GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

WEDNESDAY, MARCH 10, 2021

- **Euro area real yields edge lower in March** (link)
- **Greater demand for leveraged loans and CLOs as rates rise** (link)
- **EU carbon future prices rise to new records** (link)
- **Chinese markets stabilize following recent pressure on share prices** (link)
- **Brazil's markets react to the return of former president Lula da Silva to politics** (link)
- **Sri Lanka secures a $1.5 billion swap facility with China's central bank** (link)

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Markets Take a Breather Following Recent Volatility

Financial markets are fairly tranquil today, as investors anticipate the introduction of a new US pandemic relief package. Global equity markets are trading in generally positive territory as participants take stock of the increased volatility in stock and bond markets over the past week. European equities are slightly up, while EM stocks are somewhat mixed as Chinese markets seem to regain their footing after their recent selloff (Shanghai Comp was down 5% during the previous 2 trading sessions). Moreover, US equities are pointing to a positive start following yesterday's relief rally in tech stocks that saw the Nasdaq index rise by 3.7%. Meanwhile, the US dollar is trading sideways after weakening by close to 0.5% against other major currencies yesterday on the back of a drop in US long-term rates. But that momentum in rates seems to have shifted today, with the 10-year yield on Treasuries increasing by about 4 bps and that on Bunds remaining fairly unchanged. Anticipation for the finalization of a $1.9 tn US stimulus package is mounting as the bill makes its way through Congress. Investors will also be closely watching the results of the 10-Year and 30-Year Treasury auctions taking place over the next two days (about $62 bn in size) to gauge the market's appetite for US long-term debt against the background of the recent rise in yields.

Key Global Financial Indicators

Last updated: 3/10/21 8:35 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		3875	1.4	0	-1	34	3
Eurostoxx 50		3806	0.5	3	4	31	7
Nikkei 225		29037	0.0	-2	-2	46	6
MSCI EM		54	2.2	-2	-6	36	4
Yields and Spreads					bps		
US 10y Yield		1.54	1.1	6	41	73	62
Germany 10y Yield		-0.31	-1.3	-3	12	48	26
EMBIG Sovereign Spread		371	1	17	28	-100	20
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		56.2	0.4	-1	-3	-2	-3
Dollar index, (+) = $ appreciation		92.1	0.1	1	2	-4	2
Brent Crude Oil ($/barrel)		67.9	0.5	6	10	82	31
VIX Index (%, change in pp)		23.5	-0.5	-3	2	-24	1

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

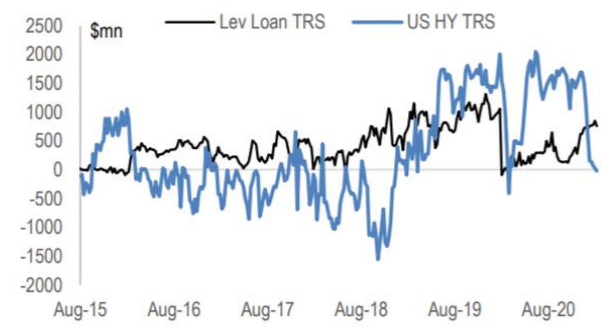
United States back to top

Yesterday's, equity market price performance reversed most of Monday's losses, partly driven by strong overnight demand from key Asian real money accounts as well as a technical correction. An index of large tech companies (NY FANG+) gained +7% on the day, offsetting the -5% loss recorded earlier in the week. Conversely, banking sector stocks dropped to last Friday's levels. Elevated Treasury yields attracted greater demand (including from Asia) leading to a 6 bp drop in 10-Year US Treasury yields (attributed almost entirely to a change in real yields).

The headline CPI release for the month of February (0.4% m/m and 1.7% y/y) came in exactly along consensus estimates. Excluding food and energy components, actual CPI was slightly below consensus on both monthly (0.1% vs. 0.2% cons.) and annual (1.3% vs. 1.4% cons.) basis. The Treasury market's reaction to the data release was fairly muted.

