GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

WEDNESDAY, JULY 22, 2020

- **Foreign investors piled into US credit market in April amid record issuance** (link)
- **Dollar depreciation accelerated with broad-based increase in short positions** (link)
- **China vows retaliation after US demands closure of Houston consulate**(link)
- **Euro appreciates following agreement on EU Recovery Fund** (link)
- **Japan PMI improving but still pointing to declining activity** (link)
- **Potential Chilean pension fund withdrawals may be impacting local assets** (link)

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

Houston, we have a problem

A flare-up of tensions between the US and China is causing a drop in risk appetite this morning with equity prices lower across regions. China has vowed retaliation after the US gave China three days to close its consulate in Houston, the fourth largest US city. In a statement, the US State Department said it ordered the closure "to protect American intellectual property and Americans' private information." China's promise of "firm countermeasures" sent Asian equity markets lower after moving higher earlier in the day. Also weighing on sentiment is the likely delay in a potential US stimulus package after Senate Majority Leader McConnell indicated it would not pass within the next two weeks. European equity markets are down about 1% after rallying on yesterday's agreement on an EU recovery fund. The euro continues to strengthen versus the dollar, reaching its highest level on the year and broaching the 1.15 level. Dollar weakness has been a theme over the last several weeks with Bloomberg's dollar index down about 2.5% since the start of the month. The dollar weakness has been a benefit to EM currencies, with JP Morgan's EM currency index rising about 3% so far in July.

Key Global Financial Indicators

Last updated: 7/22/20 8:24 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		3257	0.0	2	4	9	1
Eurostoxx 50		3381	-0.7	0	4	-3	-10
Nikkei 225		22752	-0.6	-1	1	6	-4
MSCI EM		44	-0.4	2	8	3	-3
Yields and Spreads			bps				
US 10y Yield		0.59	0.3	-4	-12	-145	-133
Germany 10y Yield		-0.48	-2.1	-4	-4	-14	-30
EMBIG Sovereign Spread		446	-1	-17	-22	112	153
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		55.9	0.1	1	2	-11	-9
Dollar index, (+) = $ appreciation		95.0	-0.2	-1	-2	-2	-1
Brent Crude Oil ($/barrel)		43.7	-1.3	0	2	-31	-34
VIX Index (%, change in pp)		25.2	0.3	-3	-7	12	11

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

United States

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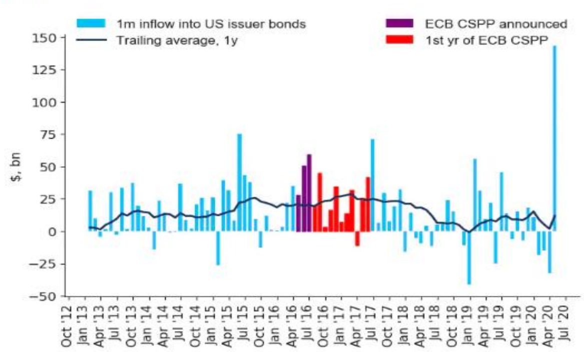
United States

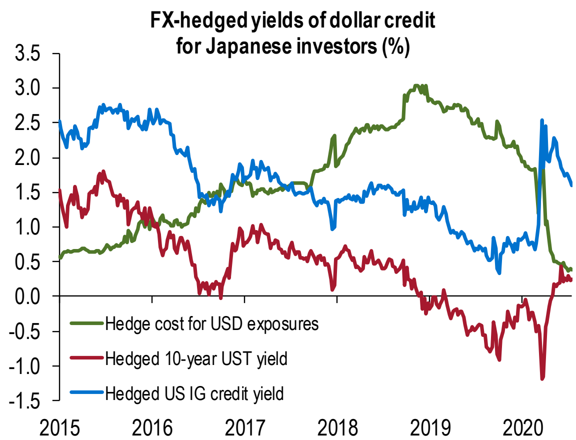
US equities pared gains after Senator McConnell said it is unlikely a deal on a stimulus package will be reached within 2 weeks, by which time many current benefits will expire. Investor preference switched from growth to cyclical sectors, after several cyclical firms reported better than feared Q2 earnings. The Dow gained as much as 1.3% before paring back in the last trading hour to close 0.6% higher. The NASDAQ dropped 0.9% weighed by the mega-cap firms. Treasury yields edged lower, hovering around the low end of the range since April. Volatility in yields has collapsed, with implied vol approaching a record low (Mar 2019) and realized vol (trading range) on the 10-year Treasury falling to the lowest this year.

