GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, JANUARY 10, 2023

- **Gap between Fed guidance and market pricing persists** (link)
- **Core inflation in Tokyo higher than expected** (link)
- **Japanese yen could appreciate on flow-related technical factors** (link)
- **Some analysts no longer call for euro area recession in 2023** (link)
- **Natural-disaster related insurance losses above average in 2022** (link)
- **Market reaction to political turmoil in Brazil remains contained** (link)
- **Analysts question consensus on Chinese inflation post reopening** (link)
- **Egyptian pound weakens as annual inflation rises further** (link)

Mature Markets | Emerging Markets | Market Tables

Rally pauses ahead of new data

The US dollar firmer and core rates are higher as investors await potential comments from Chair Powell at a Riksbank event on central bank independence as well as new data. Yesterday, US equities reversed earlier gains after Federal Reserve officials signaled that interest rates could top 5%. Long-dated Japanese yields settled higher after a measure for core inflation in Tokyo rose to its highest levels since 1982 ahead of next week's Bank of Japan meeting. ECB officials maintain a hawkish line as some analysts are no longer calling for a euro recession in 2023. The market reaction to the turmoil in Brazil continues to be relatively muted.

Key Global Financial Indicators

Last updated: 1/10/23 1:43 PM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		3892	-0.1	1	-1	-17	1
Eurostoxx 50		4043	-0.6	4	3	-5	7
Nikkei 225		26176	0.8	0	-6	-7	0
MSCI EM		40	0.7	7	3	-17	7
Yields and Spreads				bps			
US 10y Yield		3.59	5.9	-15	1	183	-28
Germany 10y Yield		2.28	5.5	-11	35	232	-29
EMBIG Sovereign Spread		464	-5	12	10	97	12
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		50.5	-0.2	1	1	-4	1
Dollar index, (+) = $ appreciation		103.4	0.4	-1	-1	8	0
Brent Crude Oil ($/barrel)		79.9	0.3	-3	5	-1	-7
VIX Index (%, change in pp)		22.4	0.4	0	0	3	1

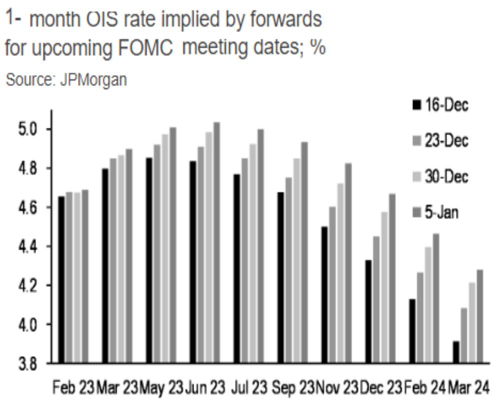
Mature Markets

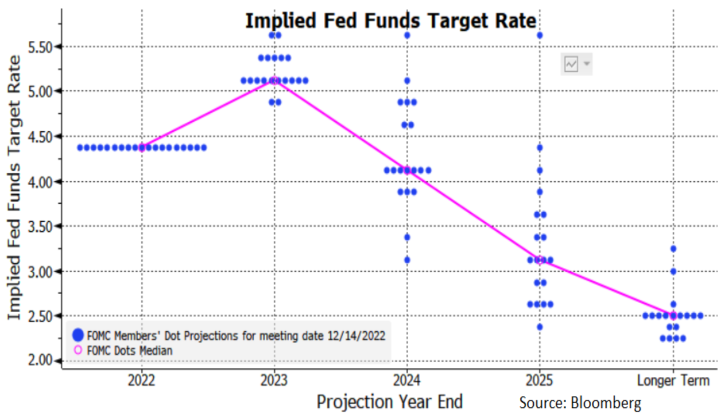
back to top

United States

Yesterday, S&P 500 closed unchanged yesterday, reversing earlier gains of +1.5% after two Federal Reserve officials signaled that interest rates could top 5%. Long-term US Treasury yields remained virtually unchanged. The US Dollar depreciated versus major (0.7%) and emerging market (0.6%) currencies.

The market continues disregarding the repeated communication of the Fed officials pinning interest rate projections at around 5% for the end of 2023. December's Dots Plot (right chart) highlights that several Fed speakers have protested expectations for Fed easing, supporting Chair Powell's earlier remarks that "It is likely that restoring price stability will require holding policy at a restrictive level for some time." However, interest rate derivatives continue pricing a sharp decline at around mid-2023, albeit the size of the priced-in decline has been narrowing in recent weeks (left chart). JPMorgan analysts suggest that the priced-in decline in rates is driven by investors' projections of inflation that promptly converge to 2.1–2.2% within a year, which doesn't contradict Fed projections—thus, meaning that almost any reaction function would expect policy rates well below 5% at year-end.