Leveraged Loan and CLOs have seen increased demand over the past weeks due to the uptrend in US Treasury yields. Both leveraged loans and CLOs (collateralized loan obligations) have floating-rate structures, which attracts investors in an environment of rising rates and higher inflation expectations. In contrast, High Yield bonds exposed to negative convexity—i.e., which experience an increase in their duration as interest rates rise—tend to perform poorly in such an environment and are typically shunned by investors, as demonstrated by the increase in short-positioning in this asset class. The chart on the left below shows how investors' net long positions for leveraged loans and HY bonds have diverged in recent weeks. It is notable that the outperformance of Leveraged Loans versus HY bonds has been correlated with the rise in US Treasury yields (right chart below). Similarly, gross US CLO issuance volume in February reached the highest monthly volume on record. Excluding refinancing, it would result in the second highest volume on record.

Investors have increased net long positions in the Lev Loan TRS while the demand for short risk HY TRS has increased



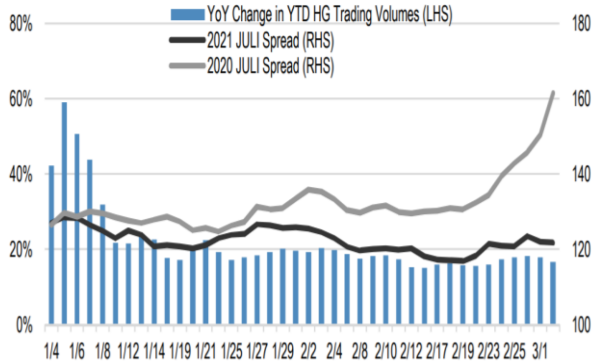
Source: J.P. Morgan.

Lev loan has outperformed the HY market driven by the increase in rates over the past few months

Source: J.P. Morgan.

Despite greater volatility in the US Treasury market, High Grade bonds remain actively traded (left chart below). JPMorgan analysts noted that this robust trading activity is due to new types of investors in the HG market that are positioning in different directions simultaneously. First, US pension funds are increasingly de-risking into HG bonds. The recent months' rally in stocks and bonds substantially improved pension funds' funded status, meaning that these funds are likely to try and de-risk, i.e., increase fixed income allocation in their portfolios. Second, overnight flows (driven primarily out of Asia) have become more volatile as investors in the region have taken a more active stance on their interest rate exposure and sought to capitalize on the recent rate move. Going forward, heavy supply, continued rate volatility and MTM losses in HG credit could put modest upward pressure on HG spreads and may ultimately lead to fund flow weakness or outflows. However, this risk may be mitigated by the relatively weak correlation between corporate HG fund flows and returns (right chart below).

Exhibit 5: Trading volumes steadily higher YoY despite placid spreads



Source: J.P. Morgan

Flows versus returns over the past 3 years

Source: JPM, EPFR.

Europe

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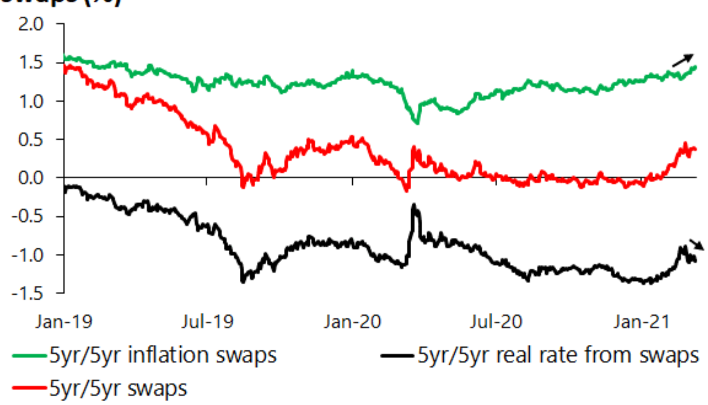
Euro area

