GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

THURSDAY, MAY 7, 2020

- **Inflation expectations plunge to decade lows** (link)
- **Deficit at $3.7 trillion sparks US bond market worries** (link)
- **US companies have drawn down their credit lines by 22%** (link)
- **Italian government bond spread continue to widen** (link)
- **Bank of England hints at further quantitative easing** (link)
- **Many emerging markets trading in distressed territory** (link)

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

Markets Hold Steady Ahead of Key US Data

Sentiment remains cautiously optimistic but is vulnerable to sudden reversals if there are bad news headlines on the virus front. Still, investors have been heartened by the gradual reopening of more countries and US states from lock down and the apparent bending of the mortality and infection curves in many areas. US equity futures pointed to a strong open for the stock market, while European equities were also higher. Government bond yields in the US and Europe and the major currencies were holding steady ahead of Friday's historic US non-farm payrolls report, the first to reflect the full impact of the COVID-19 crisis. The consensus forecast is that the US will lose 21.25 mn jobs and that the unemployment rate will hit 16%. Brent crude continued its strong rally, up seven of the last eight sessions to $31.59. As recently as April 21 it had fallen to $19.33, the lowest since 2001. Press reports indicate that Saudi Arabia increased prices paid to refiners around the world in an effort to support oil prices.

Key Global Financial Indicators

Last updated: 5/7/20 8:16 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		2848	-0.7	-3	7	-1	-12
Eurostoxx 50		2877	1.2	-2	1	-15	-23
Nikkei 225		19675	0.3	2	10	-12	-17
MSCI EM		36	0.9	-4	2	-15	-20
Yields and Spreads				bps			
US 10y Yield		0.69	4.1	6	-2	-176	-122
Germany 10y Yield		-0.51	-0.3	8	-20	-47	-33
EMBIG Sovereign Spread		590	-4	-15	-27	242	297
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		52.6	0.1	-1	-1	-15	-14
Dollar index, (+) = $ appreciation		100.2	0.1	1	0	3	4
Brent Crude Oil ($/barrel)		31.6	6.5	25	-1	-55	-52
VIX Index (%, change in pp)		31.2	-3.0	-3	-16	12	17

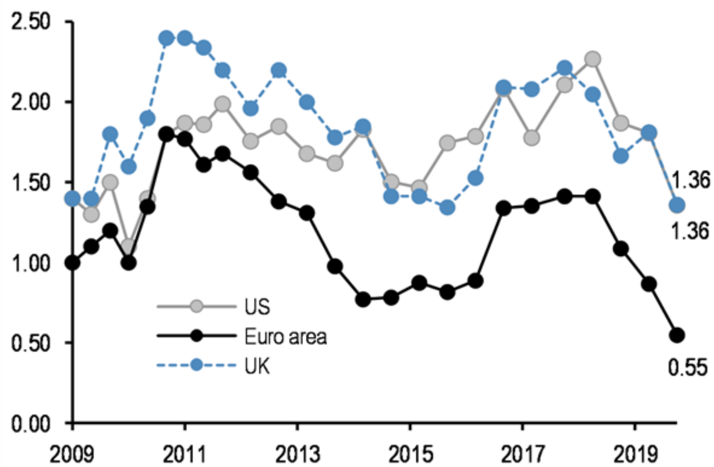
Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

Inflation Expectations

The latest JP Morgan Inflation Expectations Survey finds that inflation expectations have hit their lowest levels in a decade. Over the next 12 months (April 2021), inflation is expected to be at 1.36% in the US and the UK and 0.55% in the euro area. In the medium term (two-five years), inflation is expected to pick up in the euro area (1.69% compared to 1.31% in the previous survey), with the US and UK seeing smaller increases. Two-thirds of those surveyed expect the period of low inflation to be followed by a period of higher inflation due to the impact of COVID-19 policy measures. However, opinions are evenly divided as to whether the rise in inflation will be significant and just 27% expected a major inflation “episode” in the US. A frequently cited worry among investor contacts is that COVID-19 could push the global economy into stagflation.

