Global Markets Monitor

GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

WEDNESDAY, MAY 19, 2021

- **Investors flag inflation as biggest tail risk in latest survey** (link)
- **S&P 500 negatively correlated with dollar in recent weeks** (link)
- **Flows to Latin American local debt markets remain weak** (link)
- **Interest rates rise in Mexico on hawkish central bank comments** (link)
- **Thailand announces more fiscal support to counter virus impact** (link)

Global markets decline as inflation worries intensify

Trading screens are displaying a sea of red as most global markets are sharply lower, with a few exceptions like Korea. Interest rates in the US and Europe are moving higher as worries about inflation continue to spread. The resurgence of the virus in many countries also weighed on sentiment, with India reporting the highest one day death toll on record. The pessimistic mood extended to cryptocurrencies and the commodities markets, which are also being hard hit, although copper and nickel eked out fractional gains. This afternoon's FOMC minutes may assume special significance given the market's current fixation on interest rates. The biggest fear is that the recent high inflation numbers and supply disruptions could give rise to a sustained inflationary spike that forces central banks into preemptive rate hikes that derail the global recovery. Many central banks are pushing back, taking the view that these recent trends will be transitory.

Key Global Financial Indicators

| Last updated: 5/19/21 8:11 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		4128	-0.9	-1	-1	41	10
Eurostoxx 50		3929	-1.9	0	-2	35	11
Nikkei 225		28044	-1.3	0	-4	36	2
MSCI EM		54	1.3	0	-1	44	4
Yields and Spreads					bps		
US 10y Yield		1.65	1.5	-4	5	96	74
Germany 10y Yield		-0.10	0.4	2	14	37	47
EMBIG Sovereign Spread		330	-1	-2	-7	-224	-20
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		57.6	-0.3	1	1	8	-1
Dollar index, (+) = $ appreciation		90.0	0.3	-1	-1	-9	0
Brent Crude Oil ($/barrel)		67.3	-2.1	-3	0	94	30
VIX Index (%, change in pp)		23.5	2.2	-4	6	-7	1

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

United States

The latest Fund Manager Survey from Bank of America flags inflation risk as the biggest tail risk for markets, with the related risk of a bond market taper tantrum coming in second. The Covid crisis has fallen to fourth place. Overall, the survey is extremely bullish, with 69% predicting above trend growth with above-trend inflation and a further 19% taking the even more optimistic view that growth will be above trend while inflation stays in check. These findings reinforce the views from several analysts that markets remain very optimistic despite the recent negative surprises of very high US CPI and PPI reports from last week. They believe in the narrative from the Fed and other major central banks that the rise in inflation is likely to be temporary. Others point to the risk of a major market reversal if inflation is viewed as getting out of control.


Exhibit 8: COVID-19 is no longer the biggest 'tail risk'
What do you consider the biggest 'tail risk'?
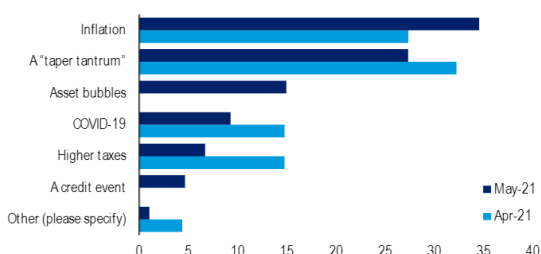
Source: BofA Global Fund Manager Survey

BofA GLOBAL RESEARCH

The S&P 500 has negatively correlated with the US dollar to a significant degree in recent weeks. Bloomberg points out than a similar trend was seen last year during the strong market rally, as foreign investors took advantage of dollar selloffs to buy surging US equities, especially in the technology sector. This year the move began when the Treasury selloff accelerated and put inflation fears front and center. The biggest fear for investors is a surge in inflation that triggers preemptive rate hikes from The Fed and major central banks.


