GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

WEDNESDAY, FEBRUARY 22, 2023

- **Risk assets sold off on resurgence in yields and geopolitics** (link)
- **Rate option pricing shows rising conviction for higher-for-longer** (link)
- **Euro area short-term bank funding rate trades below risk-free rate** (link)
- **BoJ announced unscheduled bond-buying operation to defend yield cap** (link)
- **The Reserve Bank of New Zealand throttled down its rate hikes** (link)
- **Fitch Ratings downgraded Ghana to restricted default** (link)

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10y Treasuries break 3.9% resistance amid upbeat PMIs and gloomy sentiment

Strong global PMIs spurred a selloff across bond markets. Risk sentiment continued to sour, with equity market weakness being confronted with a renewed rise in government bond yields and stronger US dollar. Upbeat S&P Global US PMIs prompted yesterday 10-year Treasuries to break the 3.9% yield resistance while market pricing of the Fed's terminal rate rose to a new cycle high above 5.35%. Geopolitical concerns and downbeat corporate earnings further added to the gloomy sentiment. In the Euro Area, the German IFO disappointed in the current assessment segment while Banque de France Governor Villeroy questioned the recent volatility of ECB terminal rate pricing. In Japan, BOJ's Board Member Tamura supported the current monetary policy, while hinting at the possibility of a future review. The RBNZ reduced its rate hike cadence from 75 bps to 50 bps. In Emerging Markets, South Africa's economic prospects are clouded by power rationing while Fitch has downgraded Ghana's long-term foreign currency issuer rating to default.

Key Global Financial Indicators

Last updated: 2/22/23 8:51 AM	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		3997	-2.0	-3	1	-7	4	-5
Eurostoxx 50		4241	-0.2	-1	3	6	12	7
Nikkei 225		27104	-1.3	-1	1	2	4	2
MSCI EM		39	-1.3	-3	-6	-18	3	-17
Yields and Spreads					bps			
US 10y Yield		3.94	-0.8	14	47	201	7	195
Germany 10y Yield		2.53	-0.1	5	35	229	-4	230
EMBIG Sovereign Spread		453	-1	11	11	57	1	40
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		50.4	0.0	-1	-1	-6	1	-5
Dollar index, (+) = $ appreciation		104.2	0.0	1	2	9	1	8
Brent Crude Oil ($/barrel)		82.5	-0.7	-3	-6	-15	-4	-15
VIX Index (%, change in pp)		23.1	0.3	4	3	-6	1	-8

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

Mature Markets

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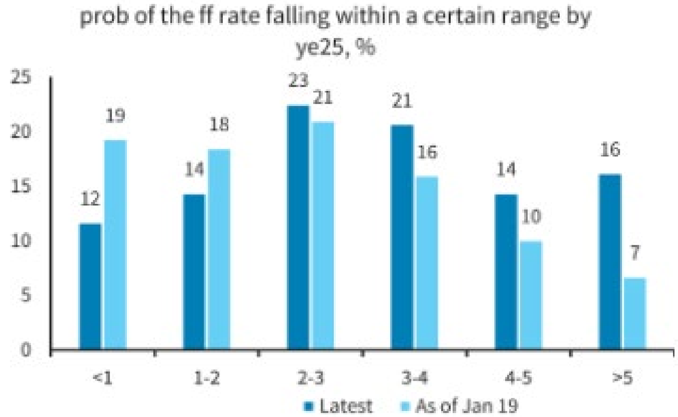
United States

Risk assets sold off sharply on a resurgence in yields, after as stronger than expected US services PMI (+3.2 to 50.5) fueled further hawkish repricing of monetary policy outlook ahead of today's publication of the January Fed meeting minutes and the PCE report later this week. Geopolitical tensions and downbeat corporate earnings also added to the gloomy sentiment. The Treasury curve was up by 11 to 15 bps across the curve, with equal contribution from real rate and inflation expectations. The 2-year yield has now reached a new cycle high of 4.727%; the 5- and 10-year yields have both reached new highs YTD but still 30bps lower than November levels. Near-term policy rate expectation was little changed, though investors have added 10 bps to 2024 rate expectation, narrowing the gap with DOTS to 50 bps and 2025 rate expectation is now slightly above DOTS. Equity markets slumped and wiped out their February gains, led by consumer discretionary (-2.9%), tech (-2.4%), industrial and real estate (-2%).

