



- Higher US Treasury yields and stronger dollar drive tighter US financial conditions ([link](#))
- Odds of a 75 bps ECB rate hike rise as inflation prints slightly above expectations ([link](#))
- Volatility in European gas markets persists ([link](#))
- Sluggish emerging market bond issuance remains at half the pace from last year ([link](#))
- Option markets suggest increasing bets on further RMB weakness ([link](#))
- Hungarian central bank hikes 100 bps and announces new liquidity measures ([link](#))

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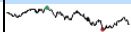







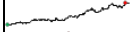


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Specter of faster central bank tightening pressures risk assets

Global equities are trading mixed and bond yields are moving higher this morning as markets interpret recent data releases as supporting a continuation of and a potentially more aggressive monetary policy tightening cycle. Yesterday in the US, some better-than-expected economic data releases reinforced the recent hawkish communications from Fed officials, driving the S&P 500 to its third consecutive daily loss. Shorter-term US Treasury yields continue to climb pressuring the 2-year, 10-year yield spread further into negative territory and markets are now pricing in higher odds for a 75 bps hike at the upcoming September FOMC meeting. In the EU this morning, August inflation releases came in slightly higher than expected, raising the probability of a 75 bps ECB policy rate hike next week to now above two-thirds. Yields are up mostly 2 to 6 bps across Euro area bond benchmarks, the euro is trading back below parity to the US dollar, and equities are modestly lower across the region. Oil prices have fallen over 5% the last 2-days and Brent is trading back below \$100/bbl as demand worries build on the back of further virus-related lockdowns in China and concerns about an upcoming OPEC supply cut fade.

Key Global Financial Indicators

Last updated: 8/31/22 8:02 AM	Level		Change from Market Close				YTD	Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		23-Feb-22
Equities			%				%	
S&P 500		3986	-1.1	-3	-3	-12	-16	-6
Eurostoxx 50		3543	-0.5	-3	-4	-16	-18	-11
Nikkei 225		28092	-0.4	-1	0	-1	-2	6
MSCI EM		39	-1.2	-1	-2	-25	-20	-17
Yields and Spreads			bps					
US 10y Yield		3.13	3.2	3	49	183	162	114
Germany 10y Yield		1.53	1.5	16	71	191	170	130
EMBIG Sovereign Spread		500	7	6	-33	155	133	87
FX / Commodities / Volatility			%					
EM FX vs. USD, (+) = appreciation		50.3	-0.2	0	0	-12	-4	-5
Dollar index, (+) = \$ appreciation		109.0	0.2	0	3	18	14	13
Brent Crude Oil (\$/barrel)		96.0	-3.3	-5	-13	32	23	-1
VIX Index (% change in pp)		26.3	0.1	3	5	10	9	-5

