GLOBAL FIXED INCOME WEEKLY

EXECUTIVE SUMMARY

- This week, investor focus was on May inflation data in the US and the European Central Bank (ECB) meeting. In May, the US core consumer price index (CPI) rose 0.7% month-over-month (MoM) and 3.8% year-over-year (YoY), beating consensus expectations. While the increase primarily reflected upward price pressure from reopening and supply shortages, the May CPI report showed broader-based price increases than last month’s. Notably, owners’ equivalent rent accelerated across regions from 0.21% MoM in April to 0.31% MoM in May, a post-pandemic high (see Chart of the Week).

- Market reaction to this upside surprise was subdued, and in recent weeks, US Treasury yields have returned to levels last seen in late February. Financial markets appear to be falling in line with the Fed’s view that the uptick in inflation data due to reopening effects and supply bottlenecks is transitory.

- At the June ECB meeting this week, ECB President Christine Lagarde echoed the Fed’s view that higher inflation rates are temporary and stated that underlying price pressures will likely remain subdued overall in the euro area due to economic slack, low wage growth, and the euro’s appreciation. The ECB Governing Council left policy rates unchanged and maintained its current pace of asset purchases under its pandemic emergency purchase program (PEPP), renewing its pledge to deliver monetary support. President Lagarde stated that “any discussion about exit from the PEPP would be premature.”

CHART OF THE WEEK
US CPI inflation surprised to the upside as owners’ equivalent rent firms up

Source: Macrobond, GSAM. As of May, 2021.
MARKET COMMENTARY AND GSAM STRATEGY

Duration
- Core global bond yields have fallen in recent weeks; US Treasury yields have returned to late February levels, with the rally led by 30-year bonds. In addition, rate volatility has generally trended lower despite macro data volatility. A moderation in Chinese PMI data alongside a second consecutive weak US labor market report has helped US rates strengthen.
- We are entering a period that tends to be supportive for global rates, in part due to lower new supply. This will inform our rates positioning, though we remain alert to potential volatility around economic data and central bank commentary.

Country
- The ECB Governing Council left policy rates unchanged and maintained its current pace of asset purchases under its PEPP, in line with our expectations. Notably, the ECB has become significantly more constructive on the growth outlook. The ECB did acknowledge the pickup in inflation but continues to view this uptick in inflation data as transitory. We expect the ECB to maintain its dovish policy stance for the foreseeable future.
- Elsewhere, we are mindful of less accommodative policies in Australia. The Reserve Bank of Australia (RBA) has dropped its formal easing bias on quantitative easing (QE) and may omit its 3-year yield curve control target. We also see scope for it to adopt a more flexible form of QE. That said, we remain biased to be overweight Australian rates at longer maturities that are less sensitive to near-term monetary policy developments.
- In Norway, we remain underweight but are cognizant of volatility given illiquidity in Norwegian rates. The Norges Bank is the most hawkish among its G10 peers by some distance and a string of strong economic data—a recent downside inflation print aside—could pull forward plans for rate lift off to September. Our underweight positions are predicated on the flat curve in Norway versus near-term hawkish policy moves.

Currency
- Our currency positions reflect a synchronized global upswing. We continue to see improved economic prospects in Europe and remain overweight European currencies while underweight the US dollar. We are also overweight pro-cyclical G10 currencies. We have increased overweight exposure to emerging market (EM) currencies given improving EM data and inflows into EM debt.

Cross Sector
- We have added exposure to emerging market debt this past week, mainly at shorter maturities, while reducing exposure to investment grade credit where we have a preference for longer-dated maturities. We also remain underweight Agency MBS.

Securitized
- Agency MBS spreads have widened slightly over the last month due to subdued bank demand, though they remain near all-time tights. We think there is room for further underperformance as we enter a period of higher seasonal supply and due to concerns over Fed tapering. As such, we have increased our sector underweight.

Investment Grade Corporate Credit
- We retain a down-in-quality bias given potentially attractive security selection opportunities in the large BBB-rated portion of the market. We are cautious on the A-rated portion of the market as this rating cohort has been the most aggressive in terms of their capital allocation decisions. Meanwhile, BBB-rated companies have largely upheld balance sheet discipline. As a result, there have been a number of downgrades from the A-rating cohort to the BBB-rating cohort.

High Yield Corporate Credit and Bank Loans
- Default activity remains benign with no defaults month-to-date. Since the start of 2021, in the US, five high yield issuers have defaulted totaling $2.6bn and one loan issuer has defaulted totaling $900mn. In Europe, there have been three defaults totaling €2.5bn. This has been the lowest number of defaults to start a year that we have seen in a decade.

Emerging Market Debt
- In May, China’s exports rose 27.9% YoY, slightly below consensus expectations. Meanwhile imports rose 51.1% YoY, in line with consensus expectations.

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10-YEAR SOVEREIGN BOND YIELDS

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<th>Country</th>
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Source: Macrobond, GSAM. As of Friday, June 11, 2021.

FIXED INCOME SECTOR SPREADS

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**US Investment Grade Corporates:** ICE BofAML US Corporate Index  
**US High Yield Corporates:** ICE BofAML US Corporate High Yield Index  
**European Investment Grade Corporates:** ICE BofAML Euro Corporate Index  
**European High Yield Corporates:** ICE BofAML Euro High Yield Index  
**ABS:** ICE BofAML US Fixed Rate Asset-Backed Securities Index  
**MBS:** ICE BofAML US Agency Mortgage-Backed Securities Index  
**CMBS:** ICE BofAML US Fixed Rate Commercial Mortgage-Backed Securities Index  
**EM External Debt:** J.P. Morgan, EMBI Global Diversified Face Constrained Index

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