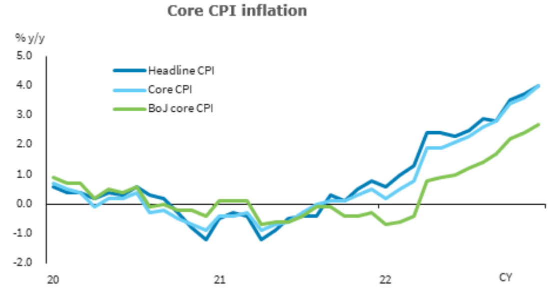


Bloomberg reports that investors' demand for the riskiest US junk bonds is growing, while companies start using this window of opportunities. Investors' demand contributed to the drop in bond yields, which was supported by junk bonds' recent light issuance. Correspondingly, the leveraged loan market is showing signs of opening up again as well. **However, there are doubts whether this demand may sustainably persist and whether HY deal volumes may significantly grow—various money managers are avoiding weaker corporate credits as they position their portfolios for a downturn at some point this year.**

Japan

30-yr yields are 6 bps higher after Tokyo CPI ex fresh food unexpectedly rose to +4.0% yoy in December (3.8% expected), the highest levels since 1982, with an increase of +0.5% mom. The Bank of Japan (BoJ) will upgrade its forecasts next week at its 17–18 Jan meeting but contacts believe that the BoJ will leave policy unchanged until it has more clarity on the "shunto" wage negotiation in spring.

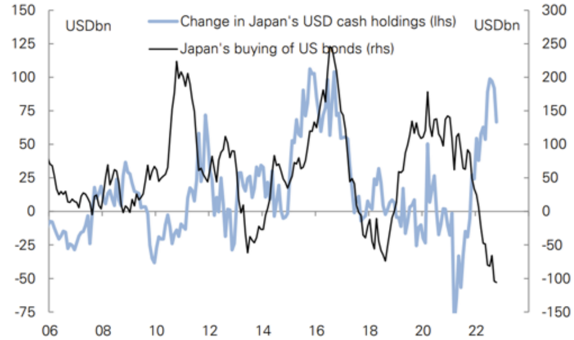
Figure 1: Core CPI inflation reaches +4% y/y threshold for first time since April 1982



Source: MIC, Barclays Research

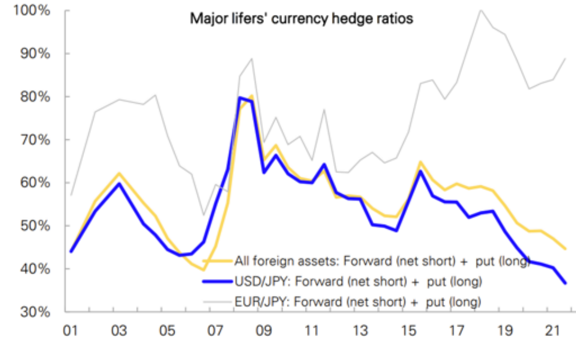
Technical factors linked to investment flows could prompt further Yen appreciation. Japanese institutions have sold a record amount of foreign bonds, not only to limit capital losses, but also given that the yield pick-up of currency-hedged foreign bonds over JGBs has been fading amid flatter yield curves abroad and higher hedging costs. **Deutsche Bank analysts two technical factors that could help further boosting the Yen. On the one hand, despite shedding foreign bonds, Japanese investors kept most of the proceeds in USD cash, likely to be repatriated (left chart below). On the other hand, Japanese life insurance companies have significantly decreased their US Dollar currency hedge ratios (right chart below).**

Japanese investors sold US bonds, leaving most of the proceeds in USD cash that could be repatriated...



Source: Deutsche Bank

...while Japanese life insurance companies have significantly decreased their US Dollar currency hedging.

