- **Stalling re-opening in the US raises fears of permanent economic damage** (link)
- **Spain faces new intra-European quarantines as virus cases surpass 1000/day** (link)
- **EM bond fund inflows held up last week while equity fund outflows increased** (link)
- **Chinese industrial profits recover further in June** (link)
- **Reserve Bank of India expects a significant deterioration in asset quality** (link)
- **Vietnam equities plunge as domestic infections emerge after three months** (link)

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

Dollar tumbles on US virus angst

Investors are focused on the weak dollar as markets stabilize after a sell-off at the end of last week. Equities slumped last Friday for a second day in a row, spurred on by US-China tensions, continuing negative virus news in the US, and concerns about exuberance in tech share prices. That sell-off has lost momentum so far this morning, with equities close to flat in most markets, despite several European countries initiating new quarantines on travelers from Spain after rising COVID-19 case numbers there. The big story for markets however is the dollar: the two-day equity slump last week was barely noticed by FX investors, who continue to pile into the short-dollar trade, pushing the greenback to its weakest level since 2018. The trade is increasingly seen as a measure of the US's comparatively weak control over the virus, which will widen the relative growth gap (notably with the euro bloc) and keep the Fed firmly dovish, narrowing the interest rate differential with the rest of the world.

Key Global Financial Indicators

Last updated: 7/27/20 8:12 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		3216	-0.6	0	7	6	0
Eurostoxx 50		3311	0.0	-2	3	-6	-12
Nikkei 225		22716	-0.2	0	1	5	-4
MSCI EM		43	0.7	1	8	2	-4
Yields and Spreads			bps				
US 10y Yield		0.58	1.1	-3	-6	-149	-134
Germany 10y Yield		-0.48	-2.7	-2	1	-10	-29
EMBIG Sovereign Spread		446	-1	-8	-30	119	153
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		56.0	0.5	1	3	-11	-9
Dollar index, (+) = $ appreciation		93.7	-0.7	-2	-4	-4	-3
Brent Crude Oil ($/barrel)		43.7	0.8	1	6	-31	-34
VIX Index (%, change in pp)		26.1	0.2	2	-9	14	12

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

The week ahead will be a busy one for the US. Thursday will see initial jobless claims released alongside Q2 GDP figures. The July FOMC meeting takes place on Wednesday, with Chairman Powell to give a press

conference thereafter. Earnings season continues, with Apple, Alphabet, and Amazon all reporting this week. In Europe, inflation and retail sales data will be released throughout the week, while French and German Q2 GDP figures will be released on Thursday and Friday. In emerging markets, investors will await inflation data in South Africa and survey PMIs in China. The central banks of Ghana and Kenya are expected to leave interest rates unchanged at 14.5% (today) and 7% (Wednesday) respectively in an otherwise quiet week for regional central bank meetings. On Wednesday, the quarterly inflation report of the Turkish central bank will be studied closely for signals of further policy actions in 2020. South Africa will report inflation data for June on Wednesday and Poland will publish CPI data on Friday.

United States   back to top

Risk assets sold off for a second day on Friday due to escalating China-US tensions and ongoing virus anxiety. The S&P 500 closed 0.6% lower to turn negative for the week, as tech posted losses for the second consecutive week despite a 15% gain year to date. The benchmark index is still up nearly 5% over the last month. Treasury yields were little changed, with the 10-year closing at 0.58%. The dollar index weakened again by 0.3% to slip below its 2020 lows to levels not seen since September 2018, with pronounced euro strength in recent days.
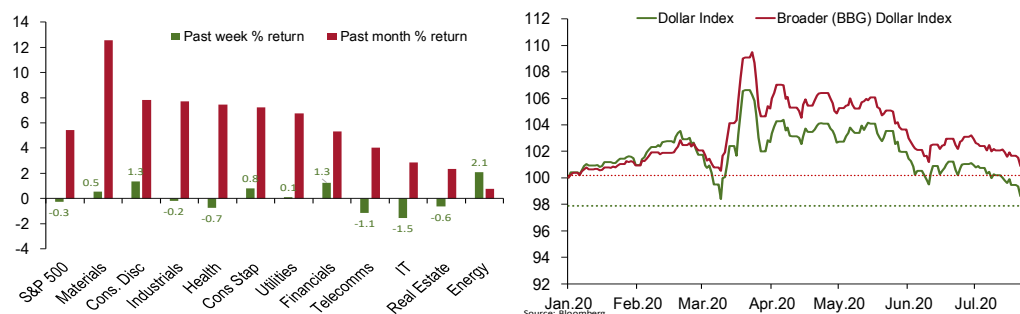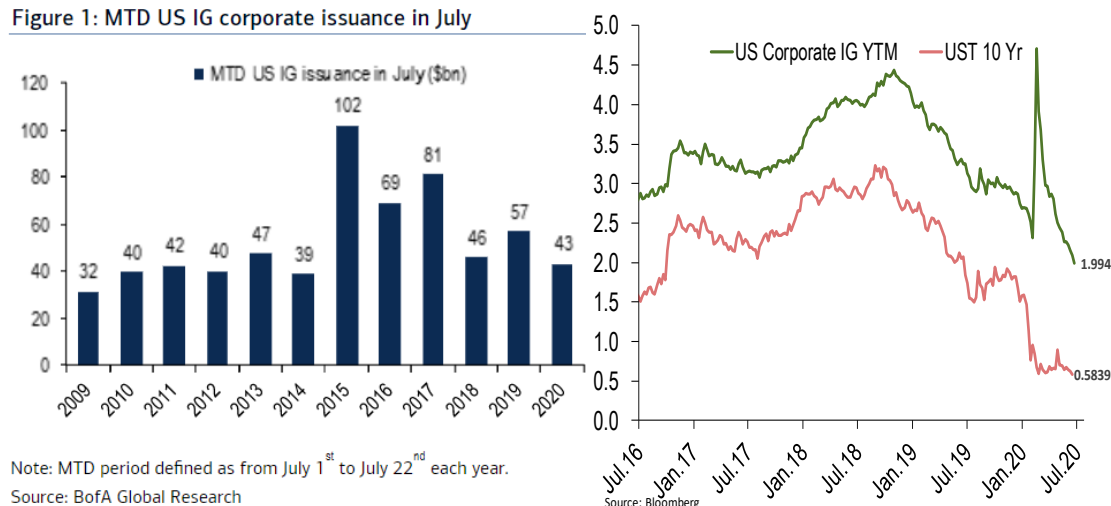

