GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, SEPTEMBER 21, 2021

- **Rating agencies flag Evergrande default risk** (link)
- **Evergrande worries hit US markets** (link)
- **Surge in European power prices raises inflation and growth concerns** (link)
- **US corporations with large sales to China outperforming broader market** (link)
- **Ongoing political turmoil pressures markets in Argentina** (link)
- **Lebanese markets react positively to formation of new government** (link)

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Markets recover after global selloff

US equity futures are in positive territory and European stocks have recovered much of the ground lost to yesterday's selloff that was triggered by worries about the potential default of property developer Evergrande with its $300 bn in debt. The European rally is widespread, with advances in all sectors of the market. Emerging market stocks are also higher today. There is an expectation that Chinese authorities will act to contain any fallout from Evergrande and reduce the overall market impact. However, this belief could be put to the test as early as tomorrow, when Evergrande is due to make $84 mn in payments on its dollar bonds. Meanwhile, a surge in power prices in Europe has raised fears about the impact of energy costs on inflation and growth, while highlighting the potential costs of measures to combat climate change.

Key Global Financial Indicators

Last updated: 9/21/21 8:01 AM	Level: Last 12m	Level: Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		4358	-1.7	-2	-2	33	16
Eurostoxx 50		4097	1.3	-2	-1	30	15
Nikkei 225		29840	-2.2	-2	10	28	9
MSCI EM		50	-2.7	-5	1	13	-3
Yields and Spreads					bps		
US 10y Yield		1.32	1.4	4	7	66	41
Germany 10y Yield		-0.32	-0.3	2	17	21	25
EMBIG Sovereign Spread		352	11	11	-1	-54	2
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		56.1	0.1	-1	1	2	-3
Dollar index, (+) = $ appreciation		93.1	-0.2	0	0	-1	3
Brent Crude Oil ($/barrel)		74.6	0.9	1	14	80	44
VIX Index (%, change in pp)		23.3	-2.5	4	5	-5	1

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

Mature Markets

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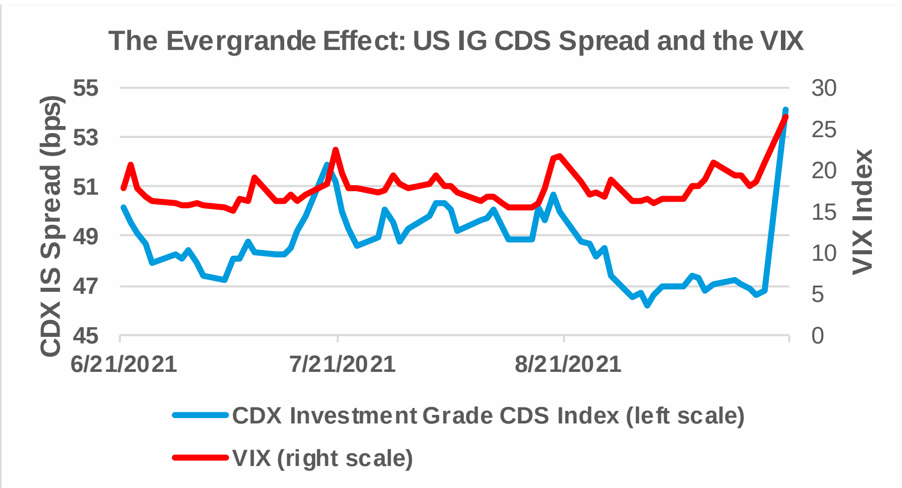
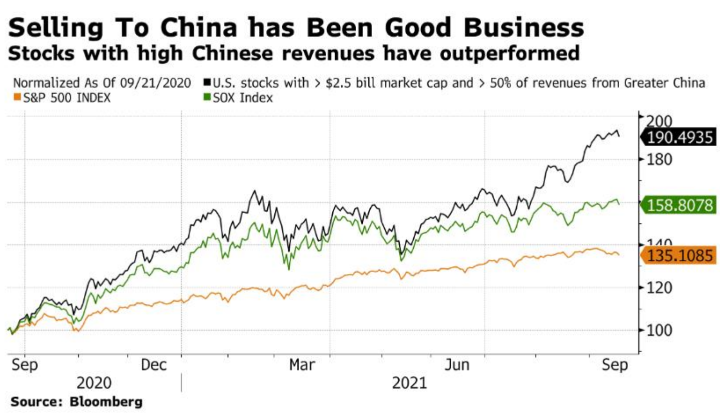
United States