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

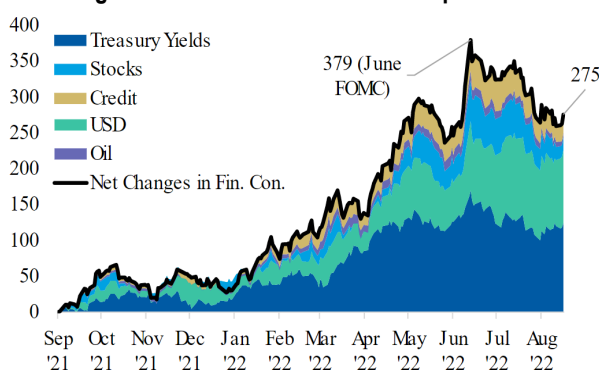
Mature Markets

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United States

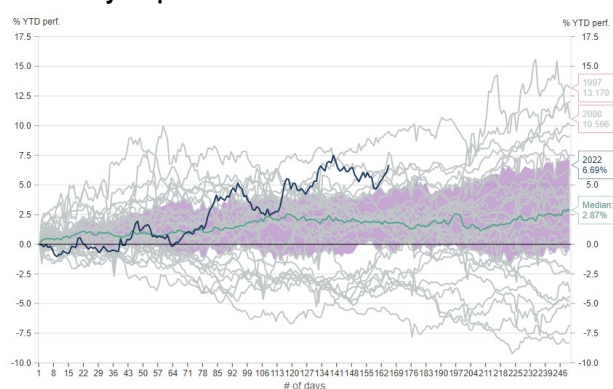
Fed policy rate hikes have so far tightened financial conditions primarily via FX and Treasury markets. From September 2021 to June 2022, financial conditions tightened significantly, reflecting the decline in Fed asset purchases and subsequent policy rate hikes. However, since the June FOMC meeting, financial conditions were easing on the back of investors expecting a Fed pivot to less aggressive policy tightening. More specifically, in terms of the Morgan Stanley US Financial Condition Index, it fell to a recent reading of 275 from a June high of 379, which was largely reflecting falling Treasury yields, which have been rebounding since the end of last week in reaction to Fed Chair Powell decisively dispelling a policy shift at last week's Jackson Hole meeting. Meanwhile, the stronger dollar remained the second largest contributor since mid-June (left chart below). By historical comparison, the appreciation of the dollar is remarkable and has only been exceeded in 1997 and 2008 over the last few decades (right chart below).

Net change in US Fin. Conditions since Sep 2021



Source: Morgan Stanley

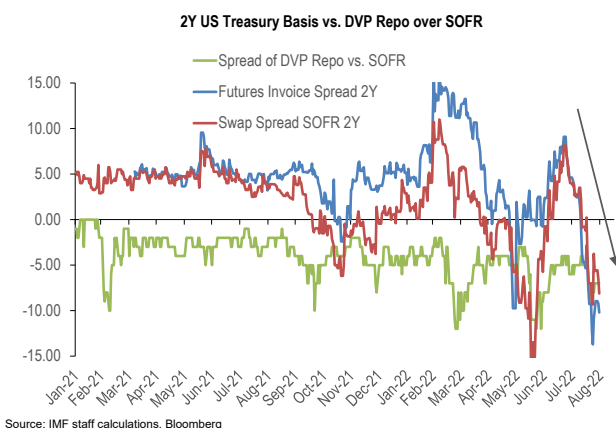
Calendar year performance of DXY over last few decades



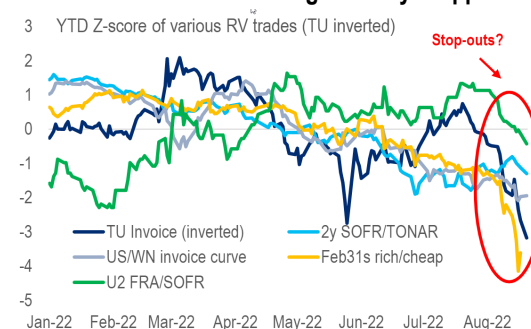
Source: Macrobond

In data releases this morning, the ADP employment numbers for August came in much lower than expected at 132k, compared to expectations for a 300k gain, suggesting some slowing in recent hiring trends. Markets were little changed following the release.

A notable development in US repo markets is that 2-yr Treasuries are trading special. Recall, repurchase agreements—agreements to borrow cash in exchange for Treasury collateral—can either trade as general collateral (GC) or bilateral (specific security). A security is said to be trading ‘special’ whenever its repo rate is lower than that offered by GC. Elevated demand for specific collateral makes lenders in a bilateral repo willing to forego return of their cash in exchange for securing, in this case, the on-the-run 2yr Treasury. This increased demand can also be seen in cash-swap spreads (nominal 2yr rates vs. 2yr SOFR) as well as the TU invoice OIS swap spreads (2yr futures vs. 2yr SOFR), which are both trading negative since mid-August (see left chart below). Analysts at Citigroup see these developments related to a short-covering of fixed-income relative value hedge funds. Several popular relative value strategies were likely stopped out as the market moved against their positioning (see right chart below).