The euro (-0.1%), equities (+0.2%) and 10-yr bund yields were little changed ahead of tomorrow's ECB press conference. Contacts expect the ECB to reiterate its willingness to use its Pandemic Emergency Purchase Program to contain any tightening of financial conditions but do not expect the ECB to announce any policy changes. The ECB is also expected to slightly downgrade near-term growth forecasts (given continued lockdowns) while upgrading the near-term inflation outlook (given higher commodity prices and the YTD decline in the euro exchange rate).

Contacts argue that the ECB is facing less pressure to act after 5yr/5yr inflation swaps, a market-based measure of inflation expectations, rose 8 bps in March while 5yr/5yr real yields fell 8 bps so far this month. This measure for real yields rose 26 bps in February, prompting verbal interventions by ECB officials.

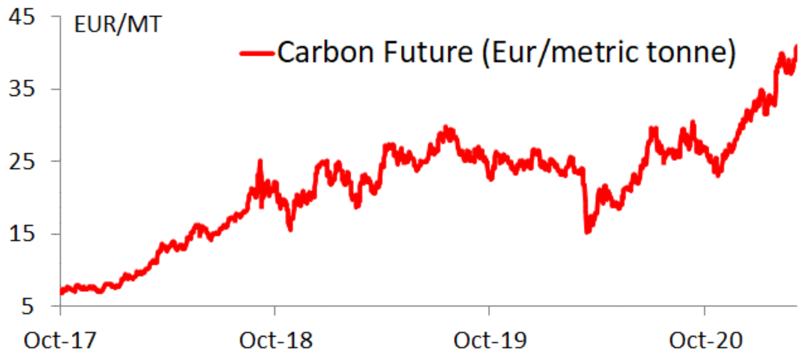
Euro area: 5yr/5yr inflation and 5yr/5yr interest rate swaps (%)



Source: Bloomberg and IMF staff

Carbon future prices (+0.8%) continue to make new records, closing almost 4% higher yesterday. Analysts expect that demand for European carbon credits could rebound 10-15% in 2021, after dropping 20% in 2020. Emissions would still be well below the 2019 level, which may leave the carbon market adequately supplied as caps on emissions are set years in advance, a potential bearish indicator for carbon allowances.

Europe: Price of carbon futures



Source: Bloomberg and IMF staff

Other Mature Markets

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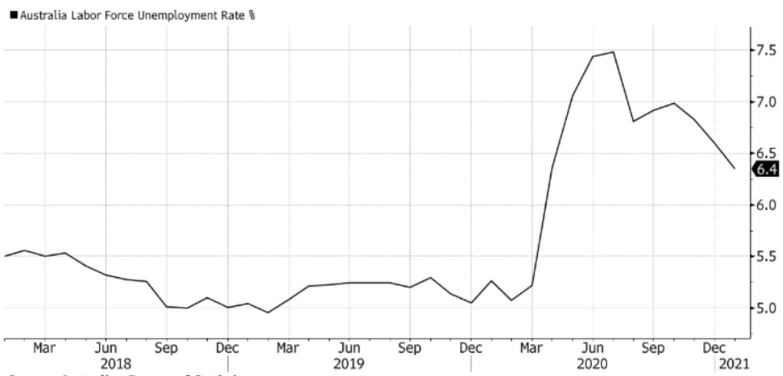
Australia

Ten-year bond yield fell -7bps, with the Reserve Bank of Australia (RBA) Governor reiterating that the policy rate is unlikely to rise at least until 2024. He mentioned that the RBA does not share the bond market's expectation of possible increases in the cash rate as early as late next year and then again in 2023. The Governor mentioned again that the RBA wants to see actual inflation to be within the 2-3% target before considering moving interest rates. Wage increases are also a long way from being consistent with the inflation target. He also said that the RBA will consider the case for extending its quantitative easing program later in the year. **The benchmark three-year bond fell below the RBA's 0.1% for the first time this year.**