International investors piled into US credit markets in April, facing attractive valuation and a record pace of issuance. Citi estimates that net foreign inflow into US corporate credit totaled $143 bn in April, nearly double the next biggest monthly inflow since 2013, and accounts for more than 2/3 of the $200 bn issuance by US IG corporate in that month. US IG credit has become very attractive to yield-seeking foreign investors as hedging costs declined while the Fed serves as the liquidity backstop.

Figure 1. Estimated foreign monthly inflow into US-issuer corporate debt, all currencies, adjusted for market value changes from FX / rates

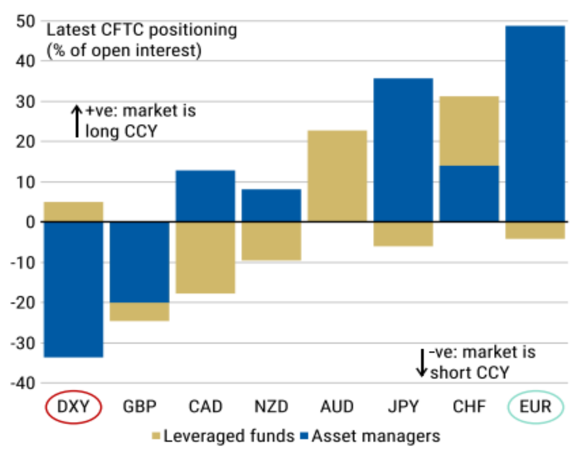


Source: Citi Research, US Treasury, Bloomberg; Note: Excludes holdings by entities located in Ireland. See methodology discussion in text.



Source: Bloomberg.

The weakening in the US dollar accelerated, with a broad-based increase in USD short positions. The DXY index dropped 0.6% to 95.2, only 0.3% away from its trough level seen in March. Dollars are being sold by both asset managers and leveraged funds in the futures market, overtaking the pound as the largest G10 short trade via futures. In the options market, the DXY-weighted call/put ratio has fallen to the year-to-date low of 0.71.



Source: Bloomberg, Macrobond, Morgan Stanley Research

Source: Bloomberg, Morgan Stanley Research

Europe

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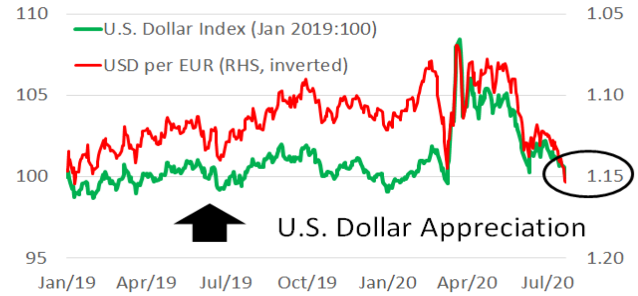
The euro (+0.5% to $1.158) passed the widely watched $1.15 mark following the agreement on the EU Recovery Fund. In recent years, the euro has struggled to appreciate beyond the psychological 1.15 level against the U.S. dollar, so a key theme in markets is if the euro will appreciate further and at what point the ECB may have to respond.

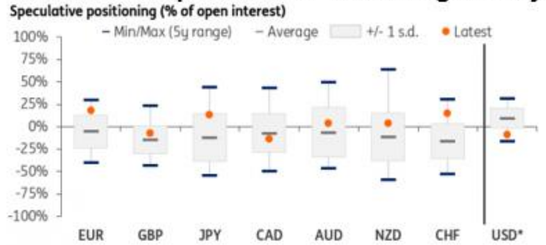
Broad U.S. Dollar Index and U.S. dollar per euro



Note: The Bloomberg Dollar Spot Index tracks the performance of a basket of 10 leading currencies versus the U.S. dollar (in terms of share of international trade and FX liquidity).
Source: Bloomberg and IMF

CFTC data for the week ending 14 July, show that **speculators are net long 5 of 7 major currencies against the U.S. dollar (with the only exception of GBP and CAD)**, for the first time since March 2018 and with the euro as a key contributor.

