

Summary

The global economy remains extremely unsettled amidst continuing unwinding of crowded positions in US stocks, Japanese stocks, and USDJPY, while the continuing rhetoric is adding to the uncertainty. While tightening of monetary policy is still far away, credit markets have been hit hard by the ongoing uncertainty. We are now fully into what will likely be the year's best buying opportunity in Emerging Markets, which are not showing signs of major changes from before the sell-off.

Global

In the US, non-farm payrolls were slightly higher than expected, but revisions were negative and unemployment rose. With the inflation backdrop also benign (PCE inflation running at just 1.1%) we see little chance of imminent Fed tapering of quantitative easing. In Europe, ECB was more hawkish than expected, while European data in general continues to slightly outperform. The past week saw stronger than expected industrial production numbers in both France and Germany, though German factory orders softened. In Japan, Prime Minister Shinzo Abe's 'third arrow' – the structural reform leg in a policy triplet, which also includes fiscal and monetary stimulus – disappointed the market, as did a passive Bank of Japan. Against this backdrop, US stocks declined 60bps on the week, while Japanese stocks declined 3.6% over the same period. VIX, the stock volatility index, rose 12% to 18.59. Greek 10 year bond yields widened 116bps to 10.56%. USDJPY fell further to 94.4 (a drop of 2.7% on the week), while EURUSD rallied 70bps to 1.3339. AUDUSD fell 1.2%. Thus, the fashionable trades of Q1 – longs in US stocks Japanese stocks, and USDJPY – continued to unwind over the past week amidst increasing evidence that nothing much has changed fundamentally in the HIDCS (Heavily Indebted Developed Countries). The other major driver of sentiment is the ongoing rhetoric from US Fed officials about commencing a gradual scaling back of quantitative easing policies.

The US treasury market is taking the talk of tighter monetary policy seriously, pushing 10 year US treasury yields 10bps higher to 2.18% albeit with considerable intra-week volatility. While this level of yields is still very low – the 60bps move over the past two months is only half of the intra-year move of last year, which in turn was only half of the intra-year move the year before. It was the speed of the move rather, which has upset sentiment. Stock markets have reacted negatively to the talk of tapering. Given that any tapering of quantitative easing from the Fed would likely have little or no direct economic impact on the cost of capital for the foreseeable future and ought therefore to be interpreted as a bullish sign for stocks it is somewhat disconcerting that US equities have performed so poorly in the face of talk of tapering. It suggests that stock market valuations could owe more to money printing than to a strong underlying growth picture. Emerging Markets cheapened considerably over the past week, further increasing the attractiveness of adding into the current market conditions. Emerging Markets stocks declined 2.8%, local bond yields rose to 6.19%, and currencies were down 90bps. Sovereign and corporate credit in dollars fell between 1.3% and 1.7% on the week. However, the market is now beginning to discriminate between credits, which suggests that some semblance of rationality is returning to the market.

Latin America

Brazil: IPCA inflation for the month of May was 6.5% yoy, exactly on the upper band of the central bank's inflation target. S&P, the ratings agency, downgraded the outlook for Brazil's BBB credit rating to negative from stable. In a very positive development, the government removed the financial transactions tax on FX derivatives, but in a more populist move the government also announced a BRL17bn subsidy for home furnishings. The central bank sold dollars via swaps to stabilise the currency, which lost 1.3% on the week against the dollar.

Mexico: Industrial production dropped -1.7% mom (up 3.3% yoy) in April versus expectations of +0.5% mom (5.3% yoy). The central bank left the overnight rate unchanged at 4.0% in Friday's monetary policy meeting.

Peru: The April trade balance was slightly wider than expected USD378m (versus USD301m expected).

Venezuela: The government in Venezuela published data revealing a sharp slowing of real spending by the government, while PDVSA, the national oil company, received an USD1bn credit line from the Export-Import Bank of China. In a notable deterioration in the inflation situation, Caracas CPI surged 6.2% mom in May after a 3.9% mom jump in April, taking the 12-month headline inflation rate to 33.7% from 27.9% in April.

Asia

China: Continued the complicated process of rotating its economy away from being driven by exports and credit towards domestic demand. The trade surplus for May rose to USD20.4bn versus expectations of USD19.3bn amidst weakening exports (up only 1% versus 7.4% expected). Investment, industrial production and retail sales continue to expand at a strong pace, but slightly short of expectations. Meanwhile, inflation dropped from 2.4% to 2.1% this month.

Indonesia: Bank Indonesia surprised the market by raising the reference rate to 6.0% from 5.75%. The less important overnight deposit facility rates (FASBI) was hiked to 4.25% from 4.0%.

South Korea: Bank of Korea kept rates unchanged as expected at 2.5%.

India: April industrial production surprised on the downside at 2% yoy versus 2.4% expected, while May CPI came marginally higher than expected at 9.3%.

Philippines: Exports fell 5.9% mom in April, while the central bank kept the overnight borrowing rate flat at 3.5%.

Malaysia: Manufacturing production rose 4.2% yoy, which was stronger than expected (exp.1.6%).

Eastern Europe, Africa, and Middle East

Czech Republic: The rate of inflation in May was 1.3% yoy from 1.7% yoy in April and 1.6% yoy expected.

Hungary: CPI inflation rose to 1.8% yoy in May (versus 1.9% expected and 1.7% yoy in April). Industrial production continued to expand in April, rising at a yoy rate of 2.9% yoy, which was more than twice the market expectation of 1.4% yoy. The limit on daily FX intervention was raised by USD200m by the Central Bank of Russia and they left the key policy rate unchanged.

Romania: Inflation was flat at 5.3% yoy in May versus the expectation of a drop to 5.1%.

Ukraine: gross FX and gold reserves fell by \$0.7bn to \$24.5bn in May, mainly due to negative valuation effects. The central bank cut the discount rate by 50 bps.

Turkey: Prime Minister Erdogan reportedly proposed to a group of activists that a referendum can be held on the controversial plans for Istanbul's Gezi Park. The central bank cut the funding for repo operations, thus effectively tightening liquidity conditions.

South Africa: Retail sales fell 0.6% mom versus a rise of 0.4% expected.

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