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## Global Markets Turn Cautious

**Markets have turned more cautious this morning after last week's exuberant rally.** Stocks are lower, while safe haven assets such as Treasuries and bunds gained, and the dollar was stronger across the board. With US equities setting multiple records and European stocks at their highest in 10 months, investors are reconsidering their risk levels in the face of continued bad news on the virus front. The vaccine rollout remains slow in many countries, the virus continues to spread relentlessly, and new mutations pose fresh challenges. Although the possibility of a second impeachment of the US President does not appear to have impacted markets so far, the risk of further political turbulence remains a concern. Germany's minister of health called for people to further curtail social activities as the death toll climbs, while China is dealing with new outbreaks in some provinces. In the US, President-Elect Biden is to reveal the details of a new fiscal stimulus package this week, while ECB president Lagarde and Fed Chair Powell will speak at important online conferences.

Key Global Financial Indicators

Last updated: 1/11/21 7:59 AM	Level		Change from Market Close				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
<b>Equities</b>			%				%
S&P 500		3825	0.5	2	4	17	2
Eurostoxx 50		3624	-0.6	2	4	-4	2
Nikkei 225		28139	2.4	3	6	18	3
MSCI EM		55	2.6	6	8	20	6
<b>Yields and Spreads</b>			bps				
US 10y Yield		1.10	-0.8	19	21	-71	19
Germany 10y Yield		-0.53	-0.6	8	11	-33	4
EMBIG Sovereign Spread		344	-4	-6	-19	55	-6
<b>FX / Commodities / Volatility</b>			%				
EM FX vs. USD, (+) = appreciation		57.1	-0.7	-2	0	-7	-1
Dollar index, (+) = \$ appreciation		90.5	0.4	1	-1	-7	1
Brent Crude Oil (\$/barrel)		55.4	-1.1	8	11	-15	7
VIX Index (% change in pp)		23.8	2.0	-3	0	11	1

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

The week ahead has a relatively light data calendar, so markets will be focused on the latest developments on the virus front. The widespread lockdowns in multiple countries raises new issues for fiscal policy, with the very weak US jobs report highlighting the challenges facing governments around the world. However, hopes for further fiscal support in the US, among others, has kept risk appetite robust. Central bank meetings are due in Peru on Thursday and Korea on Friday.

### Selected Data Releases for the Week

Source: Bloomberg

Data Report	Consensus Forecast
US CPI Wednesday	0.4%, core 0.1%
US PPI Friday	0.4%, core 0.1%
US retail sales Friday	0%, -0.1% ex-transportation
German 2020 GDP Thursday	-5.1%
China trade balance Thursday-Friday	\$72 bn
UK industrial production Friday	+0.4% mom, -4.2% yoy
India industrial production Tuesday	-1.2%

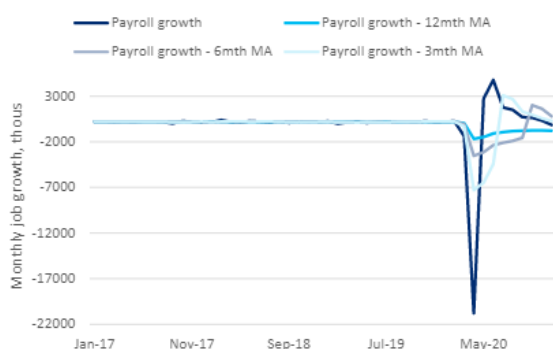
## United States

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**Stocks fluctuated between positive and negative territory before finally pushing higher following an afternoon pledge from President-Elect Biden that his fiscal package “will be in the trillions.”** His program also calls for larger \$2000 stimulus checks. Given the narrow margin in the Senate, most analysts expect package in the \$750 bn \$1 tn range, but there is no doubt that the Democratic victories in Georgia make room for a larger stimulus than was seen as likely before the election. As markets posted a fourth consecutive day of gains, all the major indexes set new records yet again. JP Morgan research on data such as stock exchange margin accounts indicates that euphoria is returning among retail investors, raising questions about the true strength of the current market rally. The Treasury market ignored the surprisingly weak jobs report and kept pushing yields higher and the curve steeper.

