- **US economy could get a significant boost from a $1 tn package** (link)
- **Vaccine tensions cool in Europe as manufacturers pledge more supplies** (link)
- **Markets assign significant odds to Fed rate hikes starting in 2023** (link)
- **EBA bank stress tests to be much more stringent this year** (link)
- **India surges on unexpectedly strong fiscal stimulus plans** (link)

US | Europe | Other Mature | Emerging Markets | Market Tables

Reversal of fortune

The first day of February is experiencing a reversal of the negative sentiments that ended the previous week. The apparent easing of the vaccine challenge in Europe, the fall of inflated money market rates in China, an unexpectedly aggressive budget plan in India, and receding worries about the impact of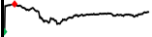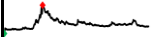 retail trading flows on US market volatility are among the factors cited for today's more optimistic tone. In further encouragement to markets, the euro area manufacturing PMI came in on target and Italy is expected to have a new government in place by tomorrow. Emerging markets continued to see strong fund inflows so far this year. Meanwhile, the civilian government in Myanmar was removed in an apparent military coup.

Key Global Financial Indicators

Last updated: 2/1/21 8:03 AM	Level		Change from Market Close				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities					%		%
S&P 500		3714	-1.9	-3	-1	15	-1
Eurostoxx 50		3540	1.7	0	0	-3	0
Nikkei 225		28091	1.5	-3	2	21	2
MSCI EM		53	-2.5	-5	3	27	3
Yields and Spreads					bps		
US 10y Yield		1.08	1.0	5	16	-43	16
Germany 10y Yield		-0.51	0.8	4	6	-8	6
EMBIG Sovereign Spread		351	-7	-4	-2	41	0
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		57.3	0.5	0	-1	-4	-1
Dollar index, (+) = $ appreciation		90.8	0.3	0	1	-7	1
Brent Crude Oil ($/barrel)		55.7	1.1	0	7	-4	7
VIX Index (%, change in pp)		30.8	-2.3	8	8	12	8

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

This week features a full slate of economic data, headlined by the US employment report and a slew of PMI reports from around the world. Among this week's central bank meetings, the most closely watched will be in the UK (Thursday), Australia (tomorrow) and India (Friday). Some analysts expect the Bank of England to open the door to negative rates, and some see a potential for another £100 bn increase to the asset purchase program already in the upcoming meeting.

Key Global Data Releases Week of February 1, 2021

Data release	Consensus Forecast
US nonfarm payrolls (Friday)	**+ 55K jobs**
US unemployment rate (Friday)	**6.7%**
US average hourly earnings mom (Friday)	**0.3%**
Euro area Q4 GDP (Tuesday)	**-1.2%**
Euro area services PMI (Wednesday)	**45**
Euro area composite PMI (Wednesday)	**47.5**
China Caixin services PMI (Tuesday)	**55.5**
UK services PMI (Wednesday)	**38.8**
Source: Bloomberg	

January Post-Mortem

The month of January saw an initial burst of enthusiasm as markets got off to a flying start and numerous new records were set for a variety of risk assets. However, the enthusiasm faded, and the month ended with a wave of pessimism in the wake of new mutant strains of the virus, rising death tolls, a slow vaccine rollout and the harsh political realities prevailing in Washington, DC. A fresh bout of volatility in the equity market fueled by leveraged retail traders last week did not help, as the VIX ended at nearly 31 from under 23 on December 31. Within days of setting new records, most major US and European indexes fell into the red for the year. However, technology stocks and some markets in Asia were among the few to buck the trend, with China, Japan and Korea among others posting decent starts to 2021. Some contacts took solace from two other trends: oil gained over 7.5% and Treasury yields were higher despite the equity selloff. These moves keep hopes alive that a stronger global economy could help reverse January's disappointments.

Key Markets: January 2021 Month-to-Date (MTD) Performance

| Market	MTD Change
S&P 500	**-1.11%**
Nasdaq	**+1.42%**
CSI 300	**+3.87%**
Euro Stoxx 600	**-0.80%**
MSCI Emerging Market ETF	**+3.2%**
10-yr Treasury	**1.0% (+15 bps)**
10-yr Bund	**-0.52% (-5 bps)**
Source: Bloomberg	

United States

A stimulus package in the $1tn range could provide a significant boost to US GDP this year, according to analysis by Bank of America. Most bank analysts expect the final package to be in the $900bn to $1.2 tn range. The consensus view is that while President Biden's $1.9 tn proposal is unlikely to pass in its entirety, a smaller and more targeted approach has a good chance of winning bipartisan consensus. According to their calculations, such a package could add a full percentage point to US GDP in 2021, with the greatest impact coming in Q3.

