GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, MAY 12, 2020

- **Fed balance sheet grows to $ 6.7 tn** (link)
- **Bond markets confront flood of new Treasury issuance** (link)
- **US high yield issuers forced to pledge specific collateral to sell bonds** (link)
- **Latin America could face funding challenges** (link)
- **Growing COVID-19 crisis in Brazil elevates sovereign risk** (link)
- **Saudi Arabia surprises markets with another oil production cut** (link)

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

Markets are cautiously optimistic

Stocks are modestly higher in Europe and US interest rate futures point to a positive open for the US stock market, although Asia had a negative session. Interest rates are little changed on both sides of the Atlantic and the major currencies are holding steady. Global markets overall have done reasonably well over the past week and cautious optimism appears to be the watchword as markets monitor the gradual rolling back of lockdowns around the world. US equity futures staged a rebound this morning after selling off overnight on a move by the US administration to prevent a government retirement fund from buying shares in Chinese companies. The Fed announced that it will begin to buy corporate bond exchange traded funds today through the Secondary Market Credit Facility. Oil markets were sharply higher after yesterday's surprise production cut from Saudi Arabia.

Key Global Financial Indicators

Last updated: 5/12/20 8:07 AM	Level: Last 12m	Level: Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		2930	0.0	3	5	2	-9
Eurostoxx 50		2892	0.3	1	0	-14	-23
Nikkei 225		20366	-0.1	1	4	-5	-14
MSCI EM		37	-0.7	3	4	-12	-18
Yields and Spreads					bps		
US 10y Yield		0.71	0.1	5	-1	-176	-121
Germany 10y Yield		-0.49	2.5	9	-14	-44	-30
EMBIG Sovereign Spread		570	-2	-26	-27	219	277
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		53.1	0.7	0	-1	-14	-13
Dollar index, (+) = $ appreciation		99.9	-0.4	0	0	3	4
Brent Crude Oil ($/barrel)		30.6	3.3	-1	-3	-57	-54
VIX Index (%, change in pp)		26.7	-0.8	-7	-15	11	13

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

Global Markets

Multiple asset classes have seen a strong rebound since the market lows in March. Equities have recouped a major portion of their losses, with US stocks and especially the technology sector leading the way. The Nasdaq erased its losses for the year and is back in positive territory. Credit spreads have narrowed, and the investment grade corporate bond market is experience record issuance of new bonds. Even high yield bonds have recovered somewhat, and issuance has resumed albeit on a selective basis. Oil prices have also risen although the outlook for the energy sector remains unclear. The speed of the recovery has raised concerns that the market is too optimistic about the fallout from COVID-19, with some worried that bad news could send prices crashing again. Others are more optimistic, pointing out that markets tend to lead economic data both on the way up and the way down. However, most are agreed that a second virus wave would be very negative for markets.

Selected Market Indicators, May 11, 2020 4pm EST Close
Source: Bloomberg

	Market Trough/Peak	Change Since Trough/Peak
S&P 500	March 23	+23.6%
Euro Stoxx 600	March 23	+17.5%
iShares Emerging Market ETF	March 23	+16.4%
CSI 300	March 23	+10.9%
Bloomberg US Corporate	March 20	-162 bps
Bloomberg US High Yield	March 23	-287 bps
Bloomberg Euro Corp	March 18	-11 bps
Bloomberg High Yield Euro	March 23	-226 bps
10yr Treasury	March 9	+18 bps
10yr Bund	March 9	+35 bps
VIX	March 16	-54 pts
Brent	April 21	35.4%

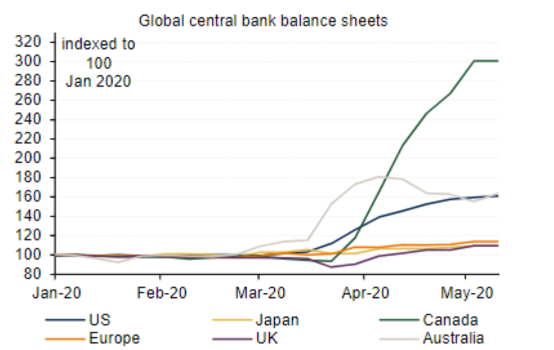
United States back to top

US CPI came in on target at -0.8%, but core CPI was lower than expected at -0.4% (vs. -0.2%). The annualized numbers were 0.3% (vs. 0.4%) and 1.4% (vs. 1.7%), with the overall trend showing that consumer inflation was weaker than expected in April. The market reaction was muted.

