GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, AUGUST 21, 2023

LEAD EDITOR: SANJAY HAZARIKA

- **US rates surge as strong economic data increases risk of more hawkish Fed** (link)
- **China selloff continues as banks do not lower key benchmark rate** (link)
- **Bank of England terminal rate expectations rise following resilient economic data** (link)
- **Surveys show investors are growing more optimistic** (link)
- **Oil up 17% from June lows** (link)
- **Markets turn hawkish on Mexico after strong economic data** (link)

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Markets stage mild recovery after a month of losses

Stocks are higher this morning as risk sentiment improves after a tough month of trading in August. The summer rally was stopped in its tracks with the S&P 500 losing nearly 5% over the course of the month after global interest rates shot up, led by US Treasuries. The benchmark 10-year Treasury yield is close to its highest level since 2007, while the 30-year Treasury yield is near its highest level since 2011. Interest rates moved higher after investors concluded that the Fed may stay hawkish for longer because of stubbornly high US inflation and a US economy that continues to perform better than expectations. Meanwhile, markets remain very worried about the situation in China, where a weakening economy is being challenged by growing problems in local financial markets.

Key Global Financial Indicators

Last updated: 8/21/23 8:19 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		4370	0.0	-2	-4	3	14	3
Eurostoxx 50		4256	1.0	-2	-3	14	12	7
Nikkei 225		31566	0.4	-2	-2	10	21	19
MSCI EM		38	-0.7	-3	-5	-4	1	-19
Yields and Spreads				bps				
US 10y Yield		4.29	4.0	10	46	132	42	230
Germany 10y Yield		2.67	4.6	3	20	144	10	244
EMBIG Sovereign Spread		424	3	25	9	-62	-27	12
FX / Commodities / Volatility				%				
EM FX vs. USD, (+) = appreciation		47.8	0.2	0	-2	-4	-4	-10
Dollar index, (+) = $ appreciation		103.2	-0.2	0	2	-5	0	7
Brent Crude Oil ($/barrel)		85.7	1.0	-1	6	-11	0	-12
VIX Index (%, change in pp)		17.5	0.2	3	4	-3	-4	-14

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

The US has a relatively quiet data calendar this week with PMIs, durable goods, and the University of Michigan consumer survey the main items. In the euro area, today's PPI data for Germany will be followed by PMIs and the German IFO business confidence survey. PMIs and retail sales data will be released in the UK while Japan reports on PMIs and inflation. Corporate earnings are still trickling in, with

Nvidia, the darling of the AI craze, due to report on Wednesday. Meanwhile, the Fed's Jackson Hole conference will be held this week with Fed Chair Powell scheduled to make a speech on Friday.

Mature Markets

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United States

US interest rates have surged as stronger than expected economic data raises the risk of more hawkish Fed policy for longer. The moderate July CPI and PPI had raised hopes that the Fed could be done with rate hikes and could turn more dovish in the months ahead, but very strong data prints for retail sales and industrial production among other variables pushed the benchmark 10-year Treasury yield to a 16-year high yield near 4.30% and the 2-year yield close to 5%. The US yield curve has steepened through the Treasury selloff, as longer maturity yields went up more than shorter maturity yields, in a possible sign that markets are looking for rates to go even higher. In addition, US real yields are also at post-financial crisis highs. The 20% surge in oil prices since the lows of June has also rattled markets, increasing worries about the pass-through effect on inflation, spurred by rising gasoline prices. Higher interest rates have strengthened the dollar and stopped the summer equity rally in its tracks, with technology stocks giving back some of their AI-fueled gains.