FX Markets: Speculative Positioning on Major Currencies

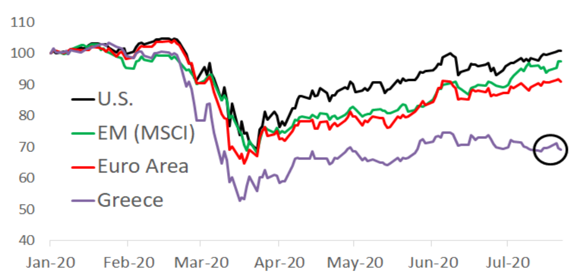


Currency (USD base)	Week Change	Latest net positioning	YTD Change
EUR	+0.9%	+18%	+32%
GBP	+1.5%	-8%	-14%
JPY	+1.4%	+14%	+28%
CAD	+0.5%	-13%	-20%
AUD	+4.6%	+4%	+27%
NZD	+4.4%	+3%	+14%
CHF	+6.2%	+15%	+25%

*Note: Aggregate USD positioning versus G10 FX. As of 14 Jul 2020 (data reported with a lag).
Source: CFTC, ING

European **equities (-1%) traded lower as global risk sentiment turned more cautious.**

Global Equity Markets in 2020 (1 Jan 2020: 100)



Source: Bloomberg and IMF

Greek equities (-1%) sold off and Greek 10-yr spreads rose 7 bps (to 166 bps) amid renewed concerns of tensions with Turkey. Yesterday, Greece's foreign minister said that the "illegal" behavior of Turkey in the Eastern Mediterranean was threatening the cohesion of NATO and Turkey's relations with the EU.

10-yr Italian spreads (-1 bps to 154 bps) are little changed as 10-yr bund yields fell 2 bps to -0.48%.

Analysts point out that the European Parliament (EP) will have to vote in favor of the EU 7-yr budget and the Recovery Fund by absolute majority. EP president Sassoli has repeatedly warned that the EP's vote should not be taken for granted. Even though elements of the agreement (such as additional rebates and cuts in programs) are expected to face opposition in the EP, analysts generally expect the EP to pass the agreement. Each national parliament will also need to ratify the line of credit within their budgets.

United Kingdom

The British pound (-0.3% to $1.27) **fell on media reports that the EU and U.K. may fail to sign a post-Brexit trade deal and that the central planning assumption of the U.K. government is that a deal will not be reached in some areas**. Intensified weekly talks will end on Thursday, with further negotiations now scheduled for 17 August. Reports suggest the EU is waiting for the UK to reciprocate on previous EU compromises.

The U.K. government has also confirmed that it will not be able to reach a trade deal with the U.S. ahead of November's U.S. Presidential election. A third round of talks are set to begin next week. Key issues reportedly remain protections on public services procurement (particularly pharmaceuticals) and access for American agri-food products.

New survey data from the British Chambers of Commerce (750 firms, 6-10 July) points to a challenging outlook for UK firms. Data suggested firms are, on average, still operating at only half their pre-Covid capacity. Customer demand and possible future lockdowns were the two main factors highlighted as precluding a return to full operation.

Other Mature Markets

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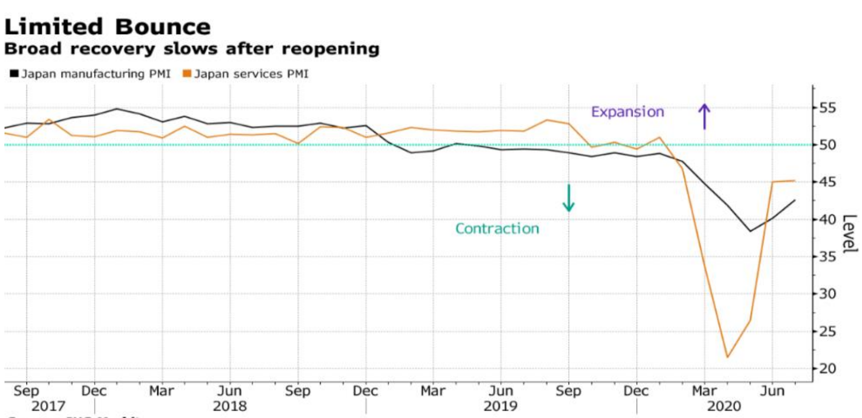
Japan

Japan PMI composite improved in June though still pointing to declining activity. The PMI composite increased to 43.9 in June from 40.8 in May, driven by the increase in manufacturing PMI. The PMI reading signaled that a broad-based recovery is struggling to gain traction. Manufacturing PMI increased to 42.6 (from 40.1), while Services PMI stalled at 45.2 (little changed from 45.0). The recent rise in COVID-19 cases in Tokyo raises concerns that increased restrictions could be coming. Meanwhile, the demand for exports remains weak. Moreover, **stimulus money seemed to pile up in bank savings accounts**. Consumers opted for precautionary savings. Market analysts noted that banks will likely use extra cash to buy long-term government bonds. Equities retreated (NIKKEI: -0.5%); Japanese yen depreciated (-0.1%).