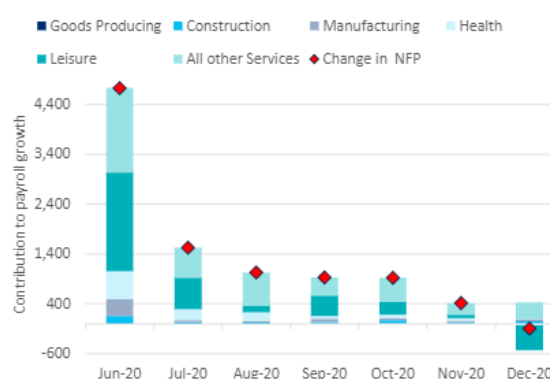
**Markets had a relatively muted response to the very disappointing December jobs report for a variety of reasons.** A key factor is that the weak numbers strengthen the case for a large stimulus package. However, a deeper dive into the numbers suggests more grounds for optimism. Firstly, the 190K jobs miss (-140K jobs lost versus the consensus forecast of a +50K jobs gain) was partly offset by a +135K upwards revision in the data from the previous two months. Secondly, the sectoral distribution of the job losses suggests that the losses are likely to be temporary and will be reversed when the economy rebounds and the vaccine distribution drive gains momentum. The job losses were concentrated in leisure sectors that were especially hurt by the spread of the virus and cold weather conditions, such as restaurants and amusement parks. Other sectors had much stronger number, such as business services (+161K) and retail hiring (+120K).

Figure 3. Payroll growth momentum: (actual, 3m MA, 6m MA, 12m MA)



