GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

FRIDAY, JUNE 10, 2022

- **US CPI for May comes in higher than expected** (link)
- **Euro area spreads continue to widen after ECB meeting** (link)
- **European bank stocks underperform despite rise in interest rates** (link)
- **CEE inflation continues to surprise on the upside** (link)
- **China's equities outperform on optimism of end to regulatory crackdown** (link)
- **Russia cuts interest rates by more than expected** (link)
- **Peru stays on course with 50bps hike and hawkish forward guidance** (link)

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US CPI surprises on upside, sending short rates higher

This morning's US CPI release came in somewhat higher than expected, both in the headline and core readings, pushing the year-over-year headline change to 8.6%. While the dollar and shorter-dated treasury yields (2-year +10 bp) rose on the release, the 10-year treasury was little changed. US equity futures fell on the release. European equities were already lower before the US CPI print, continuing the broad risk off sentiment on the heels of yesterday's ECB meeting. Chinese shares rose overnight on optimism that tight regulatory measures on the tech industry may be ending. Other Asian currencies were mixed as yesterday's risk-off sentiment weighed on markets. Russia cut its interest rate more than expected this morning—150 bps instead of the 100 bps that was anticipated—bringing the rate back to where it was before Russia's invasion of Ukraine, and sending the ruble somewhat weaker (-0.6%).

Key Global Financial Indicators

Last updated: 6/10/22 8:13 AM	Level: Last 12m	Level: Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD	Since 23-Feb-22
Equities			%				%	
S&P 500		4018	-2.4	-4	0	-5	-16	-5
Eurostoxx 50		3663	-1.6	-3	3	-11	-15	-8
Nikkei 225		27824	-1.5	0	5	-4	-3	5
MSCI EM		42	-2.4	-3	4	-25	-15	-12
Yields and Spreads			bps					
US 10y Yield		3.04	0.0	11	5	161	153	105
Germany 10y Yield		1.41	-1.9	14	41	167	159	118
EMBIG Sovereign Spread		463	10	15	-3	134	96	50
FX / Commodities / Volatility			%					
EM FX vs. USD, (+) = appreciation		52.5	-0.1	-1	2	-10	0	-1
Dollar index, (+) = $ appreciation		103.6	0.4	1	0	15	8	8
Brent Crude Oil ($/barrel)		124.1	0.8	4	21	71	60	28
VIX Index (%, change in pp)		26.6	0.5	2	-6	11	9	-4

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

The S&P 500 sold off by 2.4% Thursday amid a changed ECB' narrative pointing to secular shifts in the economic outlook that prompted market participants to be wary of today's inflation data. Conversely, 10y Treasuries remained range-bound, edging up only 2 bps to 3.04% on the back of constructive results from a $19 bn T-Bond auction.

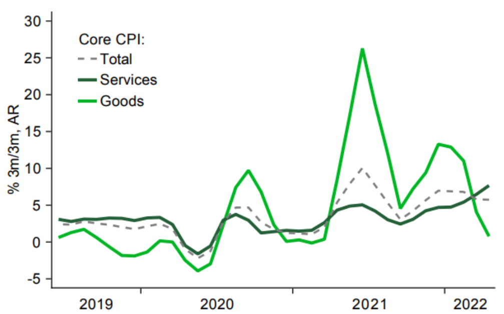
Backed by rising energy costs, headline inflation continued to climb by 1.0% m/m (vs. 0.7% exp.) or 8.6% y/y (vs. 8.3% exp). Meanwhile, core inflation continues to climb (0.6% m/m vs. 0.5% exp), rising to 6.0% y/y, the fastest pace since 1986, driven by continued growth in shelter inflation. This increases the market odds for three 50bp rate hikes at the next three FOMC meetings. In reaction, short-end yields are up (2y +10bps) driven by the breakeven components, while the S&P futures dipped 1.2% and the Dollar appreciated 0.3% vs. the Euro following the data release.