US markets took a big hit as worries about the credit woes of China's second largest property developer Evergrande took center stage on Monday. The S&P 500 recorded nine declines over the past eleven days. The sharp decline in equities was accompanied by lower Treasury yields on safe haven flows. In addition, the VIX shot up to its highest level since May and the spread on the benchmark investment grade CDX credit default swap index saw its biggest one day move upwards in a year. In addition, Bloomberg reported that eight investment grade US corporations cancelled their planned bond sales to avoid adverse pricing conditions. **Meanwhile, cryptocurrencies also joined the rout, putting cryptocurrency exchange Coinbase in the spotlight as its newly issued junk bond sold off sharply.** The company cancelled plans to launch a collateralized lending program under pressure from the Securities and Exchange Commission.

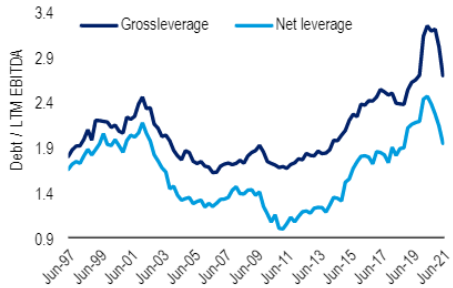


US corporations with large sales to China have outperformed the broader market and the semiconductor index over the past year. These companies are up by 90% compared to 58% for the S&P 500 and 35% for semiconductors. With the current Evergrande-related stresses in the Chinese financial markets, some analysts worry that investors might start to cash in their gains from their China exposure, potentially putting even more pressure on Chinese markets. US investors also have large exposure to the Chinese bond market, which could be another potential source of pressure.



Leverage levels at investment grade non-financial and non-utility corporations saw significant improvement, according to data from Bank of America. During the second quarter, these companies managed to erase the entire rise in leverage that occurred during the recession of 2020. Net leverage has fallen to the lowest level since Q4 2018. The analysts attribute the gains to strong earnings and a decline in gross debt. Revenue increases exceeded costs but profit margin growth was just slightly positive. Corporate America's strong balance sheets have combined with the global search for yield to lead to a torrent of new corporate bond issuance, with $118 bn of bonds already issued in September.

Figure 11: Median leverage: non-financial non-utility US IG issuers
Leverage declined strongly from elevated levels in both 1Q and 2Q-21.



Note: based on medians for US investment grade non-financial non-utility issuers. Net debt is gross debt minus cash and marketable securities.
Source: BofA Global Research

BofA GLOBAL RESEARCH

Figure 12: IG leverage relative to 4Q-19
Gross leverage has retraced the weakness from 2020, net leverage is now below pre-pandemic levels.

Sector	4Q-19	2020 peak	2Q-21	% Retracement
		Gross leverage		
Total	2.69	3.24	2.69	101%
Single-A or better	1.92	2.39	1.88	108%
BBB	2.93	3.66	2.89	104%
		Net leverage		
Total	2.18	2.46	1.94	188%
Single-A or better	1.27	1.60	1.10	150%
BBB	2.43	3.03	2.19	139%

Note: based on medians for US investment grade non-financial non-utility issuers. Net debt is gross debt minus cash and marketable securities.
Source: BofA Global Research