Stalled reopening has raised fears of more permanent economic damage as an increasing share of firms close for good. As of mid-July, states comprising nearly 75% of the population are increasing Covid-19 restrictions or halting further easing, according to Goldman Sachs. The share of business closures that are permanent since March 10 has risen to over 50% as well, according to data from Yelp, alongside other metrics showing that consumer spending has flatlined or deteriorated again in the last week. Improvement in initial jobless claims also appears to have stagnated, still hovering around 1.3-1.4 million per week, raising the stakes for policymakers in the current round of stimulus negotiations. Secretary Mnuchin said the GOP would announce its version of the next stimulus plan on Monday, before further negotiations with House Democrats.
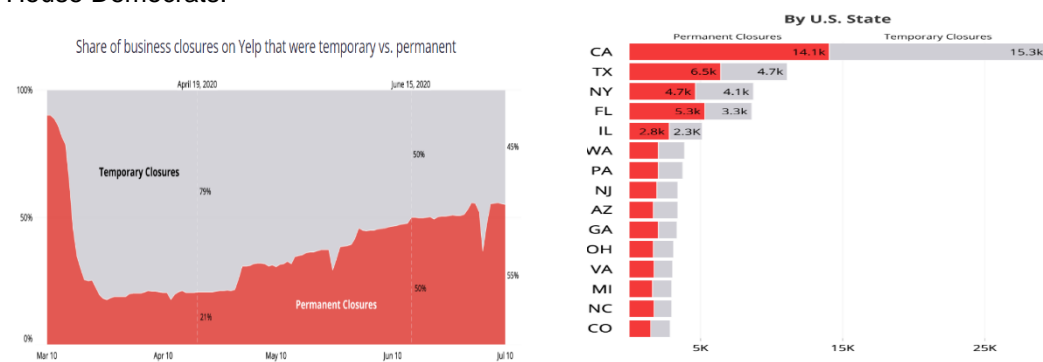

Source: Goldman Sachs

Corporate investment grade issuance on track for slowest July since 2014. US corporate IG issuance totaled just $43 bn through July 22nd, the lowest since 2014, after a record pace in April and May. Year to date issuance is about $1.3 tn, while the yield on the Bloomberg Barclays benchmark corporate (IG) bond index fell below 2% for the first time this week.

Figure 1: MTD US IG corporate issuance in July

Note: MTD period defined as from July 1st to July 22nd each year.
Source: BofA Global Research

Source: Bloomberg

Corporate earnings for Q2 released so far have beat very low expectations. About a quarter of S&P 500 firms have reported as of last week, and thus far most sectors have seen a majority of companies beat expectations. However, some analysts are questioning where the 2021 outlook is too optimistic even if 2020 consensus was too pessimistic, particularly as US-China tensions perk up again, with trade seen as a resurgent risk factor alongside Covid-19. Earnings estimates for 2021 have largely flatlined since early May.