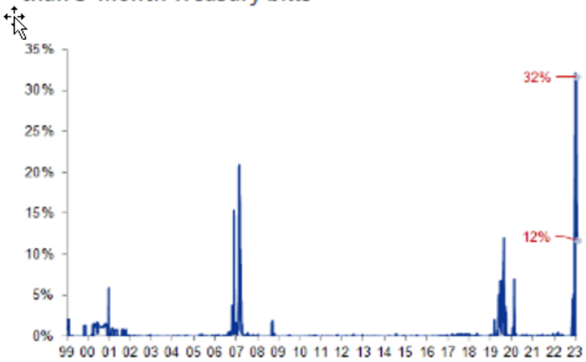
Option pricings showed easing recession fears and rising conviction for higher-for-longer. Since mid-January, there is a clear shift in how investors are pricing tail risks. Based on option pricing, the probabiliy of policy rate falling below 2% by 2025 has declined to 26%. Conversely, the probability of policy rates above 4% has increased to 30%.



Source: Barclays Research

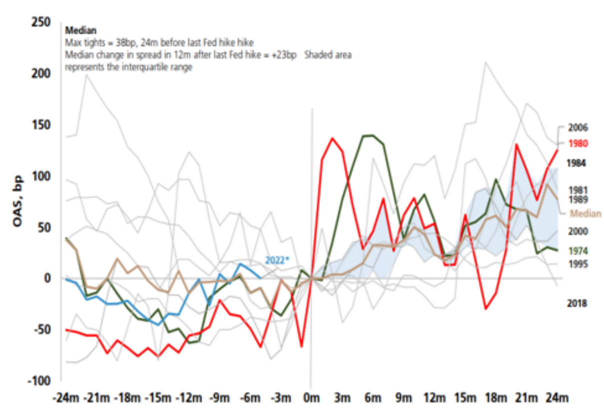
Credit spreads could face upward pressure. Pandemic-era savings buffers have supported corporate credit spreads, which have compressed to very tight levels by historical standards. This is particularly the case among investment-grade (IG) rated issuers, where credit spreads over cash have almost disappeared. For example, A rated bonds no longer offer a yield pick up over 3-month T-Bills. In fact, more than a third of the IG corporate bonds yield lower than 3-month T-Bills. UBS analysts empirically show that in four out of the past five occurrences an IG yield spreads compression to similar levels portended recessions. Furthermore, in tightening cycles, IG yield spreads sharply corrected around the last Fed rate hike with a substantial risk repricing in high inflation episodes, such as those in 1974 and 1980.

Par value share of the USD IG iBoxx index yielding less than 3-month Treasury bills



Source: iBoxx, Goldman Sachs Global Investment Research

Figure 9: Change in US IG spreads proxy before and after the last Fed hike



Source: Bloomberg Indices, MarketAxess, Federal Reserve, UBS estimates

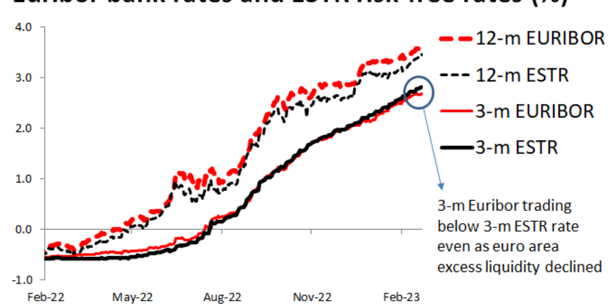
Euro Area

Equities fell ahead of FOMC minutes, declining -0.9%. The German IFO disappointed somewhat in the current assessment segment (93.9 versus 95 expected but saw sizeable increase in business expectations (+2.1pts to 88.5). Euro area rates were little changed with the euro (-0.2%) a touch lower as Bank of France governor said that the ECB's depo rate is already in restrictive territory.

Money markets and analysts have adjusted expectations for the ECB's terminal rate higher. Nevertheless, Banque de France Governor Villeroy emphasized that the ECB is '*in no way*' obliged to hike rates at every meeting between now and September. Villeroy pointed out that at 2.50, he already sees the ECB deposit facility rate in restrictive territory. According to him view, volatility on expectations for the terminal rate has gotten ahead of itself, with '*a little overreaction since Thursday*'. Money markets are indicating a 50% probability of 50 bps rate hikes for the next two ECB's monetary policy meetings in March and May.