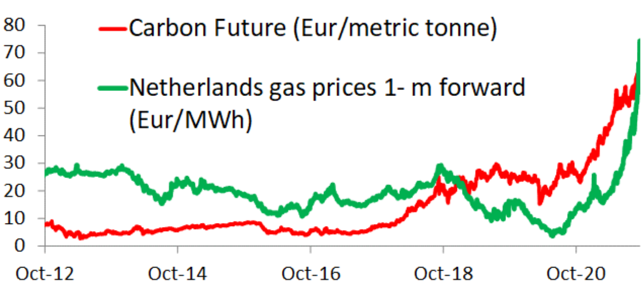
BofA GLOBAL RESEARCH

Euro Area

Equities (+1.2%) recovered some of yesterday's losses. 10-yr bund yields (+1 bps to -0.32%) were little changed after Banque de France governor Villeroy emphasized yesterday that there is no doubt that euro area inflation will come back below the ECB's 2% target between now and 2023. The euro and 10-yr spreads were little changed.

Natural gas forwards (+1%) traded higher today as contacts expect supply issues to persist throughout the winter. Reasons cited for higher natural gas prices include limited supply from Russia and Norway (which supply almost half of Europe's gas), high demand from Asia, outages at U.S. production facilities, and lack of wind for wind turbines.

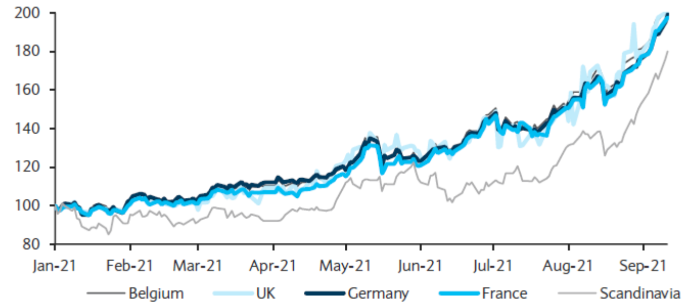
Europe: Price of natural gas and carbon futures



Source: Bloomberg and IMF staff

Higher natural gas prices and carbon prices have pushed European power prices to new highs in what is described as a perfect storm. Baseload power prices one year ahead have nearly doubled in most countries and are trading at their highest level ever.

There has been a significant rise in European power prices this year (4 Jan 2021 = 100)

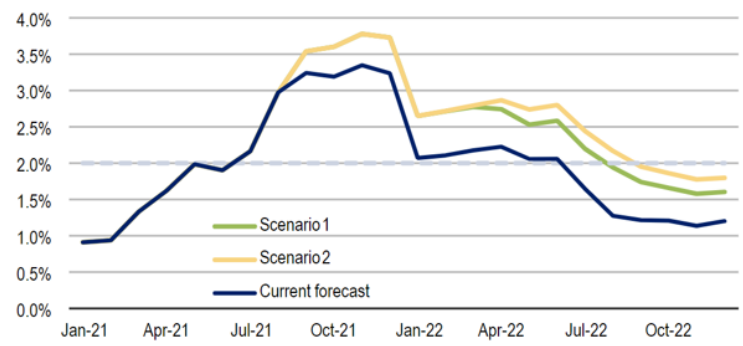


Source: Bloomberg

Analysts point to the sharp increase in carbon prices and natural gas prices as main reasons for the acceleration in power prices. Carbon prices have traded higher given the expected tightening in EU carbon emissions to achieve a 55% reduction in CO2 emissions by 2030 (compared to 1990 levels). **Following sharp rises in wholesale gas prices, several household gas suppliers in Germany have reportedly announced price hikes of up to 12% from September or October.**

According to Bank of America, higher natural gas prices could push the outlook for annual average headline inflation 20 bps higher in 2021 and 60-70 bps in 2022, purely on electricity and gas price assumptions. There is no generic wholesale electricity futures curve by country, so these estimates assume that current spot and 2022 delivery prices are unchanged going forward. Energy supply is typically hedged, which helps to smooth over spikes in spot prices but creates more persistence over time.