Source: Bloomberg.

Source: Bloomberg.

Emerging Markets

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Asian stock markets mostly retreated, led by Hong Kong (-2.3%) and (Thailand (-1.5%). Chinese equities outperformed (+0.5%); share prices initially gained following President Xi's remarks (see below) but retreated later on the escalation of China-US tensions, which affected other Asian equity markets. **Currencies mostly appreciated**, led by the Indonesian rupiah (+0.6%) and Korean won (+0.2%). Asian currencies advanced as the US dollar weakened. **Thailand extended the nationwide state of emergency by another month** even though the COVID-19 situation has been largely under control. Equities declined (-1.5%); the Thai baht appreciated (+0.1%). **Hong Kong CPI inflation declined to 0.7% y/y in June**, from 1.5% y/y in May. The inflation number came out lower expected. Equities declined (-2.3%). **EMEA equities are trading mixed** with stocks up in Turkey (+0.6%) and Russia (+0.2%), but lower in South Africa (-1.3%) and UAE (-1.1%). EMEA currencies are mostly unchanged. **Latin American equities were mixed yesterday, currencies appreciated, and spreads of dollar debt narrowed.** Equities gained in Argentina (+2.4%), Mexico (+1.5%) and Colombia (+0.9%) and printed lower in Chile (-1%). Currencies appreciated, in particular in Brazil (+3%) and Chile (+1.7%). Spreads of sovereign debt predominantly narrowed.

Key Emerging Market Financial Indicators

Last updated:	Level		Change				
7/22/20 8:24 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		43.72	-0.4	2	8	3	-3
MSCI Frontier Equities		23.82	-0.4	-1	1	-21	-22
EMBIG Sovereign Spread (in bps)		446	-1	-17	-22	112	153
EM FX vs. USD		55.93	0.1	1	2	-11	-9
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		7.00	-0.2	0	1	-2	0
Indonesian Rupiah		14650	0.6	0	-3	-5	-5
Indian Rupee		74.76	0.0	1	2	-8	-5
Argentine Peso		71.71	-0.1	-1	-2	-41	-17
Brazil Real		5.15	0.4	4	2	-27	-22
Mexican Peso		22.32	0.1	0	1	-15	-15
Russian Ruble		70.80	-0.2	0	-2	-11	-12
South African Rand		16.37	0.3	1	6	-15	-14
Turkish Lira		6.85	-0.4	0	0	-17	-13
EM FX volatility		9.33	0.0	-0.4	-1.2	2.4	2.7

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

China

President Xi Jinping called for promoting innovation and speeding up the development of key technologies. In a symposium attended by corporate executives, President Xi urged firms to invest more in human capital, modernize supply chains and undertake R&D of new technologies. He also added that China is committed to deepening reforms and opening up. The government will enhance cooperation in the sci-tech field, advance the development of an open world economy, and promote the building of a community with a shared future for mankind as the world grapples with rising protectionism. Market participants viewed his remarks as an attempt to push back against countries like the United States that look to reduce dependence on China. Chinese stock markets responded positively (+0.9%).

Chinese Equities: CSI 300

Source: Bloomberg.

China vowed retaliation after the United States forced the closure of the Chinese consulate in Houston. The US government gave China three days to close the consulate on the grounds of protecting American intellectual property and Americans' private information. The first signs of trouble came when Houston police and firefighters descended on the consulate following witness reports that papers were being burned outside in open containers. The Chinese Foreign Minister responded that China planned to react with firm countermeasures if the United States did not revoke the decision. Asian stock markets retreated across the board following the escalation.