Short term expectations for Euro area and US core inflation are at decade lows. Those for the UK are similar to the 2016 lows pre-Brexit

Evolution of average expectation for core inflation one year out from J.P. Morgan inflation expectations surveys (since Jul-09), %oya



United States

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Jobless claims came in at 3.169 mn versus the market consensus of 3 mn, while continuing claims printed much higher than expected at 22.647 mn compared to the market consensus of 19.8 mn. More than 30 mn people have filed for unemployment since the week of March 20. The market reaction was relatively muted as markets have become accustomed to large job losses as the crisis continues to unfold.

On Thursday markets were mixed ahead of the non-farm payrolls report, and trading volumes were lower than usual. Treasury yields increased for the third straight day and the yield curve continued to steepen in anticipation of the rising supply of new Treasuries expected over the next few weeks. The Treasury surprised bond traders by increasing longer maturity issuance relative to shorter ones.Volatility remained subdued by recent standards with the VIX ending at 33. The funding market continues to stabilize, with three-month US dollar Libor down to 44 bps, its lowest level since December 2015 and down from 2.85% at the end of 2019. The Libor-OIS spread, which peaked at 138 bps at the end of March is now down at 40 bps. The repo market has also been quiet with the benchmark overnight good collateral (GC) repo rate holding steady in the 10-12 bps range for the past six weeks.

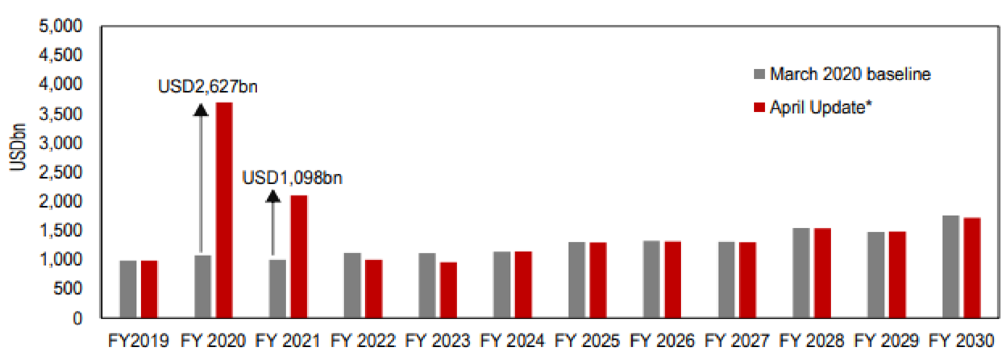
Meanwhile, markets have staged an impressive rally from the lows of late March. This has surprised many people due to the Q1 weak earnings reports and with many companies declining to offer future guidance due to the high degree of uncertainty about the impact of the crisis on the global economy. Some think that the forward-looking equity market is rising on expectations that the eventual toll of the crisis on corporate profits may not be as high as currently expected. The aggressive Fed intervention also probably played a role.

Selected Market Moves as of May 6, 2020 4pm market close
Source: Bloomberg

	Rally Since Trough/Peak	Date of Trough/Peak
S&P 500	+21.5%	March 23
Euro Stoxx 600	+16.3%	March 23
iShares Emerging Market ETF	+15.0%	March 23
Bloomberg US Corporate	-186 bps	March 20
Bloomberg US High Yield	-372 bps	March 23
10yr Treasury	+12 bps	March 9
10yr Bund	+28 bps	March 9
VIX	-50 pts. (from 82.69)	March 16