Euro area inflation outlook: Upside risks from higher natural gas prices

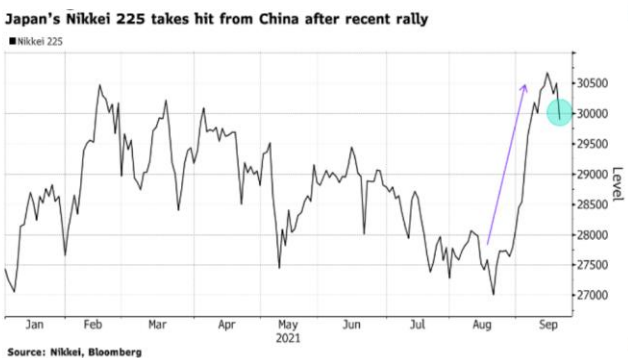


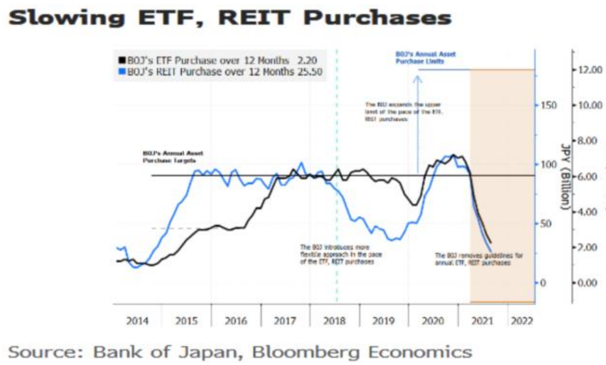
Note: We assume wholesale electricity prices unchanged at current levels. Gas prices as implied by futures curves in scenario 1, and unchanged at current levels in scenario 2.
Source: Bank of America

Higher inflation on the back of developments in natural gas prices is also expected to squeeze consumer purchasing power. Bank of America believes this could lower GDP growth by about 30 bps, mostly in 2022. Higher energy prices could also weigh on corporate profits. Italy reportedly plans to approve a disbursement of €3.5bn to mitigate the impact of higher gas prices. Bank of America calculates that up to €24-28 bn of government transfers would be needed in 2021/22 to compensate households for higher energy bills currently implied by wholesale power prices.

Japan

Japan's stock market joined the selloff from yesterday after being closed for a holiday (-1.7%). The Bank of Japan (BOJ) is expected to keep the settings for its policy framework unchanged at its two-day board meeting ending September 22, according to Bloomberg. Meanwhile, the BOJ has slowed down its exchange traded fund (ETF) purchases significantly, after its policy review in March. The last time it bought ETFs was in June, and the 12-month average of its ETF purchases is approaching a pace last seen in October 2014. Separately, Japan's biggest lender, Mitsubishi UFJ Financial Group Inc. (MUFG) reportedly plans to sell the retail arm of its U.S. banking unit to U.S. Bancorp. The transaction could be worth about ¥800bn ($7.3bn), the Nikkei newspaper reported.