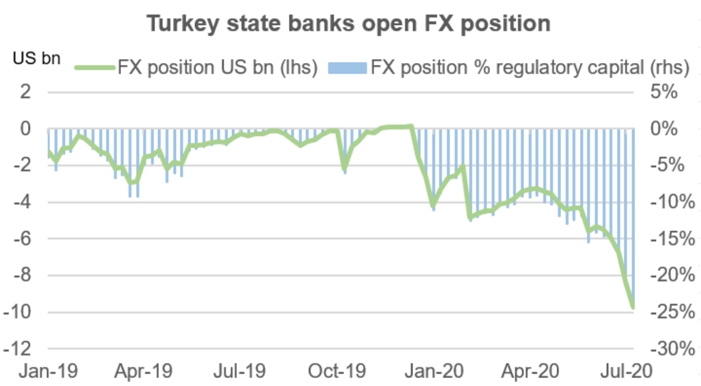
Hungary

The National Bank of Hungary (NBH) cut its policy rate by 15bps to 0.6%, as expected. At the same time, the central bank announced it will reallocate its collateralized lending facilities, but also resume government bond purchases in order to manage the recent curve steepening. The QE program has been on hold since May and year-to-date amounts only to 0.3% of GDP. Market contacts noted increased caution in the NBH stance and associate this with a concern around the risk of further pressure on the forint. Contacts expect that further easing will be carried out through liquidity injections rather than additional rate cuts. The market reacted with buying of long-end bonds, triggering 40bps of curve flattening.

Source: Bloomberg, IMF

Turkey

State banks boosted their short open FX position in July, thereby exceeding the regulatory threshold. According to the Turkey Banking Regulation and Supervision Agency (BDDK), state banks were running a net of US 9.7bn worth of long lira position or equivalent to 25% of their regulatory capital. Current bank regulations allow the position to exceed the 20% threshold for only 6 times a year. Market contacts suggest that the increase in the open FX position came as a response to renewed pressure on the lira after the recent inflation data on the 3rd of July, when both headline and core surprised to the upside. Contacts suggest that the market experienced some significant outflows while Turkey state banks were seen supporting the lira.



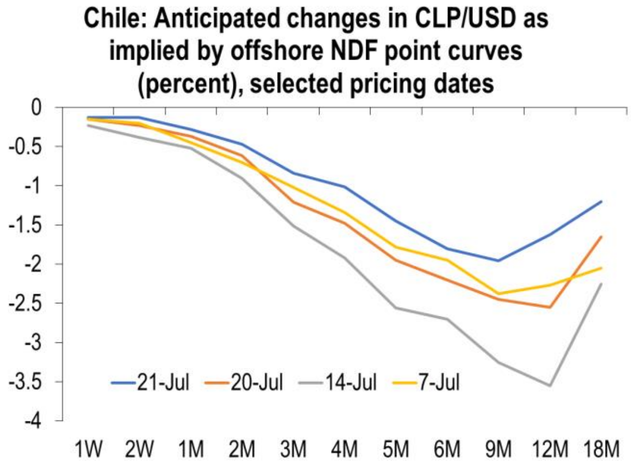
Source: BDDK, IMF

Korea

The Korean government plans to levy stock capital gains tax on retail investors from 2023. The proposal envisages a 20% capital gain tax on retail investors whose annual return from investment in Korea equity funds and shares is more than 50 million won ($42,000). The tax rate would be at 25% if annual return is more than 300 million won ($251,000). At the same time, the stock transactions tax will be lowered by 0.02 ppts in 2021 and another 0.08 ppts in 2023. Share prices were little changed.

Chile

Anticipation for withdrawals from private pension funds may have already started to affect forex and equity markets. According to Bloomberg reports, Chile's financial markets regulator estimates that a withdrawal of up to a maximum 10% from the country's private pension funds within a 30 day period, as prescribed in a draft bill currently awaiting a vote in the country's senate, is likely to exhaust market liquidity. If the maximally possible amount were withdrawn, pension funds would need to shed $19.5 bn of assets, most likely selling liquid positions such as foreign assets, term deposits and sovereign instruments first. Chile's financial market regulator called upon the senate to lengthen the withdrawal period from 30 days to 90 days in order to soften the potential price impact in markets. While the proponents of the draft bill hope for some relief for embattled consumers, market participants point out that the withdrawal could reduce private investment and hurt the economy in the longer run by corroding financial markets and adding to future fiscal pressures. The Chilean peso appreciated 1.7% on the day, while the national stock index printed 1% lower.



Source: Bloomberg.

