GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

THURSDAY, JUNE 16, 2022

- **FOMC reiterates commitment to fight inflation** (link)
- **Japanese government bonds face deteriorating liquidity at longer tenors** (link)
- **The Swiss franc rallies after Switzerland surprises with a 50 bps hike** (link)
- **The pound weakens after BoE tightens by 25 bps** (link)
- **Hungary surprises with a 50 bps hike** (link)
- **Chinese offshore renminbi weakens amid covid-related concerns** (link)
- **Brazil's central bank extends its hiking cycle with +50 bps in the policy rate** (link)

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Sentiment turns as tightening continues

US equity index futures are lower following yesterday's gain after Chair Powell said that an *unusually large* hike of 75 bps would likely not be common in future. Sentiment turned in the Asian session, while European equities were posting losses of over 2% this morning. Sovereign yields are higher as a number of central banks tightened policy over the past 24 hours. The Bank of England hiked by 25 bps as expected, while Switzerland surprised with a 50 bps hike (no change expected). Elsewhere Hong Kong tightened by 75 bps, Hungary by 50 bps and Brazil by 50 bps. European gas prices continued to increase steeply amid supply concerns.

Key Global Financial Indicators

Last updated: 6/16/22 1:11 PM	Level		Change from Market Close					Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
Equities			%				%	
S&P 500		3790	1.5	-8	-5	-10	-20	-10
Eurostoxx 50		3433	-2.8	-8	-7	-17	-20	-14
Nikkei 225		26431	0.4	-6	-1	-9	-8	0
MSCI EM		41	1.3	-5	1	-25	-17	-14
Yields and Spreads			bps					
US 10y Yield		3.45	16.7	41	57	188	194	146
Germany 10y Yield		1.84	19.1	41	90	209	201	161
EMBIG Sovereign Spread		488	7	35	19	156	121	75
FX / Commodities / Volatility			%					
EM FX vs. USD, (+) = appreciation		51.5	-0.6	-2	0	-10	-2	-3
Dollar index, (+) = $ appreciation		105.2	0.0	2	1	15	10	9
Brent Crude Oil ($/barrel)		116.4	-1.8	-5	2	56	50	20
VIX Index (%, change in pp)		32.1	2.5	6	5	14	15	1

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

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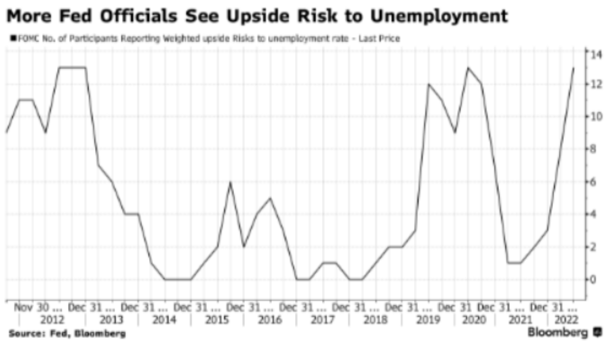
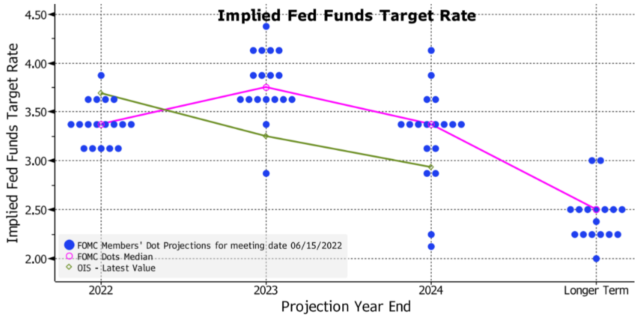
United States

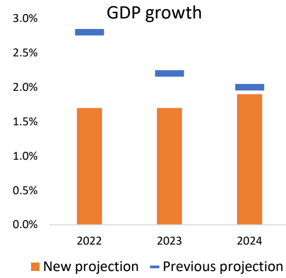
Yesterday, the Fed hiked its policy rate by 75 bps (in line with expectations), but the guidance for the next meeting was defined as either 50 or 75 bps—which was slightly more dovish than the markets priced before the FOMC meeting—leading to lower yields (3 to 5 bps across the yield curve) and correspondingly, higher equity prices (S&P 500 +1.0%) and USD depreciation (-0.6% and -1.0% versus major and emerging market currencies respectively). In today's data release, **the US Housing Starts and Building Permits were considerably lower than expected:** 1549k (vs expected 1693k) and 1695k (vs exp 1778k) respectively. The figures reflect the impact of supply chain constraints and rising mortgage rates.