EPS beats and misses for S&P 500 sectors in Q2'20 (%)*

S&P500 EPS estimates

Trailing 12m EPS for 2019: $152

Source: Bloomberg
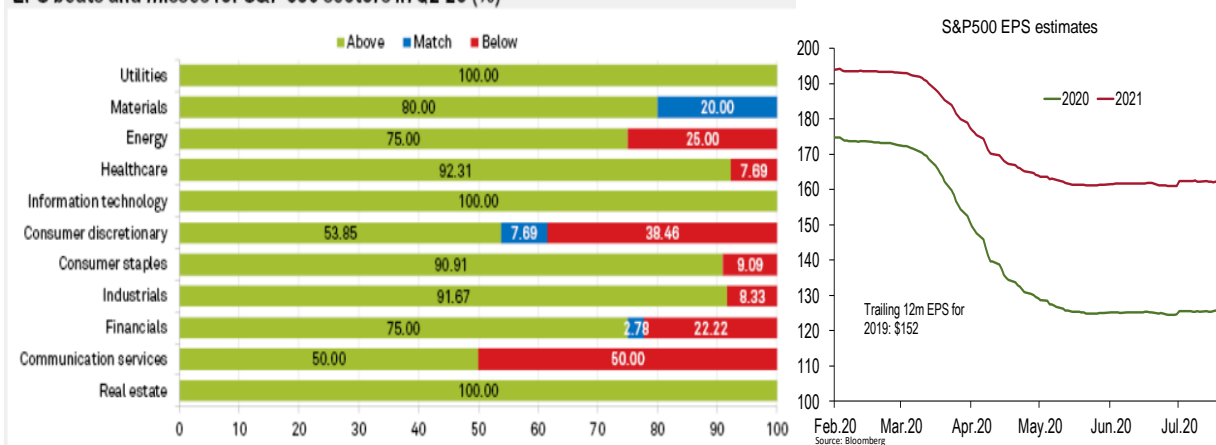
Europe

European equities are trading mostly unchanged except for Spain (-1.4%), which has suffered from new virus-related tourism headwinds over the weekend. Similarly, travel and airline stocks are underperforming with regional low-coast carrier EasyJet shares down as much as 12% this morning.

German yields are 3 bps lower with Italian and Spanish spreads are 3-4 bps wider on the back of the tourism related concerns. The sterling and the euro appreciated 0.6% against the dollar.

In the coming week we will get preliminary Q2 readings for the Euro area as well as country level data for Germany, France, Italy and Spain (Germany on Thursday, all others Friday). The latest survey results show expectation for 14.5% yoy drop for the Eurozone aggregate with country level decline between 11.5% in Germany and 20% in France.

On Friday we will also get the preliminary July CPI figures. The consensus expects the Euro area aggregate reading to decline marginally to 0.2% year on year from 0.3% in June. This is likely to be primarily driven by a big drop in the German CPI through the July VAT cut as the headlice price growth is seen to slow to 0.1% year on year as compared to 0.9% in June (released on Thursday).

Covid-19 cases per 100,000
14-day cumulative number in selected countries
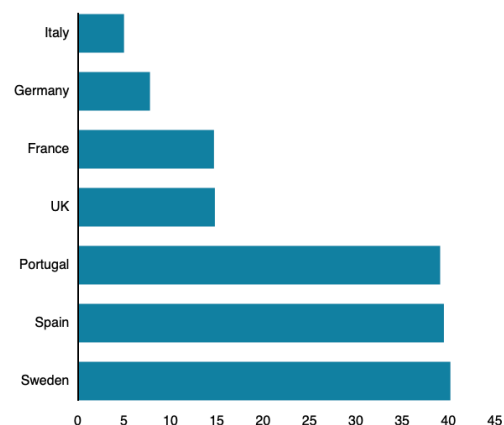
*As of 25 July
Source: European Centre for Disease Prevention and Control   BBC

Investor focus shifted back to the virus as the recent regional increase in reported virus cases in Spain triggered tourist quarantine requirements in the UK, Norway and France. Spain has recorded a rise in new cases to above a thousand per day, up from the low of 300 per day in June but significantly below the 10000 per day mark at the peak in June. The overall situation in the country remains under control with new case spikes being very localized and managed by area specific quarantine measures. **At this stage the market implications are micro rather than macroeconomic with investors reaction contained to airline and tourism operator shares as the UK accounts for about 20% of Spain's tourist arrivals**. While tourism has seen some regional recovery in Europe, high frequency data suggest both a shift towards local tourism and as well as preference for road-based travel.

Exhibit 9: Google Searches for Holiday Accommodation Have Surged, But Flight Searches Remain Well Below Normal Levels

Source: Google Trends, GSI
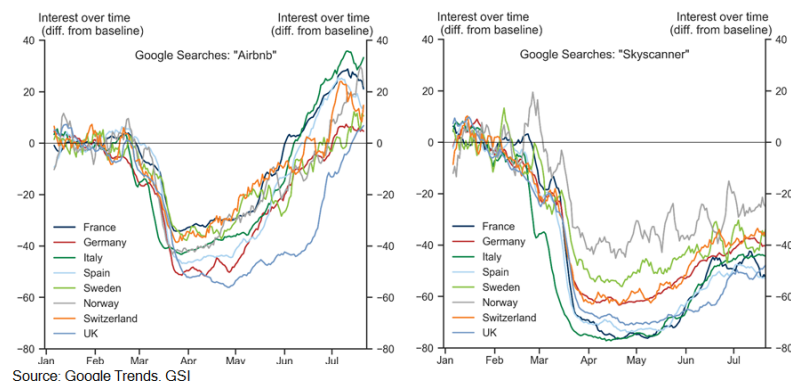
German IFO survey confirms growing confidence across firms. The business climate indicator reading beats consensus as 90.5 while the business expectations rise to 97, highest reading since 2018. Similarly to last week PMI surveys, business confirm demand recovery momentum but remain conservative in terms of headcount management.