Mexico

Weaker tails in the Mexican banking system show vulnerabilities due to non-performing loans. Some smaller banks, which provide 21.4% of the country's total bank loan volume, display rising risks that their capital buffers may fall below the regulatory minimum requirement of 10.5% of total risk weighted assets, according to Moody's. As Mexico's bank regulator allowed delays in the provisioning for losses due to relief in debt service granted during the Covid-19 crisis, the full effects of respective changes in loan terms on bank capitalization are expected to kick in only in early 2021. A recent Banxico stress test highlighted the possibility for a strong erosion of bank capital causing capitalization levels to fall below regulatory minimums for some institutions. Meanwhile Mexico's systemically important banks appear less vulnerable — on average less than a fifth of their loan portfolios are affected by loan relief programs. According to J.P. Morgan, ratios of capital to risk-adjusted assets remain more than 15% above the regulatory required minimum. With J.P. Morgan economists projecting a 10.5% contraction in Mexico's GDP in 2020, NPL pressures on more vulnerable smaller banks are poised to increase further, while the upward trend in interest rates on bank loans is likely to weigh on future loan business.

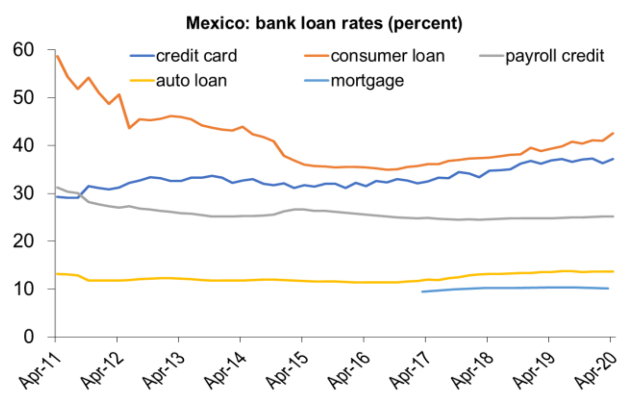
Sinking capital buffers at some smaller Mexican banks

Mexican banking institutions with the lowest ICAP ratios as of May 2020*

Company name	January 2020 (%)	May 2020 (%)	Change (bps)
Intercam Banco SA	14.0	13.1	-90
Banca Mifel SA	13.8	12.9	-90
Bankaool SA	13.7	12.8	-90
Banco Autofin México SA	12.6	11.8	-80
Banca Afirme SA	13.2	12.4	-80
ABC Capital SA	11.3	10.8	-50
Banco Actinver SA	13.4	13.0	-40
Banco Base SA	14.2	13.8	-40
Banco Inmobiliario Mexicano SA	12.9	12.6	-30
Banco Ve por Más SA	13.0	12.8	-20

Data compiled July 17, 2020.
* Excludes foreign-owned entities.
ICAP, or the Capitalization Index, is defined as the ratio of net capital to weighted assets subject to total risk.
Source: CNBV

Source: S&P Global.



Source: Banco de Mexico.

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Global Financial Indicators

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Equities					%		%
United States		3257	0.0	2	4	9	1
Europe		3381	-0.7	0	4	-3	-10
Japan		22752	-0.6	-1	1	6	-4
China		3333	0.4	-1	12	14	9
Asia Ex Japan		75	0.8	1	8	8	3
Emerging Markets		44	-0.4	2	8	3	-3
Interest Rates					basis points		
US 10y Yield		0.59	0.3	-4	-12	-145	-133
Germany 10y Yield		-0.48	-2.1	-4	-4	-14	-30
Japan 10y Yield		0.02	-0.6	-2	1	16	3
UK 10y Yield		0.14	0.0	-3	-6	-57	-69
Credit Spreads					basis points		
US Investment Grade		132	0.4	-7	-16	13	35
US High Yield		562	-0.8	-33	-35	120	169
Europe IG		58	0.5	-3	-9	10	14
Europe HY		346	3.5	-23	-47	97	138
EMBIG Sovereign Spread		446	-1.0	-17	-22	112	153
Exchange Rates					%		
USD/Majors		94.95	-0.2	-1	-2	-2	-1
EUR/USD		1.16	0.5	2	3	3	3
USD/JPY		107.0	-0.2	0	0	1	1
EM/USD		55.9	0.1	1	2	-11	-9
Commodities					%		
Brent Crude Oil ($/barrel)		44	-1.3	0	2	-31	-34
Industrials Metals (index)		111	-1.1	0	7	-4	-3
Agriculture (index)		36	0.3	0	2	-11	-14
Implied Volatility					%		
VIX Index (%, change in pp)		25.2	0.3	-2.6	-6.6	11.7	11.4
Global FX Volatility		7.2	0.0	-0.3	-1.2	0.9	1.3
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		161	1.9	-12	-11	-85	-4
Italy		153	-2.5	-12	-20	-47	-7
Portugal		83	1.1	-4	-9	2	20
Spain		82	0.4	-5	-8	8	17