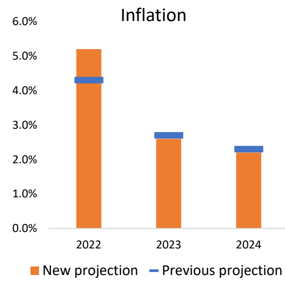
Fed Chair Powell recognized the complexity of the current inflationary environment but reiterated the Fed's commitment to fight inflation. The decision to hike by 75 bps was driven by the recent inflation surprises and most of the Fed members believe that such upside surprises are likely to continue in the future (left chart below). Yet, Powell does not see any inflationary spiral emerging and thinks that soft landing is possible with the US economy "in a strong position" and "well-positioned to deal with higher interest rates". However, he believes that the external environment is the main factor determining whether a soft landing will happen. In terms of the aggressiveness of tightening and potential costs of bringing inflation down, Powell noted that the Fed is "not trying to induce a recession now" and the Fed is "quite mindful" of the danger of going too far. He noted that 4.1% unemployment would be "a successful outcome", and the Fed is "not looking for a higher unemployment rate" per se. However, the majority of Fed members see substantial upside risks to unemployment (right chart). In terms of forward guidance, the pace of rate hikes will depend on incoming data and the evolving data. The estimates of the committee of how high the policy rate needs to go are a range of 3.5% to 4% (which is in line with the current market pricing). Powell said people generally see tightening going into early next year, and that "policy is going to need to be restrictive," while the remaining question is how restrictive.



The Fed adjusted its economic projections for the 2022-2024. GDP growth projections were considerably downgraded for 2022 and 2023 (middle chart below), while the inflation projection for 2022 was increased by 0.9 p.p. (right chart). These projections along with the new DOTS plot (left chart) indicate that the Fed assumes that disinflation will happen quickly and most of it will be finished by 2023, while preserving GDP growth significantly positive—i.e., securing a soft landing. Many analysts find these projections overly optimistic and suggest that a quick disinflation and high levels of projected DOTS policy rates may be incompatible with such generous projections of GDP growth. Additionally, some analysts mention that the currently projected policy rate path will be insufficient to curb inflation, and the rate might need to be raised to 5%.

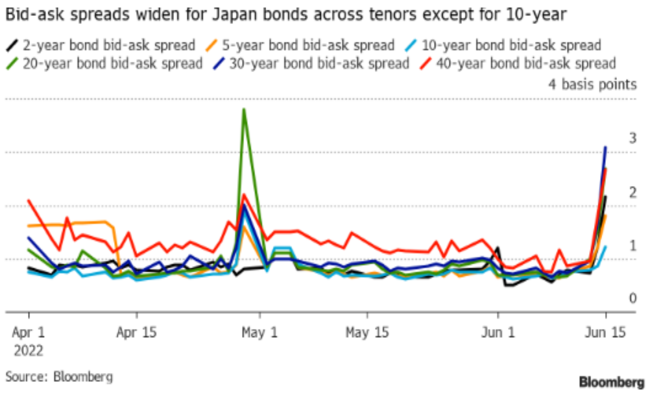






Japan

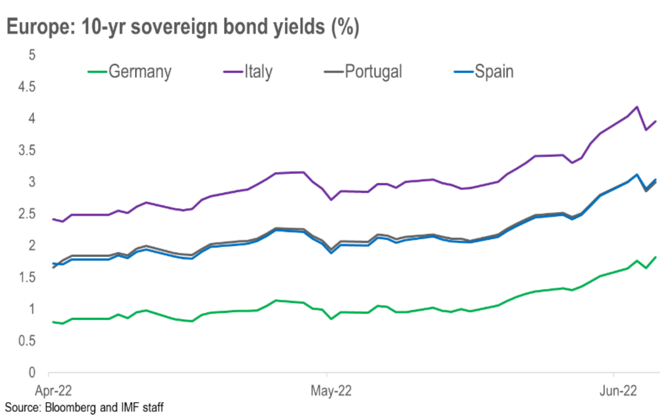
Liquidity deteriorated for government bonds beyond 10 years with bid ask spreads increasing amid high market volatility. US dollar-yen 1-week implied volatility remained near a 2-year high, ahead of the Bank of Japan's (BOJ) decision on Friday. The yen and 10-year yields were broadly unchanged while equities gained +0.6%. On the data front Japan's trade deficit worsened in May (-¥2384.7 bn (-$17.7 bn); previous: -¥839.2 bn), led by a record surge in imports (+48.9% y/y) on increased crude oil and coal prices.