The US deficit is projected to grow to 3.7 tn in fiscal year 2020 according to the latest forecasts from the Congressional Budget Office and HSBC. This is up 2.627 bn from earlier forecasts before the crisis, raising concerns about the market's ability to absorb the increased volumes of T-Bills, Cash Management Bills (CMBs) and longer maturity coupon bonds. So far, the Treasury has relied more on T-Bills and CMBs, which the market was able to absorb quite easily due to the heavy demand from government money market funds (MMFs) which saw $1.2 tn in new inflows from investors seeking a safe place to park their cash. Treasury has issued 1.245 tn in CMBs so far and T-Bills grew from $2.7 tn to $3.9 tn outstanding in just over a month. However, at some point Treasury will have to issue longer maturity bonds, including the new 20-year bond that is expected to be launched this month, potentially pushing longer maturity yields higher and steepening the yield curve. The 10-year Treasury yield went up by 12 bps this week as of the Wednesday close, and the two-year/ten-year yield spread also went up by 12 bps over the same period. Fed buying is likely to keep yields in check for the immediate future but at some point, the market will be tested by the even larger volumes generated by a potential fourth round of COVID-19 funding from Congress.

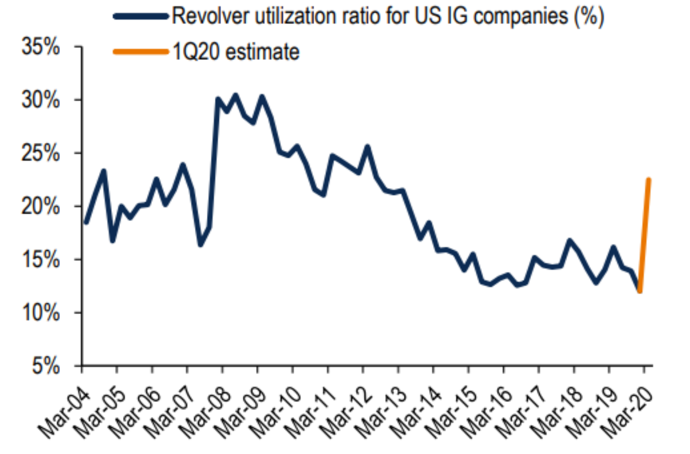
Figure 1. Deficit projections from the pre COVID-19 CBO baseline to today



Source: Congressional Budget Office, HSBC
Note: *April deficit from FY2022 onwards derived from March baseline and recovery from CARES Act loans.

Many US corporations have drawn on their revolving bank credit lines, with Bank of America estimating that revolver drawdowns have reached 22%. This compares to 12% in Q4 2019 and 30% during the global financial crisis. The analysts' data show that the number of companies announcing credit line drawdowns exceeded 180 since March 1 with $150 bn in drawdown volumes. Among these, 83 were investment grade (IG) companies of which 31 sold new corporate bonds soon after tapping their revolvers. Some companies have negotiated larger credit lines without drawing on them as a precaution for the future. With the investment grade primary market in full swing, issuance is likely to remain high. March and April set new records for monthly issuance of IG corporate bonds and May is also off to a strong start. Credit spreads have continued to tighten as risk appetite returns to the market.

Figure 5: Revolver utilization ratio for US IG companies



Source: BofA Global Research, Bloomberg

Europe

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European equities (+1%) are higher ahead of tomorrow's Eurogroup but continue to lag U.S. equity futures (+1.5%). The euro and German bund yields were little changed.

Spreads are little changed today after several senior Eurosystem officials signaled that the ECB is ready to take further actions if necessary and emphasized that past ECB actions have been proportionate. Banque de France governor Villeroy de Galhau said that the ECB must go further to boost inflation. Nevertheless, **10-yr Italian yields have widened +20 bps since the German court ruling on Tuesday**.