Lowe says unemployment too high to consider shifting policy stance



Source: Australian Bureau of Statistics

New Zealand

New Zealand central bank (RBNZ) will remove some of the temporary liquidity facilities given improving financial conditions. From mid-March the RBNZ will remove Term Auction Facility (TAF) and the Corporate Open Market Operation (COMO) introduced during the Covid-19 pandemic. The TAF allowed banks to borrow funds for 3-12 months using NZ Government securities, registered bank bills and RMBS as eligible collateral, while the COMO allowed banks to borrow funds for 3 months using corporate securities and asset backed securities as collateral. The demand for these facilities was low over the last six months as other programs resulted in significant increase in liquidity.

Emerging Markets

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In Asia, equities rose +0.4% on net, with South Asia outperforming. North Asia, notably China (Shanghai -0.1%; Shenzhen +0.2%) was mixed. Regional currencies were broadly weaker**,** led by the Philippines peso

(-0.3%), Thai baht gained (+0.2%). **In Latin America**, stock markets saw small gains on Tuesday, with Brazil up by 0.65%, Mexico up by 0.06%, and Argentina +0.04%. Local currency markets were relatively quiet**. In EMEA**, equities are up almost across the board, with the notable exception of Egyptian stocks which has bucked the positive trend and dropped 0.8% on the day.

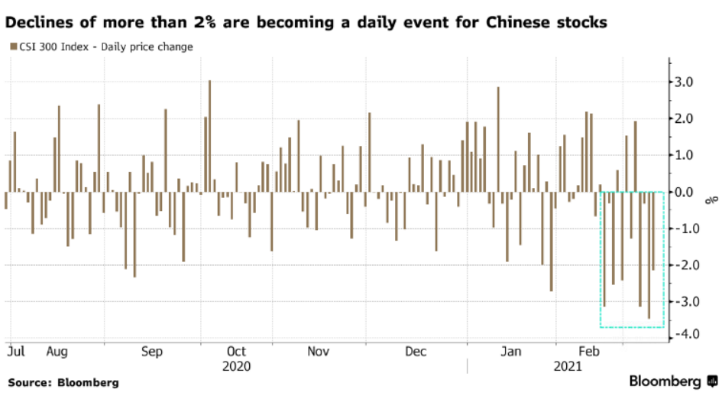
Key Emerging Market Financial Indicators

Last updated:	Level		Change				
3/10/21 8:39 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		53.53	-0.4	-2	-6	36	4
MSCI Frontier Equities		29.37	0.8	0	1	19	4
EMBIG Sovereign Spread (in bps)		371	1	17	28	-100	20
EM FX vs. USD		56.28	0.5	-1	-3	-2	-3
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.51	0.0	-1	-1	7	0
Indonesian Rupiah		14405	0.0	-1	-3	0	-2
Indian Rupee		72.92	0.0	0	0	2	0
Argentine Peso		90.72	-0.1	-1	-3	-31	-7
Brazil Real		5.76	0.9	-2	-6	-19	-10
Mexican Peso		21.09	0.5	-1	-5	-1	-6
Russian Ruble		73.75	0.2	0	0	-3	1
South African Rand		15.21	0.6	-1	-3	5	-3
Turkish Lira		7.55	0.9	-1	-7	-18	-1
EM FX volatility		10.65	0.0	0.4	0.9	0.9	-0.1

