GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

THURSDAY, DECEMBER 7, 2023

LEAD EDITOR: SANJAY HAZARIKA

- **Markets predict significant changes to the FOMC dot plot** (link)
- **US 10-year Treasury yield back near 4%** (link)
- **Dollar may be oversold versus euro** (link)
- **Stocks in China decline despite stronger than expected export growth** (link)
- **German 10-year bund yield falls back to levels last seen in May 2023** (link)

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Markets cautious ahead of tomorrow's US jobs report

Equities in Europe gave back some of yesterday's gains and US equity futures are mixed as the market mood turned cautious ahead of tomorrow's all-important US jobs report, the last major data release before the next FOMC meeting on December 13. The ECB and the Bank of England also meet next week. In Japan, BOJ Governor Ueda told Parliament that conditions could get more challenging going into the end of the year, triggering a rally in the Yen, and fueling speculation that the BOJ could end its negative interest rate policy at its upcoming meeting on December 19. At one point the overnight index swap (OIS) market assigned a 45% probability to this outcome, compared to just 3.5% a few days ago. The news pushed most global interest rates higher. Investors continued to remain pessimistic about China despite stronger trade data. The CSI 300 is down more than 12% this year in an environment where most major stock markets have posted very strong gains.

Key Global Financial Indicators

Last updated: 12/7/23 7:43 AM	Level: Last 12m	Level: Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		4549	-0.4	0	4	16	18
Eurostoxx 50		4477	-0.1	2	8	14	18
Nikkei 225		32858	-1.8	-2	2	19	26
MSCI EM		39	-0.1	-1	1	0	3
Yields and Spreads					bps		
US 10y Yield		4.16	5.1	-17	-41	74	28
Germany 10y Yield		2.20	-0.3	-25	-46	42	-37
EMBIG Sovereign Spread		400	-4	-11	-22	-67	-52
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		47.7	0.2	0	0	-5	-4
Dollar index, (+) = $ appreciation		104.0	-0.2	0	-1	-1	0
Brent Crude Oil ($/barrel)		74.9	0.8	-10	-8	-3	-13
VIX Index (%, change in pp)		13.2	0.2	0	-2	-9	-8

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

Mature Markets

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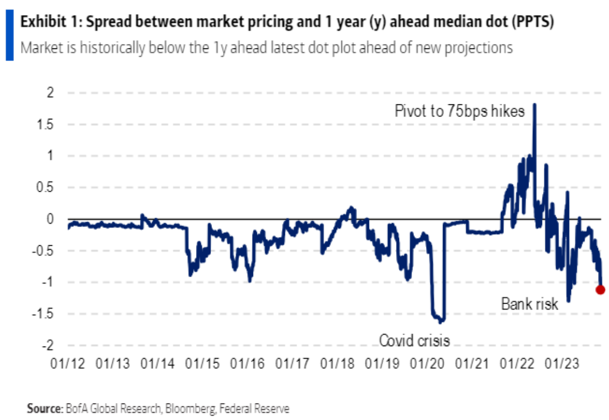
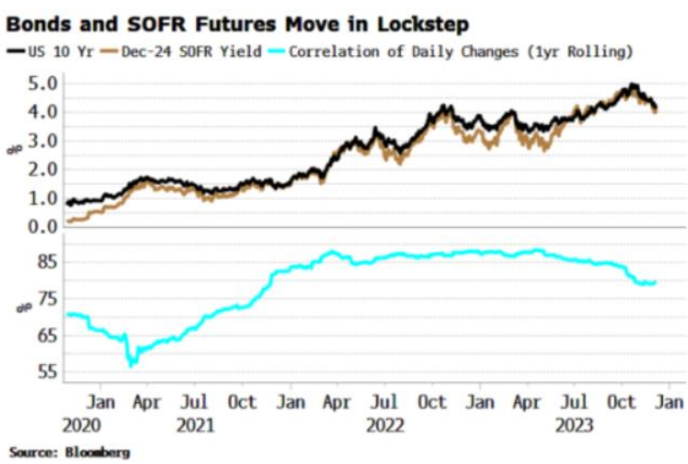
United States

US markets are predicting significant changes to the dot plot at the upcoming FOMC meeting on December 13. The two-year Treasury yield has fallen from 5.22% on October 18 to 4.6%. With the Fed Funds futures market pricing in five full rate cuts in 2024, the dot plot estimate for rates one year in the future would need to move lower by 100 bps to catch up with market pricing, according to analysis by Bank of America. This has some market participants worried, as the dot plot has not changed by such a large amount over the history of previous meetings. A smaller change could trigger another surge in interest rates that could derail the ongoing equity rally and cause greater stresses in the financial system. Others are more optimistic, arguing that the Fed may take longer to catch up with market pricing, but markets will take the adjustments in their stride.