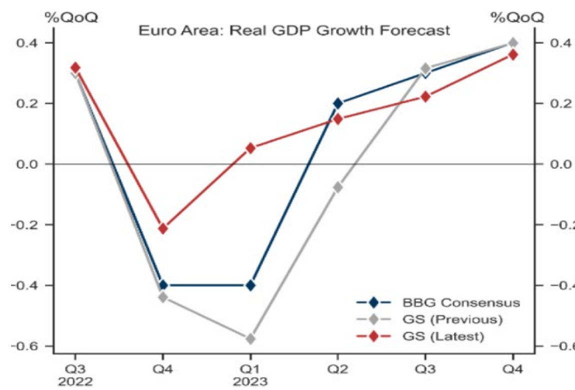


Source: Deutsche Bank

Europe

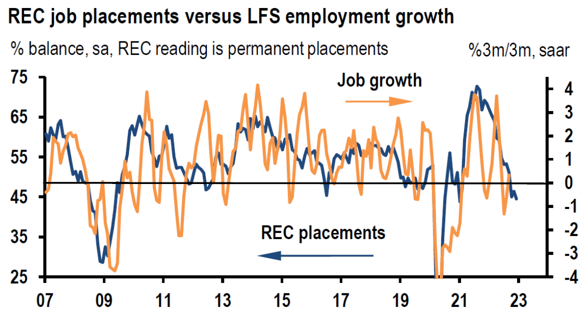
Equity markets are losing, with the Stoxx Europe 600 down 0.6%, after hitting and eight-month high yesterday. The UK FTSE 100 is down 0.2%. Currencies are broadly unchanged, with the euro up 0.1% (to 1.07/$) and the British pound down 0.1% (at 1.22 £/$). Bond yields are going up for a second session, with German 10y yields are up 4 bps to 2.27%, but are still about 30 bps lower than their end 2022 levels. Italian spreads are broadly unchanged at 197 bps. 10y gilt yields in the UK are up 3 bps to 3.56%.

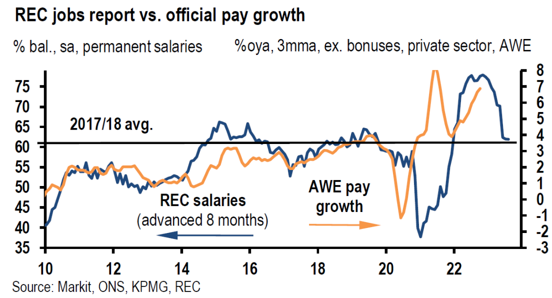
Goldman Sachs analysts no longer look for a technical recession in the Euro area in 2023 and lower their inflation forecast. They upgraded their growth forecast to +0.6% for 2023 (from -0.1%), above their previous consensus-matching expectation of -0.1%. This reflects more resilient growth momentum at the end of last year, sharply lower natural gas prices and earlier China reopening. They expect weaker growth in Germany and Italy, which are more reliant on energy-intensive industrial activity, than France and Spain, which have more diversified energy sources and are relatively more service-sector intensive. They also took down their inflation forecast for end 2023 down 1% to 3¼%. However, given more resilient activity, sticky core inflation and hawkish commentary, they expect the ECB to continue tightening significantly more in coming months, with 50 bp hikes very likely in both February and March, before slowing to 25 bp for a terminal rate of 3.25% in May. They do not see the first cut until 2024Q4.



Source: Goldman Sachs Global Investment Research, Haver Analytics

BOE Chief economist Huw Pill outlined the need to focus on inflation persistence measures, including labor market data. He signaled in a speech yesterday that the outlook for inflation is starting to improve in the UK with signs that the labor market is cooling as the economy heads into recession. He outlined however that policymakers should focus on longer-term inflation dynamics including wage setting and corporate pricing behavior as key indicators of inflation persistence and cautioned that “no single smoking gun could be identified as the key indicator or driver of inflation persistence and thus monetary policy decisions.” The report REC job report for December, released this morning shows a cooling of hiring trends, suggesting a modest contraction in employment and slower pay pressures. JP Morgan analysts note however, that recent labor market indicators have been mixed, possibly leaving enough room for MPC members to draw different conclusions about inflation persistence.





Source: JP Morgan.