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

China

Chinese markets have stabilized somewhat following recent pressure on share prices. Sectors that saw the heaviest selling in recent days such as health care-related and consumer staples led gains. Offshore investors purchased a net $803.2 mn of Chinese shares through stock links with Hong Kong SAR, a second consecutive day of net buying, according to Bloomberg. Bloomberg also reported that following the recent decline, China seems to have banned the search for the Chinese equivalent of "stock market" on social media on Wednesday. **Separately, the China Securities Regulatory Commission may introduce tighter rules for initial public offerings on Shanghai's Nasdaq-style STAR board.** The revised rules may be introduced as soon as next month and require firms to prove their technology credentials. On data releases, **China's producer prices rose at the fastest pace in more than two years in February.** They accelerated to +1.7% y/y from +0.3% y/y in January and were also stronger than expectations of +1.5% due to rising commodity prices. Consumer prices meanwhile fell -0.2% y/y in February versus -0.3% y/y in January.

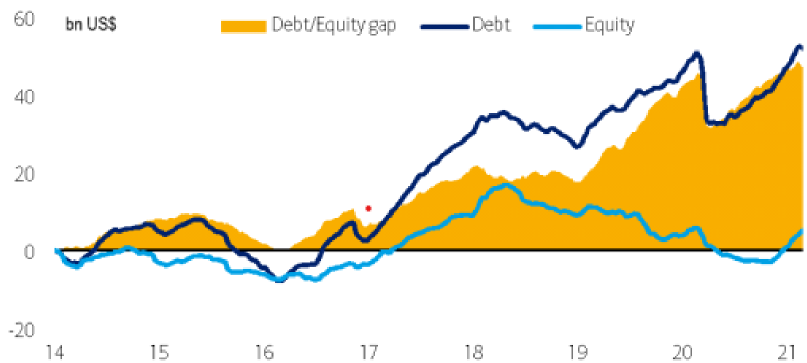


EMEA

International investors have continued to pour into EMEA assets over the last months. The inflows have been stronger for debt securities and have been steadily increasing since mid-2020. Thus, the gap between debt and equity flows has widened to its highest levels since 2004. Analysts at BofA note that inflows have been the strongest into Russia ruble-denominated assets, partly supported by the recovery in oil prices from a low of $20/barrel in April 2020 to about $67/barrel currently.

Exhibit 1: Cumulative flows into EEMEA debt and equity since Jan2014

The gap between EEMEA debt and equity flows at the highest level since 2014 (note raising real rates make debt particularly vulnerable - some scope for rotation in asset classes)



We obtain country flows from the "all bonds" and "all equity" category in EPFR, spanning funds representing a total of US$1,9tn (bonds) and US$4.2tn (equities). We include all EEMEA countries that belong to at least one among GBI-EM Bond Index, EMBI Bond Index (both in the Global Div version) or MSCI EM Equity Index. **Source:** EPFR Global, BofA

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Poland

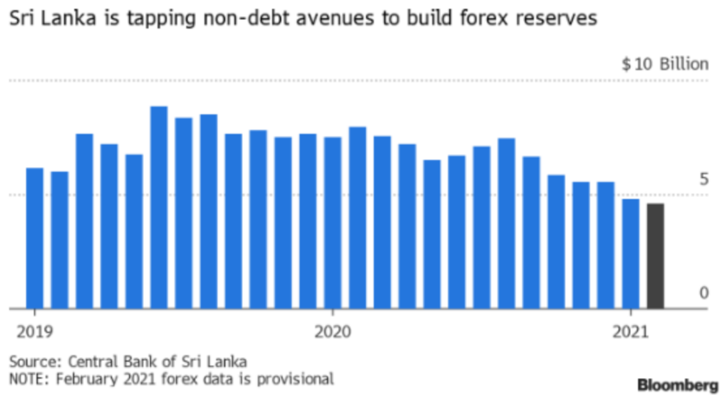
According to the local press, the Polish Bank Association estimates that **the costs of converting existing Swiss franc mortgages into local currency could costs banks about $8 bn to $14 bn** (PZ30 bn to PZ57 bn) under the current proposal by the Polish Financial Supervisory Agency. The FSA's own estimate of the costs of the transaction is around $9 bn (PZ35 bn). **Stocks of Polish banks advanced 0.4% today, compared to +0.7% for the broader market index.**