Money markets unravel the conundrum of ESTR rates sitting atop of Euribor. Analysts at SocGen have labeled the anomaly the '*Euribor mystery*': In recent months, the 3 months Euribor rate, which is a gauge for average short-term bank funding costs, has been trading below the 3 months risk-free ESTR rate, the ECB's Euro Short-Term Rate, while Euro Area excess liquidity declined by around €600 bn since last November. One reason for the comparatively lower Euribor fixings may be the strong demand for money markets products given a '*dearth of commercial paper issuance in the 3 months segment*'. Other market contacts point out that the ESTR curve has steepened relatively quickly and the Euribor curve is lagging these movements. In this line of thinking, short-term Euribor rates could trade below ESTR rates again if the ESTR curve peaks later in 2023.

Euribor bank rates and ESTR risk-free rates (%)



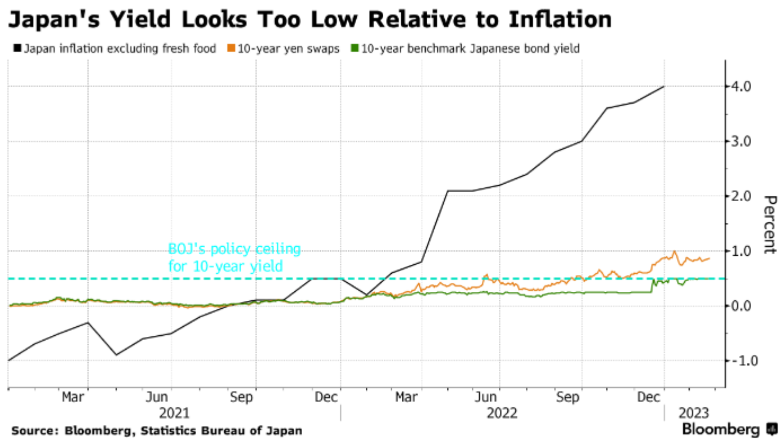
Source: Bloomberg, and IMF staff

Japan

Equities declined -1.1%, although companies that are part of the Topix Index have increased their net profit forecasts for the current fiscal year by +4.6% following Bloomberg estimates.

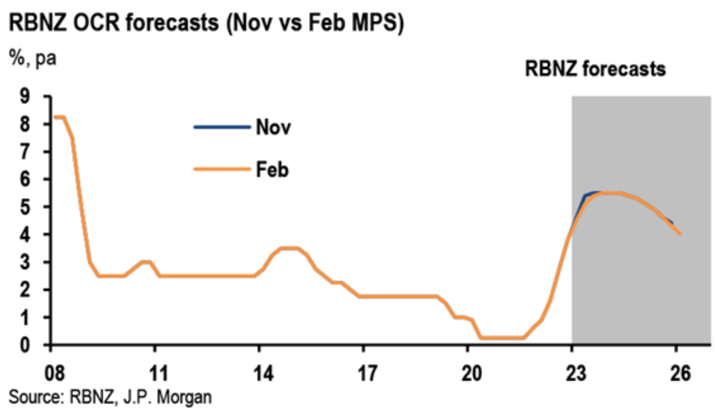
Bank of Japan's Board Member Tamura called for a policy review while supporting the current state. He said in a meeting with a business community that an assessment the BOJ's policy including its framework and inflation target will be necessary to weigh their benefits and costs in the future. Notwithstanding this, he believes that for the time it is appropriate to maintain the current policy stance.

The Bank of Japan announced an unscheduled bond-buying operation. Japanese government bond (JGB) yields in the 10-year maturity point climbed back above the central bank's ceiling as market participants continue to bet on further policy tweaks. Amidst surging inflation both domestically and globally, Bloomberg reports that the Bank of Japan's cap of 50 basis points on 10-year JGBs is becoming more unsustainable. Despite this, the announcement had little effect on 10-year JGB yields and the yen.



New Zealand

As widely anticipated, the Reserve Bank of New Zealand throttled down its rate hikes in its latest decision, reducing the increase from 75 bps to 50 bps. Following the decision, the official cash rate was raised to 4.75%. The RBNZ left its forecast peak rate at 5.5%, but the slower throttle of rate hikes would push back the expected date for reaching the terminal rate to Q4-2023. The RBNZ also communicated that it remains too early to accurately assess the monetary policy implications of the Cyclone Gabrielle. Earlier this week, the Treasury Department said the rebuild of homes and infrastructure will add demand to an already capacity constrained construction industry and entail nationwide inflation pressure. Equities declined marginally, New Zealand dollar weakened -0.1%, 10Y yields increased +10.7bps.



