GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

WEDNESDAY, JUNE 10, 2020

- **Markets focused on Fed's message following today's FOMC meeting** (link)
- **French authorities to present third revised 2020 budget** (link)
- **Volume of fallen angels decreases in May thanks to policy support** (link)
- **Latin American central banks reduce their FX interventions** (link)

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All Eyes on the Fed

Markets are lacking clear direction today as investors weigh the risks of a weak economic outlook against the potential for continued policy support. After trading in positive territory earlier in the day, risk assets have given back most of their gains as sentiment seemed to be dampened by an OECD report forecasting a 6% contraction in global output this year and my renewed warnings on Covid-19 from the US's top specialist on this subject. European stocks are trading mostly flat, while US futures are pointing to a slight positive start. Action in safe haven assets has also been relatively muted, with yields on Bunds generally unchanged and on those on 10-Year Treasuries down by about 2 bps. The USD continued to weaken today against the majors (-0.3%) while gold is slightly up (0.3%). Analysts have argued that the recent pause in the rally in risk assets, which saw global equities rise by close to 40% since end-March, comes as investors seek greater clarity from policy makers on their future support measures. Particular focus will be on the outcome of today's FOMC meeting. Though markets don't expect any announcement on rates, they will be looking for any change in the Fed's tone given the recent strong labor market data. They will also be looking for any discussion of yield-curve control following the recent uptick in Treasury yields.

Key Global Financial Indicators

Last updated: 6/10/20 8:06 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		3207	-0.8	4	9	11	-1
Eurostoxx 50		3301	-0.6	1	14	-3	-12
Nikkei 225		23125	0.1	2	15	9	-2
MSCI EM		41	0.2	3	11	-1	-9
Yields and Spreads					bps		
US 10y Yield		0.79	-5.0	5	11	-136	-113
Germany 10y Yield		-0.33	-1.7	3	21	-11	-14
EMBIG Sovereign Spread		459	-2	-21	-125	104	166
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		56.3	0.0	1	6	-9	-8
Dollar index, (+) = $ appreciation		96.2	-0.1	-1	-4	-1	0
Brent Crude Oil ($/barrel)		40.3	-2.1	1	30	-35	-39
VIX Index (%, change in pp)		27.6	0.1	2	0	12	14

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

United States

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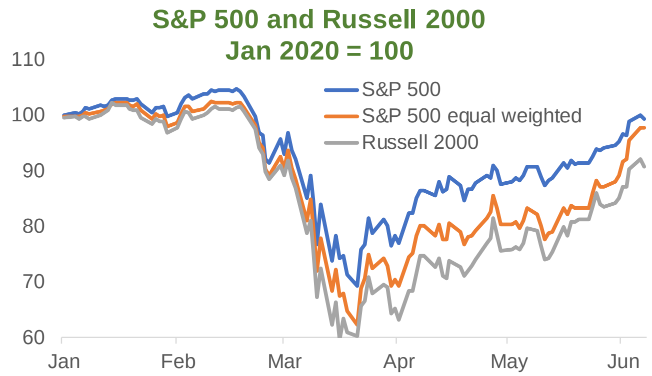
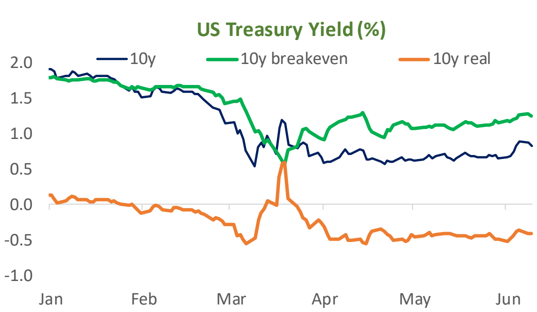
The S&P 500 failed to extend its recent rally and was down by about 1% yesterday. Conversely, the tech-heavy Nasdaq was up by 0.3%. During the recent rally, the gap between the S&P 500 market-cap weighted and equal-weighted index has narrowed, indicating that **the reopening of the economy has boosted a wide range of names, including airline, cruise ship, and even bankrupt companies such as Hertz**. Analysts posit that the speculative buying reflects retail investors betting on a big enough recovery for those firms to come out of Chapter 11 or for additional government support. Nevertheless, the Russell 2000, a proxy of small-cap firms, continues to lag behind large cap indices.



