GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, MAY 18, 2021

- **Inflation risk takes center stage in US bond markets** (link)
- **US fallen angel spreads at multi-year lows** (link)
- **Capex expected to boost US recovery** (link)
- **Chinese investors pile into US Treasuries** (link)
- **Focus shifts to ECB bond purchase plans at June 10 meeting** (link)
- **Stocks in Chile plunge over 9% on election results** (link)

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Global markets trade sideways

Global markets are looking for direction this morning. US equity futures are higher, Asia saw a decent rebound after days of tech-led weakness, and European stocks are posting modest gains after Monday's declines. However, government bonds and most major currencies were little changed as investors sifted through various narratives for what lies ahead. Inflation remains a major concern, but central bank rhetoric that sees recent inflation spikes as temporary has kept markets in check so far. Europe and the US are reopening and vaccinating at a faster pace, but there are significant areas of weakness in Asia and Latin America, where the virus crisis remains very severe and economic data have been disappointing. Q1 earnings season was strong, but Q2 could be hit by the multiple shortages that are plaguing the global supply chain. Oil prices are much higher this year on economic optimism, but sharply higher food prices could put strains on many emerging and frontier economies.

Key Global Financial Indicators

Last updated:	Level		Change from Market Close				
5/18/21 8:25 AM	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		4163	-0.3	-1	-1	41	11
Eurostoxx 50		4013	0.2	2	0	38	13
Nikkei 225		28407	2.1	-1	-4	39	4
MSCI EM		53	-0.1	-2	-3	41	2
Yields and Spreads			bps				
US 10y Yield		1.64	-0.9	2	6	91	73
Germany 10y Yield		-0.13	-1.1	4	14	34	44
EMBIG Sovereign Spread		331	-1	1	-6	-247	-19
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		57.8	0.2	0	2	9	0
Dollar index, (+) = $ appreciation		89.8	-0.4	0	-2	-10	0
Brent Crude Oil ($/barrel)		69.9	0.6	2	5	101	35
VIX Index (%, change in pp)		19.6	-0.1	-2	3	-10	-3

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

United States

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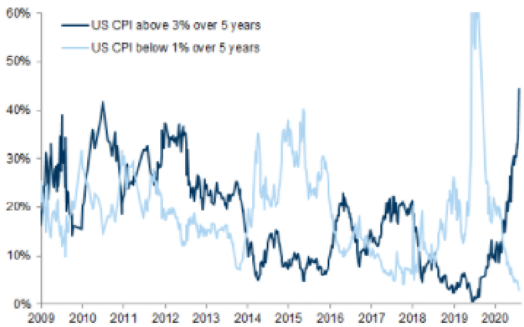
This morning's US housing starts numbers were much weaker than expected. Treasuries rallied and the dollar weakened in the immediate aftermath of the report, which was the latest in a series of worse than expected reports, including the recent payrolls and inflation data.

Fears of inflation are rising in US bond markets. The inflation derivatives market is pricing the probability of inflation over 3% over the next five years at an all-time high of 45%. The probability of low inflation has fallen sharply. In addition, inflation risk premia have turned positive. Treasury Inflation Protected Securities (TIPS) breakeven yields are close to their post-GFC highs. The biggest fear facing markets at the moment is an unexpected spike in interest rates, given the very expensive valuations priced into risk assets. Such a spike could bring the past year's rally to an abrupt end, with the potential for heavy losses.

Exhibit 1 : The market implied probablity of US inflation overshooting is at record highs

Based on the probability density function of CPI inflation derived from caps and floors



Source: Federal Reserve Bank of Minneapolis, Goldman Sachs Global Investment Research

Exhibit 2 : Inflation risk premia have turned very positive

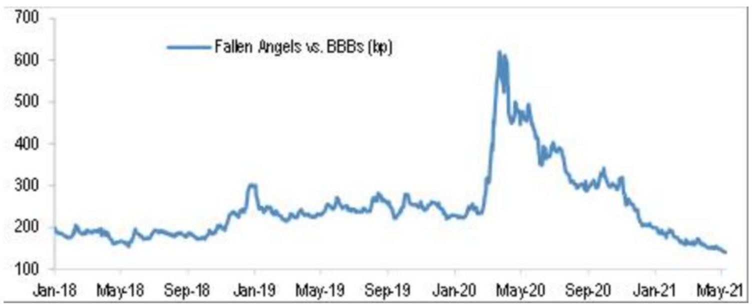
10-year breakeven inflation minus Professional Forecasters estimate over the next 10 years