Emerging Markets

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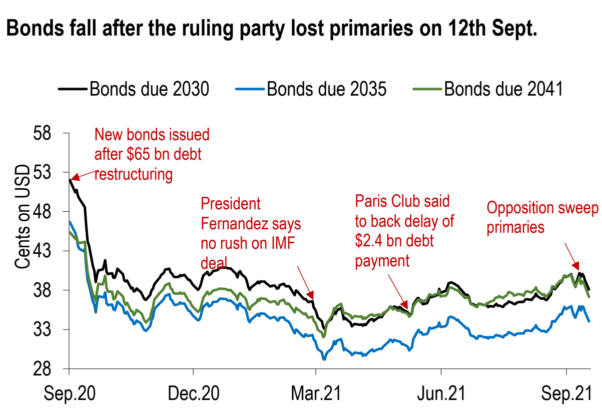
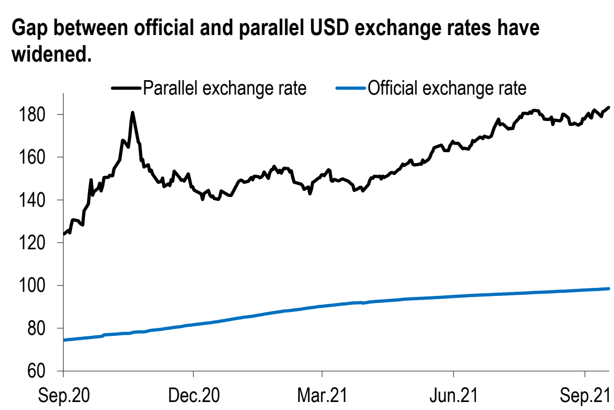
Asian stocks recovered somewhat after Monday's rout. Markets in China, South Korea and Taiwan Province of China remain closed for holidays, but Hong Kong SAR was up +0.5% and Hong Kong SAR-listed property stocks rebounded by as much as 2.6% after Monday's 6.7% plunge. Indonesia stayed on hold at 3.5% as expected. EMEA markets are also higher. Latin American markets followed global markets down yesterday.

Argentina

Local markets are jittery as political turmoil continues. Argentina's president, Alberto Fernandez, reshuffled his cabinet on Friday following the defeat in the primary elections that were held on September 12. However, local markets have continued to fall. While equities and US dollar denominated bonds plunged 6.4%, and 3.7% on Monday, their cumulative losses in the last 5 trading session stand at 8.2% and 6.4%, respectively. The official exchange rate was little changed against the US dollar over the past week; however, the parallel exchange rate depreciated by 1.6% during the period (as per Bloomberg data). According to analyst reports, markets are concerned about further deterioration of the country's fiscal balance as the current government could adopt an expansionary policy ahead of the November mid-term elections.