Daily Correlations with the S&P 500 March 18th-May 18th
Source: Bloomberg
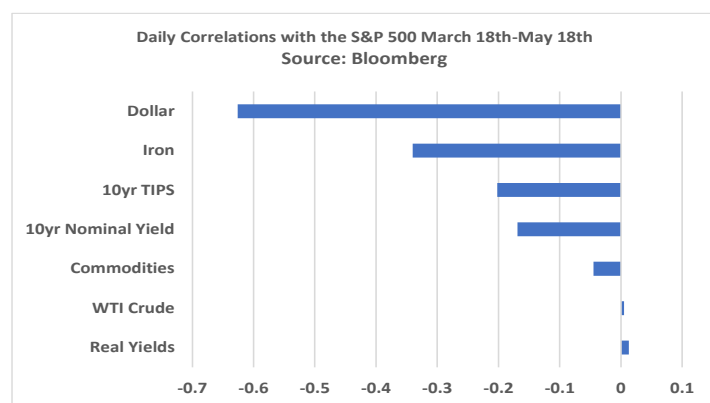
Europe

Local markets are taking heavy losses, led by the DAX (-1.2%). The CAC 40 (-0.9%), EuroStoxx 600 (-1.0%), Italy's Titans 30 (-0.9%), and Spanish Ibex (0.3%) also lost ground as investors are reassessing the inflation outlook and its implication for asset valuations.

Bank stocks (+0.2%) bucked the downward trend, as a steeper yield curve would support their business models. Compared to the start of the year, the **German sovereign yield curve has steepened** 50 bps for the 10-year tenor while the very short-end of the curve has remained anchored at around -0.60%.
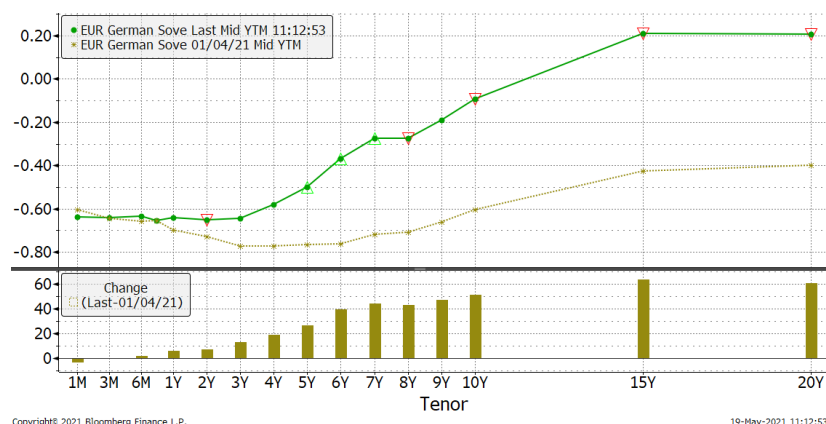
In its latest Financial Stability Review, the **ECB warns about the increasingly uneven impact of the pandemic across sectors and countries**, and that the recent rise in interest rates brings to the fore risks of asset repricing, including for non-bank entities with high duration, liquidity, and credit risks. The ECB also noted that although bank valuations have improved, profitability challenges remain and that the sovereign-bank-corporates nexus may amplify financial stability risks.

United Kingdom

UK inflation data released today showed a pick-up in headline CPI to 1.5% y/y in April, from 0.7% previously. Core inflation came in at 1.3% y/y from 1.1% previously. In testimony to the House of Lords, BOE governor Bailey remarked that the Bank thinks that "**inflation could go above target a bit temporarily**" due to a "strong shift in energy prices."
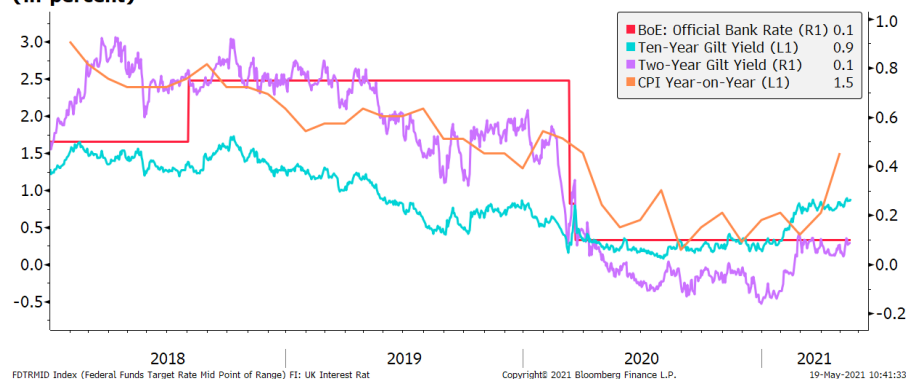
Other Mature Markets   back to top