European rates: Change since German Court Ruling

	Level (%)		Difference (bps)
	04-May	07-May	
Italy	1.77	1.99	**22**
Spain	0.76	0.88	**12**
France	-0.06	0.02	**8**
Germany	-0.56	-0.50	**7**
U.S.	0.63	0.71	**7**

Source: Bloomberg and IMF staff

The ECB has not yet officially decided whether to respond to the German court, but four ECB General Council (GC) members told the FT that the ECB should not respond directly to the German court to protect its independence and not expose it to pressure from other national courts. Most ECB GC members reportedly oppose giving a response, with ECB GC members suggesting that the Bundesbank could provide a proportionality assessment to the German government or parliament instead. According to Reuters, the Bundestag's in-house legal service advises the German parliament to legally oblige the Bundesbank to inform it on a regular basis about its activities in the Eurosystem in response to the German Court Ruling.

United Kingdom

The British pound (+0.2% to $1.24) and 10-yr gilt rates (+3 bps to 0.26%) edged higher after **the BoE voted to maintain bank rate unchanged at 0.1% but Governor Bailey said that the Bank is keeping all options open and could do more QE in June**. The MPC voted 7-2 to maintain the stock of asset purchases at £645 bn, with two members (Haskel and Saunders) voting to increase the target by an additional £100 bn.

The MPC considers the degree of uncertainty so great that they chose not to present the regular forecasts but publish an "illustrative economic scenario" with a 14% drop in GDP in 2020, followed by a 15% rise in 2021. The scenario assumed the lockdown remains in place until early June, with restrictions then being gradually unwound through Q3.

Other Mature Markets back to top

Japan remains closed for the Golden Week holiday, while Australian stocks lost ground. Equities were little changed in Canada.

Emerging Markets back to top

Most Asian markets were lower and their currencies weaker, while markets in Eastern Europe and Turkey were higher. Latin American equity markets were mixed yesterday. Currency markets were relatively quiet. The central bank in Brazil cut the policy rate by 75 bps to 3% as expected and Chile maintained its rate at 0.5% as expected.

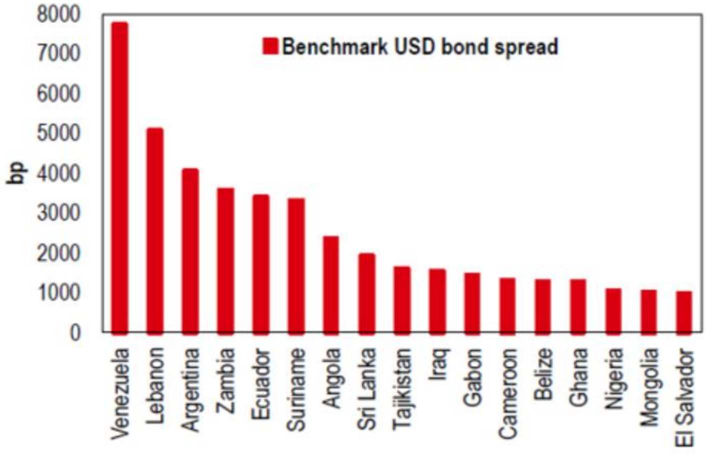
Key Emerging Market Financial Indicators

Last updated:	Level		Change				
5/7/20 8:20 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		35.79	1.1	-4	2	-15	-20
MSCI Frontier Equities		22.67	-1.3	-2	7	-21	-25
EMBIG Sovereign Spread (in bps)		590	-4	-15	-27	242	297
EM FX vs. USD		52.58	0.1	-1	-1	-15	-14
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		7.09	0.2	0	-1	-4	-2
Indonesian Rupiah		14995	0.6	2	9	-5	-8
Indian Rupee		75.77	-0.2	0	0	-8	-6
Argentine Peso		67.10	-0.1	-1	-3	-33	-11
Brazil Real		5.77	-0.9	-5	-9	-31	-30
Mexican Peso		24.12	1.1	0	1	-21	-22
Russian Ruble		73.77	1.0	1	2	-11	-16
South African Rand		18.56	1.2	0	-1	-22	-25
Turkish Lira		7.16	0.4	-2	-6	-14	-17
EM FX volatility		12.05	0.0	1.0	-0.1	3.3	5.5