Emerging Markets

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LatAm markets in corrected on Tuesday, **amid a broad risk-off sentiment**. Except for the Peruvian Sol, which fractionally appreciated, regional currencies followed the broader EM currency depreciation.

Asian equities and currencies declined while yields rose. Taiwan POC's GDP declined by -0.9% in Q4-2022, the first fall since the beginning of 2016. For China, Bloomberg reports state-owned firms to become urged hiring local auditors while phasing out Big4 ones. Offshore subsidiaries may continue using them. **EMEA equities and currencies weakened** on geopolitical concerns.

EM bond issuance

EM bond issuance volumes came in at $9 bn in the third week of Feb, vis-à-vis $21.4 bn in the week before. The week saw a pickup in sovereign issuances which rose to $5.1 bn (from $4 bn in the week before), and constituted majority of the total volumes. Issuances by other sectors, including financials ($1.4 bn) and agency ($2.2 bn) were modest, while that of corporate meagre. On the regional front, most of the issuances were from the CEEMEA region ($6.2 bn), while EM Asia ex-China saw bond issuance of $2.1 bn. With this, the YTD EM bond issuance stand at $114 bn.

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

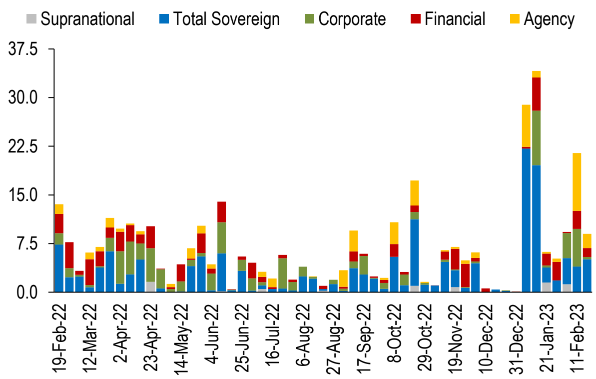
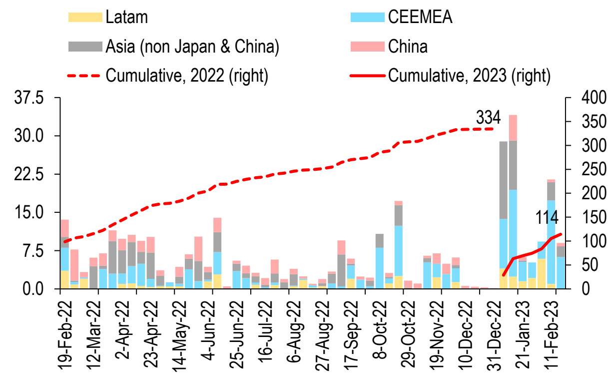


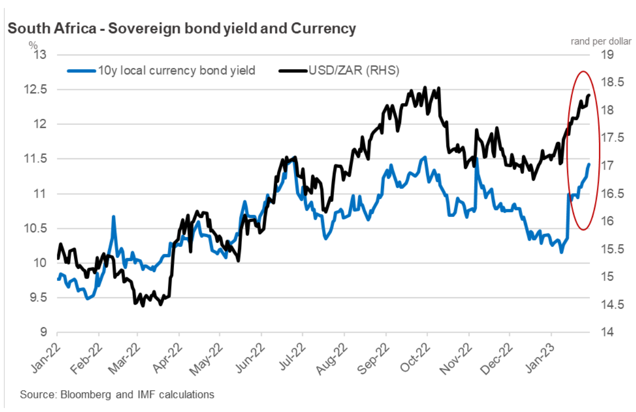
Figure 2. EM bond issuance, by region (bn. USD)



Sources: Bond Radar, and IMF staff calculations.