Table 1: What a $1tn stimulus package could look like

Provision	Cost ($bn)
State and local aid	200
"Targeted" stimulus checks	150
Extend and augment UI benefits	150
Child tax credit	150
Covid testing & vaccine distribution	150
Education	100
Aid to small business	50
Other	50
Total	**1000**

Note: Cost estimates are based on scoring of prior legislation by the Center for Responsible Federal Budget and Biden administrations estimates.
Source: BofA Global Research

Chart 7: Fiscal stimulus boost to growth from a potential $1tn package in 2021 (pp, annualized)
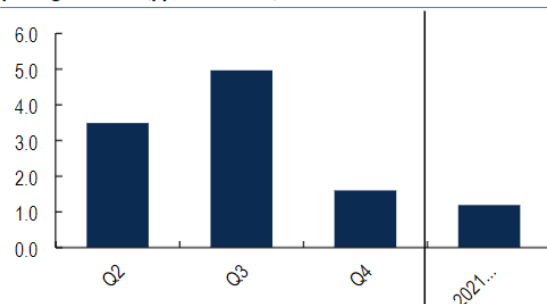
Source: BofA Global Research

The markets think the Fed could begin rate hikes as early as 2023. Barclays finds that analysis of pricing in the market for options on eurodollar futures suggests that markets are assigning a 40-45% probability of the rate hike cycle beginning in 2023, with the cycle forecasted to begin earlier than originally expected but to terminate relatively quickly. Barclays thinks markets are mistaken, based on Fed projections and communications. Although the Fed calculus could change, its stated policy of not acting until core inflation is well above 2% suggests a later starting date than 2023.

FIGURE 4. What is the market pricing in for the hiking cycle?
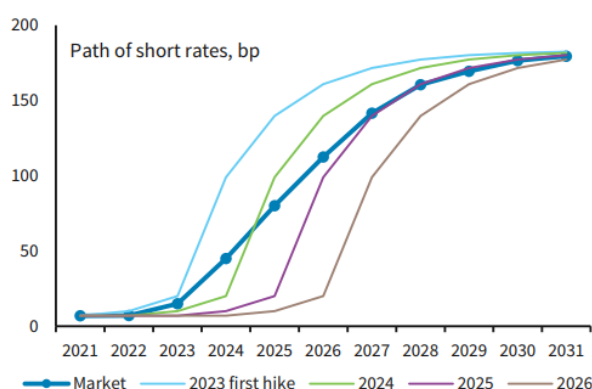
March ED implied rate is shown for each year
Source: Bloomberg, Barclays Research

FIGURE 5. The market is putting too high a weight on the hiking cycle starting in 2023
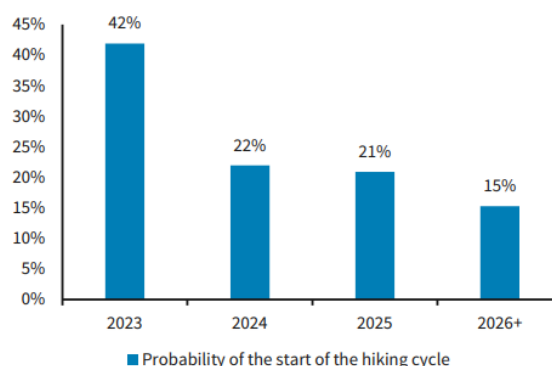

Source: Bloomberg, Barclays Research

Europe

Vaccine tensions cooled down somewhat over the weekend. AstraZeneca offered to deliver another 9 million doses to the EU in Q1 to bring the total supply to about 50% above the initial target and Pfizer-BioNtec also promised to deliver additional 75 million doses in the second quarter.