US markets were mixed in a relatively quiet session, with the Nasdaq posting its sixth consecutive day of gains. Sentiment fluctuates from one day to the next, and on Monday the focus was on negative trends on the virus front, such as new outbreaks in Korea and China and rising infection rates in Russia and Latin America. Treasury yields were higher amidst extensive hedging flows due to the large issuance of new corporate bonds, and the yield curve continued to steepen. The VIX dipped further, its second straight close below 30. Chicago Fed President Evans and Atlanta's Bostic downplayed the possibility of negative rates. A key event later this week will be Fed Chair Powell's speech on May 13th.

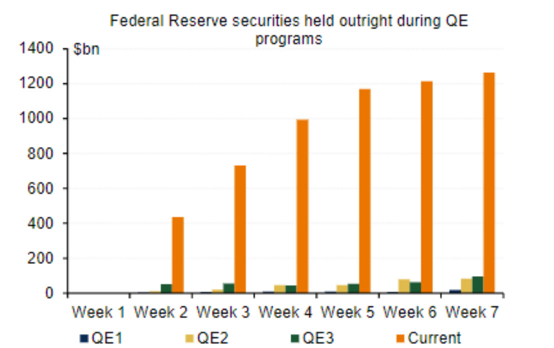
The Fed's balance sheet has grown to $6.7 tn and Bank of America forecasts that it could grow further to $8 tn by the end of the year. The balance sheet had shrunk to $4.1 tn prior to the COVID-19 outbreak. The current measures dwarf previous episodes of quantitative easing (QE), although the FOMC has emphasized repeatedly that these are not QE purchases but rather an effort to stabilize markets and promote liquidity. The analysts predict that the US economy will shrink by 5.6% in 2020 and the global economy will contract by 3%. They point out that 80% of job losses so far are furloughed workers who expect to be re-employed when the lockdown ends, so the hope is that the economy could rebound in the second half of the year provided that there is no second wave of the virus in the autumn and winter.

Chart 1: The Fed balance sheet, coupled with that of other central banks, has swollen in the past two months...



Source: BofA Global Research

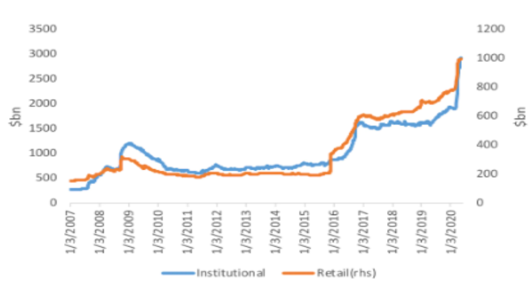
Chart 2: ...at a remarkable rate, easily outpacing any previous quantitative easing programs



Source: BofA Global Research, Board of Governors of Federal Reserve System

Bond markets face some important challenges in the face of high demand for short duration assets and the coming flood of new Treasury issuance. Assets under management (AUM) at both retail and institutional money market funds has swelled in recent weeks, with institutional AUM rising at the fastest pace since 2007. Retail inflows were probably driven by equity sales, while institutional inflows were probably driven by the proceeds for corporate bond sales, which saw record months for investment grade issuers in March and April and with another record month expected in May. Retail inflows lows have reached $200 bn while institutional flows topped $1 tn over the period of March to May. With these funds heavily invested in T-Bills, the Treasury has been able to keep yields down on its short-end issuance, but if companies and individuals begin moving cash elsewhere, short-end rates could come under upward pressure. The same goes for the longer end of the curve, where the Treasury announced much larger issuance than the market was expecting last week. Citi thinks the Fed will have to maintain its bond purchases to keep longer maturity yields in check. In its latest investor poll, Citi found that 57% expect the Fed to keep buying Treasuries at a similar pace and 35% think the Fed will have to begin a second round of large-scale purchases.

Figure 6. Retail and institutional money market funds AUM has exploded higher; retail possibly from liquidating equities, and institutional most likely from the record issuance recently as companies raise cash buffers.