Japan

Equities fell -0.7% with machinery underperforming. Japan's final industrial production for March was revised down to 1.7% m/m compared with 2.2% previously. Nomura Holdings Inc. will book a $600 mn loss this quarter after unwinding all of its positions relating to Archegos Capital Management. This will be around $30 mn greater than previously estimated, according to Bloomberg. The bank said that it will improve risk management and will refrain from areas within prime brokerage that involve lending using stocks as collateral.

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EMEA stocks and currencies were weaker. Asian equities fell -0.5%, driven by losses in South Asia.
Asian bond yields were relatively stable, except for **Thailand** bond yields (+5.1bps) on reports that the
government is planning to borrow THB700 bn ($22 bn) to fund various measures to counter the impact from
the ongoing virus outbreak. The borrowing would be on top an ongoing THB1 tn debt plan and is scheduled
to be completed before September 30, 2022. Mexico did well although most Latin American markets were
lower.

Key Emerging Market Financial Indicators

Last updated:	Level		Change					YTD
5/19/21 8:17 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M		YTD
Major EM Benchmarks					%			%
MSCI EM Equities		53.61	-1.0	0	-1	44		4
MSCI Frontier Equities		31.76	-0.1	0	3	39		12
EMBIG Sovereign Spread (in bps)		330	-1	-2	-7	-224		-20
EM FX vs. USD		57.59	-0.3	1	1	8		-1
Major EM FX vs. USD			**%, (+) = EM currency appreciation**					
China Renminbi		6.44	-0.2	0	1	10		1
Indonesian Rupiah		14290	-0.1	-1	2	3		-2
Indian Rupee		73.17	-0.2	0	2	3		0
Argentine Peso		94.17	0.0	0	-1	-28		-11
Brazil Real		5.28	-0.4	0	5	9		-2
Mexican Peso		19.89	-0.2	1	0	19		0
Russian Ruble		73.71	-0.1	1	4	-2		0
South African Rand		14.04	-0.3	1	1	31		5
Turkish Lira		8.42	-0.8	0	-4	-20		-12
EM FX volatility		9.24	0.0	-0.2	-0.6	-2.0		-1.5

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

Latin American Local Markets

**Despite the stabilization of US interest rates and stronger local currencies, flows in local currency
debt remain lackluster.** Peru and Mexico continued to see outflows in April, while Brazil has only seen
inflows in short term bonds. One exception in April was Colombia, with foreigners adding risk despite the
political uncertainty around the tax reform. JP Morgan analysts highlight that the current weak external
demand for local bonds coupled with heightened political risks (e.g. Peru/Chile/Mexico near term elections,
protests in Colombia) and pension fund withdrawals (e.g. in Chile see LHS chart) are putting more risk
premium in local bonds and have led some governments to rely on more hard currency issuance. For
example, Chile had plans to issue only $1 bn in hard currency, but they are tracking $7.7 bn. Peru, issued
$5 bn in this year, considerably above the $0.7 bn in the budget law. Colombia also updated its issuance
forecasts from $6.5 bn to $10 bn. Mexico has remained more conservative both in terms of issuance and
fiscal spending while Brazil has been issuing mostly short term local debt, as there is limited appetite for
longer duration.