Insurers

Munich Re calculates that insured losses from natural disasters were about $120 bn in 2022, above the average of the last five years by around $23 bn. Hurricane Ian, which hit Florida, was responsible for about half the losses. Before 2005, the year of Hurricane Katrina, insured losses had never exceeded an inflation-adjusted $50 bn/year. **Total losses from natural catastrophes, including those not covered by insurance, were $270 bn in 2022, compared to around $320 bn in 2021 and near the average of the previous five years.**

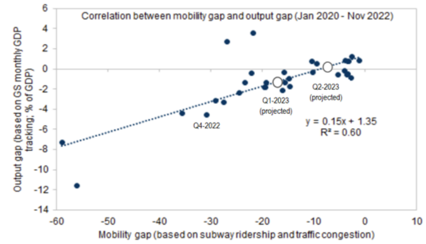
Emerging Markets back to top

The U.S. dollar is a bit firmer ahead of Chair Powell’s speech in relatively quiet trading. Equities traded lower after a strong start to the year. Local rates in Eastern Europe consolidated at lower levels. **The price for Urals grade, Russia’s top oil export, was $37.8/bbl at the Baltic Sea port of Primorsk on Friday, less than half of Brent futures prices. LATAM markets performance was mixed yesterday,** the Brazilian real and Peruvian sol depreciated against the US dollar while equity prices were up and 5YR CDS spreads narrowed across countries. **In Mexico, headline CPI rose 0.38% mom in December, as expected, and core inflation fell to 8.35% yoy in December from 8.51% in November.**

China

Analysts at Standard Chartered question consensus on inflation as they signal slowing inflation, but a transition in line with peer economies suggest significantly higher above target (right chart below). HSBC analysts have observed an increase in subway passenger numbers in cities such as Beijing, Chengdu, Shenzhen, and Shanghai, indicating a potential recovery. **The strong relationship between subway ridership and the output gap makes this an important indicator** (left chart below). Goldman Sachs predicts that the mobility gap, which measures the deviation of aggregate subway ridership and traffic congestion from their pre-pandemic trend, will narrow from currently -30% to -5% by Q2 2023. This would align with a return to trend growth for the Chinese economy by then.

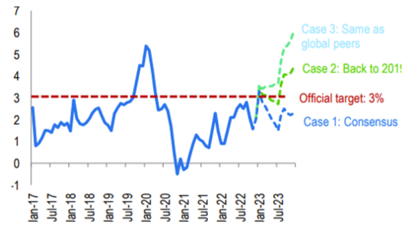
China's output gap is set to close by H2-2022 ...



Note: Mobility gap refers to the deviation of an aggregate mobility measure tracking the deviation of the 19-city subway ridership and 100-city traffic congestion index from its pre-pandemic (2018/19) levels.

Source: Goldman Sachs

...implying that an increase of China's CPI beyond the PBoCs official target appears likely.

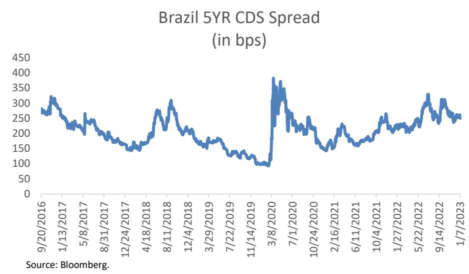


Note: Case 1 assuming monthly changes stay consistent with a full-year CPI inflation Bloomberg consensus of 2.3% for 2023, Case 2 reversion of monthly changes to pre-Pandemic averages, Case 3 assuming transition to post-Pandemic average of China's peer economies after reopening.

Source: Standard Chartered

Brazil

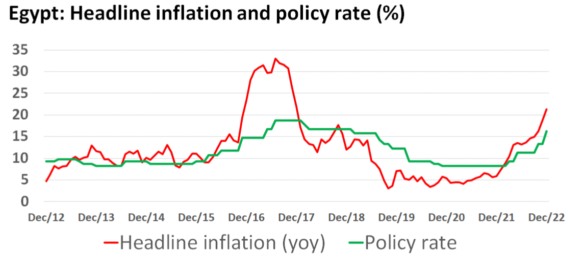
The reaction to the turmoil in Brazil has been relatively muted. The Brazilian real depreciated 0.60% against the US dollar, Bovespa closed +0.15%, 5YR CDS spreads narrowed by 1 bp, local 10y bond yields were down 3 bps to 12.85% and yields on 10-yr dollar bonds were down 1 bp to 5.91%. However, Bloomberg analysts estimate that a spike in political uncertainty could weaken the real, push stock prices down, and reduce about 0.7 percentage point off January 2023 economic activity. The estimate is based on a model of the relationship between political uncertainty, asset prices, and economic growth that assumes political uncertainty rises to the level seen in 2Q2017 when Brazil's financial markets plunged amid allegations of a corruption scandal against President Temer.



Egypt

The Egyptian pound (-0.3%) trades at a new record low after CPI inflation rose to 21.3% yoy or 2.1% mom in December. JP Morgan expects the central bank to hike its deposit rate another 150 bps to 17.75% in early 2023.