Key US Data Releases: 8.30 am EDT

Indicator	Consensus Forecast	Actual Data
CPI headline m/m	0.7%	1.0%
CPI headline y/y	8.3%	8.6%
CPI core m/m	0.5%	0.6%
CPI core y/y	5.9%	6.0%

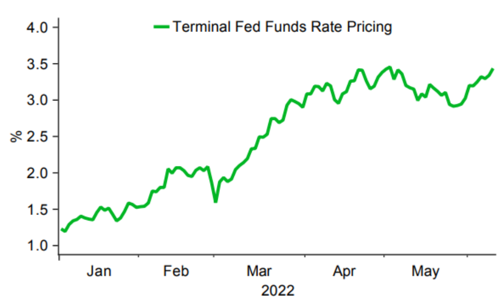
Terminal Fed fund pricing has climbed as inflation is set to continue pivoting from goods to services. So far, the dominant theme this year has been for core inflation pressures to rotate from the pandemic-related supply and demand imbalances in goods to the services category. With the bulk of the rise in the services component being due to housing, one motivation for the Fed to create tighter financial conditions has been to slow the housing market through higher mortgage rates that eventually bring down shelter inflation via second-round effects. However, as the trend in service inflation proves more persistent than that of goods, some analysts think the Fed might need to withdraw more accommodation than it announced. This may be partially behind the recent increase in the pricing of the terminal Fed Funds rate—approximated by the 2y3m forward rate—the terminal rate rebounded by 40 bps in recent weeks back to a 3.5% mark that was seen ahead of the April inflation.

Passing on the Baton: From Core Goods to Core Services



Source: BLS, TD Securities

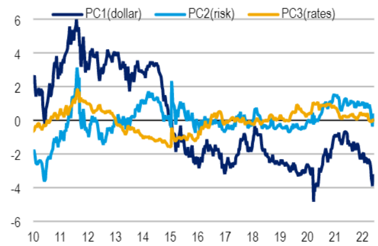
Figure 2: Market Pricing for the Terminal Funds Rate Continues to Climb



Source: Bloomberg, TD Securities

For USD currency pairs, short-term interest rate differentials became a less relevant driver. Motivated by broad dollar strength seemingly fueled by Fed policy tightening, Bank of America analysts conducted a factor analysis study to uncover the underlying drivers affecting the G10 USD FX pairs with two main findings. First, looking first at the sensitivity of FX pairs to differences between domestic and foreign short-term interest rates, the study finds that the average FX beta of USD pairs has fallen to zero over the past year, while it remained relatively constant for EUR pairs. Second, the Dollar strength seems primarily driven by a Dollar Factor and a Risk Factor—which both capture a wide range of USD supportive currents—while the influence of short-term interest rate differentials appears to be minor.

Exhibit 3: G10 FX - three principal components
All factors have moves in favor of stronger USD vs. G10



Source: Bloomberg, Note: PCA factors extracted from G10 pairs vs. USD - higher (lower) factor associated with weaker (stronger) USD.
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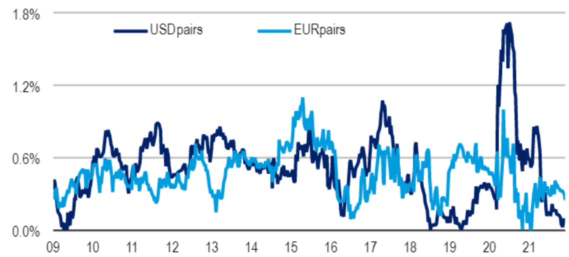
Chart of the Day: Median FX beta (26-week rolling) to 1y1y rate differentials
Front-end rates have not been a statistically significant driver of USD pairs (on average)