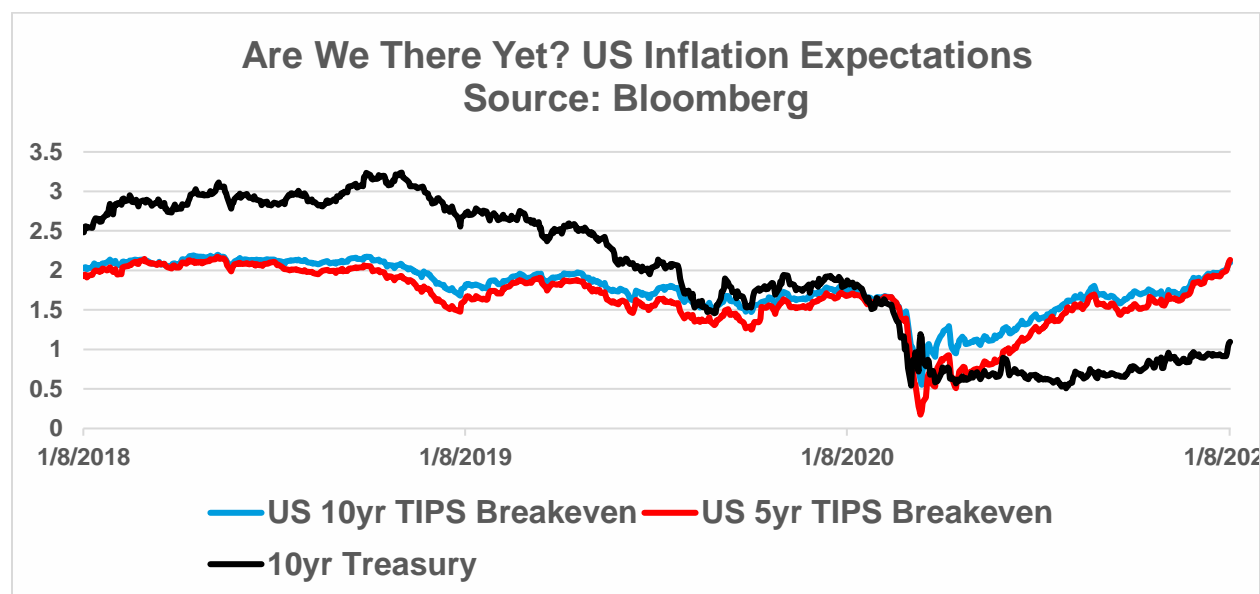
Source: Citi Research, BLS

Figure 4. Leisure dragged hiring negative in December



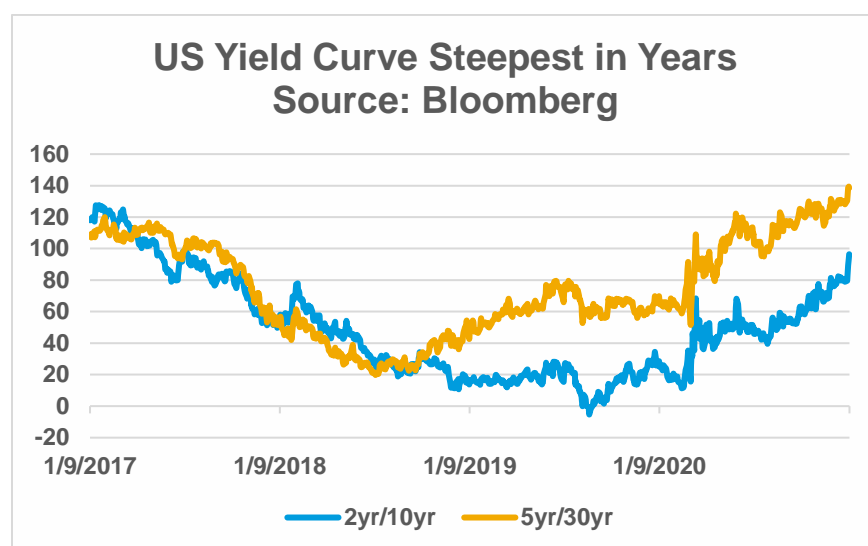
Source: Citi Research, BLS

**US inflation expectations, as measured by breakeven yields on Treasury Inflation Protected Securities (TIPS) have exceeded 2% for the first time since 2018.** The breakeven yield is the difference between the yield on the equivalent maturity Treasury note and the TIPS, and the breakeven is viewed as a key indicator of market inflation expectations. The benchmark 10-year Treasury yield was up over 20 bps last week, while the 10-year breakeven yield also gained 20 bps over the same period. The five-year TIPS breakeven is up 12 bps. These are very significant moves by recent historical standards. The Fed is expected to let the economy “run hot” and push inflation above its 2% target in order to allow the economy to recover from the pandemic. However, many are worried that inflation could break decisively higher, especially if interest rates continue to climb, forcing the Fed to reconsider its easy money policy and move towards tightening rates. Such an outcome would be completely at odds with the expectations of most market participants, with potentially negative consequences for risk assets.



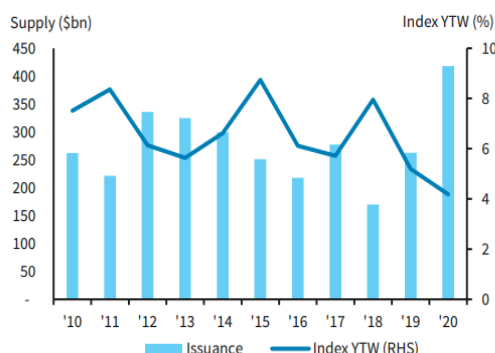
**The US yield curve has reached its steepest level in several years.** This is especially true for the spread between two-year/10-year and five-year 30-year yields, which are viewed as important benchmarks for curve steepness in the US market. The steepening is driven by expectations of higher long term interest rates, and the recent election results in the Georgia Senate runoffs has reinforced these trends. Positioning data from the interest rate futures markets show that short positions in 10-year, 30-year and ultra-long futures are at very high levels. Contacts report that many clients are putting on further curve steepening

trades, potentially putting more upward pressure on long term interest rates.



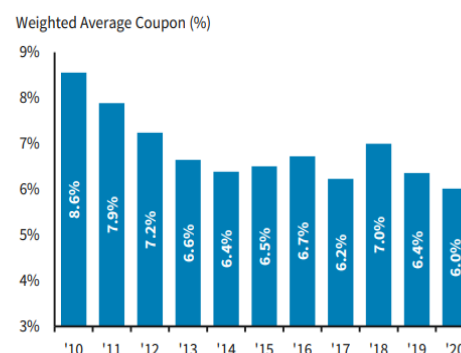
**Rising interest rates and higher inflation expectations also have important implications for the US corporate bond market, and especially the high yield (HY) market.** The year 2020 saw record issuance in the HY market as the recovery in investor confidence reignited the search for yield, allowing issuers to lock in low borrowing costs. One consequence of this trend is that the average coupon of the bonds issued in 2020 were the lowest on record. This makes the HY market very vulnerable to rising interest rates, as lower coupon bonds are much more sensitive to higher interest rates than bonds with higher coupons (they have higher interest rate durations, meaning that their prices are much more sensitive to increases in interest rates). A sustained rise in rates could cause heavy mark-to-market losses, leading to fire sales and other market disruptions.

**FIGURE 1. 2020 Set a Record for High Yield Supply as Yields Reached Record Lows**



Note: New issue includes only USD and fixed-rate bonds. Uses end-of-year levels for index YTW.  
Source: Barclays Research

**FIGURE 2. The Average New Issue Coupon Is the Lowest in Recent History**



Note: New issue includes only USD and fixed-rate bonds. Par weighted average shown.  
Source: Barclays Research