Exhibit 1: Cross Asset Changes since USD lows (14 July)
USD appreciates amid declining equities, rising US yields/commodities

Source: Bloomberg, BofA Research

Fund managers are at their most optimistic since February 2022, according to survey data from Bank of America. The improvement in sentiment was driven by factors such as stronger than expected Q2 earnings and the belief that the Fed is close to ending its rate hike cycle. In addition, more investors believe that a recession for the global economy is "unlikely." Bank of America also reports that 75% of those surveyed expect either a soft landing or no landing for the US economy. Only 15% believe that the problems in China's property sector will have an impact on global markets. Due to this optimistic view, investor allocations to cash are at a 21-month low. However, investors still believe that a resurgence in inflation is the biggest risk for markets.

Chart 2: FMS sentiment least bearish since Feb'22
Percentile rank of FMS growth expectations + cash level + equity allocation (scaled 1-10)

Source: BofA Global Fund Manager Survey

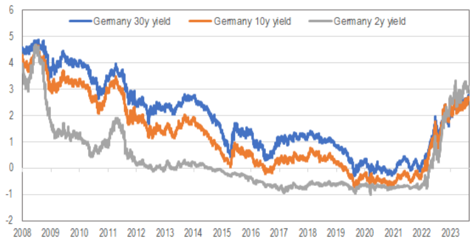
Chart 6: Recession expectations for the global economy are fading...
% FMS investors saying a global recession is unlikely in next 12 months

Source: BofA Global Fund Manager Survey

Euro Area

European equities were mostly trading higher, snapping a 4-day losing streak, with the energy sector (+1.6%) outperforming. The Stoxx 600 index is trading roughly 4% lower than at the start of the month, but remains 6.3% higher year to date. **Euro area sovereign yields continue to edge higher, with the 10y bund yieldup 4 bps up to 2.66% and the 2y yield up 4 bps to 3.06%.** On the data front, Germany's producer prices declined by more than expected in July (-6.0%y/y versus expected -5.1% from 0.1%). The euro was trading stronger against the dollar (+0.2% at 1.09/$).

Germany: Sovereign yields

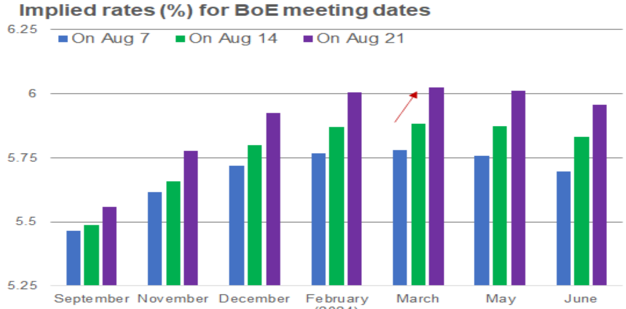


Source: Bloomberg and IMF calculations

United Kingdom

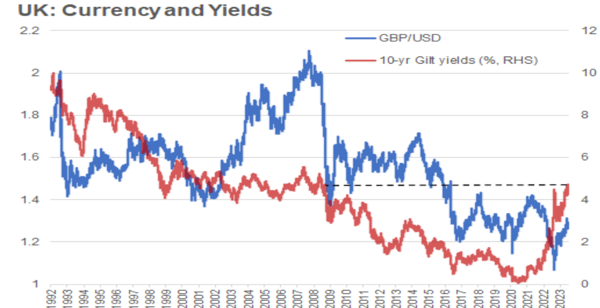
Bank of England (BOE) terminal rate expectations have increased after strong growth, core inflation and wages data. Analysts highlight that recent key data releases could validate both hawkish and dovish views—with preliminary Q2 GDP data surprising on the upside (+0.4%y/y versus expected +0.2%), the July inflation print coming in marginally higher than expected (core inflation +6.9%y/y versus expected 6.8%), wages surprising on the upside in July, while unemployment increased to 4.2% in June and retail sales data for July disappointed. Nevertheless, markets have firmed up expectations for BoE hikes—markets are now pricing in roughly 31 bps of tightening for the upcoming BoE meeting in September (compared to roughly 22 bps on August 7) with the terminal rate priced at roughly 6%.