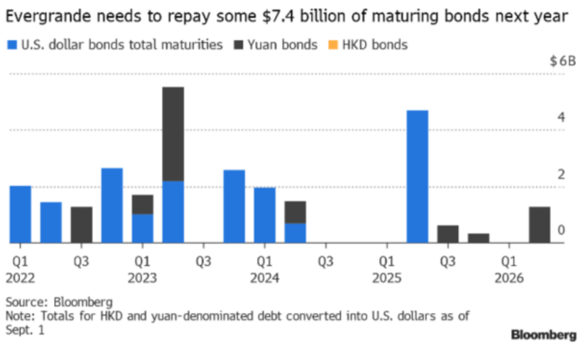


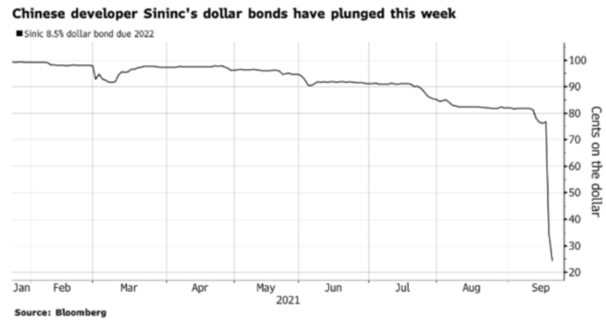


Source: Bloomberg

China/Hong Kong SAR

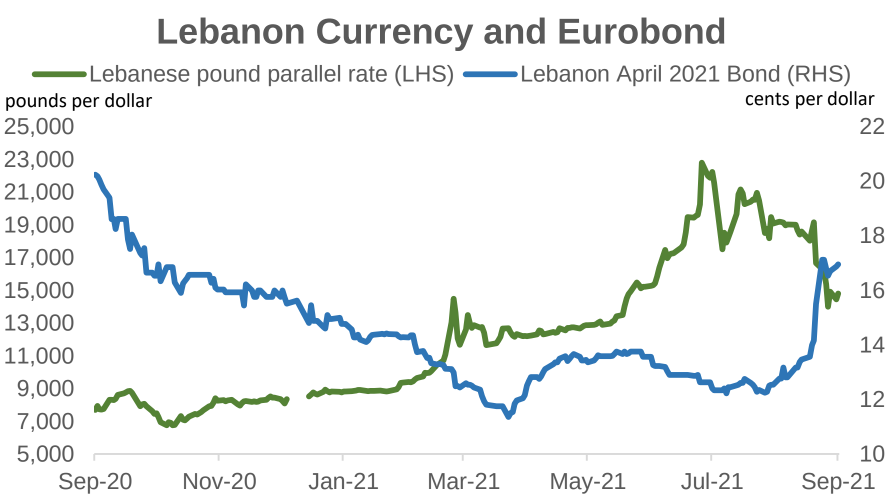
Rating agencies warned of increased chances of a payment failure by China Evergrande Group. In its report on Monday, S&P said the developer is on the brink of default. The Group fell further in equity and credit markets on Tuesday, feeding contagion fears. Another Chinese developer, Shanghai-based Sinic Holdings Group Co., has come under intense selling pressure this week. S&P lowered Sinic to CCC+ from B on Tuesday and put it on watch for a further downgrade. The firm's shares plunged and its $246mn bond due next month was trading at 25-28 cents on the dollar. **China's markets were closed and offshore renminbi was little changed (-0.2%).**





Lebanon

Financial markets reacted positively to the formation of the new government. Eurobonds, which are currently in default, recovered by 4.5c to 17c on the dollar. T**he Lebanese pound has appreciated by 30% since mid-August in the parallel market**, after trading above 20k pounds per dollar. Contacts note that the Eurobond recovery has been driven mostly by investor covering of underweight positions, but there has also been fresh interbank dealer interest. **According to media reports, Prime Minister Mikati has pledged to resume cooperation with the IMF** while the Finance Minister Al Khalil will oversee an audit on the Central Bank of Lebanon, a step perceived to be required for foreign assistance. However, some contacts remain skeptical that the new government would be able to achieve tangible reform and obtain foreign aid prior to the general elections scheduled for May 2022.



Source: Bloomberg, Lirarate.org

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Global Financial Indicators

Last updated: 9/21/21 8:02 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4358	-1.7	-2	-2	33	16
Europe		4097	1.3	-2	-1	30	15
Japan		29840	-2.2	-2	10	28	9
China		3614	0.2	-2	5	8	4
Asia Ex Japan		84	-3.0	-5	0	9	-6
Emerging Markets		50	-2.7	-5	1	13	-3
Interest Rates					basis points		
US 10y Yield		1.32	1.4	4	7	66	41
Germany 10y Yield		-0.32	-0.3	2	17	21	25
Japan 10y Yield		0.04	-1.3	-1	3	3	2
UK 10y Yield		0.79	-0.7	5	26	63	59
Credit Spreads					basis points		
US Investment Grade		89	2.3	1	-6	-38	-6
US High Yield		323	13.0	7	-22	-195	-57
Europe IG		51	-1.0	6	4	-7	3
Europe HY		248	-5.3	21	14	-75	6
Exchange Rates					%		
USD/Majors		93.08	-0.2	0	0	-1	3
EUR/USD		1.17	0.2	0	0	0	-4
USD/JPY		109.4	0.0	0	0	5	6
EM/USD		56.1	0.1	-1	1	2	-3
Commodities					%		
Brent Crude Oil ($/barrel)		75	0.9	1	14	80	44
Industrials Metals (index)		162	0.5	-1	5	39	22
Agriculture (index)		55	0.1	-1	-3	41	15
Implied Volatility					%		
VIX Index (%, change in pp)		23.3	-2.5	3.8	4.7	-4.5	0.5
US 10y Swaption Volatility		72.0	1.4	8.2	-1.3	26.7	11.9
Global FX Volatility		6.9	0.0	0.5	0.0	-2.8	-1.1
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		108	-5.8	-3	3	-53	-11
Italy		102	-1.2	4	-2	-42	-9
Portugal		56	-0.2	2	-4	-24	-4
Spain		65	-0.2	1	-5	-13	4