India

India's entry into global bond indices has been postponed due to taxation hurdle. Local media, Business Standard, reported that global bond index managers have demanded that the government states that taxes will not be changed to the disadvantage of investors. They also demanded that India list its sovereign debt securities on international central securities depositories such as Clearstream. The finance ministry and the central bank have been in discussion with the managers of at least three global benchmark indices over the past two years, including the Bloomberg Barclays Global Aggregate Index and the JP Morgan GBI EM Index. The 10-year bond yield and the Indian rupee were little changed on the news.

Sri Lanka

Sri Lanka has secured a $1.5 billion swap facility with China's central bank. State Minister for Money and Capital Markets Cabraal stated that the line is available, but the country would use the funds only as and when needed. Earlier, Bloomberg reported that the country was also negotiating swaps and loans with India as well as loans for US$700 million with the China Development Bank to build its reserves buffer. Sri Lanka has to repay $3.7 billion to holders of external debt this year, according to central bank Governor Weligamage Don Lakshman. In January Sri Lanka's forex reserves fell to $4.8 billion (from $8.9 billion about two years ago) covering just above three months of imports**.**



Brazil

Markets have reacted strongly to the possible return of Luiz Inacio Lula da Silva to the political arena. According to Bloomberg, the possible comeback of the left-leaning former president raised concerns among investors that the country's reform agenda may be derailed by early campaigning for the 2022 presidential election. Mr. Lula da Silva return's to politics has been made possible after a judge annulled his convictions under the Carwash corruption probe. The news initially sent stocks and the currency tumbling, though the markets did subsequently recover part of those losses the following day (Tuesday) amid a strong bounce back in global assets and as lawmakers assured that fiscal austerity measures would not be watered down.

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Global Financial Indicators

Last updated: 3/10/21 8:37 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities			%				%
United States		3881	1.4	2	-1	35	3
Europe		3805	0.5	2	4	31	7
Japan		29037	0.0	-2	-2	46	6
China		3358	0.0	-6	-8	12	-3
Asia Ex Japan		94	2.4	-2	-7	39	5
Emerging Markets		54	2.2	-2	-6	36	4
Interest Rates			basis points				
US 10y Yield		1.54	1.4	6	42	74	63
Germany 10y Yield		-0.31	-1.0	-2	13	48	26
Japan 10y Yield		0.13	0.1	1	5	18	11
UK 10y Yield		0.72	-1.1	-6	23	48	52
Credit Spreads			basis points				
US Investment Grade		104	-0.6	13	14	-65	9
US High Yield		364	-0.6	16	11	-284	-16
Europe IG		49	-0.1	0	1	-51	1
Europe HY		252	-1.3	1	9	-204	9
Exchange Rates			%				
USD/Majors		92.08	0.1	1	2	-4	2
EUR/USD		1.19	0.1	-1	-2	6	-3
USD/JPY		108.5	0.0	1	4	3	5
EM/USD		56.3	0.5	-1	-3	-2	-3
Commodities			%				
Brent Crude Oil ($/barrel)		68	0.5	6	10	82	31
Industrials Metals (index)		142	0.4	-3	1	38	7
Agriculture (index)		52	-0.8	0	4	37	8
Implied Volatility			%				
VIX Index (%, change in pp)		23.5	-0.5	-3.2	1.5	-23.8	0.8
US 10y Swaption Volatility		86.0	0.0	8.5	26.0	-49.4	25.9
Global FX Volatility		8.1	0.0	0.4	0.9	-1.7	0.0
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		117	-2.6	-11	-5	-128	-3
Italy		99	-0.3	-5	5	-113	-12
Portugal		56	-0.5	-1	4	-71	-4
Spain		67	0.3	-1	8	-47	5