## Europe

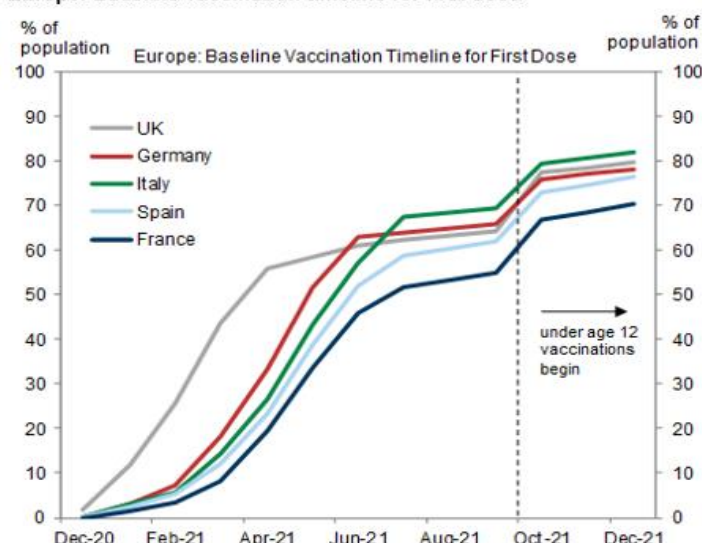
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### Euro area

**Equities (-0.5%) and the euro (-0.4% to \$1.21) edged lower as analysts point out that the vaccine roll-out is off to a slow start across Europe**, with Euro area countries having only vaccinated around 0.5-1% of the population so far. Nevertheless, the pace of immunization is expected to pick up following the announcement that the EU has secured an extra 300 mn doses from Pfizer. GS expects 50% of the

population to have received the first vaccine dose by April and June in the UK and Euro area, respectively. Significant cross-country differences are expected to persist. In other news, the ECB will issue its account of the December monetary policy meeting (Thursday).

Europe: Baseline vaccination timeline for first dose

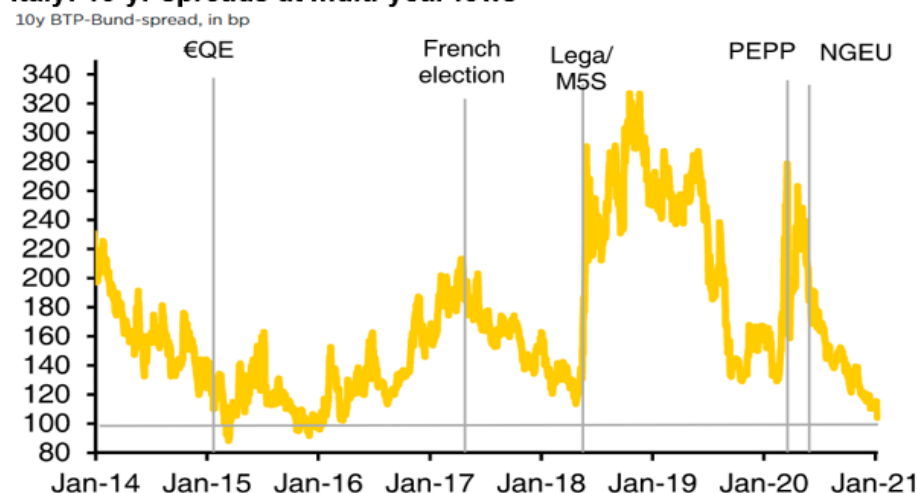


Source: GS

**10-yr bund yields are little changed at -0.52% as attention turns to the elections for the next CDU leader on 16 January.** Current candidates are Friedrich Merz, Norbert Röttgen and Armin Laschet. If no candidate reaches 50% in the first round, a run-off vote between the two leading candidates follows. Voter polls consistently see Friedrich Merz at around 30%, ahead of Laschet and Röttgen around 20%.

**Italian 10-yr spreads rose 3 bps to 108 bps but continue to trade close to multi-year lows after the government announced plans to increase its 2021 budget deficit target by 1.5% of GDP (to 8.5% GDP).** This will be the fifth request for a larger deficit the government has made since the first national lock down in March last year. FM Gualtieri said that he does not see any reason to forecast a deficit-to-GDP ratio in double digits for 2021. The government is expected to meet on Tuesday to discuss spending from the EU recovery package. Italy is also expected to impose new restrictions by the end of this week and extend a ban on movement between regions.

Italy: 10-yr spreads at multi-year lows



Source: Bloomberg and Commerzbank

**Spanish 10-yr spreads over bunds (+1 bps to 57 bps) were little changed as Spain cut its 2021 planned net debt issuance by €10bn to €100bn to account for better-than-expected tax revenues in 2020.** The new target is only slightly below last year's €110bn (or 9.4% of GDP). Of the net funding needs, €11.3bn will reportedly be covered by the EU employment-protection scheme SURE, €10bn via short-term paper, and the remaining €78.7bn covered by bond issuance. **The Tesoro also plans an inaugural green SPGB probably in the second half of 2021** with size ranging between €5bn to €10bn and a likely maturity of 20 years.

### United Kingdom

**The British pound (-0.6%) fell on reports that the U.K. government may have to tighten restrictions further.** Analysts also point out that the U.K. could benefit from negotiating new rules for trade in financial services with the EU. The U.K. will accelerate vaccinations this week with the opening of seven regional centers.