South Africa

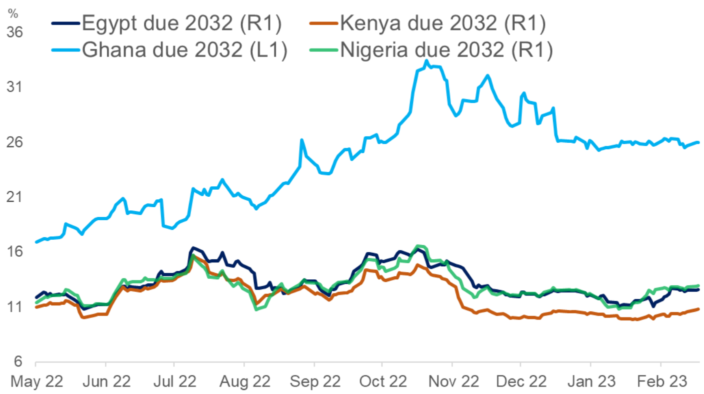
Power rationing and a looming Eskom debt mutualization cloud South Africa's economic prospects, contributing to a weakened ZAR. Market participants are attentive to the release of the annual budget statement today and announcements related to the transfer of the power utility Eskom's debt to the state's balance sheet. A Bloomberg report indicates that between 33% and 66% of Eskom's liabilities may be transferred. The intensity of power cuts has reached unprecedented levels, which raises concerns about the implications that power rationing could entail for South Africa's economic growth. Meanwhile, the country's local currency bonds have underperformed the Bloomberg index of emerging market peers with 10-year yields having increased by around 100bps since the beginning of the month. The ZAR has weakened for a third consecutive day.



Ghana

Fitch Ratings downgraded Ghana to restricted default. Specifically, the rating agency downgraded Ghana's long-term foreign currency issuer default rating yesterday to Restricted Default (RD) from C and downgraded the rating on Ghana's Eurobond maturing in 2026 to 'D' from 'C'. The downgrade follows Ghana missed its $40.6mn coupon payment on the 2026 Eurobond that became due on 18 January, with a grace period that has lapsed on February 17. Fitch also confirmed the long-term senior unsecured foreign currency denominated issue ratings at C, while withdrawing issue ratings on these bonds. Fitch Ratings noted that the 'C' ratings are, however, not relevant to its coverage since Ghana's government has announced a moratorium on these instruments and that these instruments will be included in the common framework external debt restructuring. Fitch already downgraded Ghana's local debt rating to 'restricted default' earlier this month, and the rating agency expects all these remaining instruments to default eventually as Ghana misses repayments or as a restructuring agreement is reached.

Africa: Eurobond yields



Source: Bloomberg and IMF

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Global Financial Indicators

2/22/23 8:51 AM	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		4000	-2.0	-3	1	-7	4	-5
Europe		4242	-0.2	-1	3	6	12	7
Japan		27104	-1.3	-1	1	2	4	2
China		4107	-0.9	0	-2	-11	6	-11
Asia Ex Japan		67	-1.2	-4	-6	-16	4	-15
Emerging Markets		39	-1.3	-3	-6	-18	3	-17
Interest Rates					basis points			
US 10y Yield		3.94	-1.0	14	46	200	7	195
Germany 10y Yield		2.53	-0.2	5	35	228	-4	230
Japan 10y Yield		0.51	0.0	0	12	31	8	31
UK 10y Yield		3.64	2.7	15	26	217	-3	216
Credit Spreads					basis points			
US Investment Grade		145	-0.1	4	-3	4	-13	3
US High Yield		466	-0.7	29	14	56	-14	60
Europe IG		82	0.4	6	3	10	-9	10
Europe HY		424	-0.4	29	12	74	-50	72
Exchange Rates					%			
USD/Majors		104.20	0.0	1	2	9	1	8
EUR/USD		1.06	-0.1	0	-2	-6	-1	-6
USD/JPY		134.6	-0.3	0	3	17	3	17
EM/USD		50.4	0.0	-1	-1	-6	1	-5
Commodities					%			
Brent Crude Oil ($/barrel)		82.4	-0.7	-3	-6	-1	-4	-2
Industrials Metals (index)		166	-1.5	1	-6	-12	0	-12
Agriculture (index)		71	-0.1	0	5	2	2	0
Implied Volatility					%			
VIX Index (%, change in pp)		23.1	0.3	4.2	3.3	-5.7	1.5	-7.9
US 10y Swaption Volatility		119.6	0.0	13.0	1.5	24.6	-8.0	26.4
Global FX Volatility		10.2	0.0	-0.2	-0.1	2.5	-0.5	2.7
EA Sovereign Spreads					10-Year spread vs. Germany (bps)			
Greece		190	-0.4	12	-9	-48	-15	-50
Italy		194	0.2	8	12	26	-20	23
Portugal		89	0.1	2	3	-1	-12	-2
Spain		98	-0.8	2	2	-4	-11	-5