The Q4 earnings season has enjoyed a strong start with results surprising by 13% to the upside on average, the largest surprise since the GFC. Financial sector results have been particularly upbeat. This week we will get further results from European banks including Santander, Deutsche Bank and BNP Paribas.
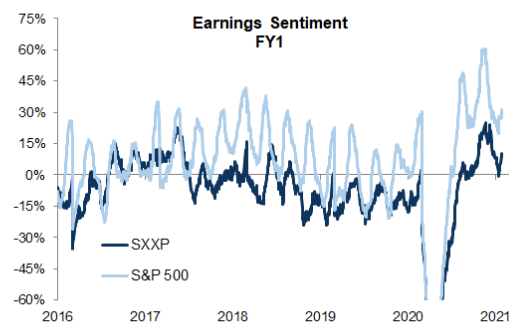
Exhibit 1 : The Q4 Earnings season started on a strong positive note
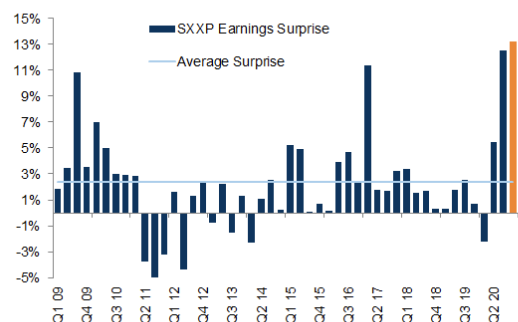
Source: FactSet, Bloomberg, STOXX, Goldman Sachs Global Investment Research

Exhibit 2 : Sentiment has increased since the start of the year
(Number of analyst upgrades - downgrades) / Total number of estimates. Based on revisions over the past month

Source: FactSet, STOXX, Goldman Sachs Global Investment Research

Germany bund yields were little changed this morning while Southern European spreads were 1-3 bps tighter. **Italy continued to outperform as markets gained confidence that a new government would be in place by tomorrow's deadline**, despite somewhat slow progress over the weekend. Potential options under consideration include keeping the existing coalition with an exchange of some of the ministerial seats. According to media reports, former ECB Governor Draghi is one of the potential candidates for both the finance minister seat as well as the prime minister's role should current Prime Minister Conte fail to get a coalition agreement.

The EBA's more stringent 2021 stress test will gauge the impact of a prolonged COVID-19 downturn and ending repayment moratoria. The 2021 worst-case scenario includes a projected 12-quarter trough GDP decline of -12.9%, significantly more severe than the -8.5% envisioned for the 2020 stress test (developed before the COVID-19 outbreak and subsequently cancelled); and other key assumptions are similarly more severe. This year's stress test will also specifically simulate the impact of the removal of government moratoria on loans, testing a key concern about asset quality. Stress test results will be published by 31 July 2021.

European Union-specific macroeconomic assumptions under 2020 and 2021 stress tests*

Source: RiskNet, EBA

Other Mature Markets   back to top

Japan

The government looks to extend a state of emergency by about one month. The state of emergency covers 11 areas, including Tokyo and Osaka, and is to expire on February 7. The parliament will also vote on measures to toughen emergency orders this week. The damage to businesses is likely to be significant.

JGB long-end yields have increased, offering more attractive returns than US treasuries on a hedged basis. 30-year JGB yield rose to 0.67% on concerns that the Bank of Japan (BOJ) may widen the trading band for 10-year bonds at its policy review in March, and that the BOJ is trimming bond purchases. Some analysts noted that more attractive JGB yields could lead to a lower demand for overseas assets. Reportedly, demand for US treasuries among Asian investors weakened in recent weeks. Japan is the largest foreign holder of US Treasuries.

Stay Home
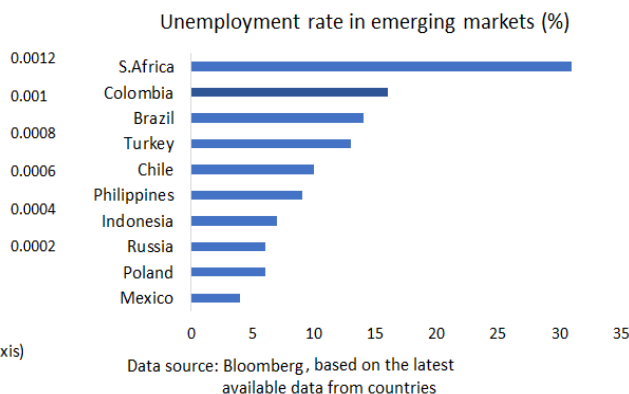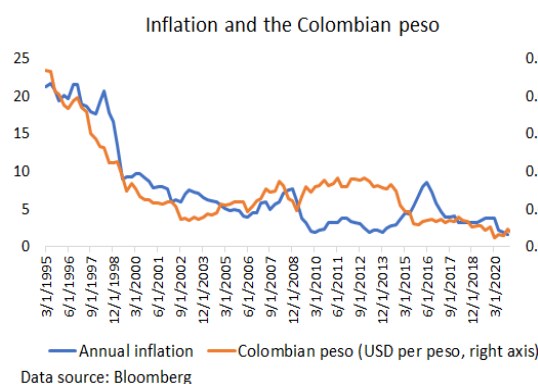Japan 30-year yield now matches 10-year FX-hedged Treasury
Source: Bloomberg