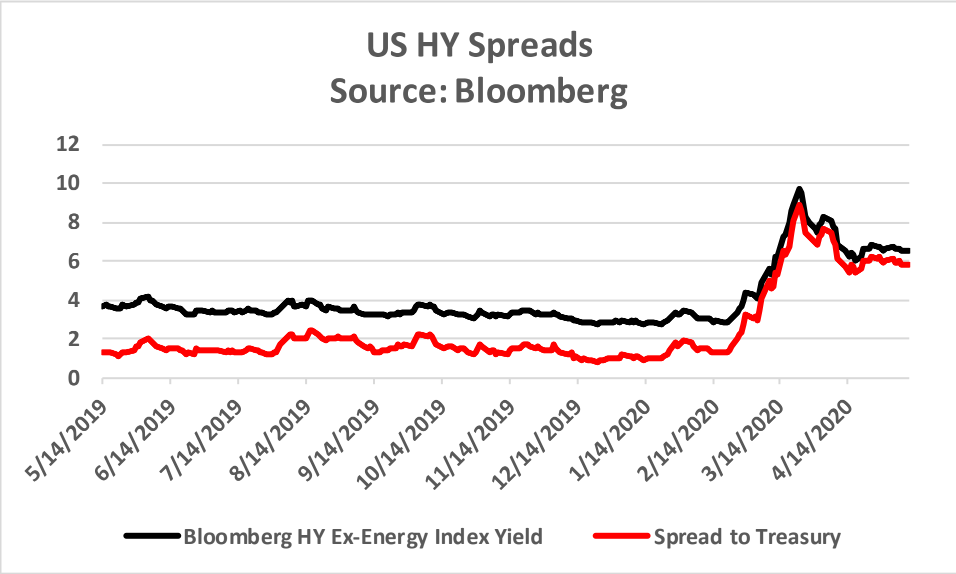


Source: Citi Research

Figure 7. Gross supply in Treasuries, supras, and IG corporates combined has ballooned in recent months. Treasury supply is ramping up significantly into year end, with only the Fed's purchases moderating the rise in yields. Looking forward, the Fed will have to keep taking down Treasury supply

Source: Citi Research

US high yield (HY) credit spreads have stabilized, although spreads remain high by recent historic standards. However, some companies are finding it difficult to issue new bonds and HY issuers are being forced to put up assets as collateral for their bonds. Last week, United Airlines was forced to abandon its $2.25 bn bond offering even after offering a yield as high as 11% because investors were dissatisfied with the pledged collateral of aircraft, which are likely to lose value as the economic crisis drags on. Viking Cruise Line was the first company to offer bonds this week after the failed United deal, marketing $600 mn of five-year bonds backed by ships as collateral. Earlier, Norwegian Cruise Line raised $675 mn of four-year debt at 12.575% pledging some of its islands, ships and certain intellectual property as collateral. In contrast the investment grade market is booming, with $75 bn of issuance of new issuance expected this week.