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

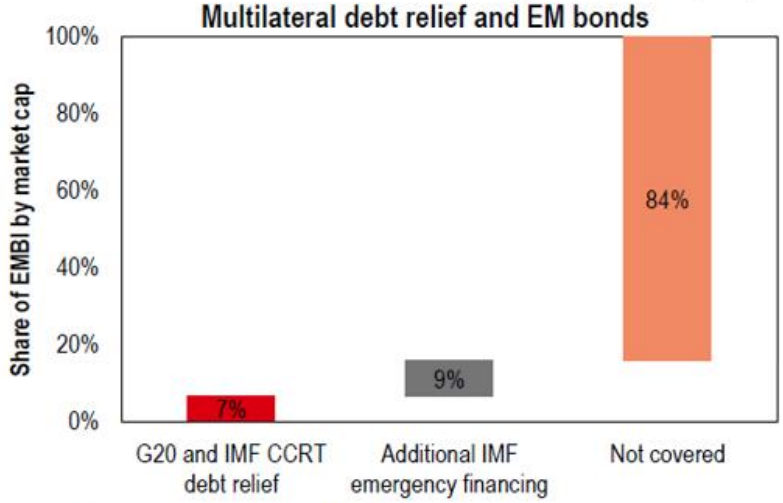
HSBC points out that 17 emerging markets with U.S. dollar debt are still trading in distressed territory (spreads above 1000 bps) and warns that current backstops for emerging markets may not cover substantial areas of vulnerability. Analysts argue that the rapid pace of negative credit migration suggests a risk that other EM sovereign issuers will become distressed. HSBC calculates that a quarter of the asset class could fall into distressed territory compared to 16% of the EMBI having some sort of backstop in place.

EM USD spreads: 17 countries have spreads over 1000 bps



Source: Bloomberg, HSBC

EM USD Debt: 16% of EMBI Universe currently have backstop in place (HSBC)



Source: HSBC, Bloomberg, Refinitiv, IMF, World Bank

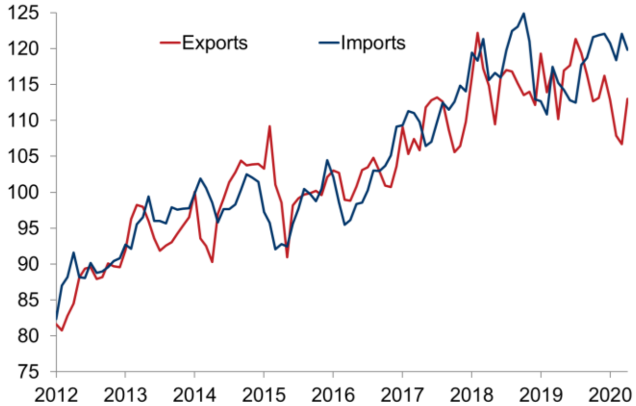
China

Chinese equities (-0.2%) were little changed after exports unexpectedly rose 3.5% yoy (-11.0% expected) on stronger demand for medical supplies, PCs, and tablets, but services PMI data disappointed. Bank of America estimates that export growth of textiles (4.8% of China's total exports, including medical masks) and medical equipment jumped by 51.0% and 50.7% yoy respectively in April, contributing 2.8 pts to the headline 3.5% export growth. Nevertheless, analysts point out that numbers could be noisy and reflect catch-up activity. Imports fell -14.2% yoy (-10% expected). The trade surplus with the US widened to $22.9 bn from $15.3 bn. China's imports of goods from the U.S. was $36.7 bn in April, or about 17% of the $219 bn target for 2020 (according to Bank of America). Caixin reported April services at

44.4 (50.1 expected) and composite PMIs at 47.6. FX reserves rose to $3.09 tn im April from $3.06 tn in March. The off-share yuan (+0.3% to 7.11/$) was slightly stronger versus the dollar.