Implied rates (%) for BoE meeting dates



Source: Bloomberg and IMF calculations

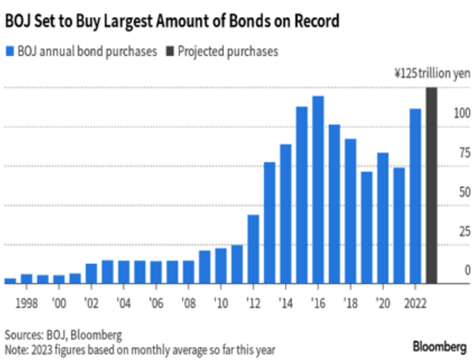
UK: Currency and Yields



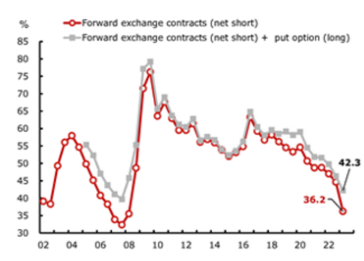
Source: Bloomberg and IMF calculations

Japan

Japanese investors were sellers of foreign bonds in July, while foreign investors sold yen bonds. Overseas investors offloaded ¥1.36 tn ($9.6 bn) last month, the most since January. Japanese selling of foreign securities was driven by banks, and such flows tend to be more tactical and opportunistic, according to Nomura. Analysts noted that Japanese investors appear more comfortable, on average, in buying foreign bonds on an unhedged basis as hedging costs increased substantially over the last twelve months.



FX hedge ratio among major lifers

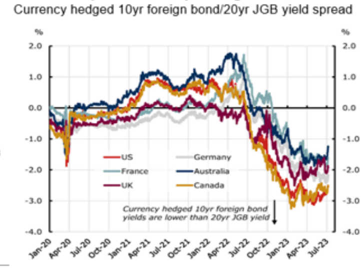


Note: Estimates are based on financial reports of 9 major lifers.

Source: Nomura, major lifers

Less attractive to invest in currency foreign bonds compared with super long-term JGBs

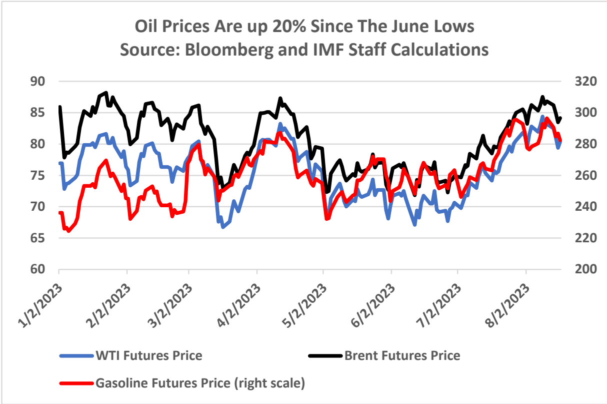
Currency hedged 10yr foreign bond/20yr JGB yield spread



Source: Nomura, Bloomberg

Commodity Markets

Oil prices have surged by over 17% since the June lows, increasing worries about inflation (although they fell 3.3% last week on worries about China). In the US, gasoline prices are at their highest level in 10 months and many grades are selling above the psychologically important $4 level. Analysts are starting to worry that the benign CPI prints of June and July could gave way to higher CPI levels later in the year. Bloomberg reports that global demand for oil hit a record 103 mn barrels in June and demand is expected to be even higher in August. Saudi Arabia has announced that it will maintain its supply restrictions for the foreseeable future and could cut production even further. Banks such as JP Morgan and UBS are predicting that oil prices will rise beyond $90. However, oil has sold off in the past week as worries about China fed speculation that demand for oil may decline in the months ahead. Chinese oil imports fell to their lowest level in six months in July. Rising global interest rates could also play a part in cooling oil demand by slowing economies down.