Euro area

European equity markets posted steep losses (Stoxx 600 Europe -2.2%) with all sectors trading in the red. The retail sector (-4%) was underperforming. **The euro weakened (-0.4%).**

Sovereign yields jumped (10-yr bund +18 bps), reversing yesterday's decline, while Southern spreads edged lower. Italy-Germany 10Y spreads fell 3 bps to 215 bps. The ECB Governing Council (GC) yesterday activated the flexibility of reinvesting redemptions that come due in the PEPP portfolio and also said that the completion of a new anti-fragmentation instrument's design should be accelerated. No details were provided on what such a backstop could look like. Goldman Sachs analysts expect details of the new fragmentation tool to be announced at the July meeting and still see a +25 bps hike in July and a +50 bps hike at both the September and October meeting. **Market pricing is little changed from the start of the week, with roughly +130 bps of tightening priced in by October and +180 bps of tightening priced in by end 2022.**



Natural gas prices in Europe increased sharply (benchmark 1-month forward +22% to €142/MwH) amid Russian supply reductions. Germany's economy minister Habeck reportedly believes that supply reductions from Russia via the Nord Stream is politically motivated, according to Bloomberg. Gazprom had reported that a technical issue is limiting supply via the Nord Stream pipeline—the largest link to the EU—by 40%. So far this month, daily gas exports from Russia to key foreign client have fallen to levels last seen in 2014—with Gazprom's daily gas production 16% lower than in May, according to Bloomberg estimates. **1-month forward gas prices have increased by 76% so far this week.**

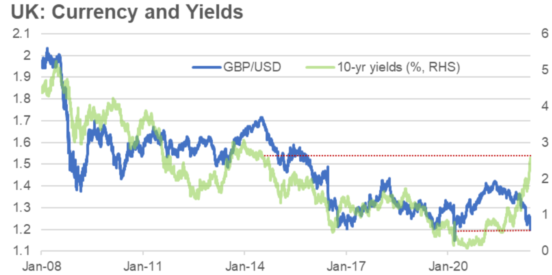
Switzerland

The Swiss franc rallied (+1.8% against the euro +1.4% against the dollar) after a surprise +50 bps hike, taking the policy rate to -0.25%. Consensus expected the rate to remain unchanged. The news conference highlighted the need to counter higher levels of inflation that are becoming more broad-based, with a weaker exchange rate also contributing to higher prices. Headline inflation increased to 2.9% yoy in May and core inflation reached +1.7%. The Swiss National Bank (SNB) now forecast inflation at 2.8% in 2022 and noted that further hikes could be necessary. **The SNB also indicated a willingness to be active in the foreign exchange market if required, with ING analysts now expecting the central bank to use FX reserves to support the currency over the next year**.

United Kingdom

10-yr gilt yields retraced some opening gains while the pound weakened (-0.9%) after the Bank of England (BoE) hiked its policy rate 25 bps to 120 bps, in line with consensus expectations. Markets had been pricing a 36% chance of a 50 bps hike prior to the meeting. No MPC members voted to keep rates unchanged, and 6 MPC members voted for a hike of 25 bps while 3 MPC members for a hike of 50 bps. The BoE policy summary noted that the assessment of the economic outlook and inflationary pressures would determine the path of monetary policy, but noted the committee "will be particularly alert to indications of more persistent inflationary pressures, and will if necessary act forcefully in response".