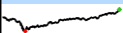








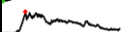




### Other Mature Markets [back to top](#)

**The yen weakened -0.2% while other Japanese markets were closed for a holiday.** A new variant of COVID-19 similar to the UK and South Africa strains has been detected in four passengers from Brazil. Additionally, the government plans to start large-scale PCR testing for COVID-19 in big cities as early as March in Tokyo, Osaka and other major cities, according to the Nikkei.

### Emerging Markets [back to top](#)

**EMEA bourses traded mixed on Monday morning amid a very thin news flow.** Currencies were slightly weaker versus the dollar, but the Turkish lira stood out by depreciating 1% and the rand weakened by 1.2% as the nation continues to be ravaged by the virus. Looking ahead, the National Bank of Poland is expected to hold interest rates at 0.1% on Wednesday. **Asian equities were also little changed on net (-0.2%),** although China underperformed. Regional currencies depreciated on broad US dollar strength. **On Friday, Latin American stocks had a good day in the wake of the US rally.** Currencies were flat and yield curves steepened, except for local currency yields in Brazil and Chile.

Key Emerging Market Financial Indicators

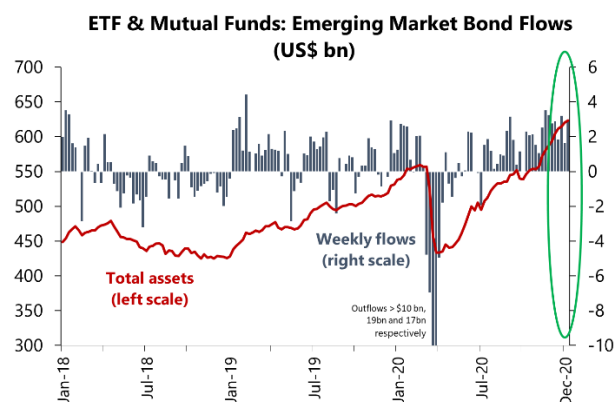
Last updated: 1/11/21 8:07 AM	Level		Change				YTD
	Last 12m	index	1 Day	7 Days	30 Days	12 M	
<b>Major EM Benchmarks</b>			%				%
MSCI EM Equities		54.71	-0.4	6	8	20	6
MSCI Frontier Equities		29.31	0.3	3	5	-5	3
EMBIG Sovereign Spread (in bps)		344	-4	-6	-19	55	-6
EM FX vs. USD		57.10	-0.7	-2	0	-7	-1
<b>Major EM FX vs. USD</b>			%, (+) = EM currency appreciation				
China Renminbi		6.48	-0.1	0	1	6	1
Indonesian Rupiah		14125	-0.7	-2	0	-3	-1
Indian Rupee		73.39	-0.2	0	0	-3	0
Argentine Peso		85.30	-0.2	-1	-4	-30	-1
Brazil Real		5.49	-1.3	-4	-8	-25	-5
Mexican Peso		20.20	-0.9	-1	0	-7	-1
Russian Ruble		74.65	-0.8	0	-2	-18	-1
South African Rand		15.48	-1.2	-5	-2	-7	-5
Turkish Lira		7.45	-1.3	0	5	-21	0
EM FX volatility		10.79	1.4	0.1	0.5	4.4	0.1

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

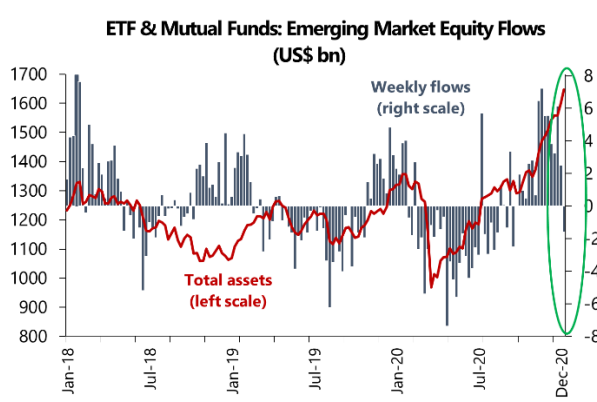


## Fund flows

**EM fund investors preferred debt over stocks.** Investors allocated over the week ending January 6 an additional \$3 bn to EM bond funds and pulled back \$1.6 bn from their equity peers, in particular from ETFs and mutual funds focusing on institutional investors. This group may have cashed in on the strong rally that EM equities experienced over the two weeks prior to January 6, as the MSCI index for emerging markets gained 4.5%, while the broader MSCI World index advanced only by 1.8%