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

Emerging Market Financial Indicators

Last updated:	Exchange Rates							Local Currency Bond Yields (GBI EM)					
9/21/2021	Level		Change (in %)					Level		Change (in basis points)			
8:04 AM	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.				
China		6.47	-0.1	-0.3	0	5	1		3.0	0	3	-24	-24
Indonesia		14238	0.0	0.1	1	3	-1		6.1	-1	-16	-68	3
India		74	0.2	0.1	1	0	-1		6.3	-5	-14	11	35
Philippines		50	0.1	-0.5	0	-4	-4		4.3	-6	-6	61	61
Thailand		33	0.0	-1.3	0	-6	-10		1.8	8	20	34	49
Malaysia		4.18	0.2	-0.5	1	-1	-4		3.4	6	5	81	82
Argentina		98	-0.1	-0.3	-1	-23	-15		48.2	87	261	724	-799
Brazil		5.30	0.5	-1.1	2	2	-2		10.2	-7	48	424	458
Chile		785	0.4	-0.1	0	-1	-9		5.1	-22	40	251	234
Colombia		3843	-0.4	-0.3	1	-1	-11		7.3	24	34	228	218
Mexico		20.08	0.3	-0.8	1	6	-1		7.1	12	12	125	156
Peru		4.1	-0.2	-0.3	0	-14	-12		6.4	-13	-35	226	277
Uruguay		43	-0.6	-0.3	1	-1	-1		7.9	0	-7	44	67
Hungary		302	0.1	-1.7	-1	2	-2		2.8	12	46	107	123
Poland		3.94	-0.3	-2.2	-1	-3	-5		1.3	-1	27	56	70
Romania		4.2	0.1	-0.5	0	-2	-6		3.5	-9	33	28	77
Russia		73.2	0.5	-0.3	1	4	1		7.1	15	22	130	136
South Africa		14.8	-0.2	-3.3	2	13	-1		9.8	13	9	-18	19
Turkey		8.65	0.3	-2.4	-3	-12	-14		17.0	19	-39	370	394
US (DXY; 5y UST)		93	-0.2	0.5	0	-1	3		0.83	5	5	57	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	7 Days	30 Days	12 M	YTD
								basis points					
China		4856	0.0	-3	2	3	-7		211	-1	-7	-28	-18
Indonesia		6061	-0.3	-1	0	23	1		184	10	1	-57	-16
India		59005	0.9	1	7	56	24		147	2	2	-74	-4
Philippines		6881	0.3	-1	4	17	-4		116	8	3	-25	4
Malaysia		1530	0.2	-3	1	2	-6		133	6	-3	-45	-2
Argentina		73635	-6.2	-8	9	81	44		1561	93	-22	309	205
Brazil		108844	-2.3	-6	-8	12	-9		300	6	-1	-15	41
Chile		4291	0.0	-2	-1	18	3		155	9	8	-28	-1
Colombia		1307	-1.2	0	-2	9	-9		293	13	4	36	78
Mexico		50558	-1.5	-2	-2	42	15		352	9	-12	-120	-5
Peru		17747	-1.3	-2	14	0	-15		174	3	-8	4	45
Hungary		51272	0.6	-2	-1	59	22		139	-1	7	-13	-10
Poland		69796	0.9	-3	3	44	22		22	-1	-14	-12	-6
Romania		12344	1.0	0	2	39	26		197	3	11	-53	-6
Russia		3984	0.4	-2	4	39	21		163	1	-8	-57	-16
South Africa		62535	1.8	-3	-5	17	5		364	22	5	-133	-20
Turkey		1392	0.0	-3	-4	28	-6		492	28	16	-128	45
Ukraine		526	0.0	0	0	5	5		488	8	-27	-163	-5
EM total		50	0.6	-5	1	13	-3		367	15	1	-28	29

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

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