Source: Bloomberg, Note: Beta shows the % move associated with a 10bp move higher in 1y1y rate differentials
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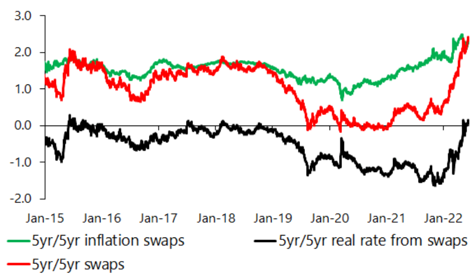
Euro area
Equities (-1.6%) fell with noteworthy underperformance in Spain (-3.5%) and Italy (-3.3%) as investors continue to digest yesterday's ECB meeting. German 10-yr bund yields (-1 bps to 1.42%) and the euro were marginally lower as measure for the medium-term real rate remain in positive territory.

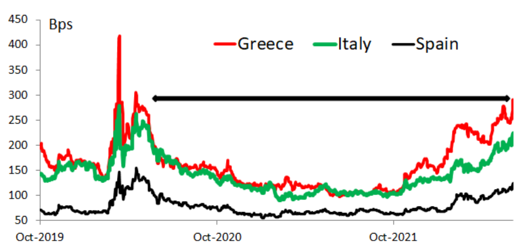
Euro area: 5yr/5yr inflation and 5yr/5yr interest rate swaps (%)



Source: Bloomberg and IMF staff

Euro area spreads widened further as contacts see a risk of increasing fragmentation risks. According to media reports, a large majority of Council members saw no need for now to announce new bond purchases to rein in spreads and fragmentation was only briefly discussed with no progress at this week's ECB meeting. **Earlier this week, a FT article suggested that the ECB would have addressed fragmentation risks more explicitly yesterday, so rates and especially Italian spreads moved sharply higher after the meeting.** Today, 10-yr Greek spreads rose a sizable 23 bps to 292 bps, a new post-pandemic high, but 10-yr Italian (+7 bps), Spanish (+5 bps), and French spreads (+2 bps) also widened as yields have become more volatile.

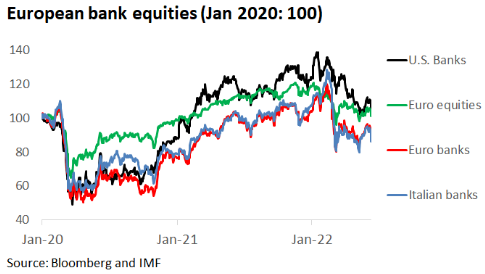
Euro area: 10-year spread over German bunds (bps)



Source: Bloomberg and IMF staff

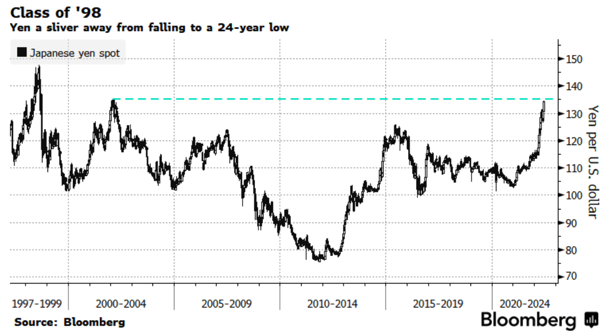
BofA warns that the ECB potentially signaled a first step towards passive QT after the ECB changed the wording on APP reinvestment from "for as long as necessary to maintain favorable liquidity conditions and an ample degree of monetary accommodation" to "for as long as necessary to maintain ample liquidity conditions and an appropriate monetary policy stance."

Bank stocks (-3%) underperformed materially even though bank analysts argue that higher inflation and interest rates should make European banks more profitable. In this line of thought, banks have plenty of cash (reserves) that will now get remunerated + higher interest margins on deposits. This will offset any loan losses from a recession – especially given the low risk of bank portfolios.