UK: Currency and Yields



Source: Bloomberg and IMF calculations

Emerging Markets

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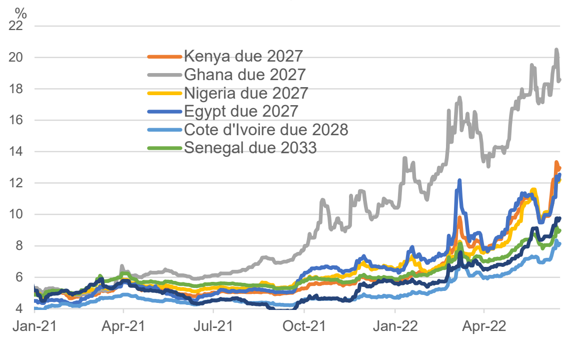
Latin American assets recovered partially, as investors' mood brightened. Stocks recovered some of their recent losses in Argentina (+1.2%), Peru (+1.1%), Brazil (+0.7%), and Chile and Mexico (both +0.4%), while currencies appreciated between 1.9% (Colombia) and 0.8% (Peru), except for a weaker Argentine peso (-0.2%). Subsequent to yesterday's US policy rate hike, treasury yield curves, both hard and currency ones, shifted down across the region, as the risk-off sentiment dissipated from international markets. **Asian equities slipped -1% on net.** Hong Kong SAR (-2.2%), India (-1.4%), and Thailand (-1.3%) fell while Vietnam (+1.9%) and the Philippines (+1.2%) gained. **Asian currencies were mixed.** Offshore renminbi underperformed (-0.8%) amid worries over covid-related lockdowns, onshore yuan renminbi was little changed. Korean won gained +0.3%. 10-year yields generally moved slightly lower while South Korea was an exception with yields up +3.4 bps. **The Hong Kong Monetary Authority hiked its base rate by 75 bps to 2%, in tandem with the US Fed's rate decision. Equity markets were mixed in EMEA,** with gains in South Africa (+2.8%) and Poland (+0.2%), while markets were down in the Czech Republic and Hungary (-1% in both) and Turkey (-0.7%). Currencies were mostly losing to reference currencies while local bond yields continued to increase after yesterday's Fed decision, but most of the repricing happened earlier this week when global markets started pricing in a +75 bps hike by the Fed.

Frontier Market

Frontier markets have also been hit by the global bond sell off over the last week, with yields now significantly above recent peaks. Over the last week, yields on Egyptian Eurobonds increased 183 bps to 12.5%, 145 bps in Nigeria to 12.1%, 102 bps in Kenya to 13%, and 52 bps in Cote d'Ivoire to 8.1%.

EMEA Frontier: Eurobond yields

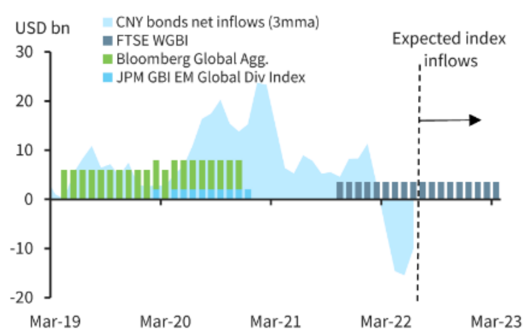


Source: Bloomberg and IMF

China

Foreign outflows from Chinese bonds continued in May. Foreign investors cut their holdings of Chinese fixed income assets by -97.7 bn yuan (-$14.6 bn) last month, with a total drawdown exceeding $60bn since February. Barclays, however, noted that WGBI-related inflows provide continued support, and outflows are likely to slowing in June. Separately, **investment project approvals tripled amid China's stimulus push.** The National Development and Reform Commission approved 48 projects worth 654.2 bn yuan ($97.6 bn) through May this year (+215% y/y YTD, and pledged to ensure reasonable economic growth in Q2, according to Bloomberg. **Equities slipped (CSI 300: -0.6%), 10-year yields were broadly unchanged, offshore renminbi weakened (-0.8%)** amid worries over covid-related lockdowns, onshore yuan renminbi was little changed.

Figure 3. Index-inclusion-related flows an offset

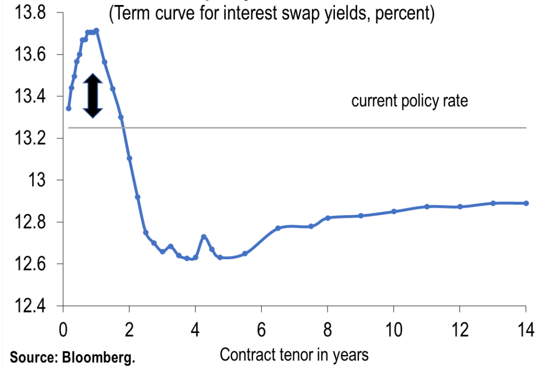


Source: Bloomberg, Barclays Research

Brazil

Brazil's central bank extends its hiking cycle with a +50 bps move in the policy rate. The central bank lifted its policy rate in an unanimous decision to 13.25% and decelerated the hiking speed by 50 bps vs. its last hike. The central bank emphasized that it sees space for additional hikes of up to 50 bps going forward. The bank perceives potentially more persistent global inflationary pressures and uncertainties around Brazil's future fiscal framework, including fiscal policies to support aggregate demand, such as recently approved plans for temporarily lower taxes on fuels, as upside risks to inflation. A possible reversion in local currency commodity price inflation and a more-than-currently anticipated deceleration of internal growth constitute drivers for respective downside risks. Markets had fully expected the decision and already price in fair chances for additional rate hikes.