Europe

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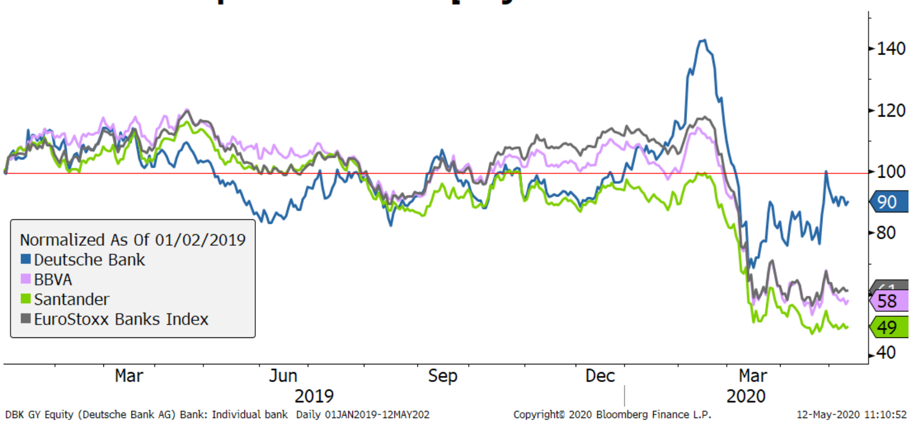
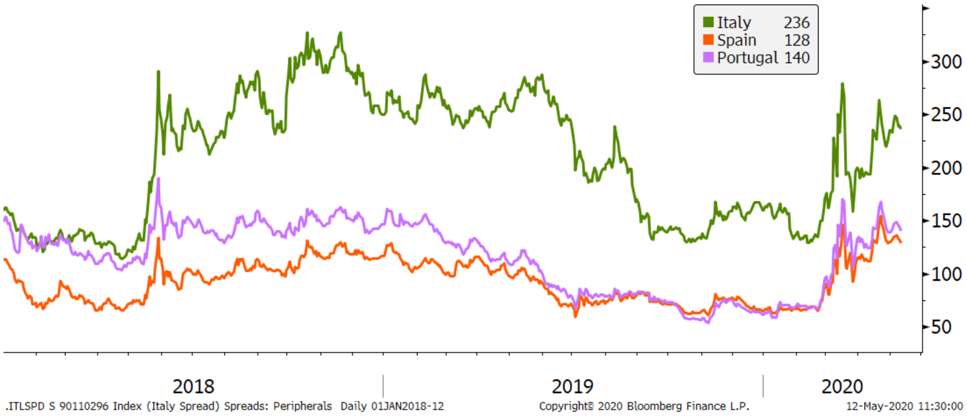
Stocks were modestly higher as countries move closer to re-opening. Bank stocks (+0.9%) outperformed the main indices. In banking news, Deutsche Bank (-3%) has announced plans to issue $1.4 bn in Tier 2 bonds in a bid to improve the bank's capital buffer. BBVA (+2.6%) has announced the re-opening of additional branches, bringing its total share of re-opened branches to 55%. Santander (+1.6%) has reopened about 60% of offices.

Selected European Banks: Equity Price

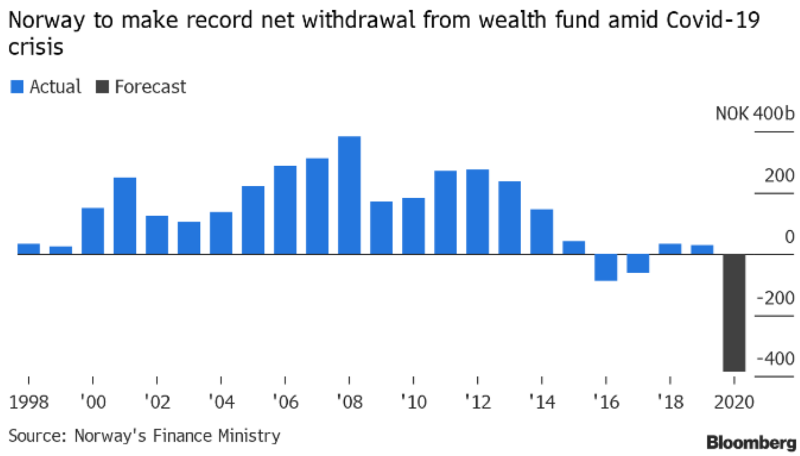


Sovereign debt markets were steady: German 10-year yields are at -0.50% (+2 bps); French OATs are at -0.01% (flat); Italian at 1.87% (-1 bp); and Spanish at 0.80% (-2 bps). Despite the small moves today, sovereign spreads to German bunds remain relatively elevated.

Southern Europe Sovereign Spreads to 10yr Bunds
(in basis points)



Norwegian authorities plan to withdraw about $37 bn ($382 bn kroner) of cash from the Norwegian Sovereign Wealth Fund – the largest in the world. The move will force a large-scale asset sale that could impact financial valuations in various markets.