China: Exports and imports, sequential

2014=100, sa, 3mma, real



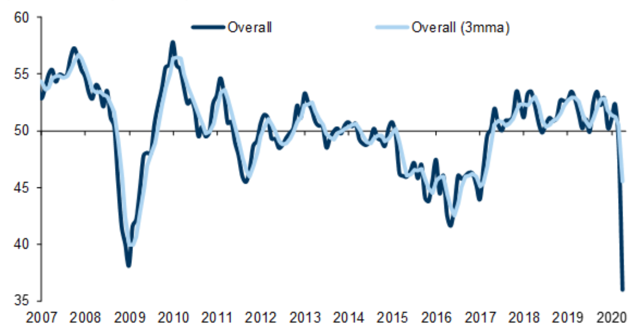
Source : Oxford Economics/CEIC

Brazil

The pandemic drove Brazil`s manufacturing and services PMIs to historical lows. Services PMI saw a 7.0 pt decline in April, adding to the 15.9 pt decrease in March, falling to 27.4. Manufacturing PMI dropped by 12.4 pt in April, adding to the 3.9pt decline in March, falling to 36.0, also the lowest level recorded. Worries about the economy have pushed Brazil`s 5-year credit-default swap spread above 320 bps compared to 100 bps in February. In addition, the Brazilian real has depreciated more than 27% against the dollar since the beginning of March.

Brazil Manufacturing PMI

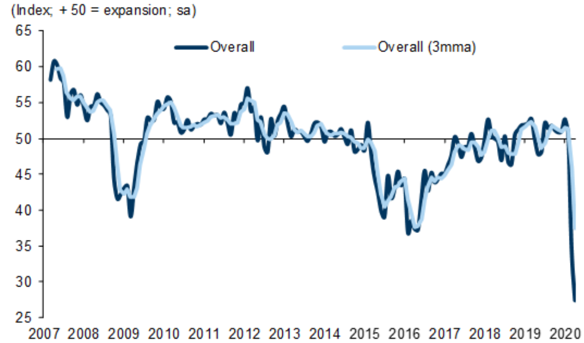
(Index; + 50 = expansion; sa)



Source: Markit, Goldman Sachs Global Investment Research

Brazil Services PMI

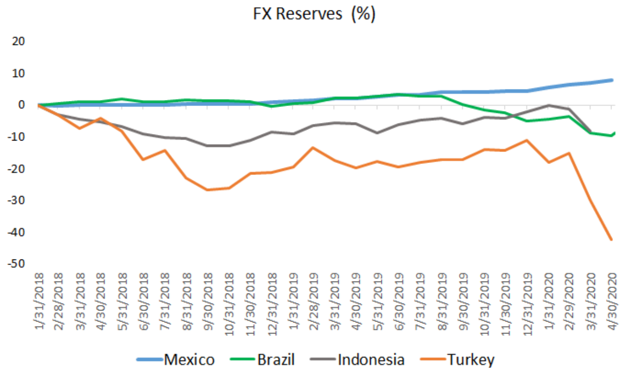
(Index; + 50 = expansion; sa)