The benchmark US 10-year Treasury yield is approaching 4%, a level not seen since the end of August. This summer's surge in interest rates eventually pushed the 10-year yield above 5% on an intra-day basis in mid-October, but the subsequent rally has been driven by expectations of slowing growth and faster rate cuts from the Fed. 10-year yields are closely tracking Secured Overnight Funding Rate (SOFR) futures, which are driven by expectations of the future path of the Fed's policy rate. Pricing in the Fed Funds market has move from expecting less than three rate cuts back in October to almost five rate cuts today. Some are worried that the market has gone too far, and that the economy is not likely to be weak enough to justify so many rate hikes. They fear a repricing towards fewer rate cuts that could destabilize the market.

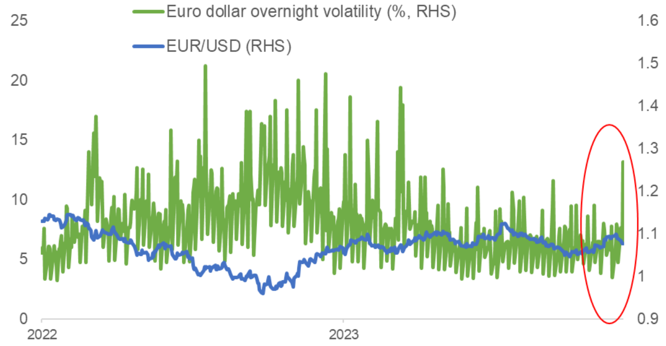


Euro Area

The euro was marginally stronger against the dollar this morning (trading at around €1.077/$) while euro area yields continued to decline. Contacts argue that recent data releases from Germany point to another quarter of contraction. Data released this morning showed that German industrial production data disappointed in October (-0.4% m/m versus expected +0.2% from -1.3%). In the meantime, contacts note that fiscal troubles persist, and yesterday the coalition could not agree on a 2024 budget.

ING analysts forecast the EUR/USD at 1.07 by end-2023, noting that a further decline could be avoided given the extreme pricing of the ECB curve. Markets are focused on tomorrow's US jobs report as well as policy meetings of the Fed and the ECB next week. Some contacts think that policy divergence remains a key driver of the lower EUR/USD, and think that for the FX market risks are skewed toward a dovish ECB and a hawkish Fed. Others expect that ECB President Lagarde would push back against market pricing, which in turn would benefit the euro.

Euro: Dollar exchange rate and Volatility



Source: Bloomberg and IMF calculations

Euro area sovereign yields continued to decline this morning with the 10y bund (-2bps) now at 2.18%, a level last seen in May 2023. 10y bund yields are now roughly 66bps lower than at the start of the quarter, and Commerzbank analysts argue that some consolidation now seems likely. Analysts also highlight further dovish statements from the ECB, with separate commentary from ECB Governing Council (GC) member Villeroy, for example, saying that there will be no further ECB hikes and also adding that "question of a reduction may arise in 2024, but not now". ECB GC member Kazimir, however, described expectations for the first interest rate cut for March (now priced in at around 65%), as "science fiction".

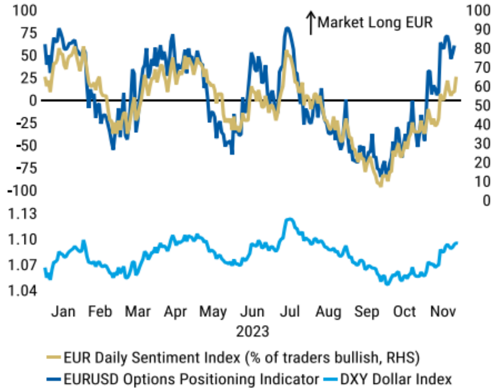
Flattening from both sides
2y and 10y Bund yields, in %