Source: Haver Analytics, Goldman Sachs Global Investment Research

Tightening credit spreads have spread throughout the US bond market, driving the fallen angel spread down to the lowest level in years. Fallen angels are formerly investment-grade companies that were downgraded below the BBB- investment grade threshold into junk or high yield territory. With the spread at 141 bps, the level is not too far from the all-time low of 85 bps before the GFC in July 2007. This is in contrast with the average spread of 250 bps seen over the last five and ten years. However, JP Morgan reports that the ratio of fallen angel to investment grade spreads is at 2.3X, which is about one standard deviation of the long term average. From this perspective, the relative spreads appear less of alignment.

Exhibit 3: Currently, the spread between BBB HG and the Bloomberg Fallen Angel index is just 141bp

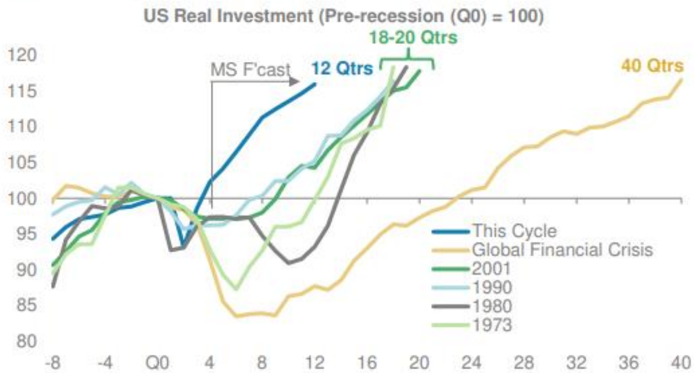
Fallen Angel spread pickup vs. BBBs



Source: J.P. Morgan, Bloomberg Finance L.P.

Capital expenditure is expected to boost the US economy, enabling it to stage a major rebound in the months ahead. Morgan Stanley forecasts that world economic investment will hit 115% and 121% of pre-pandemic levels by by the end of this year and the end pf 2022, respectively. This is much faster than cycles, were it took 20-25 quarters to exceed pre-recession levels. For the US, the investment will hit 116% of the pre-pandemic level in just 12 quarters, compared to 40 quarters after the GFC and the 21 quarter average over the past five cycles.

Exhibit 7:
US investment recovery in this cycle is similar to the one in 1990s but with a faster pace



Source: Haver Analytics, BEA, Morgan Stanley Research forecasts

Europe

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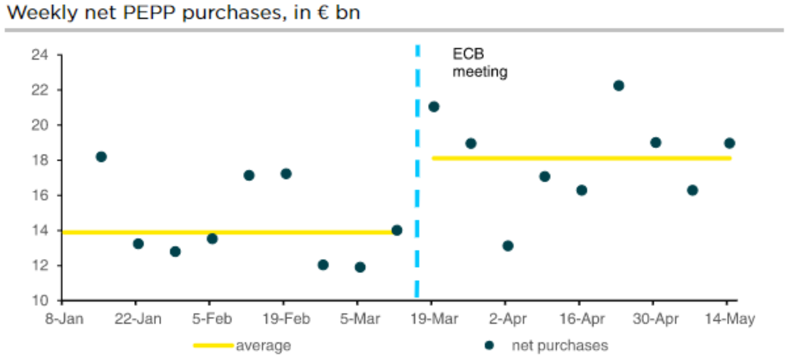
Most exchanges were slightly higher after Monday's losses higher and government bond yields were little changed. Amid quiet trading conditions, market commentary is focused on the inflation prospects for the eurozone and on whether the ECB will consider tapering at its next meeting in June. Inflation expectations have been steadily increasing in the Eurozone (as measured by the 5y5y swaps). Some market contacts expect the ECB to consider tapering in coming months, while others remark that the parameters of its programs would allow enough flexibility to adjust the pace of purchases without a formal commitment to tapering.