Several relative value strategies likely stopped out



Euro area

After Euro area inflation for August came in slightly above expectations at 9.1% y/y, most assets were trading in the red across Europe this morning. Equity markets were mostly down in Europe, with the Stoxx Europe 600 losing 0.8%, and the French, German, and UK stock markets down about 1% each. The euro was hovering around parity, losing 0.3% to the US dollar. 10-year bund yields went up 5 bps to 1.56%, and 10-year Italian spreads were up 2 bps to 234 bps. Market expectations for rate hikes at the September meeting of the ECB went up slightly in favor of a 75 bps move. European gas prices remain extremely volatile.

Markets are moving slightly closer to pricing in a 75 bps rather than 50 bps rate hike for the next ECB meeting in September after Euro area inflation for August printed at 9.1% y/y (9% expected). Euro area inflation accelerated from 8.9% y/y in July, and core inflation increased to 4.3% y/y from 4% in July. While German inflation for August matched expectations yesterday at 8.8% y/y (from 8.5% in July), French inflation surprised slightly to the downside this morning, decreasing to 6.5% y/y from 6.8% in July (6.7% y/y expected). In contrast, Italian inflation surprised largely to the upside, accelerating to 9% y/y in August (8.2% expected) from 8.4% in July.

Selected European Asset prices before and after Euro Area Inflation Release for August

	Before	After
Stoxx Europe 600 (1 day % chg)	-0.6	-0.8
Euro (against \$)	0.99	1
ECB September meeting rate hike expectations (bps)	65.8	68
Implied policy rate in :		
3M	1.33	1.37
6M	1.93	2.01
1Y	2.35	2.4
2Y	2.11	2.15
3Y	1.97	2.03
10-yr Bund	1.53	1.56
Italian Spreads	232	234

Source: Bloomberg.

Markets are eagerly listening to statements from ECB officials ahead of the upcoming policy meeting on September 8. In the aftermath of the data release, ECB official and Bundesbank chief Nagel said in emailed comments to Bloomberg that he sees a risk that high inflation will persist even longer, and

that the ECB urgently needs to act decisively next week with a “strong” rate hike. He had said yesterday that fears of a downturn should not delay hikes. Yesterday, Greek central bank governor Yanis Stournaras said that the euro area was caught in a perfect inflation storm which is mostly supply-driven and noted that the economic risks have created a dilemma for officials from the ECB, before saying that inflation will peak this year and decelerate steadily before converging to 2% in 2024.

European gas prices continue to be extremely volatile on fears about Russian supply risks. Prices went up initially 9% this morning but reversed the trend in the late morning and were down 5.5% compared to yesterday's close. The Nord Stream pipeline which brings Russian gas to Germany goes into maintenance today for three days and the market is concerned that flows might not resume when maintenance ends. Gazprom announced today that it has stopped all deliveries to French utility Engie starting tomorrow because of a dispute over payments.

Japan

July activity data came out stronger than expected. Industrial production increased 1.0% m/m (consensus: -0.5%). Retail sales increased 0.8% m/m (consensus: +0.3%). Consumer confidence improved to 32.5 in July from 30.2 in June (consensus: 29.5). However, housing starts declined 5.4%, larger than expected (-3.5%). Super Typhoon Hinnamnor, the strongest global storm of the year, is threatening Japan's southern islands. Japanese equities declined (NIKKEI: -0.4%), while Japanese yen appreciated (+0.2%). Long-end JGB yields were mixed (10-year: flat; 30-year: -0.9 bp), with the 10-year yield at 0.222%.