Source: Bloomberg

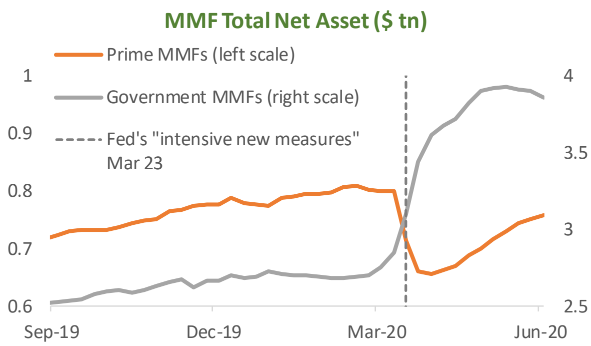
May CPI this morning was lower than expected, the overall headline index down by -0.1% m/m, and 0.1% y/y (vs. consensus 0.0% and 0.3%, respectively). Ex-food and energy index was also lower at -0.1% m/m than expected 0.0%. In the financial market, Treasury 10-year yield went down by 1bp following the headline. Stock futures and the dollar are almost unchanged.

US Treasuries bull-flattened ahead of FOMC, with the 10-year yield down by 5bps. Tuesday's 10-year note auction did not attract sufficient interest. Although Monday's 3-year note auction did generate strong bids, there seems to be more fatigue at the longer end of the yield curve. Despite the recent oil price rally, the impact on TIPS has not been significant; 10-year breakeven inflation remains relatively stable at around 1.2%. Given the recent increase in yields at the longer-end, **market participants are interested in any comments from the Fed about market rates and the possibility of introducing yield curve control and yield caps.** The market consensus appears to be that Chair Powell will indicate that the Fed is studying the example of yield curve control policies in other economies and sound moderately supportive of its potential merits. But expectations are that he will also indicate that the Fed believes that its current policy stance is appropriate and that it does not foresee introducing yield curve control yet. It will be the first time the Committee will publish a Summary of Economic Projections (SEP) since December. Any dot into negative territory may be a surprise. Markets price no hikes until at least the end of 2022.

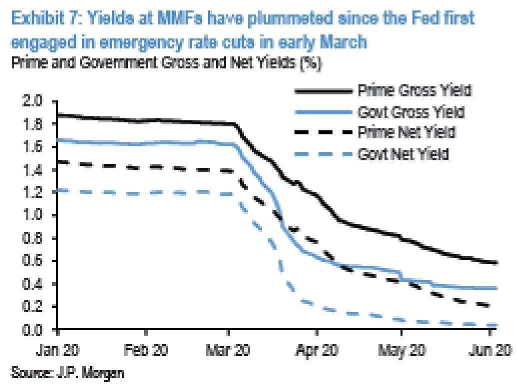


Source: Bloomberg

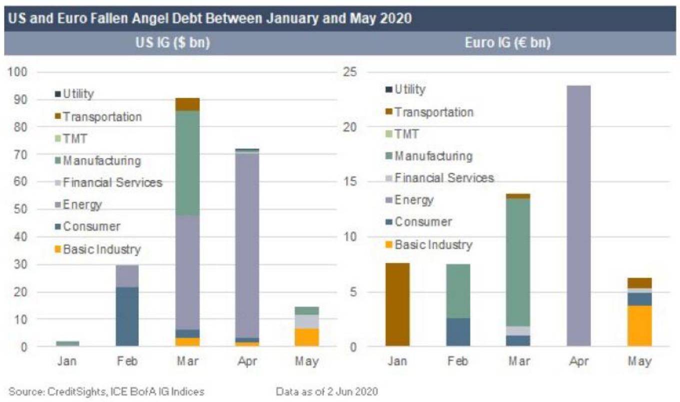
Over the past month, total Money Market Fund (MMF) balances have held steady at around $4.5 tn. Thanks to the Fed's early intervention through programs such as the PDCF and MMLF, prime MMF balances have grown by $100 bn from the end of March to $758bn, recouping nearly two-thirds of the assets lost during the crisis. Meanwhile, government MMF assets have plateaued at around $3.8 tn, after a massive increase during March and April. Moreover, MMFs yields have declined significantly since the Fed first engaged in emergency rate cuts in March. There would be no yield to offset the costs of running a money fund at -25bps, according to JPMorgan. If negative rates eventually become a reality, fund managers may have to consider a sort of reverse distribution mechanism (RDM). RDM is a measure that allows money market funds to address negative interest rates by canceling shares rather than reducing the share price – it was popular among funds in the euro area. But the practice has been prohibited under Money Market Fund Regulation (MMFR) since 2019.