Other Mature Markets

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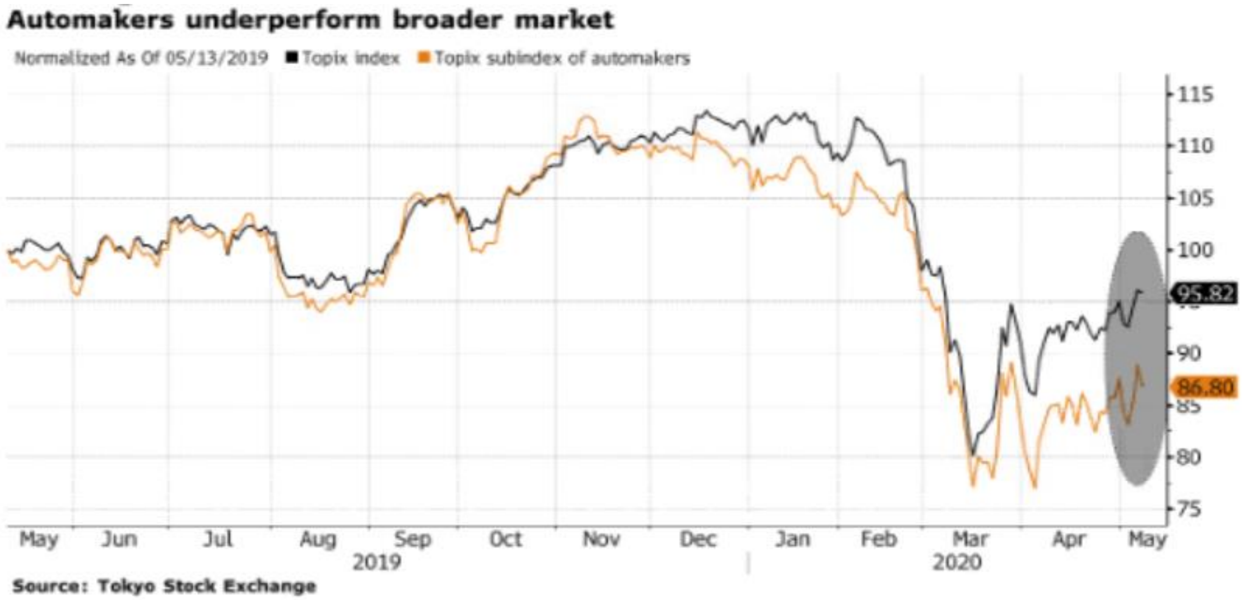
Japan

Equities (-0.3%) fell slightly with autos underperforming on disappointing guidance from Toyota. Toyota warned that profit will fall 80% to a nine-year low. The automaker said that it could take another year before global car sales return to pre-virus levels. It is targeting operating profits of JPY500 bn ($4.65 bn) for the year through March, which is significantly below analyst expectations of JPY1.8 tn and a fifth of JPY2.44 tn in the year prior. **The yen appreciated slightly while the 10-year JGB yield fell -0.9bps.**



Emerging Markets

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Equities fell across most of Asia (-0.9% on net). Currencies were little changed except for the Korean won (-0.4%) and the Indian rupee (+0.3%). The Philippines will ease the lockdown in Metro Manila, the province of Laguna and Cebu city to allow manufacturing and processing plants to activate as much as 50% of their workforce. Markets in eastern Europe and the Middle East were mostly higher. The Turkey Wealth Fund is expected to inject about $3 bn into local banks. Latin American equities were mixed, while currencies were generally weaker. Spreads to US sovereign yields widened for Mexican local currency debt, as well as for Brazilian and Colombian local currency 10-year debt, while spreads to US sovereign yields continued to narrow on USD and local currency debt in most of the region's other countries.

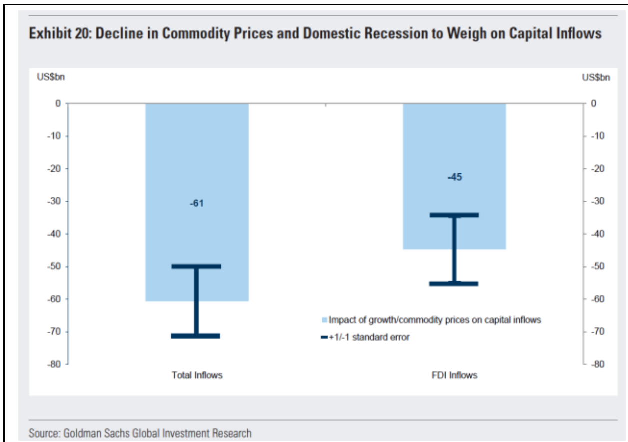
Key Emerging Market Financial Indicators