Emerging Markets

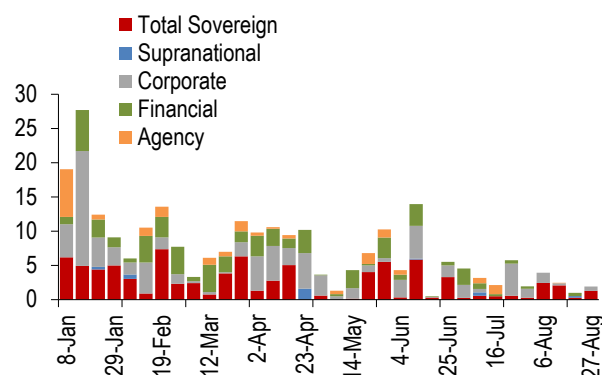
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Latin American markets closed mostly lower yesterday, as equities in Brazil (-1.7%), Colombia (-1.5%), and Mexico (0.9%) were down. Amongst major regional currencies, the Brazilian real shed 1.8% against the USD, while the currencies of Mexico and Chile were down marginally. **Asian equities were mixed, gaining +0.8% on net.** Most Asian currencies appreciated, led by Korean won (+0.6%), and long-end government bond yields generally increased. In **Korea**, industrial production declined 1.3% in July from a 1.9% increase in June, weaker than expected (consensus: -0.8%), supporting outperforming Korean equities and Korean won among regional peers. In **Sri Lanka**, the government reportedly has reached a preliminary agreement with the IMF on an emergency loan according to Reuter; equities gained (+2.6%), while the Sri Lankan rupee depreciated (-0.1%). In **EMEA**, **equities and currencies traded with a cautious tone as local rates generally edged higher in line with global markets.** The Turkish lira was little changed following news that the central bank will ask commercial banks to maintain a 10% conversion rate for individuals and corporate accounts or deposit an additional foreign currency at the central bank. Q2 GDP growth for Türkiye also came in better than expected at 7.6% y/y (vs. 7.4% expected).

Emerging Market Bond Issuance

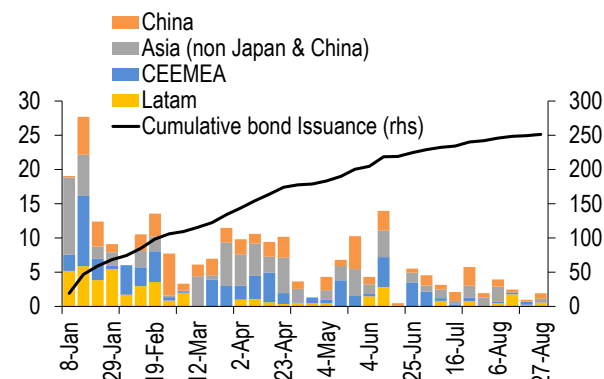
Bond issuance activity recovers from the previous week's lows but remains subdued. For the week ending on August 27, bond issuances came in at \$1.9 bn, vis-à-vis \$1 bn in the previous week. With this, the total EM bond issuance volume for the month has reached \$9.3 bn. The modest rebound in the week's issuance activity was driven by some revival in issuances by sovereigns (\$1.27 bn) and corporates (\$654 mn). Further, the issuances were concentrated in three countries. While issuance by sovereign sector was bifurcated between Mexico (\$550 mn JPY denominated bonds), and China (\$720 mn, in USD or EUR denominated bonds by local government entities), all of corporate issuance took place in Singapore (\$574 mn) and China (\$80 mn). Overall, the YTD bond issuance in EM stands at \$251 bn, 52% lower than in the corresponding period of last year.

Figure 1. EM bond issuance, by sector (bn. USD)



Sources: Bond Radar, Bloomberg, and staff calculations

Figure 2. EM bond issuance, by region (bn. USD)