Source: Ifo
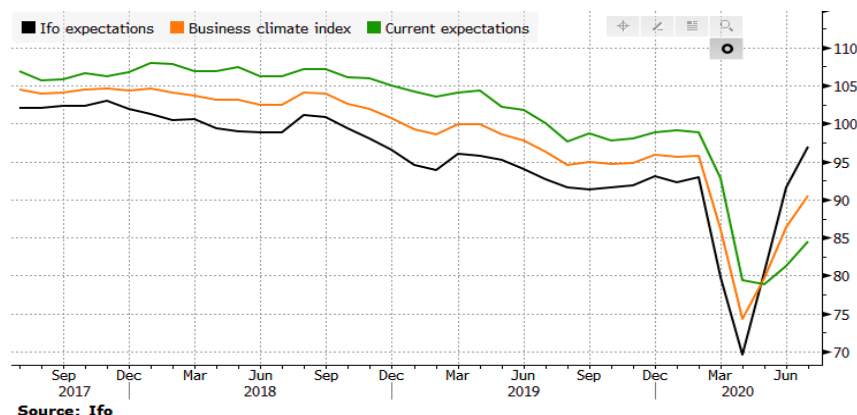
Other Mature Markets   back to top
Japan
Equities rose 0.2% reversing losses earlier in the day of as much as -1.3%. Final capex spending for Q1 came in at 0.1% y/y, weakening from 4.3% y/y, according to the Ministry of Finance. Separately, Japanese Economy Minister Yasutoshi Nishimura said that the government plans to ask businesses to have 70% of their workforce adopt telecommuting as the COVID-19 cases continue to rise. **The yen strengthened 0.6% and 10-year JGB yield rose 0.5bps.**
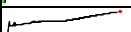
BOJ seen supporting market when Topix drops

Source: Bloomberg
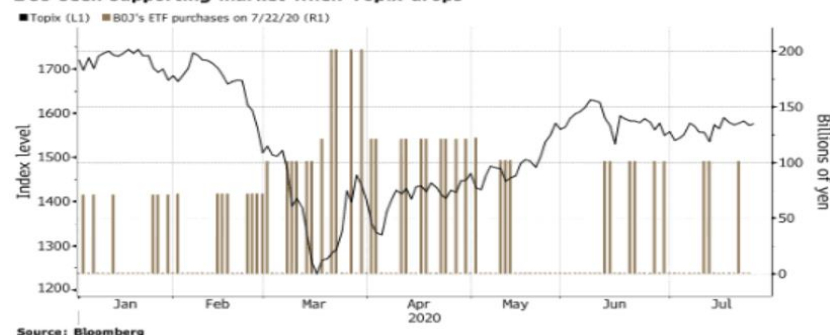
Emerging Markets

Latin American assets were mixed on Friday with currencies mostly depreciating against the dollar as tensions between US and China escalated. Chile's peso led losses (-1.1%) after the president approved the pension fund reform bill which would prompt the funds to sell foreign assets. The Mexican peso (+1%) appreciated against the weakening dollar even as May output data confirmed a worse-than-expected recession. Stocks in Chile (+0.8%) and Argentina (+0.4%) outperformed while Colombia (-0.7%) and Mexico (-0.2%) experienced losses. **In Asia, equities rose 0.7% on net, with wide dispersion across markets.** Taiwan Province of China rallied 2.3%, driven by a surge in heavyweight Taiwan Semiconductor Manufacturing. Vietnamese stocks slumped -5.3% on COVID-19 fears after domestic COVID-19 infections were discovered in Danang, the first local transmission in more than three months. Regional currencies appreciated across the board. This morning, **EMEA equities are generally trading with a positive tone.** Stocks are higher in Russia (+0.9%), Poland (+0.6%) and South Africa (+0.4%). The **South African rand gained 1.3%** against the U.S. dollar and the Russian ruble 0.3% whereas the Hungarian forint and the Polish Zloty were little changed against the euro. The Turkish lira is little changed against the U.S. dollar.

Key Emerging Market Financial Indicators

Last updated:	Level		Change				YTD
7/27/20 8:05 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		43.14	0.7	1	8	2	-4
MSCI Frontier Equities		23.58	0.4	-2	-2	-22	-22
EMBIG Sovereign Spread (in bps)		446	-1	-8	-30	119	153
EM FX vs. USD		55.93	0.4	1	3	-11	-9
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		7.00	0.2	0	1	-2	-1
Indonesian Rupiah		14535	0.5	2	-2	-4	-5
Indian Rupee		74.84	0.0	0	1	-8	-5
Argentine Peso		71.90	-0.1	-1	-3	-40	-17
Brazil Real		5.20	0.6	3	4	-27	-23
Mexican Peso		22.17	0.5	1	4	-14	-15
Russian Ruble		71.48	0.3	0	-2	-11	-13
South African Rand		16.45	1.3	1	5	-14	-15
Turkish Lira		6.85	-0.1	0	0	-18	-13
EM FX volatility		9.90	0.8	0.5	-0.9	3.0	3.3