Source: EPFR

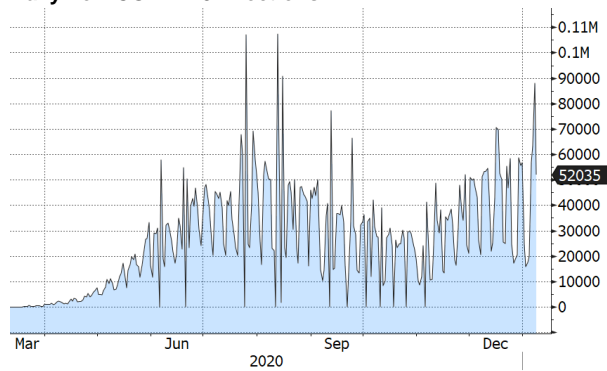


Source: EPFR

## Brazil

**Brazil's production and inflation prints delivered support to local stock markets.** Brazil's industrial production grew in November by 2.8% y/y, substantively stronger than the previous month's 0.3% but still below the 3.3% expected by market consensus. Capital goods production continued to outperform, while intermediate goods and durable consumption also contributed to the growth. In December the IGP-DI, a price index comprising wholesale, consumer and construction prices, printed at 0.76% m/m, sharply down from 2.64% in November and slightly below the 0.89% expected. The previous month's production data producer prices rose less than consumer prices (0.68% vs 1.07%), while the inflation prints still suggests robust demand in both segments. Both prints probably delivered positive impetus for the strong performance of the country's equity markets over last Friday. However, high levels of daily new COVID-19 infections and recent declines in seasonally adjusted consumer and services confidence present downside risks.

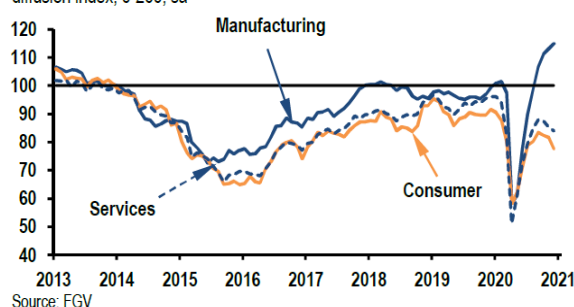
### Daily new COVID-19 infections



Source: Bloomberg

### Figure 5: Confidence indicators

diffusion index, 0-200, sa



Source: FGV

Source: J.P. Morgan.

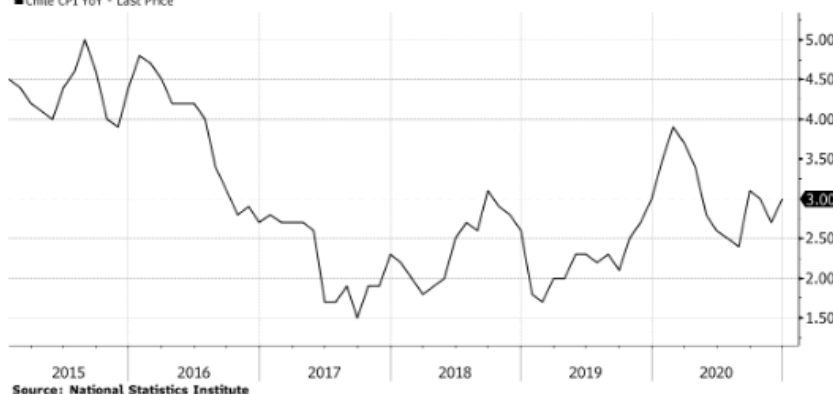
## Chile

**Chile's December inflation print brings the real yield on 10-year sovereign peso debt to -0.3%.** Chile's inflation rate printed in December at 3% yoy, 20 bps higher than expected and 30 bps higher than in November. The increase was mainly driven by clothing items and was helped by the option for Chileans to withdraw in December for the second time in 2020 funds from their pension fund accounts. J.P. Morgan analysts see annual inflation in 2021 rather above the central bank's 3% target than below and expect for the end of 2021 a policy rate 25 bps higher than its current level of 0.5% — at 22 bps below the respective market-implied rate still a conservative estimate. The country's non-deliverable forward forex markets currently price in a stable exchange rate over the course of 2021, while market consensus forecasts a GDP growth of 5.1% for the year. December's inflation print added Chile to the club of emerging markets with negative real yields on their 10Y sovereign debt and could help to ease the financing of the country's sustained fiscal stimulus which most recently included plans for an additional \$470 mn in benefits for quarantined households.