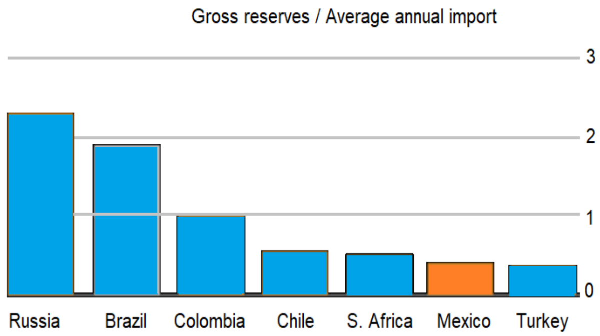
Source: Markit, Haver Analytics

Mexico

Mexico`s foreign exchange reserves rose to a five-year high even as reserves held by other emerging markets fell. Reserves reached $186 bn in the beginning of May, the highest since August 2015. Meanwhile, the peso depreciated against the dollar by around 20% in March, one of the worst performing currencies among emerging markets, although it has done better more recently with a 3% depreciation since the beginning of April. The Turkish lira and Brazilian real have depreciated more than 9% against the dollar in April. However, Mexico still has the lowest ratio of gross reserves to average annual imports among major regional peers, and also relative to many other emerging markets. Brazil`s reserves cover almost 2 years of imports compared to less than half year for Mexico, slightly higher than Turkey.



Data source: Bloomberg



Source: Bloomberg

Russia

Russia's sovereign debt load is expected to increase as GDP contracts amid the oil price shock and COVID-19 outbreak. In a press interview, Finance Minister Siluanov indicated that the authorities plan to double borrowings as budget revenues are expected to fall by RUB 4 tn below expectations and GDP to contract by 5% this year. Notably, amid a decline in oil and gas revenues, the budget deficit is expected to reach 4% of GDP for the year, compared to a surplus of 1.8% last year. In addition to increased borrowings, the authorities will use more funds from the National Wealth Fund as well as proceeds from the recent sale of a stake in Sberbank. Crude oil prices have rebounded since the end of April; the front-month Brent futures contract is currently trading just below $32/barrel. Meanwhile, sovereign bond yields are 1 to 3 bps lower across the curve, with the 10-year note at 6.12%, down from nearly 8.50% in mid-March. The ruble is slightly stronger at RB 73.90/USD.

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Global Financial Indicators

Last updated: 5/7/20 8:18 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		2848	-0.7	-3	7	-1	-12
Europe		2877	1.2	-2	1	-15	-23
Japan		19675	0.3	2	10	-12	-17
China		2872	-0.2	2	2	-2	-6
Asia Ex Japan		63	0.1	-4	3	-10	-15
Emerging Markets		36	0.9	-4	2	-15	-20
Interest Rates					basis points		
US 10y Yield		0.70	4.1	6	-2	-176	-122
Germany 10y Yield		-0.51	-0.6	7	-20	-48	-33
Japan 10y Yield		0.01	2.4	4	-1	6	2
UK 10y Yield		0.26	2.4	2	-16	-90	-57
Credit Spreads					basis points		
US Investment Grade		202	0.0	6	-41	87	104
US High Yield		754	1.1	-3	-86	347	361
Europe IG		86	0.1	6	-10	25	42
Europe HY		517	-2.8	27	-32	253	311
EMBIG Sovereign Spread		590	-4.0	-15	-27	242	297
Exchange Rates					%		
USD/Majors		100.20	0.1	1	0	3	4
EUR/USD		1.08	-0.1	-2	-1	-4	-4
USD/JPY		106.6	-0.4	1	2	3	2
EM/USD		52.6	0.1	-1	-1	-15	-14
Commodities					%		
Brent Crude Oil ($/barrel)		32	6.5	25	-1	-55	-52
Industrials Metals (index)		96	1.0	1	4	-16	-16
Agriculture (index)		35	0.7	-1	-4	-8	-16
Implied Volatility					%		
VIX Index (%, change in pp)		31.1	-3.0	-3.1	-15.6	11.8	17.3
10y Treasury Volatility Index		4.7	-0.2	-0.2	-2.3	0.4	0.6
Global FX Volatility		9.4	0.0	0.8	-0.6	2.5	3.4
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		273	3.1	-2	56	-65	108
Italy		235	0.0	0	42	-31	75
Portugal		140	0.0	0	15	27	78
Spain		137	1.4	7	25	37	72