Source: Bloomberg, Commerzbank Research

Foreign Exchange

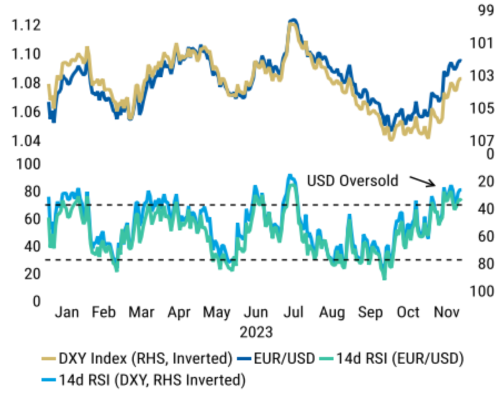
The dollar may be oversold against the euro, according to Morgan Stanley. As US interest rates fell sharply starting in October, the euro appreciated from 1.0467 to almost 1.1, before falling back below 1.08. The Morgan Stanley analysts believe this move is overdone and that the euro is likely to weaken again. Long positions in the euro versus the dollar have moved to extreme levels, and technical momentum indicators suggest that the dollar is oversold, the analysts contend. They think the market is too negative about the strength of the US economy and point out that the euro area is likely to face a recession while the US has a reasonable chance of a soft landing. The market is pricing five rate cuts for the ECB by October, but the ECB may have to act more aggressively if the euro area goes into recession.

Exhibit 12: EUR/USD positioning has turned from noticeably short to near-extreme long...



Source: Macrobond, Morgan Stanley Research

Exhibit 13: ...while momentum indicators suggest the USD is a bit oversold



Source: Macrobond, Morgan Stanley Research

Emerging Markets

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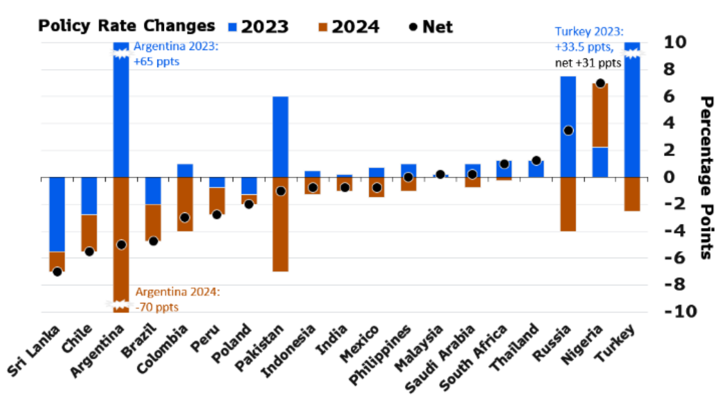
EMEA equity markets were mostly weakening while currencies were mixed. Equities in Poland (-1.4%) and Egypt (-1.3%) underperformed, while those in Romania (+0.6%) saw the largest gains. Namibia and Uganda stayed on hold as expected. **Most Asian equities declined, down 0.7% on net, as optimism on an early Federal Reserve rate cut was taken over by concerns on a global growth slowdown and weak oil prices.** Asian currencies were mixed, fluctuating in a narrow range with the exception of Korean won which depreciated 0.9%. **Foreign exchange markets favored Latam on Wednesday as currencies rose in Chile (+1%), Mexico (+0.6%), and Brazil (+0.5%).**

Analysts at Bloomberg expect growth in EM ex-China to grow at a rate of 3.7% next year, as monetary easing and spending on elections create tailwinds. Central banks from five EM countries (Brazil, Chile, Poland, Sri Lanka, and Peru) have all cut rates this year and given monetary policy transmission appears through long-and-variable lags, the full effect of these cuts have not yet surfaced. Rates are expected to decline in these countries and others in 2024. In Latin America, Brazil is expected to lower rates by 3.25 ppts while growth is expected to be 1.6% by the end of next year, twice the historical average since 2013. A global slowdown, driven by advanced economies will also threaten EM's such as Mexico.