Brazil: markets price in fair chances for additional policy rate hikes.
(Term curve for interest swap yields, percent)



Source: Bloomberg.

Colombia

Solid macroeconomic data and the fading of investors' risk-off attitude supported Colombia's currency and its sovereign debt. Retail sales (+23.3% y/y) and manufacturing (+13.5% y/y) as well as industrial production (+9.1% y/y) printed solid in April, all higher than in March and the first two substantially above expectations. The government increased its forecast for 2022 GDP growth to 6.5% and lowered the 2022 deficit forecast to 5.6% of GDP. The benign macroeconomic data boosted, along with the turn in global risk sentiment, the peso and the country's sovereign debt but failed to support Colombian stocks, as plans to phase out fuel subsidies are expected to bite into households' budgets and aggregate demand.

Hungary

The Hungarian forint initially rallied vs. the euro after the Hungarian central bank raised the one-week deposit rate by +50 bps to 7.25% against expectations of no change, but later traded flat to the euro (398/euro). Comments by vice governor Virag at a briefing following the hike suggest that the central bank 's stance on inflation might have taken a hawkish turn. The vice governor said that inflation will increase further in the summer months (10.7% yoy in May) and that the central bank will continue raising rates until inflation is brought under control. He also said that the benchmark rate and the one-week rate will be aligned by the time inflation peaks. The forint has lost 6.8% against the euro in 2022 so far reaching an all-time low of 402.9/euro on Monday, and bond yields have reached historical highs (10Y at 8.6% yesterday).

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Global Financial Indicators

Last updated: 6/16/22 1:13 PM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD	Since 23-Feb-22
Equities					%		%	%
United States		3764	1.5	-6	-6	-11	-21	-11
Europe		3435	-2.7	-8	-7	-17	-20	-14
Japan		26431	0.4	-6	-1	-9	-8	0
China		4250	-0.7	2	6	-17	-14	-8
Asia Ex Japan		70	1.1	-4	3	-25	-16	-12
Emerging Markets		41	1.3	-5	1	-25	-17	-14
Interest Rates					basis points			
US 10y Yield		3.45	16.3	40	56	187	194	146
Germany 10y Yield		1.82	18.0	39	89	207	200	160
Japan 10y Yield		0.26	0.3	1	1	21	19	6
UK 10y Yield		2.66	19.3	34	93	192	169	118
Credit Spreads					basis points			
US Investment Grade		161	-1.4	8	-5	73	50	19
US High Yield		485	-14.2	33	-4	166	147	78
Europe IG		109	4.2	16	16	62	62	38
Europe HY		552	25.2	81	101	318	310	200
Exchange Rates					%			
USD/Majors		105.14	0.0	2	1	15	10	9
EUR/USD		1.04	-0.5	-2	0	-13	-9	-8
USD/JPY		133.0	-0.6	-1	3	20	16	16
EM/USD		51.5	-0.6	-2	0	-10	-2	-3
Commodities					%			
Brent Crude Oil ($/barrel)		117	-1.7	-5	4	71	55	30
Industrials Metals (index)		171	-1.6	-7	-4	10	-1	-9
Agriculture (index)		75	0.2	-3	-5	34	23	7
Implied Volatility					%			
VIX Index (%, change in pp)		32.1	2.4	6.0	4.6	13.9	14.8	1.0
US 10y Swaption Volatility		128.3	-1.7	25.5	10.1	62.8	49.3	34.0
Global FX Volatility		11.6	0.0	1.3	0.6	5.1	4.2	4.1
EA Sovereign Spreads					10-Year spread vs. Germany (bps)			
Greece		247	-12.4	-22	-12	148	96	7
Italy		199	-18.6	-19	8	96	64	27
Portugal		112	-8.9	-9	0	49	48	20
Spain		116	-8.1	-3	10	52	42	13