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

EM fund flows

EM bond fund inflows (+$1.2 bn) held up in the past week, though at a declining pace, while outflows from equity funds (-$3 bn) picked up, according to the EPFR data. YTD flows to EM bonds and equities are now at -$34 bn and -$48 bn respectively. Bond funds saw inflows into hard currency. After inflows in the previous week, local bond funds essentially saw flat flows, according to JP Morgan analysts.
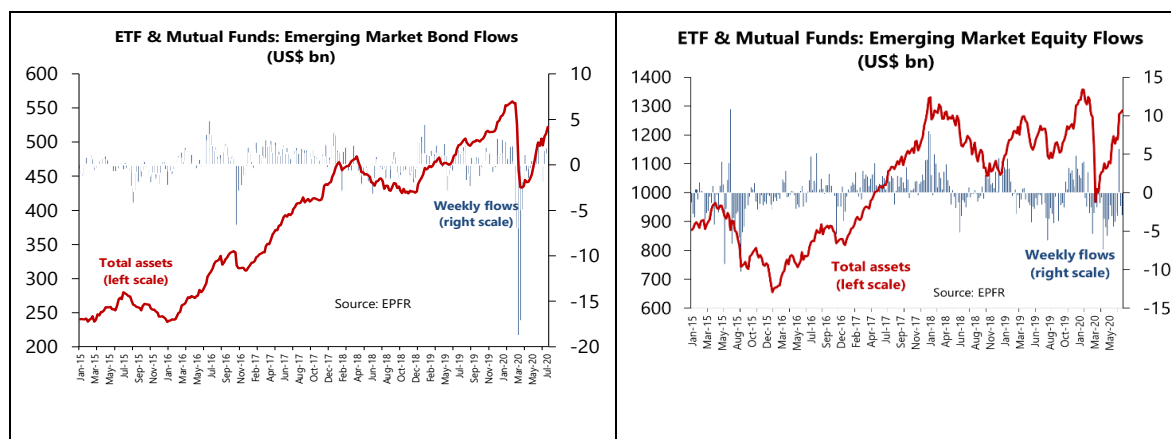
Real yield compression offers less scope for future interest-rate cuts, according to analysts, limiting scope for further easing. Two-year inflation-adjusted real yields are testing all-time lows after rising to near-record levels in early 2019. according to Bloomberg analysis. Of the 19 benchmark-eligible EM local government bond issuers, only Turkey, Mexico and the Czech Republic have nominal policy rates above their historical lows.
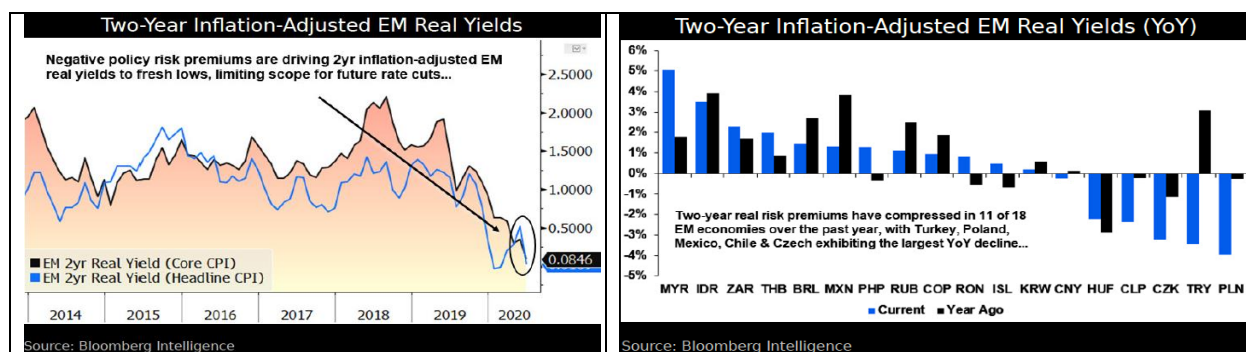
China

Industrial profits for the month of June rose further to 11.5% y/y, from 6% in May. This brought the year-to-date y/y figure to -12.8% (2019: -3.3%). The increase in June was driven by higher industrial production growth (4.8% y/y in June from 4.4% in May) and an improvement in producer price inflation (-3.0% from -3.7%). **Separately, Chinese authorities have taken over the US consulate in Chengdu.** The closure was announced on Friday. The Chinese government gave the Americans the same 72-hour timeframe to close their Chengdu mission as China had been given in Houston after the announcement on Friday. **Equities rose (0.3%) and the RMB appreciated (0.3%).**

Fig. 1: Industrial profit growth: year-to-date versus year-on-year

Source: Wind and Nomura Global Economics

China reported 61 new virus cases, with local infections at 57, the most domestic infections in more than four months. 41 of these came from Urumqi in Xinjiang province. The city of Dalian also saw infections and the authorities have launched mass testing and are tracking seafood products processed by a local company where the first infection was reported. Hong Kong SAR will ban all dine-in services, require masks outdoor and public gatherings will be limited to two people. Mobility in Hong Kong as measured by Google has fallen since the 'third wave' of infections emerged on July 5 (grey line in chart below).