... as ECB maintains higher purchase pace
Weekly net PEPP purchases, in € bn

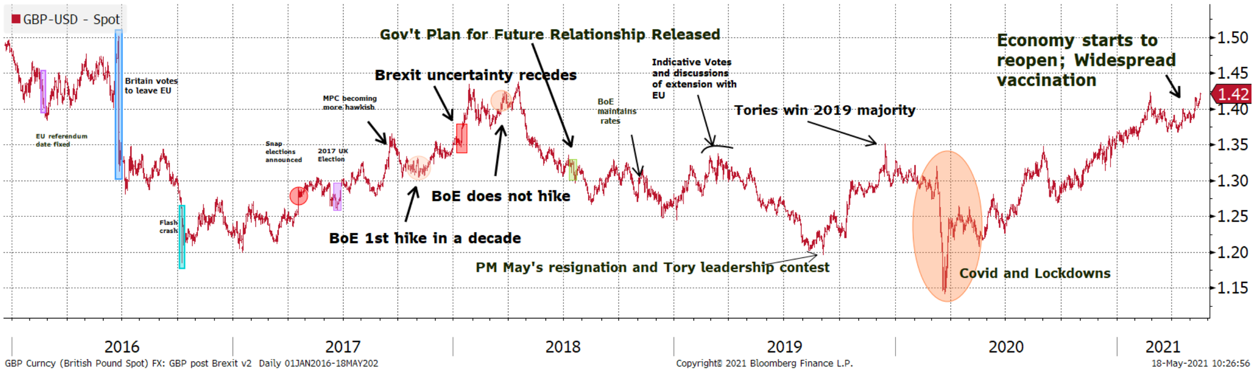


Source: Bloomberg, Commerzbank Research

United Kingdom

In the UK, high frequency indicators suggest the economic recovery is in train: jobless claims dropped 15k in April, while the unemployment rate for March inched down to 4.8% from 4.9 and weekly earnings grew 4.0% y-o-y. **Sterling (+0.5%) continued to strengthen to the dollar**, reaching $1.42 and bringing its gains for 2021 to around 4%.

British Pound vs US Dollar



Other Mature Markets

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Australia

The Reserve Bank of Australia (RBA) said in its May meeting minutes that July's decision on bond purchases would depend on economic data and financial market conditions. The RBA is set to make a call at its July 6 meeting on whether to move the three-year yield target to the November 2024 bond from the current April 2024 security. The current AUD100 bn ($80 bn) government bond purchase program will be completed in September. The Board said that it remained willing to purchase more bonds if the buying assists with achieving the RBA's full employment and inflation goals. The RBA reiterated that the conditions for an increase in the cash rate are unlikely to be fulfilled until at least 2024 at the earliest. Markets are pricing a 2022 move.

Japan

Equities rebounded, rising +1.5%, despite the GDP miss. Japan's economy shrank more than expected in Q1, contracting by annualized -5.1% from the previous quarter (versus consensus of -4.5%), ending six months of double-digit growth. The decline was driven by companies cutting capital investment, shoppers holding back spending and government outlays falling amid a suspension of a travel-promotion campaign.

Emerging Markets

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EMEA equities were trading higher with main indices up in Russia (+1.5%), the UAE (+1.2%) and Israel (+1.1%). **EMEA currencies mostly appreciated** with the South African rand (+0.7%) outperforming. The sentiment in CEE markets was supported by better than expected Q1 GDP growth in Hungary and Romania. **Asian equities rose +1.7% on broad-based gains, with Taiwan Province of China (+5.2%) in the lead due to a tech rebound and currencies appreciated.** Some are worried that Korean equities are being driven by heavy retail financing. In **Latin America the Peruvian Sol** weakened by 1% as the polls continue to show that the gap between the two presidential candidates has narrowed down to a statistical tie. Some analysts highlighted that the Sol's underperformance came after several centrist politicians refused to support the more market friendly candidate in the upcoming presidential election. **Moody's downgraded Ethiopia's credit rating to Caa1 while maintaining a negative watch.** The downgrade puts Moody's rating below S&P's (B-) but above Fitch (CCC).