Emerging Markets   back to top

Most emerging markets are higher today as last week's market angst appeared to fade. India's Sensex stands out with a 5% gain, but there were strong performances in many other countries. Latin American markets followed the US lower on Friday, but local futures markets indicate they will also benefit from today's revival of risk appetite. Colombia stayed on hold as expected at 1.75%. Its unemployment rate of 16% is among the highest among major emerging markets.

Inflation and the Colombian peso

— Annual inflation   — Colombian peso (USD per peso, right axis)
Data source: Bloomberg

Unemployment rate in emerging markets (%)

Data source: Bloomberg, based on the latest available data from countries

Key Emerging Market Financial Indicators

| Last updated:	Level		Change				
2/1/21 8:06 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		53.31	1.8	-5	3	27	3
MSCI Frontier Equities		28.98	0.0	-2	2	-5	2
EMBIG Sovereign Spread (in bps)		351	-7	-4	-2	41	0
EM FX vs. USD		57.33	0.5	0	-1	-4	-1
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.47	-0.6	0	1	9	1
Indonesian Rupiah		14023	0.0	0	0	-2	0
Indian Rupee		73.03	-0.1	0	0	-2	0
Argentine Peso		87.59	-0.3	-1	-4	-31	-4
Brazil Real		5.44	0.6	1	-5	-22	-5
Mexican Peso		20.29	1.4	-1	-2	-7	-2
Russian Ruble		75.82	0.1	-1	-2	-16	-2
South African Rand		15.02	0.9	1	-2	-1	-2
Turkish Lira		7.19	1.6	3	3	-17	3
EM FX volatility		10.44	0.8	0.2	-0.3	3.6	-0.3

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

China

Money market conditions were easier after last week's unexpected tightness as the benchmark overnight repo rate fell from a five year high in response to a RMB 98 bn liquidity injection from the central bank. Liquidity conditions became tight last week as the PBOC surprised market participants by withdrawing liquidity of 236 bn yuan ($36.5 bn).

PBC's Liquidity Provision
In trillions of RMB

Source: Bloomberg.
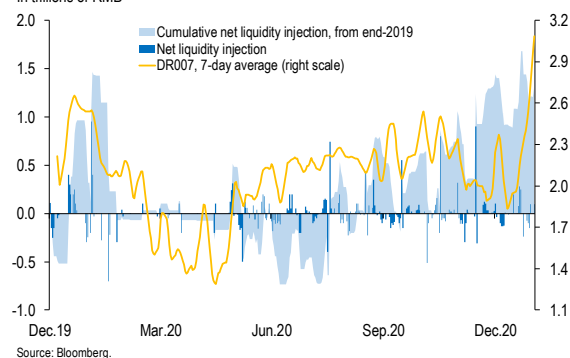
Analysts still do not expect a policy rate hike; they generally viewed the PBOC's move as a strong signal to curb growing financial risk-taking in a more ample liquidity environment towards end-2020. **With tightening liquidity conditions, Chinese firms have rushed to cancel bond issuances.** The number of canceled issuances reached the level seen in November 2020 after some state owned enterprise defaults.