Japan

The Japanese yen appreciated (+0.3%). A rebound was supported by the news on a joint meeting of officials from the Ministry of Finance, the Bank of Japan, and the Financial Services Agency. In a joint statement, officials said that they would act appropriately if needed. Analysts commented that verbal intervention is easy, but actual intervention would be more complicated as it would go against Japan's agreements with its peer nations. Despite some rebound today, the yen has still depreciated 2.3% over the past week. Market participants started voicing some concerns about how a weak Japanese yen may affect other Asian economies' competitiveness and their economic recovery, which may prompt FX interventions by other country authorities. **PPI remained flat m/m in May,** decelerating from +1.2% in April (consensus: +0.6%). Equities declined (NIKKEI: -1.5%), in line with regional trends. Long-end JGB yields rose (10-year: +0.2 bp; 30-year: +0.4 bps), with the 10-year yield touching 0.247%.



Emerging Markets

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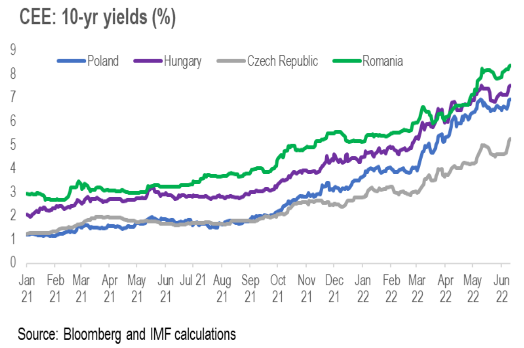
Asian equities generally declined, falling 1.0% on net, led by Philippine (-3.4%), Indian (-1.9%) and Indonesian (-1.3%) equities, following a global sell-off yesterday. Meanwhile, Chinese equities rose (CSI 300: +1.5%). Asian currencies were mixed. The Thai baht (-0.8%) depreciated, while the Singapore dollar appreciated (+0.2%). Long-end government bond yields increased, with 10-year yields rising in Thailand (+1.6 bps). **EMEA equities were trading in the red,** while currencies were mostly strengthening against the dollar with sentiment dampened in the aftermath of the ECB meeting yesterday and ahead of the US CPI release later today. Equities in Poland (-1.3%) and Kenya (-1.2%) saw the largest declines while the Hungarian forint (-0.8% against the euro) was underperforming. In **Latin America,** local markets weakened amid the global sell-off. Colombia underperformed again with equities down 2.2% and the peso weaker by 1.1%, weighed by waning election optimism and weaker commodity prices amid global growth concerns. Brazil held up, as local rates dropped and the real was only marginally weaker, supported by lower inflation print and the $6.9 bn share offering of Eletrobras, the second largest equity deal so far this year.

China

Chinese equities gained on optimism around an end to the regulatory crackdown, outperforming regional peers (CSI 300: +1.5%; HangSeng China Enterprises: flat). Markets are seeing that the worst of regulatory tightening on the tech sector has passed. Tech stocks listed in Hong Kong SAR gained (+1.6%).

RMB was little changed. CPI inflation remained at 2.1% y/y in May, lower than expected (consensus: +2.2%). Core CPI inflation also stayed unchanged, reflecting persistent weak consumer demand. Meanwhile, PPI inflation eased to 6.4% y/y in May from 8.0% in April, in line with expectations. Sequentially, PPI picked up (+0.1% m/m) amid rising crude oil prices. Aggregate financing increased by 2.79 bn RMB ($417 bn) in May, larger than expected, underpinned by a stronger than expected increase in bank loans. While government bond issuance was strong, the net issuance of corporate bonds turned negative.