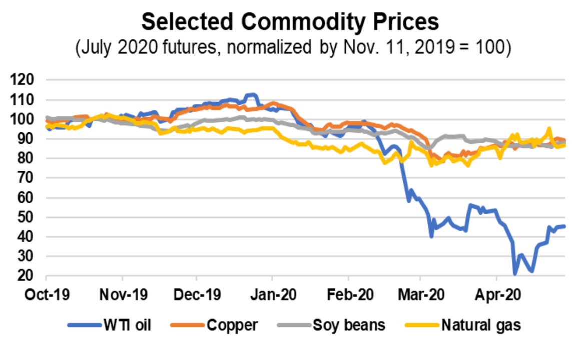
Last updated:	Level		Change				
5/12/20 8:09 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		36.60	0.2	3	4	-12	-18
MSCI Frontier Equities		22.44	-2.0	0	5	-22	-26
EMBIG Sovereign Spread (in bps)		569	-3	-27	-28	218	276
EM FX vs. USD		53.14	0.7	0	-1	-14	-13
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		7.09	0.2	0	0	-3	-2
Indonesian Rupiah		14905	-0.1	1	5	-3	-7
Indian Rupee		75.50	0.3	0	1	-7	-5
Argentine Peso		67.37	-0.1	-1	-3	-33	-11
Brazil Real		5.77	0.8	-3	-10	-31	-30
Mexican Peso		23.81	0.4	1	-1	-19	-20
Russian Ruble		73.15	0.7	1	1	-11	-15
South African Rand		18.20	1.2	2	0	-21	-23
Turkish Lira		6.99	1.2	1	-3	-13	-15
EM FX volatility		11.78	0.0	-0.1	0.3	3.1	5.2

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

Funding Risk in Latin America

Latin America could face significant funding risks as its economies weaken. According to Goldman, a scenario assuming an average 20% price decline in commodities and a contraction in real GDP of 5% to 6% generates a loss in aggregate private capital inflows to the region's main economies of $60 bn to $70 bn in 2020, 75% of which is expected to be Foreign Direct Investment (FDI). While increased funding from multilateral agencies and ample reserve cushions in some countries may mitigate immediate risks, the structural deterioration in capital flows point to mounting external constraints on countries' policy space in the medium term.

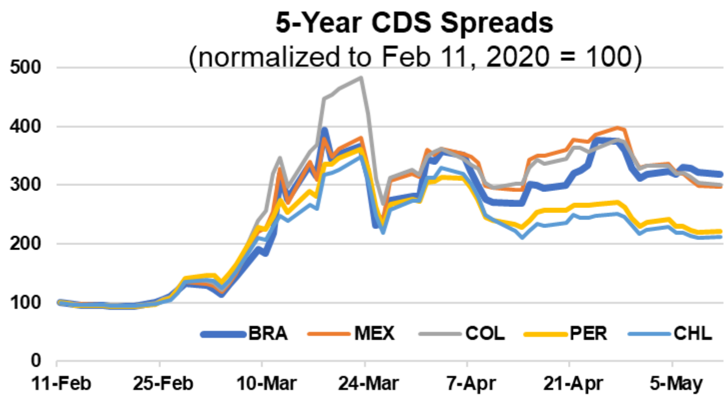




Source: Bloomberg.

Brazil

Accelerating COVID-19 infections threaten the future path of GDP, boosting sovereign credit risk. Infections have risen to 170K cases and are growing at 4% per day, putting severe strains on the health care system. JP Morgan expects a further tightening in the country's quarantine measures, potentially including generalized lockdowns. Economic activity is expected to remain subdued for longer and the analysts have lowered their 2020 growth forecast from -3.2% y/y to -7%. The liquidity support of 17% of GDP provided by the central bank, which successfully revived corporate credit in March, and the fiscal stimulus in excess of 100bn reals are not enough to allow for a return to pre-crisis levels of economic activity during 2021. The widening crisis has likely pushed up Brazil's CDS spread, which has risen above local peers.

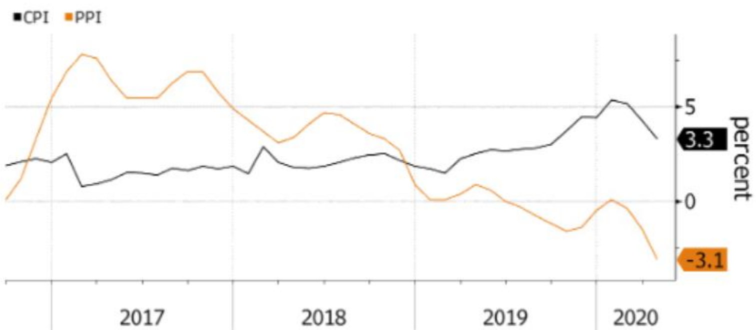


Source: Bloomberg.