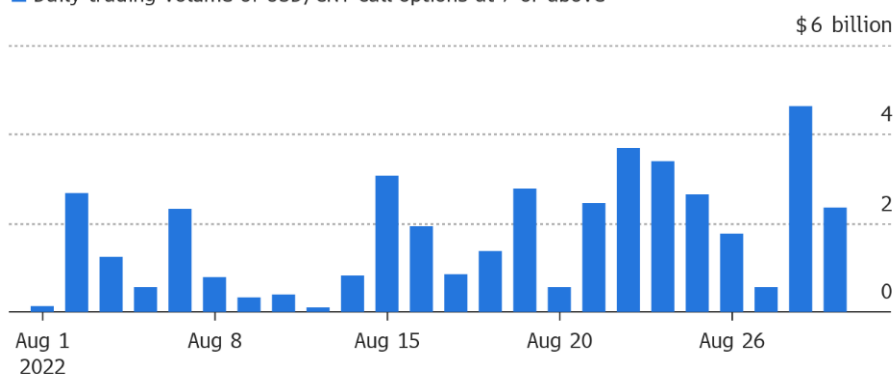
China

The official PMI composite weakened to 51.7 in August from 52.5 in July. Manufacturing PMI improved to 49.4, better than expected (consensus: 49.2), while non-manufacturing PMI deteriorated to 52.6, though still better than expected (consensus: 52.3). Chinese equities gained (CSI 300: +0.1%). RMB appreciated (+0.2%) as the People's Bank of China (PBC) continued to manage the RMB depreciation pressure by setting the RMB fixing stronger than expected by 177 pips. **Markets are betting on a weakening RMB.** The daily volume of dollar-yuan call options targeting levels of 7 yuan per dollar and beyond has picked up since August 15 when the PBC unexpectedly lowered the policy rates. **China sets to hold the Party Congress from October 16.** The Party Congress will be closely watched by markets as it is the most important political event being held once every five years.

More Bearishness

Bets on yuan falling to 7 per dollar grow

■ Daily trading volume of USD/CNY call options at 7 or above



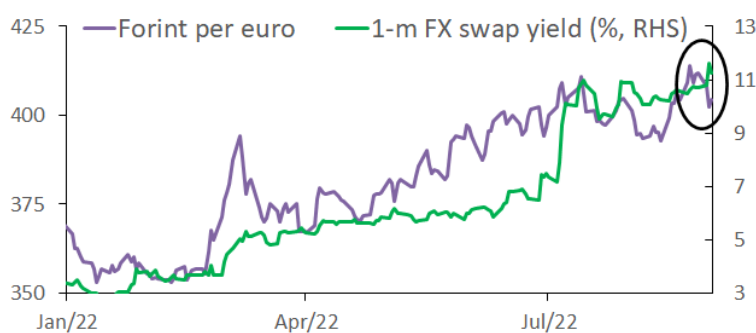
Source: DTCC, Bloomberg

Bloomberg

Hungary

The forint (-0.6%) is weaker today but gained 1.5% yesterday against the euro after the National Bank of Hungary (NBH) hiked its policy rate 100 bps to 11.75%. The NBH also emphasized that it sees the case to maintain tighter monetary conditions for a longer period. In addition, the NBH announced new measures to enhance the transmission of monetary policy: an increase in the required reserve ratio to 5% (from 1%), regular NBH discount bill auctions and a new deposit instrument to sterilize banking system liquidity in longer maturities. **Analysts at JP Morgan expect that the NBH will increase its policy rate to 13.5% and expect that the liquidity measures will improve the efficiency of tightening.**

Hungary: Forint per euro and FX implied yield

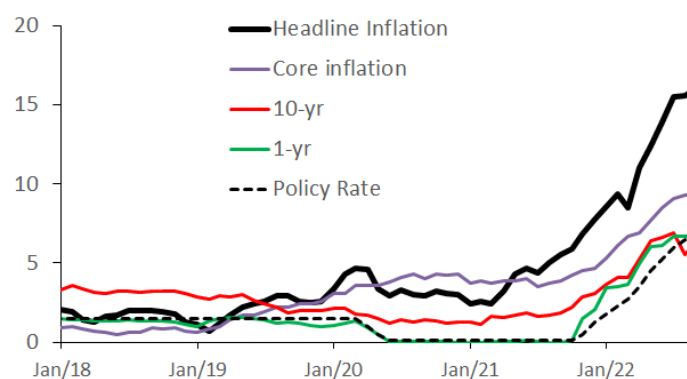


Source: Bloomberg and IMF staff

Poland

Polish 5-yr swap rates rose 16 bps to 6.64% after headline inflation rose to 16.1% y/y (15.4% expected) or 0.8% m/m (0.2% expected) in a flash data release.