Refinancing Pressure
Chinese companies abandon more local bond sales amid cash squeeze
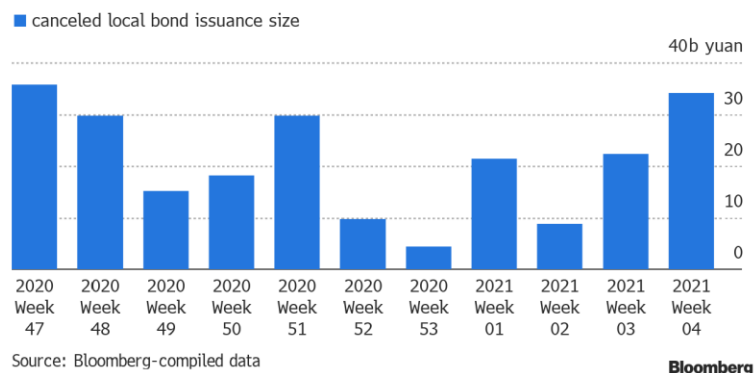
India
Markets were surprised by an unexpectedly aggressive fiscal stimulus proposed in FM Sitharam's new budget, sending local stocks to their biggest one day rally in many months. New spending is expected to push the budget deficit to 9.5% of GDP in 2021, against earlier plans for a 3.5% deficit. The 2022 deficit is projected at 6.8% of GDP versus the market consensus of 5.5%. The budget plans feature more spending on healthcare, raising funds through the sale of state owned enterprises, earmarking funds to recapitalize banks, setting up a new entity to manage non-performing loans, and launching a government sponsored company to buy investment grade corporate bonds.

Road to Recovery
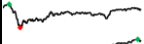India's economy seen rebounding while deficit eases
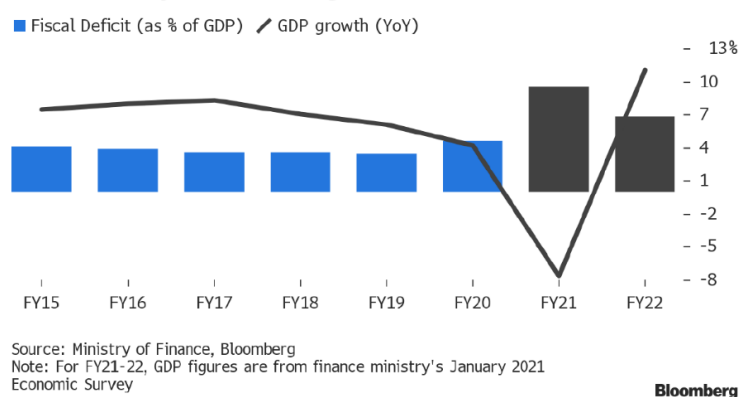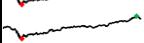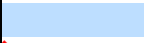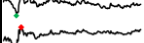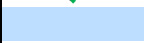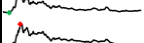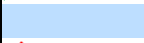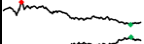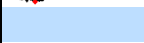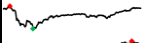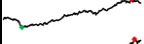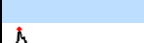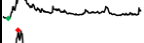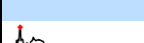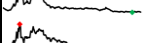
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Global Financial Indicators

Last updated: 2/1/21 8:04 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities					%		%
United States		3728	-1.9	-3	-1	16	-1
Europe		3540	1.7	0	0	-3	0
Japan		28091	1.5	-3	2	21	2
China		3505	0.6	-3	1	18	1
Asia Ex Japan		94	-2.5	-5	4	36	4
Emerging Markets		53	-2.5	-5	3	27	3
Interest Rates				basis points			
US 10y Yield		1.08	1.0	5	16	-43	16
Germany 10y Yield		-0.51	0.8	4	6	-8	6
Japan 10y Yield		0.06	0.5	1	4	13	4
UK 10y Yield		0.33	0.3	7	13	-19	13
Credit Spreads				basis points			
US Investment Grade		96	-0.5	1	1	-10	1
US High Yield		377	-1.6	4	-3	-69	-3
Europe IG		51	-0.7	1	3	5	3
Europe HY		266	-3.3	3	25	38	25
EMBIG Sovereign Spread		351	-6.9	-4	-2	41	0
Exchange Rates					%		
USD/Majors		90.84	0.3	0	1	-7	1
EUR/USD		1.21	-0.5	-1	-1	9	-1
USD/JPY		104.9	-0.2	-1	-2	4	-2
EM/USD		57.3	0.5	0	-1	-4	-1
Commodities					%		
Brent Crude Oil ($/barrel)		56	1.1	0	7	-4	7
Industrials Metals (index)		133	0.1	-3	0	25	0
Agriculture (index)		51	0.5	3	5	29	5
Implied Volatility					%		
VIX Index (%, change in pp)		30.8	-2.3	7.6	8.0	11.9	8.0
US 10y Swaption Volatility		60.3	-0.2	5.1	2.4	-16.9	0.2
Global FX Volatility		7.7	0.1	0.1	-0.4	1.9	-0.4
EA Sovereign Spreads				10-Year spread vs. Germany (bps)			
Greece		117	-3.3	-7	-3	-44	-3
Italy		113	-3.6	-10	1	-24	1
Portugal		55	-1.1	-3	-5	-15	-5
Spain		61	-0.7	-1	-1	-6	-1