China

China's April inflation data missed expectations, reflecting a slow recovery. The producer price index weakened -3.1% y/y (consensus: -2.5% y/y) from -1.5% y/y in March. The decline was driven by a slump in global oil prices and weakening demand for industrial products in upstream sectors such as mining and raw materials. The consumer price index rose 3.3% y/y (consensus: 3.7%) moderating from 4.3% y/y in March on cooling food and non-food inflation. Food and non-food inflation fell to 14.8% y/y and 0.4%, respectively from 18.3% and 0.7% in March. **Analysts view the disinflation as conducive for Chinese policymakers to enact further stimulus to offset the impact from COVID-19.** Equities (Shanghai -0.1%; Shenzhen +0.3%) and the RMB were little changed. On COVID-19, Wuhan, the origin of the virus, will test its entire population of 11 mn. The move to universal testing came after the city reported 6 new locally transmitted cases on May 10 and May 11 in the same residential compound, the first new infections since its lockdown was lifted in early April.

China's CPI moderated while PPI weakened further



Source: National Bureau of Statistics

Saudi Arabia

Saudi Arabia announced a surprise cut in its oil output in a bid to boost prices. The move aims to slash output by another 1 million barrels a day to 7.5 million barrels by June, the lowest in 18 years, as the authorities look to "further expedite the [supply and demand] re-balancing process". Before the price war, Saudi Arabia was producing about 12.3 million barrels a day but has since reduced its production by about 4.8 million barrels. Meanwhile, the plunge in prices has weighed on the kingdom's fiscal outlook and forced the government to impose austerity measures; the latest include a tripling of VAT and a reduction in allowances for state workers worth about SAR 100 bn ($27 bn). The front-month WTI futures contract is over 5% higher this morning at $25.43/barrel, and Brent is 3% higher at $30.50.

Saudis Cut Output
Riyadh will pump the least in 18 years in June

Source: Bloomberg
OPCRSAUD Index (Bloomberg OPEC Crude Oil Production Output Data/Saudi Arabia) Li Copyright© 2020 Bloomberg Finance L.P. 11-May-2020 20:55:07

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Global Financial Indicators

Last updated: 5/12/20 8:08 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		2930	0.0	3	5	2	-9
Europe		2892	0.3	1	0	-14	-23
Japan		20366	-0.1	1	4	-5	-14
China		2892	-0.1	1	3	-2	-5
Asia Ex Japan		64	-0.4	3	5	-7	-13
Emerging Markets		37	-0.7	3	4	-12	-18
Interest Rates					basis points		
US 10y Yield		0.71	0.1	5	-1	-176	-121
Germany 10y Yield		-0.49	2.5	9	-14	-44	-30
Japan 10y Yield		0.00	-1.2	2	-2	5	1
UK 10y Yield		0.27	0.0	6	-4	-87	-55
Credit Spreads					basis points		
US Investment Grade		208	-0.7	11	5	92	111
US High Yield		753	-0.4	-2	-16	336	360
Europe IG		83	-1.0	-1	4	16	39
Europe HY		502	-4.5	-7	39	213	296
EMBIG Sovereign Spread		570	-2.0	-26	-27	219	277
Exchange Rates					%		
USD/Majors		99.87	-0.4	0	0	3	4
EUR/USD		1.08	0.3	0	-1	-3	-3
USD/JPY		107.4	0.3	-1	0	2	1
EM/USD		53.1	0.7	0	-1	-14	-13
Commodities					%		
Brent Crude Oil ($/barrel)		31	3.3	-1	-3	-57	-54
Industrials Metals (index)		96	-0.4	2	4	-15	-16
Agriculture (index)		35	-0.2	0	-4	-6	-16
Implied Volatility					%		
VIX Index (%, change in pp)		26.7	-0.8	-6.9	-14.9	10.7	13.0
10y Treasury Volatility Index		5.3	0.1	0.6	-1.3	1.2	1.1
Global FX Volatility		9.1	0.0	-0.2	-0.1	2.2	3.1
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		266	-2.5	-13	51	-90	100
Italy		236	-2.7	-8	43	-36	77
Portugal		141	-4.1	-7	15	25	78
Spain		129	-4.1	-7	16	26	63