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: 7/22/2020 8:24 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	1 Day	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.					
China		7.00	-0.2	-0.1	1	-2	0		3.1	-1.8	-11	12	-14	-8
Indonesia		14650	0.6	-0.4	-3	-5	-5		7.1	-3.9	-9	-24	-14	-7
India		75	0.0	0.5	2	-8	-5		5.9	0.9	0	-15	-68	-95
Philippines		49	0.0	0.2	2	3	3		3.8	1.5	-7	-30	-87	-47
Thailand		32	0.0	-0.1	-2	-2	-6		1.4	-1.0	-6	-6	-65	-20
Malaysia		4.25	0.2	0.3	1	-3	-4		2.5	-1.4	-6	-34	-110	-85
Argentina		72	-0.1	-0.6	-2	-41	-17		45.8	-62.1	-11	-73	1615	-1679
Brazil		5.15	0.4	4.3	2	-27	-22		5.2	7.2	-3	-6	-142	-100
Chile		774	1.8	1.8	6	-11	-3		2.8	-4.7	14	43	-38	-53
Colombia		3624	0.8	0.0	3	-12	-9		5.2	-3.5	-4	-31	-44	-77
Mexico		22.32	0.1	0.0	1	-15	-15		6.0	-4.4	16	-13	-161	-99
Peru		3.5	0.3	0.1	0	-6	-5		4.1	1.1	-17	-24	-28	-42
Uruguay		43	1.0	1.6	-1	-19	-13		9.5	0.0	-27	-68	-71	-137
Hungary		301	0.8	2.9	2	-4	-2		1.5	-6.5	-13	-17	6	32
Poland		3.82	0.7	2.6	3	-1	-1		0.8	-0.8	-4	-7	-111	-108
Romania		4.2	0.5	1.6	3	1	2		3.8	-4.0	-1	9	-13	-19
Russia		70.8	-0.2	0.3	-2	-11	-12		5.4	-3.2	-5	16	-180	-73
South Africa		16.4	0.3	1.4	6	-15	-14		10.3	-8.3	-3	14	116	73
Turkey		6.85	-0.4	0.1	0	-17	-13		11.2	-11.8	-26	76	-469	-48
US (DXY; 5y UST)		95	-0.2	-1.2	-2	-2	-1		0.26	0.0	-2	-8	-154	-143

	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	1 Day	7 Days	30 Days	12 M	YTD
								basis points						
China		3333	0.4	-1	12	14	9		216	-1	-6	-11	39	40
Indonesia		5110	-0.1	1	4	-21	-19		247	0	-15	-8	74	91
India		37872	-0.2	5	8	0	-8		249	-2	-1	9	114	124
Philippines		6064	-1.2	1	-4	-26	-22		143	-4	-18	-16	73	77
Malaysia		1587	-0.6	0	5	-4	0		169	-4	-10	-17	52	57
Argentina		46781	2.4	6	16	21	12		2340	-4	-1	-155	1556	571
Brazil		104310	-0.1	4	9	0	-10		340	1	-26	-30	128	125
Chile		3887	-1.0	-7	-3	-23	-17		195	-1	-10	-13	65	62
Colombia		1167	0.9	2	0	-27	-30		253	1	-29	-42	81	90
Mexico		36882	1.5	2	-3	-11	-15		493	2	-24	-22	161	201
Peru		17135	1.9	3	1	-18	-17		162	0	-13	-20	43	55
Hungary		35447	-0.1	0	-5	-14	-23		162	-3	-1	-3	69	76
Poland		52402	-0.3	3	4	-14	-9		37	3	-5	-10	-2	19
Romania		8558	0.0	1	-1	-5	-14		281	-3	-14	-5	93	108
Russia		2839	0.5	3	3	6	-7		211	4	-1	10	19	80
South Africa		55697	-1.3	0	3	-4	-2		513	-3	-12	15	243	193
Turkey		118187	0.1	0	3	17	3		593	-4	-19	20	122	192
Ukraine		500	0.0	0	0	-8	-2		634	-3	-43	5	173	214
EM total		44	-0.4	2	8	3	-3		446	-1	-17	-22	112	153

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

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