Egypt: Headline inflation and policy rate (%)



This monitor is prepared under the guidance of Charles Cohen (Acting Division Chief), Nassira Abbas (Deputy Division Chief), and Antonio Garcia-Pascual (Deputy Division Chief). Fabio Cortes (Senior Economist), Reinout De Bock (Senior Economist-London Representative), Sanjay Hazarika (Senior Financial Sector Expert), Esti Kemp (Financial Sector Expert-London Representative), Tom Piontek (Senior Financial Sector Expert) and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Mustafa Oguz Caylan, Yingyuan Chen (Financial Sector Expert), Deepali Gautam (Research Officer), Frank Hespeler (Senior Financial Sector Expert), Shoko Ikarashi (Externally Financed Appointee), Phakawa Jeasakul (IMF Resident Representative in Hong Kong SAR), Johannes S Kramer (New York Representative), Harrison Kraus (Research Assistant), Yiran Li (Research Assistant), Aurelie Martin (Senior Economist-London Representative), Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), Silvia Ramirez (Senior Financial Sector Expert), Patrick Schneider (Financial Sector Expert), Ying Xu (Economist), Dmitry Yakovlev (Senior Research Officer), and Akihiko Yokoyama (Senior Financial Sector Expert). Javier Chang (Senior Administrative Assistant) Olga Lefebvre (Staff Assistant), and Srujana Sammeta (Staff Assistant) are responsible for the word processing and production of this monitor.

Global Financial Indicators

Last updated: 1/10/23 2:05 PM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		3884	-0.1	2	-1	-17	1
Europe		4043	-0.6	4	3	-5	7
Japan		26176	0.8	0	-6	-7	0
China		3170	-0.2	2	-1	-11	3
Asia Ex Japan		69	0.8	7	4	-16	7
Emerging Markets		40	0.7	7	3	-17	7
Interest Rates					basis points		
US 10y Yield		3.59	5.9	-15	1	183	-28
Germany 10y Yield		2.28	5.5	-11	35	232	-29
Japan 10y Yield		0.51	0.3	9	25	37	9
UK 10y Yield		3.59	6.0	-7	41	240	-9
Credit Spreads					basis points		
US Investment Grade		160	0.9	-2	6	47	1
US High Yield		456	0.0	-28	-6	107	-25
Europe IG		82	2.4	-7	-7	31	-8
Europe HY		426	8.9	-36	-38	169	-48
Exchange Rates					%		
USD/Majors		103.45	0.4	-1	-1	8	0
EUR/USD		1.07	-0.1	2	2	-5	0
USD/JPY		132.5	0.4	1	-4	15	1
EM/USD		50.5	-0.2	1	1	-4	1
Commodities					%		
Brent Crude Oil ($/barrel)		80	0.3	-3	5	-1	-7
Industrials Metals (index)		167	-0.1	1	-1	-3	1
Agriculture (index)		66	-0.6	-2	1	8	-4
Implied Volatility					%		
VIX Index (%, change in pp)		22.4	0.4	-0.5	-0.4	3.0	0.7
US 10y Swaption Volatility		119.4	0.9	-13.5	-25.4	36.2	-7.2
Global FX Volatility		10.7	0.0	-0.2	0.1	3.4	0.0
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		213	-4.6	-11	6	53	8
Italy		195	-0.6	-16	5	63	-19
Portugal		96	-0.7	-5	3	35	-5
Spain		104	-0.9	-3	1	36	-6