CEE

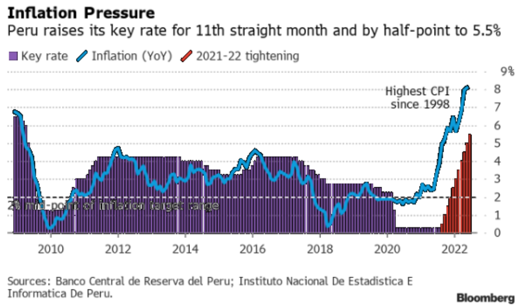


Yields increase in Central and Eastern Europe as headline inflation continued to surprise on the upside in May. 10-yr sovereign yields increased by roughly 9 bps in Czech Republic after data this morning showed headline inflation increasing to +16.0%y/y in May (vs expected 15.5%). 10-yr yields in Romania increased by 7 bps after headline inflation increased to 14.5%y/y (expected 14.4%). Earlier data this week showed inflation in Hungary increased to 10.7%y/y (expected 10.4% from 9.5%) mainly as a result of food inflation, and preliminary May headline inflation in Poland increasing to +13.9% y/y (expected 13.6% from 12.4%), mainly driven by higher food and energy prices. **Yesterday the National Bank of Poland's press conference hinted that the bulk of tightening has been done but** noted that the tightening cycle would only come to an end if there were clear signs that inflation has peaked.

Russia

The ruble weakened (-0.6% to 58/$) and equities reversed losses (+0.1%) after the central bank of Russia (CBR) cut its policy rate by 150 bps to 9.5%, back to the level it was prior to Russia's invasion of Ukraine. Analysts were generally expecting a 100 bps cut. Since lowering the policy rate by 300 bps at an unscheduled meeting on May 26, inflation has eased, while the ruble has strengthened by roughly 3% (+29% in the year to date). In the press release the CBR said that the need for further cuts would be considered at upcoming meetings. Goldman Sachs analysts expect the interest rate to remain on hold now as the central bank assesses the economic outlook. The next policy meeting is on July 22.

Peru



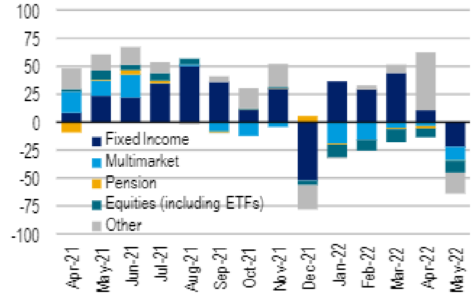
The BCRP stayed on course by hiking 50bps, as expected, and maintained its hawkish guidance. The 50bps hike raised the policy rate to 5.5%, bringing the total tightening to 525bps since August 2021. The statement highlighted inflation pressures pushed up by food and energy prices with core inflation remaining outside the target band for the fifth consecutive month, as well as concerns on the slower-than-expected global recovery. The BCRP expects inflation to peak around July 2022 and revert back to target band between Q2 and Q3 of 2023. Forward guidance was kept hawkish, with additional changes to monetary policy stance if necessary.

Brazil

Swap rates dropped on lower headline inflation in May. IPCA headline inflation moderated to 11.7% y/y in May, helped by falling electricity tariffs, smaller increases in fuel prices and downside surprises in food prices. However, the core measure (excluding food at home and regulated items) accelerated to 10.4% y/y. Separately, **local investors continue to withdraw from equity funds while earlier rotation into fixed income funds reversed in May.** Brazil's local fund industry had BRL 63bn outflows in May. Equity and multimarket/hedge funds had 10 bn and 12 bn outflows and fixed income funds had 22 bn outflow, the first net withdrawal this year. Investment in local funds make up 70% of Brazilian household savings.

Exhibit 23: Flows to Brazil local fund industry (R$bn), Apr-21 to May-22

Fixed Income funds had R$97bn inflows YTD.



Source: ANBIMA

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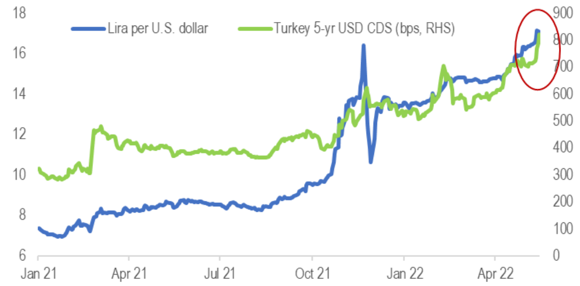
Turkey

The lira strengthened (+0.1%) while Turkey's CDS spreads jumped to 821 bps (+99 bps since the start of the week) after new support measures were announced yesterday. Measures include plans to issue new government bonds to boost lira savings as well as macroprudential measures, including a doubling of the reserve requirements for lira-denominated cash loans to 20%. Contacts note that while the new measures could support currency stability, they lack incentives to convert foreign savings into lira. The lira is trading roughly 20% weaker than at the start of the year.