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: 2/1/2021 8:07 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	1 Day	7 Days	30 Days	12 M	
vs. USD / % p.a.			(+) = EM appreciation											
China		6.47	-0.6	0.2	1	9	1		3.3	0.1	7	3	29	5
Indonesia		14023	0.0	0.0	0	-2	0		6.2	-4.8	-9	23	-60	17
India		73	-0.1	-0.1	0	-2	0		6.1	0.3	1	9	-79	12
Philippines		48	0.0	0.0	0	6	0		3.6	0.0	-2	-5	-54	-5
Thailand		30	-0.2	0.0	0	4	0		1.3	0.5	-3	3	-19	3
Malaysia		4.04	0.1	0.1	0	1	0		2.7	7.7	6	11	-48	10
Argentina		88	-0.3	-0.8	-4	-31	-4		49.8	1.0	-182	-715	-548	-632
Brazil		5.44	0.6	0.5	-5	-22	-5		6.3	-8.6	-36	74	28	70
Chile		727	0.7	0.7	-2	8	-2		2.8	0.9	-3	-1	-62	0
Colombia		3564	0.2	0.7	-4	-5	-4		5.1	-2.7	3	2	-53	4
Mexico		20.29	1.4	-0.9	-2	-7	-2		5.6	3.8	-1	4	-113	3
Peru		3.6	0.2	-0.1	0	-8	-1		3.8	-5.9	-6	16	-55	15
Uruguay		42	0.0	-0.3	0	-11	0		7.2	1.3	0	-10	-313	-2
Hungary		295	-0.1	-0.1	1	3	1		1.6	3.7	3	10	28	8
Poland		3.73	-0.1	0.2	0	4	0		0.6	0.9	1	-6	-137	-4
Romania		4.0	-0.5	-0.5	-1	7	-1		2.3	-3.0	-7	-46	-156	-46
Russia		75.8	0.1	-0.6	-2	-16	-2		6.0	-1.5	-1	26	-2	26
South Africa		15.0	0.9	1.5	-2	-1	-2		9.6	-0.2	-1	-6	15	0
Turkey		7.19	1.6	3.0	3	-17	3		13.3	6.1	-9	21	343	20
US (DXY; 5y UST)		91	0.3	0.5	1	-7	1		0.42	0.5	2	6	-89	6

	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		5418	1.2	-4	4	35	4		206	0	3	-3	35	-2
Indonesia		6068	3.5	-3	1	2	1		178	1	-3	-9	-5	-9
India		48601	5.0	-1	2	22	2		156	0	1	2	23	5
Philippines		6815	3.1	-4	-5	-5	-5		100	0	1	-4	19	-5
Malaysia		1566	0.0	-2	-4	2	-4		116	0	6	6	4	6
Argentina		48257	-2.8	0	-6	20	-6		1452	-1	19	83	-639	84
Brazil		115068	-3.2	-2	-3	1	-3		270	-3	-9	20	46	20
Chile		4358	-2.8	-3	4	-5	4		138	-2	-7	-6	-12	-6
Colombia		1348	-1.4	-4	-6	-17	-6		220	-2	-4	15	45	15
Mexico		42986	-2.9	-4	-2	-3	-2		381	-2	-3	21	71	21
Peru		21110	-0.8	-1	1	6	1		131	-1	-3	-1	8	-1
Hungary		44212	1.5	2	5	3	5		79	-1	-4	-17	-38	-17
Poland		57519	1.0	1	1	1	1		-14	-1	-3	-12	-59	-13
Romania		10383	0.7	1	6	4	6		199	-4	-3	-4	2	-4
Russia		3302	0.7	-3	0	7	0		164	-3	-11	-2	13	-2
South Africa		63144	1.0	-2	6	13	6		384	-3	-11	4	32	4
Turkey		1496	1.5	-3	1	26	1		440	-6	-25	-5	70	-5
Ukraine		514	0.0	3	3	1	3		506	0	12	15	104	15
EM total		53	1.8	-5	3	27	3		421	0	17	-10	97	128

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