Emerging Markets

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EMEA equity markets were mostly trading higher while currencies and local bond yields were mixed. Equities in Türkiye (+2%) outperformed, while equities in Egypt saw the largest declines (-0.5%). **Asian stocks were down for an eighth consecutive day on aggregate, led by China.** India (up 0.5%) and Korea (up 1.3%) were the main outliers. Most Asian currencies were weaker. Over the past week, Latin American markets moved in tandem with the broader global trend of higher yields, lower equity prices and weaker currencies against the US dollar.

Emerging Market Fund Flows

Outflows continued for a third consecutive week, led by hard currency funds. Local currency funds also saw outflows.

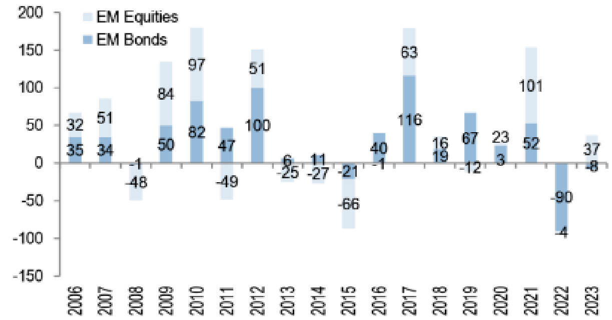
Weekly Cross-asset Flows

USD billion

Asset	8w flows (8w ago → current)	This wk	YTD
EM Bonds and Equities		-3.9	28.5
EM Bonds		-2.0	-8.4
Hard Ccy		-1.4	-8.0
Local Ccy^		-0.6	-0.4
o.w. EM ex-China		-0.6	2.5
o.w. China		0.0	-4.1
EM Equities		-1.9	36.9
US HG		1.8	215.2
US HY		-0.6	-1.8
Global Equities		-6.3	-40.2
EM Bond and Equity ETFs		-1.4	38.8
EM Bond ETFs		-0.9	1.0
EM Equity ETFs		-0.5	37.8
Non-resident EM flows*		-3.2	37.3

EM Bond and Equity Fund Flows

USD billion



*High frequency non-resident EM portfolio flow data where available. ^Local ccy split is retail only. All charts and data in this report: J.P. Morgan, EPFR Global, Bloomberg Finance L.P.

China

Chinese banks kept the 5-year loan prime rate (LPR) on hold, disappointing markets. Most economists had predicted that the key interest rate that guides mortgages rates would be cut by 15 bps after the central bank cut the 1-year LPR by 15 bps to 2.5% last week. **In other news, financial regulators met with bank executives late last week and told them to again to boost loans**. According to a statement from the People's Bank of China (PBOC) on Sunday, the lenders were urged to adjust and optimize home mortgages policies. Major financial institutions, especially big state-owned banks, must increase loan disbursements and avoid big fluctuations in lending, while regulators and financial institutions should cooperate to reduce risks associated with local government debt. **Some analysts cut China's growth outlook to less than 5% in 2023**, arguing that the authorities' policies are behind the curve and highlighting further downside risks. **Stocks in China and Hong Kong fell further (CSI -1.4%, Hang Seng -1.8%), extending the sell-off.**

MSCI China Has Lost More than 20% From January High

Source: Bloomberg

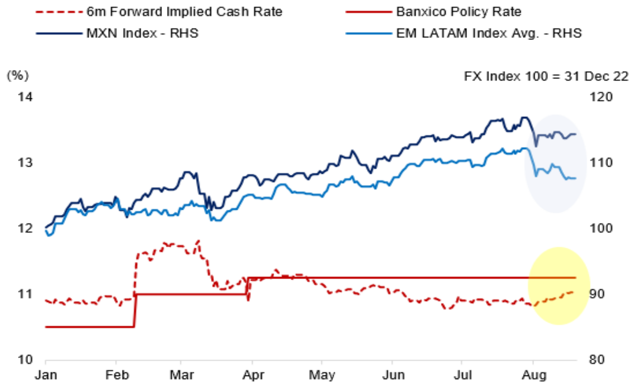
China 10Y yield hovering near record low...

