Local Currency Bond Yields (GBI EM)						
	Level		Change (in %)					Level		Change (in basis points)				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
	vs. USD		(+) = EM appreciation					% p.a.						
China		6.86	0.4	0.8	2	4	1		3.2	0.8	6	23	14	9
Indonesia		14632	0.2	1.0	-1	-3	-5		6.7	3.2	8	-18	-68	-40
India		73	0.6	2.0	2	-2	-3		6.3	2.7	21	33	-38	-61
Philippines		48	0.3	0.3	2	8	5		3.6	-3.9	-2	-13	-74	-70
Thailand		31	0.5	1.4	1	-2	-5		1.5	0.4	4	9	-2	-12
Malaysia		4.16	0.2	0.3	2	1	-2		2.5	1.3	6	2	-85	-87
Argentina		74	-0.1	-0.6	-3	-24	-19		45.0	76.2	25	-32	-998	-1760
Brazil		5.50	1.3	2.2	-6	-24	-27		5.6	3.1	14	51	-123	-64
Chile		779	0.8	1.9	-2	-7	-3		2.5	1.7	-2	-13	-22	-80
Colombia		3816	0.5	-0.7	-4	-9	-14		5.3	-1.1	13	14	-41	-64
Mexico		21.88	1.2	0.4	0	-8	-13		6.1	-2.1	12	18	-115	-88
Peru		3.6	0.2	0.4	-1	-5	-7		4.1	-3.5	-4	15	-29	-41
Uruguay		43	0.1	1.3	0	-14	-12		8.2	3.1	4	-85	-262	-264
Hungary		298	1.0	-0.3	-1	0	-1		1.7	1.3	-1	21	73	49
Poland		3.70	1.0	1.3	2	7	3		0.8	-0.6	2	3	-82	-105
Romania		4.1	0.6	0.9	1	5	5		3.5	0.0	-24	-15	-17	-48
Russia		74.5	0.6	0.5	-3	-10	-17		5.7	-5.8	2	31	-130	-38
South Africa		16.7	2.0	2.7	-1	-8	-16		10.1	-1.5	2	13	75	61
Turkey		7.34	0.2	-0.3	-6	-21	-19		13.5	-22.6	-13	212	-272	181
US (DXY; 5y UST)		92	-0.8	-1.1	-2	-6	-4		0.29	-1.9	3	3	-109	-140

	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	1 Day	7 Days	30 Days	12 M	
								basis points						
China		4844	2.4	3	6	27	18		208	1	0	-6	24	32
Indonesia		5347	-0.5	1	5	-15	-15		217	8	-3	-25	26	61
India		39467	0.9	3	3	5	-4		216	1	-1	-19	78	91
Philippines		5884	-0.6	-2	-1	-25	-25		136	11	8	-4	48	70
Malaysia		1525	-1.9	-3	-5	-4	-4		148	0	0	-12	23	36
Argentina		44255	-3.4	-7	-10	74	6		2146	2	1	-113	146	377
Brazil		100624	0.0	-1	-3	2	-13		319	1	-7	-19	75	104
Chile		3888	0.7	-3	-4	-16	-17		172	1	-5	-22	34	39
Colombia		1225	-0.2	3	5	-20	-26		254	-1	6	-8	63	91
Mexico		37647	-0.3	-3	0	-8	-14		466	1	-9	-36	108	174
Peru		18338	0.0	0	4	-4	-11		151	2	-2	-11	21	44
Hungary		35153	-0.9	-2	1	-9	-24		126	6	-3	-29	16	40
Poland		52429	-0.2	1	1	-4	-9		22	2	-8	-11	-15	4
Romania		8866	-0.1	2	3	-4	-11		263	-2	-5	-3	45	89
Russia		2997	-0.5	0	4	12	-2		197	4	-2	-20	-19	66
South Africa		56339	-0.9	1	0	4	-1		494	6	-8	-22	163	174
Turkey		1108	-0.1	0	-4	16	-3		601	-2	-25	-20	69	200
Ukraine		500	0.0	0	0	-5	-2		622	-2	-3	-25	86	202
EM total		45	0.9	2	3	15	0		421	5	-2	-26	50	128

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

[back to top](#)