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

Emerging Market Financial Indicators

Last updated: 6/16/2022 1:50 PM	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		6.71	0.0	-0.3	1	-5	-5	-6		2.9	-1.5	4	2	-38	3	2
Indonesia		14768	-0.2	-1.4	-1	-4	-3	-3		7.4	-4.1	19	1	97	101	90
India		78	0.0	-0.4	-1	-6	-5	-4		6.3	0.0	0	9	75	0	
Philippines		53	-0.1	-1.0	-2	-10	-5	-4		5.7	-2.5	20	25	158	118	68
Thailand		35	-0.2	-1.7	-1	-11	-5	-8		3.1	10.0	24	-22	121	126	88
Malaysia		4.40	0.2	-0.2	0	-7	-5	-5		4.3	0.6	14	-7	107	76	68
Argentina		123	-0.2	-1.0	-4	-22	-16	-13		61.1	20.3	452	792	1567	1055	1315
Brazil		5.06	1.2	-3.1	0	0	10	-1		#######	######	######	#######	#######	######	-100000965
Chile		864	-0.9	-4.6	-1	-16	-1	-9		6.6	0.0	15	27	274	118	69
Colombia		3892	1.9	-2.2	4	-6	5	1		9.1	0.0	6	1	341	268	122
Mexico		20.55	-1.4	-4.3	-3	-1	0	-1		9.2	4.0	27	55	228	168	136
Peru		3.7	0.8	1.0	1	4	7	0		8.0	-0.2	21	13	255	206	196
Uruguay		40	0.1	-1.4	3	9	12	5		10.9	0.0	27	81	311	221	278
Hungary		382	-0.2	-2.4	-2	-23	-15	-16		8.3	7.5	79	124	564	375	345
Poland		4.52	-1.4	-4.1	-1	-17	-11	-10		7.4	0.0	66	132	561	389	352
Romania		4.7	-0.2	-1.8	0	-13	-8	-8		9.0	25.6	88	103	626	414	382
Russia		57.3	-2.6	0.2	12	27	31	42		8.2	-13.0	-1	-307	90	-54	-295
South Africa		16.0	-1.3	-2.9	1	-12	0	-5		8.9	-12.5	23	36	167	144	128
Turkey		17.32	-0.5	-1.2	-10	-50	-23	-20		19.7	-11.0	-607	-528	161	-467	-277
US (DXY; 5y UST)		105	-0.1	1.8	1	15	10	9		3.50	13.5	44	67	261	224	160

	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		4250	-0.7	2	6	-17	-14	-8		191	-7	-17	-18	-12	-17
Indonesia		7050	0.6	-2	6	16	7	2		196	18	-12	24	31	11
India		51496	-2.0	-7	-5	-2	-12	-10		174	8	-11	29	42	20
Philippines		6393	1.2	-5	-3	-7	-10	-13		137	14	-22	43	36	0
Thailand		1561	-2.0	-5	-3	-3	-6	-8		0	0	0	0	0	0
Malaysia		1473	0.9	-2	-5	-6	-6	-7		125	3	-10	1	8	-8
Argentina		88466	1.2	-2	-2	31	6	-3		2115	145	221	651	435	378
Brazil		102807	0.7	-5	-5	-20	-2	-8		333	22	25	82	22	2
Chile		5139	0.0	-1	6	18	19	17		168	20	-1	18	28	-6
Colombia		1464	-2.5	-4	-4	17	4	-3		379	32	-4	135	31	-13
Mexico		48345	0.4	-3	-4	-4	-9	-6		420	42	37	89	88	50
Peru		19785	1.1	-4	-1	4	-6	-15		194	22	4	30	44	4
Hungary		38980	-0.9	-2	-5	-20	-23	-18		232	0	28	91	108	79
Poland		53357	0.0	-5	-3	-19	-23	-15		92	17	90	55	60	76
Romania		12180	0.9	-2	1	5	-7	-8		295	45	61	117	103	63
Russia		2367	2.1	2	0	-38	-38	-23		3411	-577	938	3228	3234	2897
South Africa		67502	0.0	-3	-2	0	-8	-10		445	58	32	137	90	56
Turkey		2488	-1.7	-3	4	74	34	23		661	27	59	201	83	98
Ukraine		519	0.0	0	0	-2	-1	0		3706	285	299	3226	2947	2233
EM total		41	-2.9	-5	1	-25	-17	-14		419	32	8	70	32	-39

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

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