Poland: Inflation (yoy) and interest rates (%)















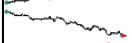















Source: Bloomberg and IMF staff

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Global Financial Indicators

Last updated: 8/31/22 8:04 AM	Level		Change				YTD	Since 23-Feb-22
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		
Equities			%				%	%
United States		3993	-1.1	-4	-3	-12	-16	-5
Europe		3543	-0.5	-3	-4	-16	-18	-11
Japan		28092	-0.4	-1	0	-1	-2	6
China		4079	0.1	0	-3	-16	-17	-12
Asia Ex Japan		66	-0.9	-1	-2	-25	-20	-16
Emerging Markets		39	-1.2	-1	-2	-25	-20	-17
Interest Rates			basis points					
US 10y Yield		3.13	3.2	3	49	183	162	114
Germany 10y Yield		1.53	1.5	16	71	191	170	130
Japan 10y Yield		0.23	-0.2	0	4	20	16	3
UK 10y Yield		2.79	8.8	9	93	208	182	131
Credit Spreads			basis points					
US Investment Grade		161	0.6	1	-6	70	49	18
US High Yield		505	-1.6	23	0	183	168	99
Europe IG		120	1.2	10	18	75	72	48
Europe HY		587	6.1	44	77	359	346	235
Exchange Rates			%					
USD/Majors		109.00	0.2	0	3	18	14	13
EUR/USD		1.00	-0.1	0	-3	-15	-12	-12
USD/JPY		138.8	0.0	1	5	26	21	21
EM/USD		50.3	-0.2	0	0	-12	-4	-5
Commodities			%					
Brent Crude Oil (\$/barrel)		96	-3.3	-5	-8	43	29	6
Industrials Metals (index)		152	-1.3	-3	-4	-6	-12	-19
Agriculture (index)		69	-0.6	0	3	20	13	-2
Implied Volatility			%					
VIX Index (% change in pp)		26.3	0.1	3.5	5.0	9.8	9.1	-4.7
US 10y Swaption Volatility		130.7	1.3	-1.0	15.1	57.3	51.7	36.4
Global FX Volatility		11.1	0.0	-0.2	0.3	4.5	3.6	3.6
EA Sovereign Spreads			10-Year spread vs. Germany (bps)					
Greece		257	4.4	-6	43	142	105	17
Italy		234	1.6	2	13	124	99	62
Portugal		109	0.1	0	6	49	45	17
Spain		119	0.0	0	9	47	45	16