China government 10-year yield %

Source: BofA Global Investment Strategy, Bloomberg

Mexico

Mexico's retail sales increased more than consensus estimates in June, offsetting declines in May. Retail sales were up 2.3% m/m in June, (consensus estimates +0.9%). The outsized monthly growth number was the largest since March 2022 and fully offset the -0.5% decline in the prior month. The strong print strengthened expectations that the central bank (Banxico) will keep it policy rate higher for longer. The Mexican peso continue to outperform its peers in August, as markets concluded that the central bank will be more hawkish than earlier expectations.

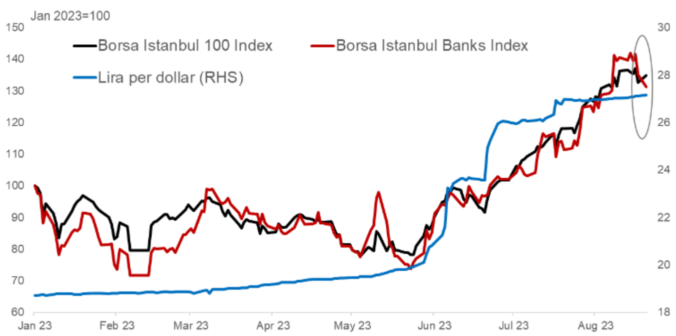


Source: Bloomberg, IMF staff calculations

Türkiye

Turkish bank equities fell sharply this morning after the central bank of the republic of Türkiye (CBT) announced a move away from a tool designed to halt a lira selloff. The central bank noted in an online statement that the objective of the decision, that lifts targets that were applied to banks for conversion from foreign currency deposits to FX-protected deposits, is "to contribute to strengthening macro financial stability by supporting Turkish lira time deposits". The central bank also increased the reserve requirement ratios for FX deposits. Turkish banking stocks fell 4.6% on Friday and continued to decline this morning (-2.8%).

Türkiye: Equity and exchange rate



Source: Bloomberg and IMF staff calculations

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Global Financial Indicators

Last updated: 8/21/23 8:19 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4382	0.0	-2	-3	4	14
Europe		4256	1.0	-2	-3	14	12
Japan		31566	0.4	-2	-2	10	21
China		3730	-1.4	-3	-2	-11	-4
Asia Ex Japan		64	-0.9	-3	-5	-4	-1
Emerging Markets		38	-0.7	-3	-5	-4	1
Interest Rates					basis points		
US 10y Yield		4.29	4.0	10	46	132	42
Germany 10y Yield		2.67	4.6	3	20	144	10
Japan 10y Yield		0.65	1.4	4	20	45	23
UK 10y Yield		4.68	0.3	11	40	227	101
Credit Spreads					basis points		
US Investment Grade		148	-0.6	3	2	-12	-10
US High Yield		428	-2.4	17	12	-42	-52
Exchange Rates					%		
USD/Majors		103.17	-0.2	0	2	-5	0
EUR/USD		1.09	0.3	0	-2	10	2
USD/JPY		145.9	0.4	0	3	6	10
EM/USD		47.8	0.2	0	-2	-4	-4
Commodities					%		
Brent Crude Oil ($/barrel)		86	1.0	-1	6	-3	4
Industrials Metals (index)		139	0.1	0	-3	-12	-16
Agriculture (index)		67	1.0	1	-5	1	-3
Implied Volatility					%		
VIX Index (%, change in pp)		17.5	0.2	2.7	3.9	-3.1	-4.2
US 10y Swaption Volatility		119.1	0.0	0.4	19.8	-13.9	-6.6
Global FX Volatility		8.7	0.1	0.2	0.4	-2.4	-2.0
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		129	-2.1	3	-4	-118	-76
Italy		169	-1.6	5	8	-58	-45
Portugal		73	-1.6	2	2	-33	-29
Spain		105	-1.0	3	4	-11	-5