Lower Interest Rates in Most Emerging Markets

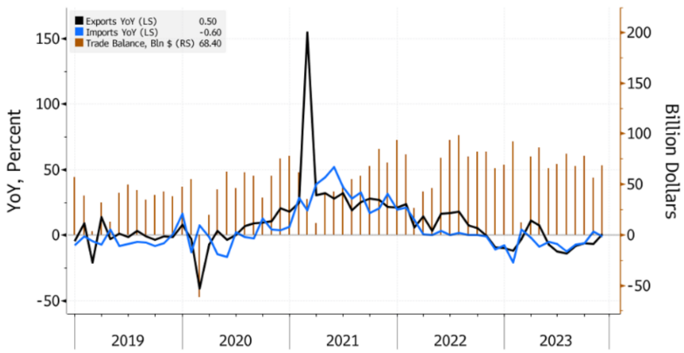


Source: Bloomberg Economics forecasts

China

Equities declined despite stronger-than-expected export growth (CSI 300: -0.2%, Hong Kong SAR-listed: -0.8%), as market sentiment was dented by disappointing import data and a slew of Moody's negative rating actions on Chinese enterprises on Wednesday. Following the downgrade of the outlook of China's sovereign to 'negative,' Moody's similarly cut the outlook for many Chinese entities, including state-owned banks, local government financing vehicles and some tech firms (e.g., Alibaba and Tencent). Analysts view that Moody's recent credit actions would have a limited impact on China's bond markets, as risk factors flagged by Moody's have largely been priced in. China's exports in dollar terms grew 0.5% y/y in November (previous: -6.4% y/y, consensus: +0.0%), the first expansion since April 2023. Imports unexpectedly contracted by 0.6% y/y (previous: +3.0% y/y, consensus: +3.9%), a sign that domestic demand remained fragile, considering a low base effect given that pandemic-induced disruptions caused a significant shrinkage in trade last November.

Chinese Trade Statistics

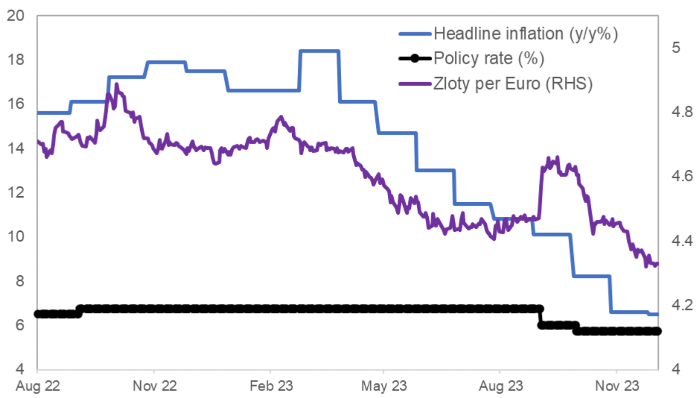


Source: Bloomberg

Poland

The central bank left rates unchanged, as expected, and retained a hawkish message. Following rate cuts in September and October, the National Bank of Poland (NBP) kept its policy rate on hold at +5.75% for the second consecutive meeting yesterday. Analysts point to a hawkish shift in the central bank's reaction function after the parliamentary elections in October. Goldman Sachs analysts continue to expect rate cuts to resume in Q1 2024 amidst weak underlying inflation dynamics. The Polish Zloty appreciated (+0.3%) against the euro after the announcement but closed the day marginally weaker. Contacts are focused on Governor Glapinski's press conference set to take place later today.

Poland: Policy rate, Inflation and Currency



Source: Bloomberg and IMF calculations

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Global Financial Indicators

12/7/23 7:45 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		4549	-0.4	0	4	16	18
Europe		4477	-0.1	2	8	14	18
Japan		32858	-1.8	-2	2	19	26
China		3391	-0.2	-3	-6	-14	-12
Asia Ex Japan		64	0.0	-2	0	-2	0
Emerging Markets		39	-0.1	-1	1	0	3
Interest Rates					basis points		
US 10y Yield		4.16	5.1	-17	-41	74	28
Germany 10y Yield		2.20	-0.3	-25	-46	42	-37
Japan 10y Yield		0.76	11.9	9	-13	50	34
UK 10y Yield		3.99	4.7	-19	-28	95	32
Credit Spreads					basis points		
US Investment Grade		141	0.2	0	-17	-18	-17
US High Yield		420	-0.5	-1	-9	-53	-61
Exchange Rates					%		
USD/Majors		103.97	-0.2	0	-1	-1	0
EUR/USD		1.08	0.0	-1	1	2	1
USD/JPY		145.1	-1.5	-2	-3	6	11
EM/USD		47.7	0.2	0	0	-5	-4
Commodities					%		
Brent Crude Oil ($/barrel)		74.9	0.8	-7	-8	-2	-7
Industrials Metals (index)		134	0.1	-3	-4	-22	-19
Agriculture (index)		64	0.9	-2	-2	-3	-7
Implied Volatility					%		
VIX Index (%, change in pp)		13.2	0.2	0.3	-1.6	-9.5	-8.5
Global FX Volatility		7.7	0.0	0.2	0.0	-3.4	-3.0
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		118	1.4	-6	-13	-75	-88
Italy		174	0.5	-4	-15	-8	-40
Portugal		66	0.6	-3	-8	-23	-36
Spain		100	0.1	-3	-6	2	-10