Source: ICI, Bloomberg



The monthly volume of fallen angels decreased in May. The volume of debt owed by fallen angels—or firms downgraded from investment-grade to sub-investment-grade—declined in May as credit spreads tightened on the back of policy supports. At the end of May 2020, $14.5 bn and €6.3 bn of debt fell out of the ICE BofA US and Euro IG indices, respectively, bringing the YTD total to $208 bn and €59 bn respectively. Energy and Manufacturing sectors featured most prominently on both sides of the Atlantic. After an initial strong reaction to the COVID crisis and oil price shocks, rating agencies appear to be giving low-BBB firms some breathing space to improve liquidity and reduce leverage, according to analysts. The debt management may be easier at the current spread and yield levels. While lower spreads and yields are also beneficial to lower-rated (B/CCC) issuers, there is much less room to maneuver for distressed issuers. This is particularly true for debt refinancing, as analysts expect to see a continued rise in defaults for the rest of 2020.



Europe

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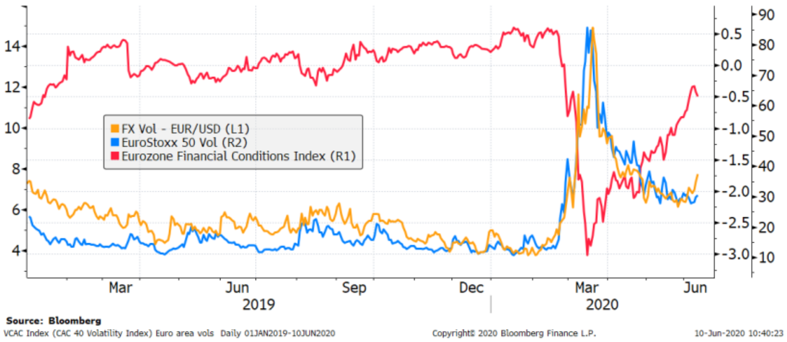
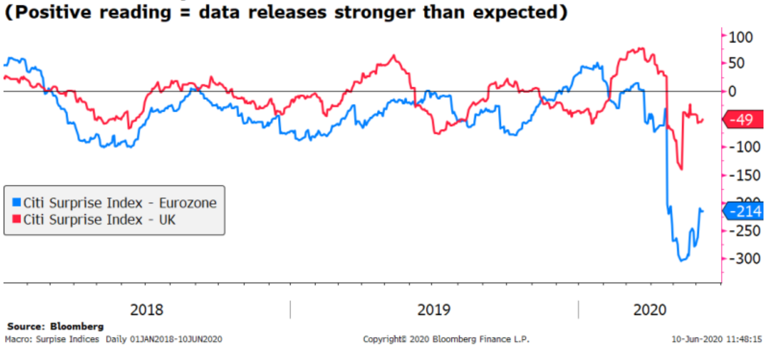
Equity markets slipped again today as focus shifts to Fed's comments later today and European data continue to show weakness. DAX (-0.8%), CAC 40 (-0.5%), EuroStoxx 600 (-0.5%), Italy's Titans 30 (-0.9%), and Spanish Ibex (-0.5%). Bank stocks (-1.5%) underperformed.

Broad market gauges point towards a return of more normal conditions. Financial conditions in the eurozone have eased markedly from the severe tightening observed in mid-March, and the volatility of various asset classes has come down also – albeit it remains elevated compared to the 2019 average.