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

Emerging Market Financial Indicators

Last updated: 10/01/2023 1:41 PM	Exchange Rates: Level, Last 12m	Level, Latest	Change (in %), 1 Day	Change (in %), 7 Days	Change (in %), 30 Days	Change (in %), 12 M	YTD	Since 23-Feb-22	Local Currency Bond Yields (GBI EM): Level, Last 12m	Level, Latest	Change (in basis points), 1 Day	Change (in basis points), 7 Days	Change (in basis points), 30 Days	Change (in basis points), 12 M	YTD	Since 23-Feb-22
		vs. USD	(+) = EM appreciation							% p.a.						
China		6.78	-0.2	2.0	3	-6	2	-7		3.1	5.0	7	-4	26	6	26
Indonesia		15576	-0.1	0.2	0	-8	0	-8		6.8	-6.4	-21	-10	37	-10	34
India		82	0.7	1.3	1	-9	1	-9		7.3	-3.1	-7	7	56.2	-13	
Philippines		55	0.5	1.7	1	-7	2	-7		6.1	0.0	5	5	155	5	108
Thailand		34	-0.4	2.5	4	0	3	-4		2.6	2.5	-9	5	50	-7	34
Malaysia		4.37	0.0	0.8	1	-4	1	-4		3.9	-2.3	-7	-13	27	-10	28
Argentina		180	-0.2	-1.1	-5	-43	-2	-41		85.8	24.7	-68	-318	3674	-244	3782
Brazil		5.26	-0.1	3.8	1	8	0	-5		12.8	9.7	-23	-26	136	24	129
Chile		838	-0.3	2.5	3	0	1	-6		5.2	9.0	-13	-4	-68	-13	-71
Colombia		4846	0.1	1.0	0	-16	0	-19		10.1	4.0	25	5	310	32	222
Mexico		19.15	0.0	1.3	4	6	2	6		8.2	5.9	-47	-22	30	-57	32
Peru		3.8	-0.2	0.1	1	3	0	-2		7.7	0.1	-30	-4	160	-27	170
Uruguay		40	0.0	-0.3	-3	12	0	6		10.7	0.0	0	-16	202	0	253
Hungary		373	-0.9	1.8	6	-15	0	-14		8.2	20.0	-120	-120	335	-145	334
Poland		4.38	-0.1	1.2	2	-8	0	-7		5.3	17.0	-69	-25	128	-93	136
Romania		4.6	-0.2	1.6	2	-5	0	-5		7.4	-7.8	-32	-11	235	-32	221
Russia		69.5	0.0	4.4	-10	8	7	17		11.9	0.0	135	112	285	-1	67
South Africa		17.1	-1.1	-0.6	3	-8	-1	-12		8.8	14.0	-31	-49	93	-40	118
Turkey		18.78	-0.1	-0.3	-1	-26	0	-26		8.6	0.0	-7	-239	-1631	-123	-1382
US (DXY; 5y UST)		103	0.4	-1.1	-1	8	0	7		3.73	5.2	-17	-4	221	-28	182

	Equity Markets: Level, Last 12m	Level, Latest	Change (in %), 1 Day	Change (in %), 7 Days	Change (in %), 30 Days	Change (in %), 12 M	YTD	Since 23-Feb-22	Bond Spreads on USD Debt (EMBIG): Level, Last 12m	Level, Latest	Change (in basis points), 7 Days	Change (in basis points), 30 Days	Change (in basis points), 12 M	YTD	Since 23-Feb-22
									basis points						
China		4017	0.1	3	0	-16	4	-13		183	6	1	-13	6	-25
Indonesia		6622	-1.0	-4	-1	0	-3	-4		171	31	17	8	31	-14
India		60115	-1.0	-2	-3	-1	-1	5		148	6	7	24	6	-6
Philippines		6757	-0.5	3	3	-5	3	-8		141	44	20	43	44	4
Thailand		1691	0.0	1	4	1	1	0		0	0	0	0	0	0
Malaysia		1485	-0.6	1	1	-5	-1	-6		104	4	10	-10	4	-29
Argentina		215725	0.9	4	26	158	7	136		2093	-112	-261	300	-112	356
Brazil		108699	-0.4	4	1	7	-1	-3		285	11	26	-30	11	-46
Chile		5149	-0.2	0	-1	20	-2	18		158	26	22	20	26	-16
Colombia		1327	0.6	3	7	-5	3	-12		385	13	3	41	13	-7
Mexico		52280	1.1	7	4	-1	8	2		384	3	7	51	3	14
Peru		22545	1.3	6	2	1	6	-4		200	20	35	43	20	10
Hungary		45600	-0.5	2	3	-13	4	-5		253	31	34	140	31	100
Poland		61225	-0.2	6	10	-13	7	-3		102	29	24	83	29	86
Romania		12288	0.0	2	0	-7	5	-7		275	19	23	89	19	42
Russia		2156	-0.3	-1	-1	-42	0	-30		3411	-577	938	3228	3234	2897
South Africa		77828	-0.7	5	4	5	7	4		361	-6	-23	20	-6	-28
Turkey		5152	-0.4	-8	3	152	-6	156		473	33	31	-103	33	-90
Ukraine		514	0.0	-1	-1	-2	-1	-1		4185	106	234	3412	106	2712
EM total		40	-0.7	7	3	-17	7	-15		388	12	12	-8	12	-70

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

back to top