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

Emerging Market Financial Indicators

Last updated: 2/22/2023 8:54 AM	Exchange Rates								Local Currency Bond Yields (GBI EM)							
	Level		Change (in %)					Since	Level		Change (in basis points)					Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
		vs. USD	(+) = EM appreciation							% p.a.						
China		6.90	-0.2	-0.6	-2	-8	0	-8		3.2	0.0	7	1	32	17	37
Indonesia		15202	-0.1	0.0	-1	-5	2	-6		6.8	2.5	1	14	27	-17	27
India		83	-0.1	-0.1	-2	-10	0	-10		7.7	4.0	20	23	96.3	21	
Philippines		55	-0.2	0.0	-1	-7	1	-7		6.0	0.0	5	0	98	-5	98
Thailand		35	-0.1	-0.8	-5	-6	0	-7		2.7	2.0	-6	22	51	9	49
Malaysia		4.44	-0.2	-1.2	-4	-6	-1	-6		3.9	3.9	2	19	26	-13	25
Argentina		195	-1.0	-1.3	-5	-45	-9	-45		87.8	0.0	-26	282	3984	-36	3989
Chile		800	0.2	-0.8	2	-1	6	-1		5.6	-6.0	12	42	-33	25	-33
Colombia		4939	0.4	-0.3	-8	-20	-2	-21		10.1	0.0	64	26	238	37	227
Mexico		18.39	0.4	1.1	2	10	6	10		9.1	-2.0	36	84	128	38	127
Peru		3.8	0.3	0.8	1	-2	-1	-2		8.0	1.1	-3	-3	197	1	198
Uruguay		39	0.0	0.9	0	9	2	8		9.8	0.0	9	-61	171	-89	164
Hungary		359	0.2	-1.0	1	-13	4	-11		8.4	-41.0	17	61	359	-121	358
Poland		4.46	0.1	-0.1	-3	-10	-2	-9		6.0	-3.0	54	72	213	-17	207
Romania		4.6	0.0	-0.8	-2	-6	0	-5		7.5	10.2	13	26	236	-18	235
Russia		74.9	0.0	-0.5	-8	5	-1	9		10.6	0.0	25	-71	-11	-128	-60
South Africa		18.2	0.3	-0.9	-6	-17	-6	-17		9.3	0.0	24	50	179	14	171
Turkey		18.88	0.0	-0.1	0	-27	-1	-27		10.6	9.0	-75	45	-1152	75	-1184
US (DXY; 5y UST)		104	0.0	0.9	2	9	1	8		4.15	-2.3	11	59	229	15	225

	Equity Markets								Bond Spreads on USD Debt (EMBIG)						
	Level		Change (in %)					Since	Level		Change (in basis points)				Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22	Last 12m	Latest	7 Days	30 Days	12 M	YTD	23-Feb-22
									basis points						
China		4107	-0.9	0	-2	-11	6	-11		166	-5	-20	-41	-11	-42
Indonesia		6810	-0.9	-2	-1	-2	-1	-2		148	5	-3	-42	8	-37
India		59745	-1.5	-2	-2	4	-2	4		143	-2	-4	-12	1	-11
Philippines		6699	-1.5	-2	-5	-9	2	-9		129	12	11	-12	32	-8
Thailand		1659	-0.5	1	-1	-2	-1	-2		0	0	0	0	0	0
Malaysia		1464	-0.7	-2	-2	-8	-2	-8		100	0	-7	-30	0	-33
Argentina		248979	-3.2	0	1	178	23	173		2191	208	307	484	-14	454
Brazil		109177	-0.7	0	-3	-3	-1	-3		265	2	-6	-66	-9	-66
Chile		5269	-1.3	-3	1	18	0	20		131	-5	-8	-35	-1	-43
Colombia		1198	-1.1	-2	-10	-20	-7	-21		422	38	58	44	50	30
Mexico		53240	-1.2	1	-1	1	10	4		364	1	11	0	-17	-6
Peru		21865	-0.3	0	-5	-7	3	-7		180	-3	-14	-3	0	-10
Hungary		44972	-0.3	-3	-3	-7	3	-6		219	8	-14	62	-3	66
Poland		58559	-1.6	-3	-4	-9	2	-7		72	6	-29	57	-1	56
Romania		12284	-0.5	-1	2	-6	5	-7		250	9	-14	34	-6	18
Russia		2208	-0.2	2	2	-28	3	-28		3411	-577	938	3228	3234	2897
South Africa		78431	-0.6	-1	-1	4	7	5		385	21	14	-5	18	-4
Turkey		5060	-1.7	2	-8	151	-8	151		522	1	8	-29	82	-41
Ukraine		507	0.0	0	0	-2	-2	-2		4567	132	410	3570	488	3094
EM total		39	-0.5	-3	-6	-18	3	-17		392	11	25	-36	17	-66

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

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