Broad Market Indicators

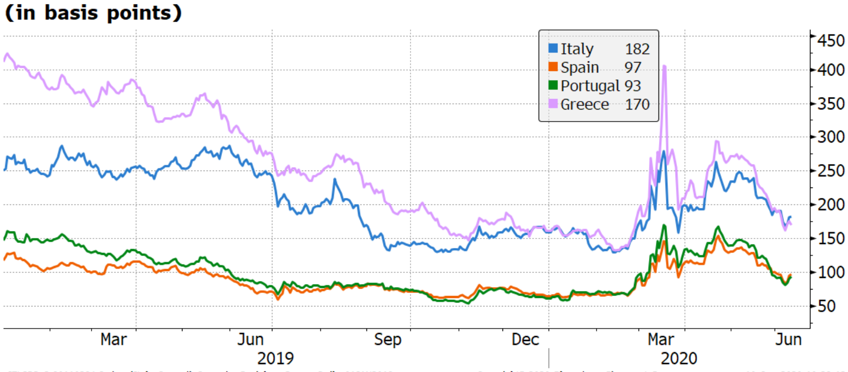


Economic Surprise Indices
(Positive reading = data releases stronger than expected)



Sovereign yields were steady despite heavy auction calendars. German 10-year yields at -0.33% (-2 bps); French OATs are at 0.06% (-2 bps); Italian at 1.49% (-1 bp); and Spanish at 0.65% (+1 bp). In recent weeks, the sovereign spreads of Italy, Spain, Portugal, and Greece have trended towards their pre-pandemic levels.

Selected European Sovereign Spreads to 10yr Bunds
(in basis points)



French FM Le Maire and Budget Minister Darmanin are presenting today the third revised emergency budget for 2020. The new budget considers about €15 bn in extra in public spending, according to media outlets, bringing the total to €57 bn since the outbreak of Covid-19. Analysts anticipate a fourth supplementary budged to be presented in the Fall. Meanwhile, **French industrial production and manufacturing plummeted in April**, coming in at -34.2% y/y and -37.1% y/y, respectively.

In the UK, **BoE deputy governor Cunliffe suggested that the Bank should consider negative rates among other tools**. He also noted that the UK's economy will not recover to pre-pandemic levels until mid-2021, and added that he sees 'a great deal of pain' forthcoming for the financial sector. Separately, UK authorities plan to allow the reopening of retail businesses next Monday

In other news, **Portugal**'s FM and Eurogroup president Mario Centeno announced his resignation effective June 15, 2020.

Other Mature Markets back to top

Japan

Equities declined slightly (-0.2%), paring earlier losses of around -0.8%. Machine orders dropped 12% m/m in April, missing expectations for -7% decline. This marked the biggest fall since the typhoon disruption in September 2018. **The yen appreciated +0.4% and 10-year JGB yield rose +0.7bps.**

Emerging Markets back to top

Asian equities were mixed with little direction and news catalysts. Thailand (+0.8%), India, (+0.7%), and Taiwan Province of China (+0.7%) outperformed while Indonesia (-2.3%) and Philippines (-2.2%) declined the most. Currencies were mostly stronger led by Thai baht strength (+0.6%) while the Indonesian rupiah weakened -0.6%. **EMEA bourses** traded with a cautious tone. Turkish equities (+0.6%) outperformed after unemployment was slightly lower than expected at 13.2% (13.6% expected) and as Turkey continues to remove lockdown measure. Currencies were mixed. **In Latin America,** equities and exchange rates had a small pullback after strong gains since mid-May. The Brazilian real and the Mexican peso underperformed depreciating by ~1.8% against the dollar.

Key Emerging Market Financial Indicators

Last updated: 6/10/20 8:08 AM	Level: Last 12m	Level: index	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		40.89	0.2	3	11	-1	-9
MSCI Frontier Equities		24.60	-0.4	3	7	-17	-19
EMBIG Sovereign Spread (in bps)		459	-2	-21	-125	104	166
EM FX vs. USD		56.28	0.0	1	6	-9	-8
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		7.06	0.2	1	0	-2	-1
Indonesian Rupiah		13980	-0.6	1	7	2	-1
Indian Rupee		75.60	0.0	0	0	-8	-6
Argentine Peso		69.17	-0.1	-1	-3	-35	-13
Brazil Real		4.90	-1.7	6	19	-21	-18
Mexican Peso		21.82	0.4	0	9	-12	-13
Russian Ruble		68.78	-0.3	0	7	-6	-10
South African Rand		16.65	-0.1	2	11	-11	-16
Turkish Lira		6.79	0.0	-1	4	-15	-12
EM FX volatility		9.54	0.0	-0.3	-2.3	1.0	2.9