Exhibit 11: Pension funds withdrawal bills highlights

Source: J.P. Morgan, Superintendencia

Foreign holdings of Mbonos and of total local debt; as % of stock
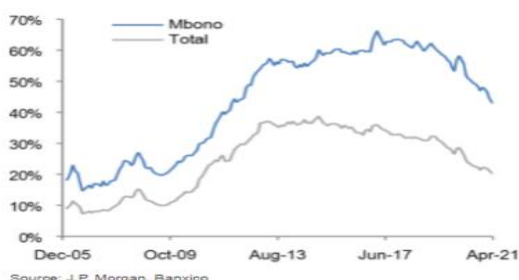
Source: J.P. Morgan, Banxico

China

The Biden administration is reportedly planning to delay the deadline on a new US investment ban in certain Chinese companies by two weeks until June 11, according to Bloomberg. Biden's government has been examining former President Trump's executive order that was issued in November to ban US investments in Chinese companies owned or controlled by the military. Bloomberg also reported that the US is not looking to change its policy but seeks to maintain the ban in a manner that is legally sound and can be sustained over the long-term. **Separately, Huarong bonds are facing volatility on conflicting news reports.** The volatility started on May 12 when various reports said that the authorities had urged Huarong to solve its issues on its own and the Chinese government is 'strongly committed' to making sure both foreign and domestic bondholders do not receive full repayment of their principal. That said, the company has continued to repay its maturing bonds on time and has also reached funding agreements with state-owned banks to ensure it is able repay its debt through at least end-August, when it also aims to finalize its 2020 annual results, according to Bloomberg.

Huarong bonds swing as Beijing remains silent

Source: Bloomberg
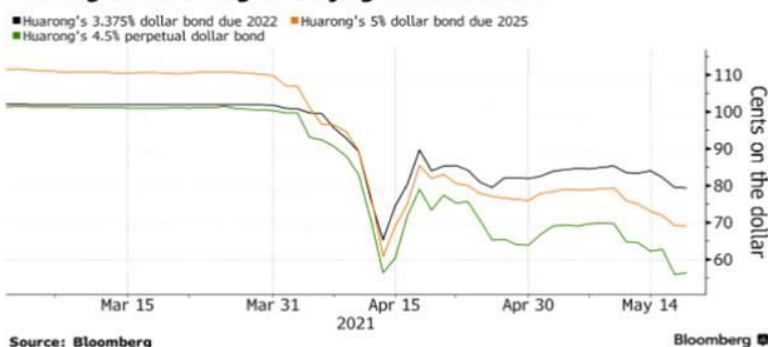
Mexico

Two year swap rates rose by 7 bps to 5.3% following comments by the Deputy Governor Espinosa that the central bank may need to raise rates before the Fed. The swap curve is now pricing 200 bps of hikes over the next 2 years, an almost 40 bps increase since the higher than expected CPI release in the US last week. Local stocks saw a decent rally yesterday despite the weakness in other Latin American bourses as well as US stocks.
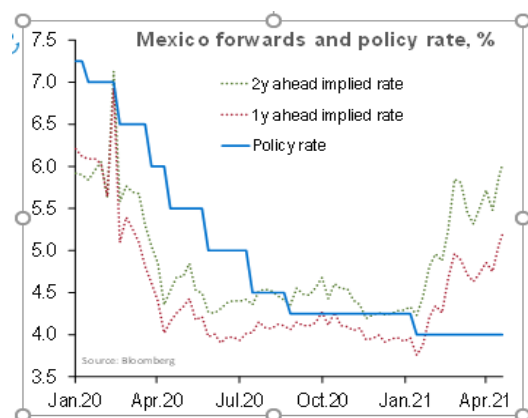
Nigeria