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

Emerging Market Financial Indicators

Key Emerging Market Financial Indicators

Last updated: 8/21/23 8:29 AM	Level: Last 12m	Level: index	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Major EM Benchmarks				%			%
MSCI EM Equities		38.40	0.1	-3	-5	-4	1
MSCI Frontier Equities		26.25	-2.2	-5	-5	-5	3
EMBIG Sovereign Spread (in bps)		424	1	6	2	-13	-6
EM FX vs. USD		47.83	0.2	0	-2	-4	-4
Major EM FX vs. USD				%, (+) = EM currency appreciation			
China Renminbi		7.28	0.0	0	-1	-6	-5
Indonesian Rupiah		15325	-0.2	0	-2	-3	2
Indian Rupee		83.11	0.0	0	-1	-4	0
Argentine Peso		349.90	0.0	-18	-24	-61	-49
Brazil Real		4.96	0.1	0	-4	4	6
Mexican Peso		17.04	0.1	0	0	18	14
South African Rand		18.95	0.2	1	-5	-10	-10
Turkish Lira		27.17	-0.2	0	-1	-33	-31
EM FX volatility		9.26	1.2	0.7	6.7	-23.9	-15.1

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

Last updated: 8/21/2023 8:29 AM	Exchange Rates — Level: Last 12m	Level: Latest (vs. USD)	Change (in %), (+) = EM appreciation: 1 Day	7 Days	30 Days	12 M	YTD	Local Currency Bond Yields (GBI EM) — Level: Last 12m	Level: Latest (% p.a.)	Change (in basis points): 1 Day	7 Days	30 Days	12 M	YTD
China		7.28	0.0	-0.4	-1	-6	-5		2.6	-2.5	-10	-13	-16	-50
Indonesia		15325	-0.2	-0.1	-2	-3	2		6.6	10.8	23	37	-49	-32
India		83	0.0	-0.2	-1	-4	0		7.7	7.0	14	36	24	26
Philippines		56	-0.3	0.9	-3	0	-1		#N/A	#N/A	#N/A	#N/A	#N/A	#N/A
Thailand		35	0.8	0.3	-2	3	-1		3.0	5.0	17	25	43	35
Malaysia		4.65	0.0	-0.7	-2	-3	-5		3.9	-0.5	0	3	-10	-18
Argentina		350	0.0	-17.9	-24	-61	-49		107.9	226.4	1471	1645	3218	1970
Brazil		4.96	0.1	0.0	-4	4	6		11.4	4.8	21	42	-70	-114
Chile		869	-0.1	-1.1	-6	7	-2		5.4	-1.5	9	43	-133	8
Colombia		4121	-0.5	-3.8	-3	7	18		8.3	0.0	15	69	-128	-152
Mexico		17.04	0.1	0.1	0	18	14		8.9	2.0	29	82	60	19
Peru		3.7	0.2	-0.7	-4	4	3		7.0	1.9	26	16	-87	-97
Uruguay		38	0.0	0.0	1	7	6		9.2	0.0	15	-22	-170	-151
Hungary		350	0.5	0.6	-3	18	7		7.5	14.0	40	64	-176	-206
Poland		4.11	-0.1	-0.7	-2	17	7		5.1	1.8	20	40	-83	-109
Romania		4.5	0.4	0.0	-2	8	2		6.7	-1.2	7	33	-99	-100
Russia		94.0	0.0	7.2	-4	-36	-21							
South Africa		19.0	0.2	0.7	-5	-10	-10		9.7	3.7	27	42	91	58
Turkey		27.17	-0.2	-0.4	-1	-33	-31		22.1	16.0	143	381	512	1222
US (DXY; 5y UST)		103	-0.2	0.0	2	-5	0		4.40	1.8	4	31	131	40

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