Turkey: Currency and CDS



Source: Bloomberg and IMF staff calculations

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Global Financial Indicators

Last updated: 6/10/22 8:13 AM	Level Last 12m	Latest	Change 1 Day	7 Days	30 Days	12 M	YTD	Since 23-Feb-22
Equities				%			%	%
United States		4020	-2.4	-2	0	-5	-16	-5
Europe		3663	-1.6	-3	3	-11	-15	-8
Japan		27824	-1.5	0	5	-4	-3	5
China		4239	1.5	4	6	-19	-14	-8
Asia Ex Japan		71	-2.4	-2	6	-25	-14	-11
Emerging Markets		42	-2.4	-3	4	-25	-15	-12
Interest Rates				basis points				
US 10y Yield		3.04	0.0	11	5	161	153	105
Germany 10y Yield		1.41	-1.9	14	41	167	159	118
Japan 10y Yield		0.25	0.2	2	1	20	18	6
UK 10y Yield		2.32	-0.7	16	47	157	135	84
Credit Spreads				basis points				
US Investment Grade		154	0.2	3	-7	61	42	11
US High Yield		451	-0.2	19	-14	119	114	45
Europe IG		96	2.2	7	0	48	48	25
Europe HY		484	13.0	38	19	248	242	132
Exchange Rates				%				
USD/Majors		103.65	0.4	1	0	15	8	8
EUR/USD		1.06	-0.4	-1	0	-13	-7	-6
USD/JPY		133.9	-0.4	2	3	22	16	16
EM/USD		52.5	-0.1	-1	2	-10	0	-1
Commodities				%				
Brent Crude Oil ($/barrel)		124	0.8	4	23	85	65	38
Industrials Metals (index)		182	-1.3	-2	1	15	5	-3
Agriculture (index)		77	-0.3	3	3	28	26	10
Implied Volatility				%				
VIX Index (%, change in pp)		26.6	0.5	1.8	-6.4	10.5	9.4	-4.4
US 10y Swaption Volatility		103.5	0.7	6.5	-23.4	43.6	24.5	9.2
Global FX Volatility		10.3	0.0	0.7	-0.8	3.8	2.9	2.8
EA Sovereign Spreads				10-Year spread vs. Germany (bps)				
Greece		287	18.1	42	36	181	136	47
Italy		223	5.5	10	23	118	88	51
Portugal		126	4.9	6	12	62	62	34
Spain		124	5.0	8	14	60	50	21