Asia Google COVID-19 Mobility Activity
(Percent from Baseline; 15-Mar-2020)
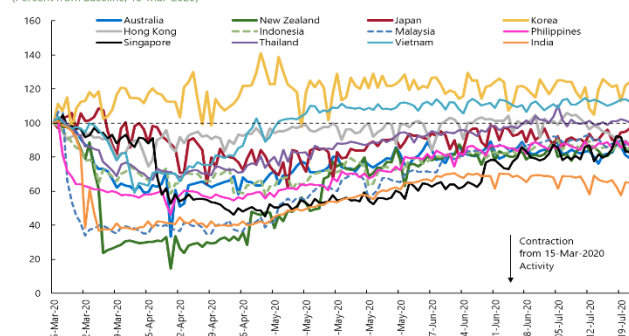
Sources: Google COVID-19 Community Mobility Reports, IMF staff calculation
Note: Average of Retail & Recreation, Grocery & Pharmacy, Parks, Transit Stations, Workplaces

India

The Reserve Bank of India (RBI)'s financial stability report showed that banks' asset quality could deteriorate significantly under COVID-19 stress. The stress tests indicated that gross non-performing assets (GNPA) would rise to 12.5% by March 2021 from 8.5% in March 2020 under the baseline scenario of -4.4% real GDP growth. Under the very severe scenario, GNPA would rise to 14.7% should GDP decline -8.9%. Public sector banks would experience the largest increase in GNPA. The system-level capital adequacy ratio (CAR) would fall to 13.3% from 14.6% under the baseline scenario and 11.8% in the very severe case. In the very severe case, five banks would fail to meet minimal capital requirements of 9% should there be no further capital infusion. For non-bank financial institutions, a one-standard deviation shock to GNPA would see their CAR drop to 17.2% from 19.6% while a three-standard deviation increase would see CAR decline close to minimum regulatory requirement of 15%. **The report also provides evidence of growing risk aversion across financial markets in India:** among banks (lending mainly to higher-rated wholesale borrowers), among depositors (move to public sector banks from private banks), a growing dependence by the non-banking finance company (NBFC) sector on banks due to waning market-based funding sources (from mutual funds) and the slow progress made in insolvency proceedings (34% of the corporate insolvency resolution processes have been delayed beyond 270 days). **Equities fell -0.3% and the Indian rupee was little changed.**

Fig. 10: RBI's macro scenario assumptions

	Baseline	Medium stress	Severe stress	Very severe stress
GDP growth (% y-o-y)	-4.4	-5.5	-7.2	-8.9
Combined gross fiscal deficit (% of GDP)	10.9	11.6	12.8	13.9
CPI inflation (% y-o-y)	4.1	5.9	8.9	11.8
Weighted average lending ratio (%)	10.1	10.6	11.3	12.1
Exports (% of GDP)	10.2	8.8	6.5	4.2
Current account balance (% of GDP)	-0.5	-1.3	-3.5	-4.9

Note: The scenarios are hypothetical adverse economic conditions and should not be interpreted as RBI's forecasts.
Source: RBI and Nomura Global Economics.

Fig. 11: Projection of banks' GNPA ratios in March 2021
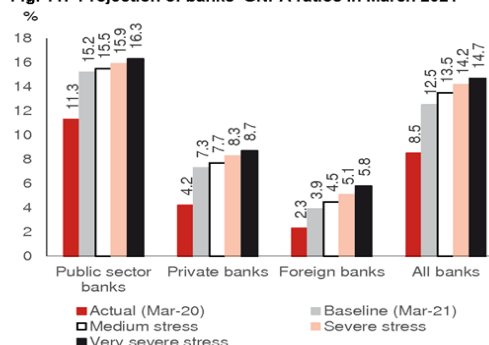
Note: All projections are for March 2021
Source: RBI and Nomura Global Economics.

Brazil

Swap rates dropped after mid-month inflation rose 0.30% m/m (vs expected 0.52%) in July, reinforcing the view that the central bank could deliver an additional interest rate cut in August. Market analysts expect the BCB to reduce the Selic rate by 25bp, to 2%. Rates on the contract maturing Jan 2021 dropped 8 bps to 1.95%. Brazil's yield curve is pricing in 17 bps of rate cuts at the next Copom meeting in August.

Turkey

According to Bloomberg, analysts expect state-owned banks to generally report a strong increase in net income (including threefold to fourfold increases) when Q2 results are published this week. Private-sector banks such as Akbank and Turkiye Garanti Bankasi are expected to post profit changes ranging from a decline of 17% yoy to an increase of 58% yoy. Analysts point out that net non-performing loan formation could be limited in Q2 given loan availability and payment delays in response to the pandemic. GS forecasts that Turkish banks could be among the few banks in emerging markets to deliver earnings forecast in 2020. GS nevertheless expects that the ratio of non-performing loans could deteriorate to 6.7% by 2020q4 and peak at 8.7% in 2021 (from 4.5% at end May).