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)						
5/7/2020	Level		Change (in %)					Level		Change (in basis points)				
8:21 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		7.09	0.2	-0.3	-1	-4	-2		2.4	2.4	6	-23	-94	-72
Indonesia		14995	0.6	2.0	9	-5	-8		8.1	6.5	18	-17	5	99
India		76	-0.2	-0.1	0	-8	-6		6.2	-5.4	-13	-41	-136	-72
Philippines		51	-0.2	-0.3	0	3	0		4.8	-5.8	-9	-28	-37	50
Thailand		32	0.0	0.1	1	-2	-8		1.3	0.0	-6	-40	-127	-27
Malaysia		4.32	-0.4	0.5	1	-4	-5		2.8	0.9	-8	-48	-109	-60
Argentina		67	-0.1	-0.5	-3	-33	-11		41.4	104.6	256	-1893	1454	-2124
Brazil		5.77	-0.9	-4.8	-9	-31	-30		5.9	-4.5	-9	-70	-226	-36
Chile		839	-0.6	-0.5	1	-19	-10		2.7	-0.9	-2	-79	-139	-56
Colombia		3964	-0.8	-0.9	0	-18	-17		6.0	-8.7	-42	-148	-38	3
Mexico		24.12	1.1	0.2	1	-21	-22		6.4	-11.2	-31	-99	-184	-56
Peru		3.4	-0.8	-1.4	-1	-3	-3		4.7	0.8	4	-93	-66	17
Uruguay		43	-1.1	-1.4	1	-19	-13		11.7	-0.3	-33	-146	77	86
Hungary		324	0.3	-0.5	2	-11	-9		1.7	-0.8	13	-22	-42	55
Poland		4.21	0.0	-1.5	-1	-9	-10		1.1	2.5	4	-20	-133	-79
Romania		4.5	-0.1	-1.2	-1	-5	-5		4.1	-1.0	-8	-21	-13	10
Russia		73.8	1.0	0.8	2	-11	-16		5.8	-2.5	-2	-73	-211	-29
South Africa		18.6	1.2	-0.2	-1	-22	-25		10.3	-1.1	-53	-118	92	83
Turkey		7.16	0.4	-2.4	-6	-14	-17		11.4	39.8	57	-243	-941	-29
US (DXY; 5y UST)		100	0.1	1.2	0	3	4		0.36	-1.0	0	-9	-190	-133

	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		2872	-0.2	2	2	-2	-6		256	-1	0	11	84	80
Indonesia		4609	0.0	2	-4	-27	-27		333	2	-10	-38	147	177
India		31443	-0.8	-4	5	-18	-24		330	-1	-3	-28	180	205
Philippines		5653	0.2	0	0	-29	-28		177	4	-10	-25	94	111
Malaysia		1377	0.0	0	1	-16	-13		268	-8	-18	-26	148	156
Argentina		34159	1.8	3	28	4	-18		3371	-2	-122	-383	2454	1602
Brazil		79064	-0.5	-3	4	-16	-32		425	-1	8	4	177	210
Chile		3965	1.1	-1	7	-22	-15		272	0	-7	-43	146	139
Colombia		1090	-0.8	-5	-6	-29	-34		362	-3	-28	-24	177	199
Mexico		36986	1.0	3	7	-15	-15		630	-12	-27	-65	323	338
Peru		14954	0.4	0	9	-28	-27		235	-2	-16	-50	104	128
Hungary		34715	0.5	0	6	-16	-25		217	-9	6	11	116	131
Poland		44700	0.9	-3	1	-23	-23		93	0	-46	-33	52	75
Romania		8161	0.7	-1	2	-3	-18		347	-6	-17	-47	165	174
Russia		2661	1.1	0	1	4	-13		259	0	-12	-7	49	128
South Africa		49975	0.3	-2	5	-14	-12		670	3	2	-18	362	350
Turkey		98917	0.4	-3	7	8	-14		711	10	33	-72	204	310
Ukraine		500	0.0	0	-1	-12	-2		779	-23	-112	-59	137	359
EM total		36	1.1	-4	2	-15	-20		590	-4	-15	-27	242	297

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

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