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

China

Equities were mixed with tech stocks outperforming. The tech-heavy Shenzhen index gained 0.3%, while the Shanghai which has more financials and industrials declined 0.4%. Separately, headline consumer price inflation (CPI) eased to a weaker-than-expected of 2.4% y/y in May (consensus: 2.7%) from 3.3% in April on moderating food price inflation. Produce price inflation (PPI) fell further to -3.7% y/y (consensus: -3.3%) from -3.1% in April. The drop in PPI was mainly driven by upstream sectors with mining and materials prices falling -14.8% and -9.9%, respectively, in May (from -11.6% and -8.8% in April). Analysts view the disinflationary environment as providing the authorities with space to ease monetary policy further. **The onshore and offshore RMB appreciated 0.2%.**

LatAm Central Banks

Central banks have reduced their FX intervention over the last month as volatility and market functioning concerns have subsided. JP Morgan highlights that:

i) In Brazil, BCB sold \$12.8 bn in FX swaps and \$17.4 bn in spot over March and April, sales declined to \$0.5 bn in May;

ii) Mexico has not intervened in the NDF market since the $2 bn sold in March;
iii) In Colombia, the NDF stock stands at $1.7 bn, below the more than $ 2bn originally sold;
iv) Chile recently announced that it will again stop rolling over NDF contracts. BCCh has not intervened in spot or auctioned new contracts but the treasury has been active in FX markets. Since FX auctions data became public in mid-April, the treasury sold $3.2 bn.

Exhibit 9: Central banks have generally scaled back their FX intervention efforts

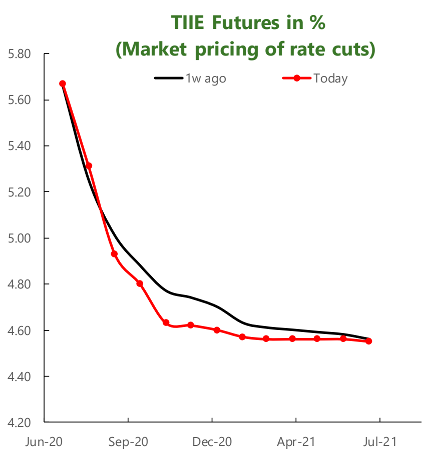
Year-to-date FX intervention by central banks; in USDbn

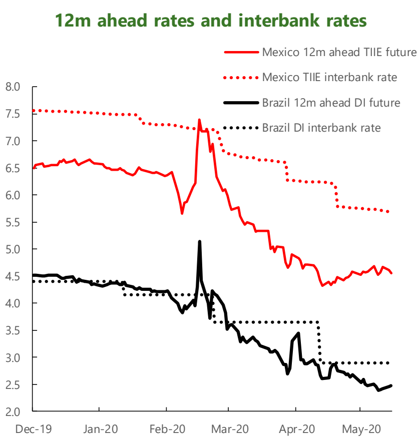
	Spot	FX swaps (new)	NDF (new)	Total
Brazil	18.4	21.5	-	39.9
Peru	0.0	3.1	-	3.2
Mexico	-	-	2.0	2.0
Colombia	-	-	1.7	1.7
Chile	-	-	0.3	0.3

Source: J.P. Morgan, Central Banks websites

Mexico

Local swap rates declined marginally as inflation data for the second half of May surprised to the downside. The overall inflation data for May (2.84% y-o-y vs target of 3%) support analyst views of 50bps rate cuts at the next meeting on June 25. However, sticky core inflation (3.64% y-o-y in May is up from 3.5% in April) is seen as a limiting factor for additional rate cuts in 2020. Banxico has cut rates by 150bps since mid-February to 5.5% and rate markets have been pricing around 100-125bps of cuts over the next year throughout the recent risk rally. In contrast, Brazil has already lowered rates to a new low of 3% and expectations for additional rate cut have increased over the last month as the currency appreciated and activity/inflation outlook was downgraded further.