Source: Bloomberg and IMF
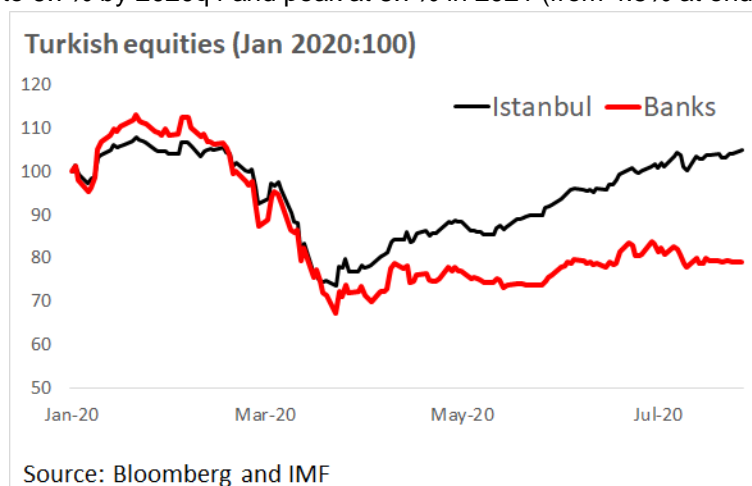
Exhibit 1: Turkish banks are among the few in EM set to deliver earnings growth this year, on GS forecasts
2020E EPS growth for GS EM banks coverage
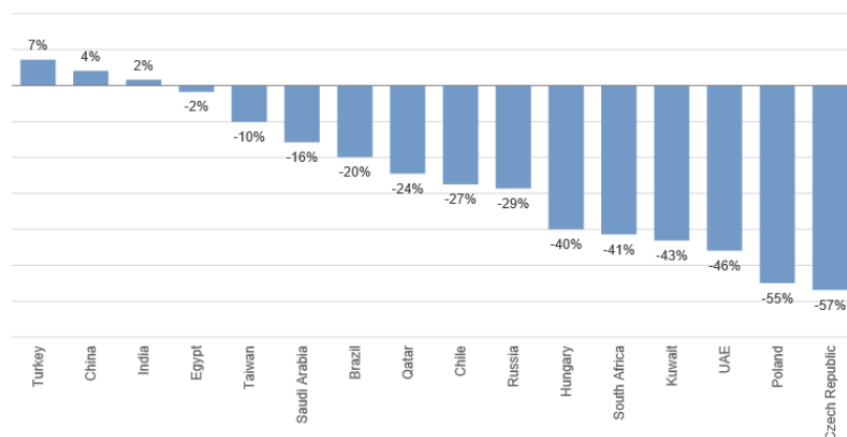
Source: Goldman Sachs Global Investment Research

Argentina

The central bank's negative FX derivative position fell to a multi-year low as it struggles to control the gradual slide in the peso. The futures positioning reflect mounting bets by investors that the local currency will depreciate against the dollar, with the central bank committed to covering the difference in pesos between the exchange rate and the contracted exchange rate. The balance stood at -$4.2 bn at the end of June, down from -$2.9 bn in May. Futures contracts are being used as a dollar substitute for some market players at a time when access to greenbacks is strictly limited by capital controls. For those who trade in legal markets, dollar futures are the only way to hedge against the risk of a devaluation.

Under Pressure
Argentine central bank with negative balance in futures

■ BCRA's position sold in forwards, futures and options
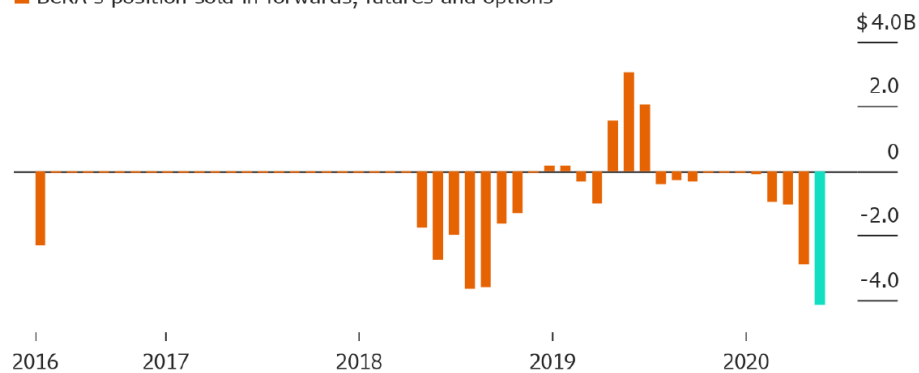
Source: Argentine central bank

Bloomberg

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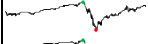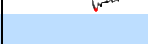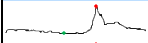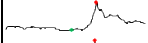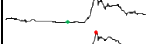
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Global Financial Indicators