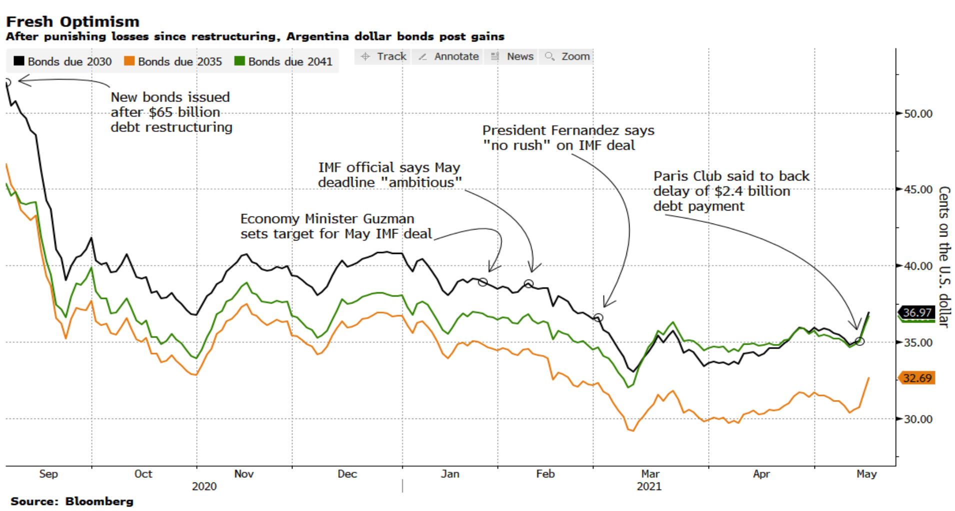
Key Emerging Market Financial Indicators

Last updated: 5/18/21 8:28 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		52.90	1.5	-2	-3	41	2
MSCI Frontier Equities		31.79	-0.1	1	3	40	12
EMBIG Sovereign Spread (in bps)		331	-1	1	-6	-247	-19
EM FX vs. USD		57.79	0.2	0	2	9	0
Major EM FX vs. USD					%, (+) = EM currency appreciation		
China Renminbi		6.42	0.2	0	1	11	2
Indonesian Rupiah		14273	0.1	-1	2	4	-2
Indian Rupee		73.04	0.2	0	3	4	0
Argentine Peso		94.14	-0.1	0	-1	-28	-11
Brazil Real		5.26	0.2	-1	5	9	-1
Mexican Peso		19.77	0.1	1	0	20	1
Russian Ruble		73.74	0.2	1	4	-1	0
South African Rand		13.99	0.7	0	2	31	5
Turkish Lira		8.34	-0.3	-1	-3	-17	-11
EM FX volatility		9.29	0.0	0.0	-0.7	-2.2	-1.5

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

Argentina

Bond prices climbed to a three month high after the President said at the end of last week that he wants to reach an agreement with an IMF as quickly as possible. Over the last two trading sessions, the yield on the 2035 bond declined by 80 bps to 16.4%. Markets also reacted positively to an unconfirmed story by Bloomberg on Monday that a nonpayment to the Paris Club at the end of this month would not be interpreted as a default. Argentina has formally asked the Paris Club for more time to make the $2.4 bn payment and is expecting to receive a response by the end of the month.



Chile

Chile's equity index declined by 9.3%, the largest decline since the COVID-19 selloff following this weekend's constitutional assembly election results. The ruling coalition is set to fall well short of the one-third threshold of assembly seats that market participants were expecting. Analysts highlight that these results imply that the center right will lack veto power and hence have greater difficulty in blocking marketunfriendly policies. In addition, the results suggest that anti-establishment candidates may be more competitive in the presidential elections in November.