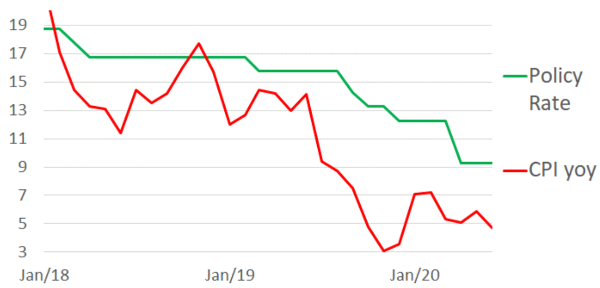


Source: Bloomberg

Egypt

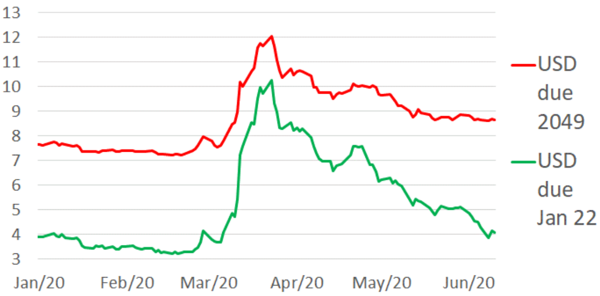
Yields on U.S. dollar bonds due Jan 2022 fell 6 bps to 4.15% and the pound was little changed as headline inflation fell to a 2020 low of 4.7% yoy in May (from 5.9% yoy in April) on lower food prices. Inflation is currently well below the target of 9% +/- 3 ppt. The central bank last cut rates to 9.25% in March but expectations are that the central bank will remain hesitant to cut its policy rate further given concerns about FX revenues from tourism, worker remittances and Suez Canal receipts. Net international reserves fell $9 bn since February (to $36 bn in May) as capital outflows reached around $17 bn in March and April. **The pound fell 2.5% in June, reaching a 2020 low of 16.23/$ on 5 June before rising 0.3% in recent days**.

Egypt: Urban inflation (%,yoy) and policy rate (%)



Source: Bloomberg and IMF

Egypt: Yields on U.S. dollar bonds (%)



Source: Bloomberg and IMF

Turkey

Equities (+0.6%) rose after unemployment was slightly lower than expected at 13.2% (13.6% expected) **and as Turkey continues to remove lockdown measure.**The government has now lifted all restrictions on people under 18 and people older than 65 will be allowed to leave home between 10 am and 8 pm again. In separate news**, the Turkish central bank has reportedly asked for weekly accounting reports** from companies that have more than $15 mn in FX loans (compared to quarterly reports previously). The **lira is little changed** (+0.1% at 6.79 per U.S. dollar).

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Global Financial Indicators

Last updated: 6/10/20 8:07 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		3207	-0.8	4	9	11	-1
Europe		3301	-0.6	1	14	-3	-12
Japan		23125	0.1	2	15	9	-2
China		2944	-0.4	1	2	3	-3
Asia Ex Japan		70	-0.6	3	8	3	-5
Emerging Markets		41	0.2	3	11	-1	-9
Interest Rates					basis points		
US 10y Yield		0.79	-5.0	5	11	-136	-113
Germany 10y Yield		-0.33	-1.7	3	21	-11	-14
Japan 10y Yield		0.03	0.5	1	3	14	4
UK 10y Yield		0.31	-2.7	4	7	-53	-51
Credit Spreads					basis points		
US Investment Grade		149	4.5	-17	-57	20	51
US High Yield		561	15.0	-64	-186	108	168
Europe IG		68	2.6	3	-16	7	24
Europe HY		376	14.9	0	-131	107	168
EMBIG Sovereign Spread		459	-2.0	-21	-125	104	166
Exchange Rates					%		
USD/Majors		96.22	-0.1	-1	-4	-1	0
EUR/USD		1.14	0.1	1	5	0	1
USD/JPY		107.4	0.4	1	0	1	1
EM/USD		56.3	0.0	1	6	-9	-8
Commodities					%		
Brent Crude Oil ($/barrel)		40	-2.1	1	30	-35	-39
Industrials Metals (index)		103	0.4	3	6	-7	-10
Agriculture (index)		35	0.2	1	1	-13	-14
Implied Volatility					%		
VIX Index (%, change in pp)		27.6	0.1	1.9	-0.4	11.6	13.8
10y Treasury Volatility Index		4.7	-0.3	0.0	-0.4	0.3	0.6
Global FX Volatility		8.0	0.0	0.3	-1.1	1.2	2.0
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		172	-7.1	-16	-102	-133	6
Italy		183	2.0	-8	-55	-75	23
Portugal		95	4.6	2	-51	5	32
Spain		98	3.3	1	-35	16	33