The naira depreciated as the central bank appeared to take steps to unify its multiple exchange rates, measures that are viewed as negative for the currency. The local interbank exchange rate depreciated from 380 to 411 naira per dollar (-8%) on Friday and has remained at that level this week. Contacts noted that the adjustment of the onshore interbank rate to the Investors and Exporters Window

rate (411 $/NGN) is likely to be the next step in exchange rate policy unification. The Central Bank of Nigeria has stopped publishing the official exchange rate level on its website since the middle of last week. Contacts note that investors have welcomed the recent steps towards currency liberalization and normalization of domestic interest rates. That said, the official rate is still seen as overvalued compared to the parallel market rate (480 $/NGN), while domestic interest rates do not appear to fully incorporate inflation risks (inflation is at over 18% yoy) or the legacy of past currency market disruptions.
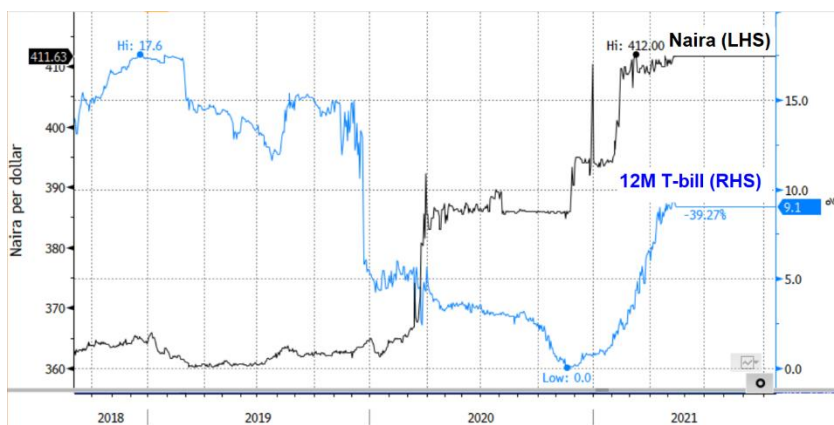
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Global Financial Indicators

Last updated: 5/19/21 8:15 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		4112	-0.9	1	-1	41	9
Europe		3929	-1.9	0	-2	35	11
Japan		28044	-1.3	0	-4	36	2
China		3511	-0.5	1	1	22	1
Asia Ex Japan		92	1.4	0	-2	41	3
Emerging Markets		54	1.3	0	-1	44	4
Interest Rates			basis points				
US 10y Yield		1.65	1.5	-4	5	96	74
Germany 10y Yield		-0.10	0.4	2	14	37	47
Japan 10y Yield		0.08	-0.6	0	-1	8	6
UK 10y Yield		0.88	0.8	-1	12	63	68
Credit Spreads			basis points				
US Investment Grade		94	0.6	0	-1	-99	-1
US High Yield		342	0.5	5	7	-372	-38
Europe IG		53	1.1	1	3	-30	5
Europe HY		261	5.3	1	15	-230	20
Exchange Rates			%				
USD/Majors		89.98	0.3	-1	-1	-9	0
EUR/USD		1.22	-0.1	1	1	12	0
USD/JPY		109.1	0.2	0	1	1	6
EM/USD		57.6	-0.3	1	1	8	-1
Commodities			%				
Brent Crude Oil ($/barrel)		67	-2.1	-3	0	94	30
Industrials Metals (index)		158	-2.1	-2	7	62	19
Agriculture (index)		58	-1.3	-5	9	67	21
Implied Volatility			%				
VIX Index (%, change in pp)		23.5	2.2	-4.1	6.2	-7.0	0.8
US 10y Swaption Volatility		70.9	-0.1	-2.1	-6.8	5.7	10.8
Global FX Volatility		7.2	0.0	-0.2	-0.1	-1.5	-0.9
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		120	1.7	4	5	-113	0
Italy		122	1.0	7	20	-88	11
Portugal		72	1.1	2	7	-51	12
Spain		71	0.9	3	6	-39	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: 5/19/2021 8:19 AM	Exchange Rates (Level, Last 12m)	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Local Currency Bond Yields (GBI EM) (Level, Last 12m)	Latest	Change (in basis points) 1 Day	7 Days	30 Days	12 M	YTD
	vs. USD		(+) = EM appreciation					% p.a.						
China		6.44	-0.2	0.3	1	10	1		3.2	0.3	1	-4	65	-5
Indonesia		14290	-0.1	-0.6	2	3	-2		6.5	2.3	5	-7	-121	43
India		73	-0.2	0.4	2	3	0		6.3	1.3	1	-9	11	35
Philippines		48	-0.1	-0.1	1	6	0		4.3	0.3	11	29	-17	68
Thailand		31	-0.1	-0.4	-1	2	-5		1.8	-0.1	0	-9	48	50
Malaysia		4.14	-0.4	-0.4	0	5	-3		3.3	-0.4	0	5	46	71
Argentina		94	0.0	-0.2	-1	-28	-11		45.8	-11.3	-33	-50	226	-1037
Brazil		5.28	-0.4	0.5	5	9	-2		8.4	11.4	24	34	246	281
Chile		713	0.6	-1.4	-2	15	0		3.8	0.2	20	37	128	100
Colombia		3657	0.8	1.3	-1	5	-6		6.7	-3.2	-18	56	116	164
Mexico		19.89	-0.2	1.4	0	19	0		6.8	-0.5	2	34	63	125
Peru		3.7	-0.7	-0.8	-2	-8	-3		4.9	4.1	12	18	65	132
Uruguay		44	0.1	-0.4	0	0	-4		7.6	11.6	27	26	-354	38
Hungary		287	-0.1	3.1	4	12	3		2.4	1.1	38	48	91	91
Poland		3.70	0.0	2.0	2	13	1		1.3	-3.5	14	45	35	66
Romania		4.0	-0.1	1.2	1	10	-1		2.7	0.0	7	3	-128	-2
Russia		73.7	-0.1	1.2	4	-2	0		6.8	0.6	6	10	155	108
South Africa		14.0	-0.3	0.6	1	31	5		9.9	-1.2	10	6	-17	25
Turkey		8.42	-0.8	0.1	-4	-20	-12		17.6	-0.1	6	19	585	453
US (DXY; 5y UST)		90	0.2	-0.8	-1	-9	0		0.83	1.0	-4	0	50	47