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

Emerging Market Financial Indicators

Last updated: 12/7/2023 7:46 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)						
	Level		Change (in %)					Level		Change (in basis points)				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.					
China		7.15	0.1	-0.3	2	-3	-4		2.7	1.9	-4	-3	-48	-40
Indonesia		15515	-0.1	0.0	1	1	0		6.6	0.2	-4	-9	-41	-35
India		83	0.0	0.0	0	-1	-1		7.3	-4.0	-18	-24	5.7	-15
Philippines		55	0.0	0.3	2	0	1		5.9	-2.4	0	0	-12	-12
Thailand		35	-0.1	0.3	1	-1	-2		2.8	-0.5	-14	-33	31	18
Malaysia		4.67	-0.1	-0.3	0	-6	-6		3.7	-1.3	-10	-16	-34	-32
Argentina		364	-0.1	-1.0	-4	-53	-51		100.7	60.6	235	-856	1163	1245
Brazil		4.89	0.2	0.5	0	7	8		10.8	-14.7	0	-80	-194	-174
Chile		866	0.8	0.5	2	0	-2		5.0	4.8	-10	-54	-16	-30
Colombia		4001	0.0	-0.2	-1	21	21		7.9	0.0	-35	-40	-162	-187
Mexico		17.34	-0.3	0.3	1	13	12		8.7	0.0	-12	-48	32	-2
Peru		3.8	0.2	-0.6	0	2	1		7.0	0.1	-21	-25	-74	-97
Uruguay		39	0.1	0.2	2	0	2		9.6	0.0	15	-22	-119	-105
Hungary		354	-0.2	-1.4	0	10	5		6.1	-16.0	-60	-107	-216	-349
Poland		4.02	0.0	-0.5	4	11	9		4.5	2.5	-27	-27	-103	-162
Romania		4.6	0.0	-1.0	1	1	0		6.5	0.6	-19	-17	-96	-118
Russia		92.7	0.3	-3.0	-1	-32	-20							
South Africa		18.8	0.9	0.4	-2	-9	-9		9.2	-0.9	-8	-39	5	0
Turkey		28.94	-0.1	-0.3	-2	-36	-35		26.8	3.0	-95	-486	1587	1701
US (DXY; 5y UST)		104	-0.2	0.4	-2	-1	0		4.15	4.9	-11	-38	53	15

	Equity Markets							Bond Spreads on USD Debt (EMBIG)					
	Level		Change (in %)					Level		Change (in basis points)			
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	7 Days	30 Days	12 M	YTD
								basis points					
China		3391	-0.2	-3	-6	-14	-12		155	-8	-11	-30	-22
Indonesia		7135	0.7	1	5	5	4		111	-6	-8	-54	-29
India		69522	-0.2	4	7	11	14		118	-5	-12	-18	-24
Philippines		6235	-1.1	0	1	-4	-5		89	-7	-7	-41	-8
Thailand		1379	-0.8	-1	-2	-15	-17		0	0	0	0	0
Malaysia		1443	-0.2	-1	-1	-2	-4		87	-1	-7	-9	-13
Argentina		894502	1.0	13	46	423	343		1915	-113	-616	-479	-290
Brazil		125623	-1.0	0	5	15	14		217	-1	-2	-55	-57
Chile		5920	0.3	2	5	14	13		129	0	-14	-21	-3
Colombia		1134	-1.4	-1	4	-8	-12		299	-3	-13	-104	-73
Mexico		54100	0.0	2	6	7	12		354	3	-4	-46	-27
Peru		22160	-0.9	0	3	0	4		148	2	-11	-36	-32
Hungary		58225	-0.4	1	2	31	33		166	-7	-20	-68	-56
Poland		76248	-1.2	3	6	36	33		108	-2	1	25	35
Romania		14906	0.6	1	2	22	28		200	-13	14	-60	-55
South Africa		74974	-0.6	-1	5	1	3		344	0	-12	-57	-23
Turkey		7802	-0.7	-2	-1	62	42		360	3	-4	-100	-80
Ukraine		507	0.0	0	0	-2	-2		3743	2	316	-108	-336
EM total		39	-0.5	-1	1	0	3		359	-14	-31	-33	-17

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

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