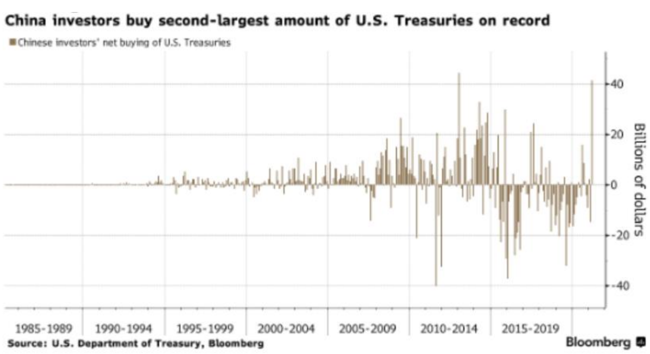
Table 1: Constitutional Convention
Number of seats, preliminary

Independents	48
Vamos por Chile (center-right)	39
Apruebo (center-left)	25
Apruebo Dignidad (extreme-left)	28
Original people (pre-assigned)	17
Memo	
1/3 threshold	52

Source: Emol and La Tercera

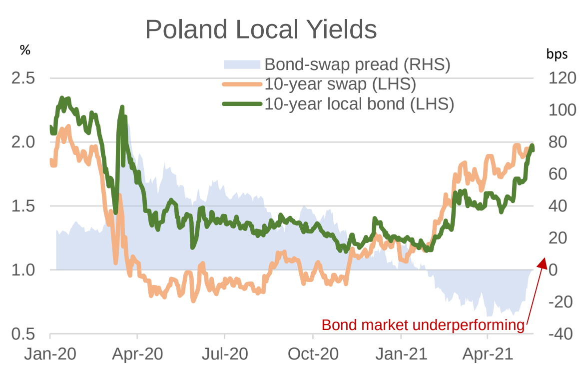
China

China-based investors purchased the most US treasuries in eight years in March. They purchased $41.6b of the securities, the most since the all-time high in January 2013 based on data starting in 1985, according to Bloomberg citing US Treasury figures. While they bought more treasuries, the market value of their total holdings fell in the month, possibly due to the drop in treasury prices. **Separately, corporate bond rating downgrades by domestic rating agencies have more than tripled.** 366 bonds were downgraded in the first four months of 2021, compared with 109 in the same period a year ago, according to Financial Times citing Wind data. **Equities (Shanghai +0.3%; Shenzhen +0.2%) rose while the RMB appreciated +0.3%.**



Poland

The government bond market comes under pressure on regional inflation concerns. The 10-year government bond yield touched 2% ahead of yesterday's core inflation release (3.9% yoy against 3.7% expected) while interest rate forwards priced 70 bps of hikes on a 1-year horizon, with the first 15 bps increase moved forward to the July meeting. Market pricing stands in stark contrast with the National Bank of Poland policy stance that foresees no rate increase this year**. Contacts noted that the selling pressure emanated primarily from non-resident investors on broader regional inflation concerns ahead of the vaccination driven reopening this summer.** In contrast to the February sell-off, there has been a notable underperformance of bonds as compared to swaps as investors saw bonds overvalued.



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Global Financial Indicators

Last updated: 5/18/21 8:27 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4169	-0.3	0	0	41	11
Europe		4013	0.2	2	0	38	13
Japan		28407	2.1	-1	-4	39	4
China		3529	0.3	3	1	22	2
Asia Ex Japan		91	-0.2	-2	-4	39	1
Emerging Markets		53	-0.1	-2	-3	41	2
Interest Rates					basis points		
US 10y Yield		1.64	-0.9	2	6	91	73
Germany 10y Yield		-0.13	-1.1	4	14	34	44
Japan 10y Yield		0.09	0.3	1	-1	10	7
UK 10y Yield		0.85	-1.2	2	9	60	66
Credit Spreads					basis points		
US Investment Grade		94	0.3	-1	0	-102	-1
US High Yield		341	0.6	4	8	-377	-39
Europe IG		51	0.3	0	1	-33	3
Europe HY		255	1.5	0	8	-249	14
Exchange Rates					%		
USD/Majors		89.76	-0.4	0	-2	-10	0
EUR/USD		1.22	0.6	1	2	12	0
USD/JPY		108.9	-0.3	0	1	1	6
EM/USD		57.8	0.2	0	2	9	0
Commodities					%		
Brent Crude Oil ($/barrel)		70	0.6	2	5	101	35
Industrials Metals (index)		163	0.9	0	10	68	23
Agriculture (index)		59	1.5	-3	12	71	24
Implied Volatility					%		
VIX Index (%, change in pp)		19.6	-0.1	-2.2	3.4	-9.7	-3.1
US 10y Swaption Volatility		70.9	0.6	-0.5	-6.7	5.6	10.8
Global FX Volatility		7.2	0.0	-0.2	0.0	-1.8	-0.9
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		119	-1.8	2	3	-127	-1
Italy		121	-0.8	7	20	-93	10
Portugal		72	-1.5	2	6	-60	12
Spain		72	-1.3	4	6	-48	10