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:	Exchange Rates							Local Currency Bond Yields (GBI EM)						
6/10/2020	Level		Change (in %)					Level		Change (in basis points)				
8:08 AM	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		7.06	0.2	0.7	0	-2	-1		2.9	-2.1	12	39	-36	-25
Indonesia		13980	-0.6	0.8	7	2	-1		7.4	-1.5	11	-73	-69	26
India		76	0.0	-0.2	0	-8	-6		6.1	-1.4	0	-3	-101	-78
Philippines		50	0.2	0.5	1	5	2		4.2	-4.1	-5	-47	-89	-14
Thailand		31	0.6	1.3	3	1	-4		1.4	-6.5	2	13	-97	-16
Malaysia		4.25	0.6	0.3	2	-2	-4		2.9	4.7	17	17	-77	-41
Argentina		69	-0.1	-0.7	-3	-35	-13		47.9	32.8	249	507	1577	-1469
Brazil		4.90	-1.7	6.2	19	-21	-18		5.3	1.2	5	-47	-202	-93
Chile		770	-0.2	1.3	7	-9	-2		2.7	-13.4	27	2	-100	-56
Colombia		3657	-1.4	-0.6	7	-11	-10		5.4	4.3	8	-29	-61	-55
Mexico		21.82	0.4	-0.2	9	-12	-13		6.4	-4.7	8	33	-164	-56
Peru		3.4	-0.2	-1.4	-1	-3	-4		4.4	1.6	3	-7	-70	-16
Uruguay		43	-0.7	1.1	3	-17	-12		10.1	2.2	-21	-133	-104	-77
Hungary		303	0.2	1.4	7	-7	-3		1.7	1.0	13	-2	1	55
Poland		3.93	-0.3	-0.2	7	-4	-4		0.9	-4.7	9	-19	-116	-97
Romania		4.3	0.0	0.9	5	-2	0		3.7	-7.0	-4	-35	-36	-27
Russia		68.8	-0.3	-0.2	7	-6	-10		5.4	-6.0	11	-29	-213	-72
South Africa		16.7	-0.1	1.6	11	-11	-16		10.0	10.0	35	5	51	51
Turkey		6.79	0.0	-0.8	4	-15	-12		10.8	5.4	39	-103	-870	-92
US (DXY; 5y UST)		96	-0.1	-1.1	-4	-1	0		0.38	-2.1	1	5	-154	-131

	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		2944	-0.4	1	2	3	-3		225	-2	-9	-30	44	49
Indonesia		4921	-2.3	0	7	-22	-22		249	1	-12	-80	61	93
India		34247	0.9	0	8	-14	-17		231	-15	-35	-95	74	106
Philippines		6439	-2.2	3	15	-20	-18		146	1	-7	-29	70	80
Malaysia		1575	0.0	4	14	-5	-1		175	-2	-13	-81	44	63
Argentina		46471	-4.9	11	28	27	12		2599	2	122	-719	1666	830
Brazil		96747	-0.9	6	21	-1	-16		341	13	-30	-74	94	126
Chile		4126	-0.3	10	8	-18	-12		202	0	-6	-67	66	69
Colombia		1210	-1.5	8	9	-19	-27		270	7	-7	-80	74	107
Mexico		39186	-1.9	5	4	-10	-10		481	19	-34	-126	140	189
Peru		17323	-0.9	10	12	-15	-16		171	0	-2	-65	42	64
Hungary		37409	-1.3	0	8	-9	-19		153	-2	-18	-66	59	67
Poland		51080	-0.4	3	13	-13	-12		53	-6	-5	-42	1	35
Romania		8817	0.1	0	5	3	-12		279	6	-27	-65	84	105
Russia		2776	-0.7	-2	5	1	-9		200	0	10	-58	-7	69
South Africa		53832	-1.2	0	6	-8	-6		473	-4	-43	-199	160	153
Turkey		109900	0.6	1	12	17	-4		557	-3	-18	-156	36	156
Ukraine		499	0.0	0	0	-10	-2		595	-2	-60	-176	30	175
EM total		41	0.2	3	11	-1	-9		459	-2	-21	-125	104	166

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

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