### Firming Inflation

Chile's consumer prices are near the 3% target

■ Chile CPI YoY - Last Price



Source: Bloomberg

## China

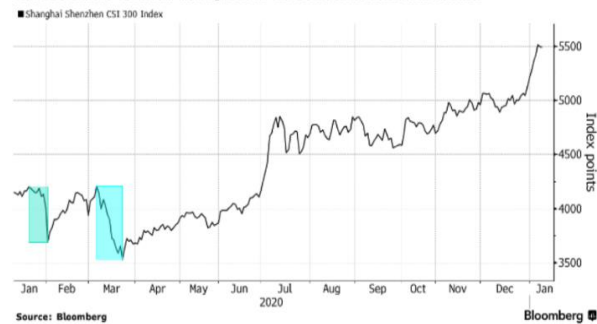
**China issued new rules to protect its companies from “unjustified” foreign laws and to allow Chinese courts to punish global companies for complying with foreign restrictions.** The rules allow Chinese authorities to issue orders stating that companies or people in China do not need to comply with foreign restrictions. Chinese citizens or firms are also allowed to sue for compensation in Chinese courts if their interests are damaged by the application of foreign laws. The measures were announced by the Ministry of Commerce on Saturday and were effective immediately, according to Bloomberg. **Equities (Shanghai -1.1%; Shenzhen -1.8%) fell the most in two weeks driven by consumer underperformance, while the RMB was little changed.**

**People's Bank of China (PBC) Governor Yi Gang reiterated a stable monetary policy in 2021.** In an interview with Xinhua News, he said that the central bank will use various monetary policy tools to maintain reasonable and ample liquidity such that money supply will expand at a pace consistent with nominal GDP. The PBC will also provide greater targeted support to small and micro enterprises, and areas such as technology and innovation, as well as green finance. He also mentioned that the central bank will continue to deepen the reform of the loan prime rate and maintain exchange rate stability. **Separately, inflation picked up in December.** The consumer price index (CPI) surprised to the upside, accelerating to +0.2% y/y in December due to higher food prices from -0.5% y/y in November. PPI Core CPI however cooled

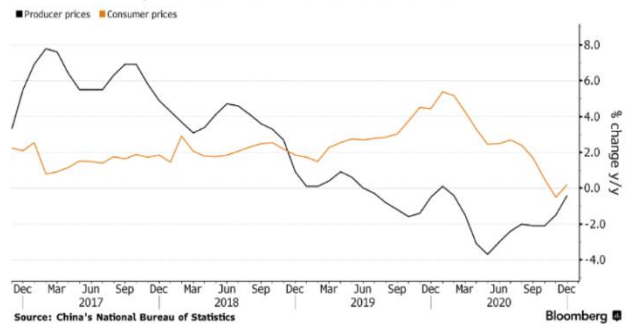


slightly to +0.4% y/y in December, following five straight months at +0.5% y/y. The decline in the producer price index eased to -0.4% y/y versus -1.5% y/y in November.

Chinese stocks tumbled during Covid-19 outbreaks but since rallied



China's consumer prices rose in December after brief decline



## India

**India's short-end bond yields rose following the central bank's announcement that it plans to drain liquidity via reverse repos.** The one-year bond yield rose +16bps to 4%, the five-year increased +6bps to 5.31%, while the weighted interbank call rate rose to 3.44% from a close of 3.18%, according to Bloomberg. The Reserve Bank of India (RBI) announced on Friday that it will withdraw INR2 tn (\$27.3 bn) via a 14-day reverse repo auction on January 15, which was unexpected. The central bank said that it is restoring normal liquidity management operations in a phased manner. **The Indian rupee weakened -0.2% and equities rose +0.6%.**

Shorter India bond yields spike on RBI move to tighten cash



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## Global Financial Indicators

Last updated: 1/11/21 8:01 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		3825	0.5	2	4	17	2
Europe		3624	-0.6	2	4	-4	2
Japan		28139	2.4	3	6	18	3
China		3531	-1.1	1	6	14	2
Asia Ex Japan		95	2.8	6	9	27	6
Emerging Markets		55	2.6	6	8	20	6
Interest Rates			basis points				
US 10y Yield		1.10	-0.8	19	21	-71	19
Germany 10y Yield		-0.53	-0.6	8	11	-33	4
Japan 10y Yield		0.04	0.0	1	2	4	1
UK 10y Yield		0.28	-0.5	11	11	-49	9
Credit Spreads			basis points				
US Investment Grade		95	-1.0	0	-8	-10	0
US High Yield		372	-0.4	-8	-28	-24	-8
Europe IG		49	1.2	0	-2	5	1
Europe HY		252	6.0	3	-11	45	11
EMBIG Sovereign Spread		344	-3.6	-6	-19	55	-6
Exchange Rates			%				
USD/Majors		90.47	0.4	1	-1	-7	1
EUR/USD		1.22	-0.4	-1	0	9	0
USD/JPY		104.2	-0.2	-1	0	6	-1
EM/USD		57.1	-0.7	-2	0	-7	-1
Commodities			%				
Brent Crude Oil (\$/barrel)		55	-1.1	8	11	-15	7
Industrials Metals (index)		136	-1.5	0	1	17	2
Agriculture (index)		49	0.3	2	12	19	2
Implied Volatility			%				
VIX Index (% change in pp)		23.8	2.0	-3.4	0.3	11.0	0.9
US 10y Swaption Volatility		59.5	0.9	-3.2	-2.4	0.5	-0.7
Global FX Volatility		7.9	0.1	-0.1	-0.4	2.5	-0.1
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		114	2.8	-9	-9	-41	-5
Italy		107	2.0	-8	-12	-45	-4
Portugal		51	1.3	-11	-9	-9	-9
Spain		57	1.3	-5	-7	-7	-4