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: 5/18/2021 8:32 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		6.42	0.2	0.1	1	11	2		3.2	0.2	0	-4	66	-6
Indonesia		14273	0.1	-0.5	2	4	-2		6.5	0.0	1	-18	-138	39
India		73	0.2	0.4	3	4	0		6.3	-1.1	0	-11	10	34
Philippines		48	0.1	0.0	1	6	0		4.3	9.5	12	28	-18	68
Thailand		31	0.2	-0.8	-1	2	-5		1.8	-0.2	-2	-9	48	50
Malaysia		4.13	0.1	-0.2	0	6	-3		3.3	-0.4	1	5	46	71
Argentina		94	-0.1	-0.2	-1	-28	-11		45.9	22.3	-22	-39	328	-1025
Brazil		5.26	0.2	-0.8	5	9	-1		8.4	3.5	18	3	217	277
Chile		717	-2.3	-3.1	-2	15	-1		3.8	10.7	20	37	119	100
Colombia		3686	0.0	0.6	-2	5	-7		6.7	-1.6	-4	50	108	167
Mexico		19.77	0.1	0.9	0	20	1		6.8	1.3	14	34	62	125
Peru		3.7	-1.0	0.3	-1	-8	-3		4.8	5.8	-21	7	46	119
Uruguay		44	0.1	-0.3	0	0	-4		7.5	-0.1	16	15	-366	27
Hungary		287	0.9	3.0	5	13	4		2.4	16.1	45	47	84	90
Poland		3.70	0.7	1.2	2	13	1		1.3	6.7	31	48	41	70
Romania		4.0	0.5	0.6	1	10	-1		2.7	-1.0	11	3	-129	-3
Russia		73.7	0.2	0.5	4	-1	0		6.8	0.2	8	10	144	107
South Africa		14.0	0.7	0.0	2	31	5		9.9	2.1	11	7	-44	26
Turkey		8.34	-0.3	-0.6	-3	-17	-11		17.6	-0.5	14	19	573	453
US (DXY; 5y UST)		90	-0.4	-0.4	-2	-10	0		0.83	-1.0	3	0	46	47

	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		5188	0.1	3	2	31	0		199	0	-2	-9	30	-9
Indonesia		5834	0.0	-2	-4	28	-2		158	0	-9	-25	-5	-29
India		50193	1.2	1	5	66	5		163	-2	-1	0	-148	12
Philippines		6245	-0.6	-1	-3	12	-13		83	0	-9	-17	13	-22
Malaysia		1591	0.5	0	-1	12	-2		113	0	-2	-3	9	3
Argentina		56095	0.0	8	18	39	10		1459	0	19	8	-570	91
Brazil		122938	0.0	1	2	51	3		253	0	0	-16	58	3
Chile		4148	0.0	-9	-17	10	-1		126	0	-6	-16	-14	-18
Colombia		1290	0.0	-2	-2	22	-10		207	0	-4	-15	44	2
Mexico		49372	0.0	-1	1	33	12		348	0	-9	-34	55	-12
Peru		21833	0.0	4	3	39	5		133	0	-4	-3	22	1
Hungary		45706	-0.3	3	6	29	9		65	0	-6	-15	-42	-31
Poland		63421	0.5	1	5	38	11		-22	0	-4	-11	-54	-21
Romania		11663	0.5	0	5	41	19		181	1	1	-13	-171	-22
Russia		3693	1.5	1	3	37	12		159	0	-5	-3	19	-7
South Africa		67484	0.4	0	-2	31	14		357	0	-4	-35	25	-23
Turkey		1463	0.6	2	4	43	-1		421	0	-5	-47	34	-24
Ukraine		529	0.0	0	0	6	6		479	0	12	-21	127	-12
EM total		53	1.5	-2	-3	41	2		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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