Last updated: 7/27/20 8:12 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		3216	-0.6	0	7	6	0
Europe		3311	0.0	-2	3	-6	-12
Japan		22716	-0.2	0	1	5	-4
China		3205	0.3	-3	8	9	5
Asia Ex Japan		74	-0.3	0	7	7	1
Emerging Markets		43	0.7	1	8	2	-4
Interest Rates			basis points				
US 10y Yield		0.58	1.1	-3	-6	-149	-134
Germany 10y Yield		-0.48	-2.7	-2	1	-10	-29
Japan 10y Yield		0.02	0.3	-1	1	17	3
UK 10y Yield		0.12	-2.0	-3	-5	-56	-70
Credit Spreads			basis points				
US Investment Grade		130	-0.3	-4	-23	15	33
US High Yield		549	-0.5	-28	-85	119	155
Europe IG		59	0.7	0	-12	10	15
Europe HY		354	7.3	9	-43	107	147
EMBIG Sovereign Spread		446	-1.0	-8	-30	119	153
Exchange Rates			%				
USD/Majors		93.74	-0.7	-2	-4	-4	-3
EUR/USD		1.17	0.8	3	4	5	5
USD/JPY		105.4	0.7	2	2	3	3
EM/USD		56.0	0.5	1	3	-11	-9
Commodities			%				
Brent Crude Oil ($/barrel)		44	0.8	1	6	-31	-34
Industrials Metals (index)		111	0.3	1	8	-3	-3
Agriculture (index)		36	0.4	1	5	-10	-13
Implied Volatility			%				
VIX Index (%, change in pp)		26.1	0.2	1.6	-8.7	13.9	12.3
10y Treasury Volatility Index		#N/A N/A	#N/A N/A	#N/A N/A	#N/A N/A	#N/A N/A	#N/A N/A
Global FX Volatility		7.9	0.1	0.6	-0.6	1.5	1.9
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		154	2.5	-6	-21	-90	-11
Italy		150	5.5	-6	-27	-44	-10
Portugal		86	5.1	3	-8	4	23
Spain		84	4.1	3	-10	9	19
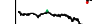
Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations.

Data source: Bloomberg.

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Emerging Market Financial Indicators

Last updated: 7/27/2020 8:05 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	-0.3	1	-2	-1		3.0	-1.3	-8	3	-17	-13
Indonesia		14535	0.5	1.7	-2	-4	-5		6.9	-3.2	-18	-36	-37	-23
India		75	0.0	0.1	1	-8	-5		5.9	-0.2	0	-18	-78	-96
Philippines		49	0.2	0.3	1	4	3		3.7	-1.4	-8	-38	-92	-56
Thailand		32	0.4	0.9	-2	-2	-6		1.4	1.3	-1	-3	-65	-20
Malaysia		4.25	0.3	0.3	1	-3	-4		2.5	0.2	-6	-37	-114	-88
Argentina		72	-0.1	-0.6	-3	-40	-17		45.9	3.7	-72	80	1553	-1675
Brazil		5.20	0.6	2.6	4	-27	-23		5.2	-12.3	2	-22	-136	-105
Chile		776	-1.1	1.2	6	-11	-3		2.5	-2.8	-30	9	-55	-78
Colombia		3694	-0.7	-1.2	1	-13	-11		5.2	2.2	0	-35	-36	-73
Mexico		22.17	0.5	1.4	4	-14	-15		5.9	-1.1	-6	-24	-161	-102
Peru		3.5	-0.4	-0.5	-1	-7	-6		4.0	-1.7	-7	-35	-46	-53
Uruguay		42	0.3	3.3	-1	-20	-12		9.1	-44.3	-44	-104	-81	-181
Hungary		294	0.8	4.5	8	0	0		1.5	-0.2	-14	1	22	29
Poland		3.75	0.9	3.9	6	3	1		0.8	0.7	3	-2	-98	-107
Romania		4.1	0.8	2.8	5	3	4		3.7	0.0	-16	-1	-10	-32
Russia		71.5	0.3	-0.1	-2	-11	-13		5.4	1.7	-4	11	-168	-70
South Africa		16.5	1.3	1.1	5	-14	-15		10.1	7.9	-21	-1	92	57
Turkey		6.85	-0.1	0.1	0	-18	-13		11.3	1.0	-16	83	-468	-42
US (DXY; 5y UST)		94	-0.7	-2.1	-4	-4	-3		0.27	-1.0	-1	-4	-158	-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		3205	0.3	-3	8	9	5		214	0	-5	-13	37	38
Indonesia		5117	0.7	1	4	-19	-19		246	0	-8	-16	76	90
India		37935	-0.5	1	8	0	-8		238	-1	-14	0	102	113
Philippines		5861	-2.4	-5	-5	-28	-25		143	1	-11	-21	76	77
Malaysia		1591	0.1	0	7	-3	0		158	-1	-17	-26	42	46
Argentina		48605	0.4	7	20	16	17		2215	-4	-179	-331	1422	446
Brazil		102382	0.1	0	9	0	-11		344	-1	-4	-35	143	129
Chile		4015	0.8	2	1	-19	-14		197	0	-4	-13	68	64
Colombia		1174	-0.7	2	6	-26	-29		262	-2	0	-41	93	99
Mexico		37357	-0.2	3	0	-8	-14		503	-3	3	-31	176	211
Peru		17289	0.1	3	4	-16	-16		163	-1	-6	-20	49	56
Hungary		35078	-0.1	0	-4	-14	-24		158	0	-9	-14	66	72
Poland		52053	0.8	0	5	-13	-10		33	1	-2	-17	-4	15
Romania		8571	0.2	1	0	-4	-14		271	1	-15	-15	84	97
Russia		2895	1.1	3	5	7	-5		212	-1	3	4	26	81
South Africa		55869	0.5	-1	4	-3	-2		512	-5	-14	-13	223	192
Turkey		1199	0.6	1	5	17	5		587	-2	-19	-9	141	186
Ukraine		500	0.0	0	0	-7	-2		631	-5	-19	-25	167	211
EM total		43	0.7	1	8	2	-4		446	-1	-8	-30	119	153

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

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