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

Emerging Market Financial Indicators

Last updated: 6/10/2022 8:13 AM	Exchange Rates: Level Last 12m	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Since 23-Feb-22	Local Currency Bond Yields (GBI EM): Level Last 12m	Latest	Change (in basis points) 1 Day	7 Days	30 Days	12 M	YTD	Since 23-Feb-22
		vs. USD	(+) = EM appreciation							% p.a.						
China		6.68	0.1	-0.3	1	-4	-5	-5		2.8	-2.4	-2	-5	-40	-1	-2
Indonesia		14567	-0.5	-0.6	0	-2	-2	-2		7.2	3.0	19	-8	80	82	70
India		78	0.0	-0.2	0	-6	-4	-4		6.3	0.0	0	9	75	0	
Philippines		53	-0.1	-0.3	-1	-10	-4	-3		5.5	0.0	0	10	114	98	48
Thailand		35	0.1	-0.8	0	-10	-4	-6		2.9	1.0	-9	-42	95	102	64
Malaysia		4.39	0.0	-0.1	0	-6	-5	-5		4.2	0.2	-3	-18	94	62	54
Argentina		121	-0.1	-0.9	-4	-22	-15	-12		56.6	18.8	7	396	1124	603	864
Brazil		4.88	0.4	-1.7	6	4	14	3		12.7	-4.5	13	16	358	200	116
Chile		822	0.7	0.3	6	-13	4	-4		6.4	0.0	17	-19	246	93	44
Colombia		3803	-0.4	0.0	8	-5	7	3		8.9	0.0	50	-14	336	246	99
Mexico		19.56	0.1	-0.2	4	1	5	3		8.9	-2.0	32	-16	221	140	108
Peru		3.8	-0.4	-1.0	2	4	6	-1		7.7	0.5	16	-58	251	183	173
Uruguay		39	0.4	1.3	6	10	13	7		10.7	15.5	41	60	274	193	251
Hungary		369	0.0	-0.7	-2	-23	-12	-13		7.4	13.0	39	21	480	291	261
Poland		4.28	0.1	-0.4	4	-14	-6	-5		6.8	15.5	47	28	498	331	294
Romania		4.6	0.2	-0.1	2	-12	-5	-5		8.1	2.6	30	71	536	326	293
Russia		58.1	3.8	9.5	20	25	29	41		8.2	9.2	0	-385	75	-60	-301
South Africa		15.3	0.0	1.2	6	-10	4	-1		8.7	4.5	26	-12	155	126	110
Turkey		17.23	-0.5	-4.4	-12	-50	-23	-20		26.0	66.0	347	296	737	165	355
US (DXY; 5y UST)		104	0.4	1.5	0	15	8	8		3.07	4.0	16	12	232	181	117

	Equity Markets: Level Last 12m	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Since 23-Feb-22	Bond Spreads on USD Debt (EMBIG): Level Last 12m	Latest	Change (in basis points) 7 Days	30 Days	12 M	YTD	Since 23-Feb-22
									basis points						
China		4239	1.5	4	6	-19	-14	-8		198	-4	-3	-11	-5	-10
Indonesia		7183	-1.3	0	5	18	9	4		178	-8	-4	1	13	-7
India		55320	-1.8	-1	2	6	-5	-3		166	-3	-7	22	34	12
Philippines		6759	-3.4	1	1	-2	-5	-8		123	-8	-16	26	22	-14
Thailand		1641	-0.5	-1	1	1	-1	-3		0	0	0	0	0	0
Malaysia		1510	-1.0	-3	-3	-4	-4	-5		122	-2	-2	0	5	-11
Argentina		89947	-1.1	-2	9	32	8	-2		1970	58	163	499	290	233
Brazil		108368	-1.6	-3	5	-17	3	-3		311	8	19	63	0	-20
Chile		5277	-1.5	-1	11	24	22	21		148	-3	-13	0	8	-26
Colombia		1561	-1.7	-3	3	24	11	3		347	15	-29	106	-1	-45
Mexico		49819	-0.6	-3	2	-2	-6	-3		378	5	9	53	46	8
Peru		20628	0.0	0	3	5	-2	-12		172	4	-16	2	22	-18
Hungary		40201	-0.7	-1	-3	-17	-21	-16		232	23	48	89	108	79
Poland		56106	-1.0	-2	4	-15	-19	-11		75	64	73	36	43	59
Romania		12476	-0.6	1	2	10	-4	-6		251	2	23	68	58	18
Russia		2282	-0.5	-2	-5	-41	-40	-26		3411	-577	938	3228	3234	2897
South Africa		69789	-1.1	-2	5	3	-5	-7		387	7	-6	76	32	-2
Turkey		2543	-0.1	-2	3	75	37	26		634	52	99	166	56	71
Ukraine		519	0.0	0	0	-2	-1	0		3421	48	-95	2947	2662	1948
EM total		42	0.3	-3	4	-25	-15	-12		387	10	-6	36	1	-71

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

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