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: 5/12/2020 8:10 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		7.09	0.2	-0.3	0	-3	-2		2.5	4.9	15	5	-78	-60
Indonesia		14905	-0.1	1.2	5	-3	-7		8.0	-7.4	-2	-8	-5	91
India		76	0.3	0.2	1	-7	-5		6.2	9.8	-3	-48	-127	-66
Philippines		50	0.0	0.4	1	4	1		4.6	-4.2	-30	-48	-55	29
Thailand		32	0.3	0.8	2	-1	-7		1.3	0.2	-6	-32	-127	-29
Malaysia		4.33	0.1	-0.5	0	-4	-6		2.8	0.0	-4	-49	-106	-58
Argentina		67	-0.1	-0.7	-3	-33	-11		41.4	-143.7	124	-1717	1332	-2120
Brazil		5.77	0.8	-3.4	-10	-31	-30		5.8	2.6	-26	-38	-218	-43
Chile		824	0.4	1.5	3	-16	-9		2.7	-1.5	-4	-64	-141	-60
Colombia		3898	-0.1	2.3	-1	-15	-16		5.7	5.5	-47	-145	-47	-21
Mexico		23.81	0.4	0.8	-1	-19	-20		6.1	9.3	-44	-100	-208	-80
Peru		3.4	-0.3	-1.0	-1	-3	-3		4.3	-10.7	-49	-81	-102	-19
Uruguay		44	-0.1	-2.5	-1	-20	-15		11.5	6.2	-23	-168	61	63
Hungary		323	0.2	-0.1	0	-11	-9		1.7	-6.2	-1	-26	-44	50
Poland		4.19	0.7	-0.1	0	-8	-9		1.1	0.1	3	-2	-125	-78
Romania		4.5	0.3	-0.1	-1	-5	-4		4.0	-9.0	-16	-29	-24	-1
Russia		73.2	0.7	0.8	1	-11	-15		5.7	0.0	-16	-80	-223	-43
South Africa		18.2	1.2	1.7	0	-21	-23		10.1	11.4	-59	-100	77	57
Turkey		6.99	1.2	1.2	-3	-13	-15		11.9	5.4	95	-113	-1057	17
US (DXY; 5y UST)		100	-0.4	0.1	0	3	4		0.36	0.5	-2	-5	-191	-134

	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		2892	-0.1	1	3	-2	-5		254	-1	-1	7	80	78
Indonesia		4589	-1.1	0	-1	-26	-27		325	0	-11	-39	138	169
India		31371	-0.6	0	1	-16	-24		326	0	-5	-33	175	201
Philippines		5652	-0.3	0	3	-27	-28		175	1	-3	-13	94	109
Malaysia		1380	-0.2	-2	2	-14	-13		254	1	-26	-39	131	142
Argentina		38582	6.6	19	38	16	-7		3045	-29	-440	-815	2150	1276
Brazil		79065	-1.5	0	2	-16	-32		413	-1	-4	30	168	198
Chile		3812	-0.2	-3	0	-25	-18		266	1	-11	-33	139	133
Colombia		1104	-0.6	0	-7	-29	-34		347	1	-19	-5	161	184
Mexico		37632	0.0	3	9	-13	-14		600	-3	-40	-17	294	308
Peru		15266	-0.9	4	10	-24	-26		232	0	-10	-38	100	125
Hungary		35097	0.5	1	4	-15	-24		216	0	-12	10	119	130
Poland		45543	1.6	1	2	-20	-21		91	-3	-12	-37	51	73
Romania		8396	-0.1	4	1	1	-16		342	-3	-17	-37	154	168
Russia		2634	-0.3	0	-2	5	-14		249	-1	-15	-12	41	118
South Africa		50533	0.7	3	5	-11	-11		647	-10	-33	-10	347	327
Turkey		99054	1.3	0	3	12	-13		677	-10	-2	-18	148	276
Ukraine		500	0.0	0	0	-13	-2		732	-12	-87	-93	84	312
EM total		37	0.2	3	4	-12	-18		569	-3	-27	-28	218	276

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

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