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

Emerging Market Financial Indicators

Last updated: 8/31/2022 8:08 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)								
	Level		Change (in %)				YTD	Since 23-Feb-22	Level		Change (in basis points)				YTD	Since 23-Feb-22
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M			Last 12m	Latest	1 Day	7 Days	30 Days	12 M		
	vs. USD		(+) = EM appreciation						% p.a.							
China		6.89	0.2	-0.5	-2	-6	-8	-8		2.7	0.4	0	-9	-24	-12	-13
Indonesia		14843	0.0	0.0	0	-4	-4	-3		7.1	0.1	8	1	106	75	63
India		79	0.6	0.5	-1	-8	-6	-6		7.5	0.2	0	19	101	118	79
Philippines		56	0.1	-0.1	-1	-11	-9	-9		5.5	15.0	15	8	170	100	50
Thailand		36	-0.3	-1.1	-1	-12	-8	-12		2.7	9.5	15	34	114	86	48
Malaysia		4.48	0.3	0.3	-1	-7	-7	-7		4.0	-1.2	0	9	79	40	32
Argentina		139	-0.2	-1.2	-5	-30	-26	-23		77.7	33.1	229	1268	3162	2714	2975
Brazil		5.15	-0.5	-0.7	1	0	8	-3		12.1	0.2	16	-56	155	144	61
Chile		886	-0.2	3.5	1	-12	-4	-11		6.6	0.0	-21	20	213	117	68
Colombia		4422	-1.2	-1.5	-3	-14	-8	-12		9.6	0.0	15	91	379	316	169
Mexico		20.20	-0.2	-1.5	1	-1	2	0		8.8	0.0	17	71	187	125	93
Peru		3.8	0.3	1.3	2	7	4	-2		8.0	0.7	-1	-21	191	209	199
Uruguay		41	-0.4	-1.2	0	4	9	3		11.0	-3.6	20	2	309	227	284
Hungary		403	-0.3	1.9	-3	-27	-19	-21		9.4	1.0	6	105	658	485	455
Poland		4.73	-0.2	1.2	-3	-19	-15	-14		6.3	11.0	9	105	449	273	236
Romania		4.9	0.0	0.4	-1	-14	-10	-10		7.7	-21.9	-2	-38	439	288	255
Russia		60.6	0.4	-0.5	2	21	24	35		8.3	3.5	-22	1	92	-52	-293
South Africa		17.1	-0.4	-0.7	-3	-15	-7	-11		9.0	8.0	14	17	185	157	141
Turkey		18.19	0.0	-0.2	-2	-54	-27	-24		13.0	-37.0	-23	-483	-416	-1133	-943
US (DXY; 5y UST)		109	0.2	0.3	3	18	14	13		3.29	2.2	5	61	251	202	138

	Equity Markets								Bond Spreads on USD Debt (EMBIG)							
	Level		Change (in %)				YTD	Since 23-Feb-22	Level		Change (in basis points)			YTD	Since 23-Feb-22	
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M			Last 12m	Latest	7 Days	30 Days	12 M			
									basis points							
China		4079	0.1	0	-3	-16	-17	-12		205	-6	-19	-13	2	-3	
Indonesia		7179	0.3	0	3	18	9	4		179	0	-25	-4	14	-6	
India		59537	0.0	1	3	3	2	4		155	-7	-35	7	23	1	
Philippines		6584	-1.6	-1	4	-3	-8	-11		127	0	-15	15	26	-10	
Thailand		1639	0.0	0	3	0	-1	-3								
Malaysia		1512	0.0	2	1	-6	-4	-5		108	-6	-29	-27	-9	-25	
Argentina		141134	-1.9	3	15	85	69	54		2418	24	14	924	738	681	
Brazil		110431	-1.7	-2	7	-7	5	-1		312	-6	-17	26	1	-19	
Chile		5536	0.4	2	5	23	29	27		186	7	12	43	46	12	
Colombia		1270	-1.5	-2	-2	-4	-10	-16		423	12	18	150	75	31	
Mexico		45922	-0.9	-4	-5	-14	-14	-11		421	16	1	74	89	51	
Peru		19164	-1.4	-2	-1	9	-9	-18		195	7	7	22	45	5	
Hungary		42298	-0.2	-2	1	-19	-17	-11		249	33	34	115	125	96	
Poland		50069	-0.3	-5	-9	-29	-28	-20		20	4	8	-18	-12	4	
Romania		12125	-0.5	-1	-3	0	-7	-8		290	16	-31	104	97	57	
Russia		2391	3.6	6	8	-39	-37	-22		3411	-577	938	3228	3234	2897	
South Africa		67594	-0.5	-3	-2	0	-8	-10		441	-8	-6	90	86	52	
Turkey		3178	0.4	2	23	118	71	58		650	-12	-87	190	72	87	
Ukraine		519	0.0	0	0	-1	-1	0		3591	214	-3016	3098	2832	2118	
EM total		39	0.8	-1	-2	-25	-20	-17		428	5	-15	74	42	-30	

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

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