	Equity Markets (Level, Last 12m)	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Bond Spreads on USD Debt (EMBIG) (Level, Last 12m)	Latest	Change (in basis points) 1 Day	7 Days	30 Days	12 M	YTD
								basis points						
China		5172	-0.3	3	2	31	-1		199	0	-2	-9	30	-9
Indonesia		5761	-1.3	-3	-5	27	-4		158	0	-9	-25	-5	-29
India		49903	-0.6	2	5	62	5		161	-2	-5	-2	-140	10
Philippines		6246	0.0	-1	-4	12	-13		83	0	-9	-17	13	-22
Malaysia		1581	-0.7	0	-2	10	-3		113	0	-2	-3	9	3
Argentina		56079	0.0	10	17	42	9		1459	0	19	8	-570	91
Brazil		122980	0.0	0	2	52	3		253	0	0	-16	58	3
Chile		4144	0.0	-8	-17	11	-1		126	0	-6	-16	-14	-18
Colombia		1268	0.0	-2	-3	19	-12		207	0	-4	-15	44	2
Mexico		49789	0.0	0	4	39	13		348	0	-9	-34	55	-12
Peru		21684	0.0	4	6	40	4		133	0	-4	-3	22	1
Hungary		45050	-1.8	2	6	27	7		65	0	-6	-15	-42	-31
Poland		62785	-0.8	1	5	37	10		-22	0	-4	-11	-54	-21
Romania		11639	0.0	-1	5	39	19		182	1	2	-12	-158	-21
Russia		3643	-1.2	0	2	34	11		159	0	-5	-3	19	-7
South Africa		65961	-1.9	-2	-3	27	11		357	0	-4	-35	25	-23
Turkey		1460	0.0	1	6	43	-1		421	0	-5	-47	34	-24
Ukraine		529	0.0	0	0	6	6		479	0	12	-21	127	-12
EM total		54	-1.0	0	-1	44	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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