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

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## Emerging Market Financial Indicators

Last updated: 1/11/2021 8:03 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		(+)= EM appreciation					% p.a.						
China		6.48	-0.1	-0.3	1	6	1		3.3	-0.9	-1	-13	12	-1
Indonesia		14125	-0.7	-1.6	0	-3	-1		6.2	11.0	18	7	-87	18
India		73	-0.2	-0.5	0	-3	0		5.9	0.5	-1	-4	-93	-1
Philippines		48	-0.1	-0.2	0	5	0		3.7	2.4	1	1	-62	1
Thailand		30	0.0	-0.7	0	0	-1		1.3	-0.4	2	-12	-17	2
Malaysia		4.05	-0.6	-1.2	0	0	-1		2.6	1.4	3	-4	-70	3
Argentina		85	0.1	-0.4	-3	-29	-1		52.5	32.1	-361	-189	-211	-361
Brazil		5.49	-1.3	-4.0	-8	-25	-5		6.1	5.7	55	21	-7	55
Chile		717	-0.9	-2.0	2	8	-1		2.8	0.6	1	-16	-60	1
Colombia		3484	-0.3	-1.0	-1	-6	-2		5.1	0.4	-1	-11	-80	-1
Mexico		20.20	-0.9	-1.1	0	-7	-1		5.7	0.1	6	-7	-128	6
Peru		3.6	0.4	0.3	0	-8	0		3.7	1.3	14	-6	-73	14
Uruguay		42	-0.1	-0.4	1	-12	0		7.2	0.5	-1	-11	-356	-1
Hungary		296	-0.8	-0.5	-1	1	0		1.6	3.6	6	-6	43	6
Poland		3.72	-0.8	-0.1	-1	2	0		0.6	-2.2	-3	-10	-136	-3
Romania		4.0	-0.4	-0.7	0	7	-1		2.6	0.0	-13	-27	-134	-13
Russia		74.7	-0.8	-0.3	-2	-18	-1		5.7	-0.1	0	16	-39	0
South Africa		15.5	-1.0	-4.7	-2	-7	-5		9.7	-0.8	7	-7	19	7
Turkey		7.45	-1.3	-0.3	5	-21	0		13.3	-5.6	17	-14	157	17
US (DXY; 5y UST)		90	0.4	0.7	-1	-7	1		0.48	-0.6	13	11	-115	12

	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		5441	-1.0	3	11	31	4		209	0	1	3	33	1
Indonesia		6383	2.0	5	7	2	7		180	0	-4	-13	16	-7
India		49269	1.0	2	7	18	3		154	0	3	2	31	3
Philippines		7305	0.2	1	1	-6	2		99	-1	-2	-17	23	-6
Malaysia		1617	-1.0	1	-4	2	-1		123	0	11	6	17	13
Argentina		51674	-1.6	1	-4	21	1		1383	0	-17	-10	-435	15
Brazil		125077	2.2	5	9	8	5		254	-1	3	-7	41	4
Chile		4500	0.7	6	10	-10	8		135	-1	-9	-17	-6	-9
Colombia		1453	1.2	1	5	-12	1		207	-1	-1	-8	37	2
Mexico		46729	1.2	6	7	5	6		359	-1	-8	-45	62	-1
Peru		21625	-0.3	4	6	6	4		125	-1	-6	-30	13	-7
Hungary		44477	0.2	5	8	-2	6		78	-1	-17	-22	-14	-18
Poland		59992	0.2	5	8	2	5		-11	0	-10	-16	-32	-10
Romania		10120	-0.2	3	6	2	3		197	-2	-6	-14	28	-6
Russia		3497	1.2	6	7	12	6		159	0	-7	-12	16	-7
South Africa		63697	0.3	5	7	11	7		381	0	5	-3	57	1
Turkey		1550	0.6	4	13	31	5		440	0	-6	-57	43	-5
Ukraine		499	0.0	-2	-2	-2	0		474	-1	-8	-18	94	-17
EM total		55	-0.4	6	8	20	6		421	0	17	-10	97	128

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