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)						
3/10/2021	Level		Change (in %)					Level		Change (in basis points)				
8:40 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		6.51	0.0	-0.6	-1	7	0		3.4	-0.1	0	1	68	7
Indonesia		14405	0.0	-1.1	-3	0	-2		6.9	2.9	31	67	-34	85
India		73	0.0	-0.3	0	2	0		6.5	4.2	8	23	19	57
Philippines		49	-0.3	-0.2	-1	4	-1		3.7	17.4	19	19	-34	4
Thailand		31	0.2	-1.4	-3	2	-3		2.1	0.3	23	63	108	75
Malaysia		4.13	-0.2	-1.8	-2	3	-3		3.3	9.5	33	60	48	77
Argentina		91	-0.1	-0.5	-3	-31	-7		43.4	3.2	91	-585	-624	-1271
Brazil		5.76	0.9	-2.3	-6	-19	-10		7.5	13.7	-6	101	139	190
Chile		732	0.4	-0.5	-1	14	-3		3.2	-2.1	14	42	12	42
Colombia		3598	0.5	1.1	0	5	-5		5.9	-3.8	28	82	-23	87
Mexico		21.09	0.5	-0.7	-5	-1	-6		6.2	0.2	20	50	-56	57
Peru		3.7	0.1	-0.9	-2	-5	-2		4.7	-7.4	31	89	40	110
Uruguay		45	0.2	-1.1	-4	-3	-5		7.1	9.2	6	-2	-323	-14
Hungary		308	-0.1	-2.0	-4	-4	-4		2.1	-5.9	13	47	91	59
Poland		3.84	-0.1	-1.9	-4	0	-3		0.9	-1.3	7	26	-40	29
Romania		4.1	0.0	-1.6	-2	4	-3		2.7	-9.0	0	39	-98	-7
Russia		73.8	0.2	0.3	0	-3	1		6.4	0.3	-2	42	14	67
South Africa		15.2	0.6	-0.8	-3	5	-3		10.3	-0.4	45	74	55	61
Turkey		7.55	0.9	-1.2	-7	-18	-1		14.5	1.7	93	116	291	138
US (DXY; 5y UST)		92	0.1	1.3	2	-4	2		0.82	1.5	9	37	15	46

	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		5004	0.7	-8	-14	23	-4		199	0	-2	-9	30	-9
Indonesia		6265	1.0	-2	1	20	5		158	0	-9	-25	-5	-29
India		51280	0.5	0	0	44	7		169	6	10	14	-43	18
Philippines		6808	0.6	-2	-4	8	-5		83	0	-9	-17	13	-22
Malaysia		1640	0.9	3	3	15	1		113	0	-2	-3	9	3
Argentina		46476	0.4	-3	-11	42	-9		1459	0	19	8	-570	91
Brazil		111522	0.7	0	-6	21	-6		253	0	0	-16	58	3
Chile		4841	2.7	1	7	19	16		126	0	-6	-16	-14	-18
Colombia		1342	0.4	0	-2	-1	-7		207	0	-4	-15	44	2
Mexico		47104	0.1	3	5	19	7		348	0	-9	-34	55	-12
Peru		22567	0.0	-1	0	27	8		133	0	-4	-3	22	1
Hungary		43628	0.7	0	-1	14	4		65	0	-6	-15	-42	-31
Poland		59311	0.6	2	5	32	4		-22	0	-4	-11	-54	-21
Romania		10622	0.2	4	0	22	8		203	-2	2	13	-87	0
Russia		3477	0.0	2	2	39	6		159	0	-5	-3	19	-7
South Africa		68227	-0.6	0	3	38	15		357	0	-4	-35	25	-23
Turkey		1556	0.4	2	1	54	5		421	0	-5	-47	34	-24
Ukraine		517	0.0	-1	-1	-3	3		479	0	12	-21	127	-12
EM total		54	-0.4	-2	-6	36	4		421	0	17	-10	97	128

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

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