GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, JULY 10, 2023

- **US yield curve steepens on expectations of higher long term rates** (link)
- **China's zero CPI print prompts worries about deflation** (link)
- **BOJ injects liquidity to ease pressure on interbank rates** (link)
- **Corporations in US remain resilient despite fears of recession** (link)
- **UK seen as more vulnerable to mortgage refinancing risk** (link)
- **Sticky core inflation in Mexico to keep policy rate higher for longer** (link)
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Markets start week in cautious mood

Stocks in Europe posted modest gains while US equity index futures were mixed as markets started the week in a cautious mood. Flat core inflation in China raised concerns about deflation, with investors hoping that that the authorities will step in with stimulative policies to jump start the economy. Worries about a slowdown in China have weighed on risk sentiment for several months as the post lockdown recovery continues to disappoint. Meanwhile, all eyes are on this week's CPI and PPI inflation reports from the US, which are expected to guide Fed policy moves in the near future. A rate hike at the July 26 FOMC meeting is viewed as almost certain, but markets are gradually pushing up their estimates of the terminal policy rate as expectations for higher interest rates gradually take hold. Last week's steepening of the US Treasury yield curve underlined market expectations of higher rates.

Key Global Financial Indicators

Last updated: 7/10/23 8:03 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		4399	-0.3	0	2	13	15	4
Eurostoxx 50		4264	0.6	-3	-1	22	12	7
Nikkei 225		32190	-0.6	-5	0	20	23	22
MSCI EM		39	1.1	0	-1	-2	4	-17
Yields and Spreads					bps			
US 10y Yield		4.04	-2.6	18	30	96	16	204
Germany 10y Yield		2.64	0.1	20	26	129	7	241
EMBIG Sovereign Spread		434	5	2	-19	-106	-18	21
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		48.7	0.1	-1	-2	-2	-2	-8
Dollar index, (+) = $ appreciation		102.4	0.2	0	-1	-4	-1	6
Brent Crude Oil ($/barrel)		78.1	-0.5	5	4	-27	-9	-19
VIX Index (%, change in pp)		15.4	0.6	2	2	-9	-6	-16

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

Market attention will switch from last week's quite robust US payrolls data to this week's crucial US CPI and PPI inflation data. Markets currently assign an 89% probability of a 25 bps rate hike at the July 26 FOMC meeting. In the euro area, key data releases include eurozone industrial production and the German CPI and ZEW business confidence reports. China is due to report GDP and industrial production. The UK jobs report is also due this week. Central bank meetings will be held in South Korea, New Zealand, Canada, Argentina, and Peru. Earnings season is scheduled to begin, starting with JP Morgan, Wells Fargo, and Citi all reporting on Friday. The 74th Annual NATO meetings will be held in Lithuania.

Mature Markets

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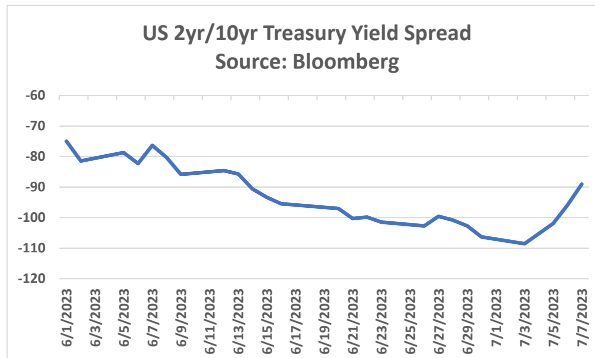
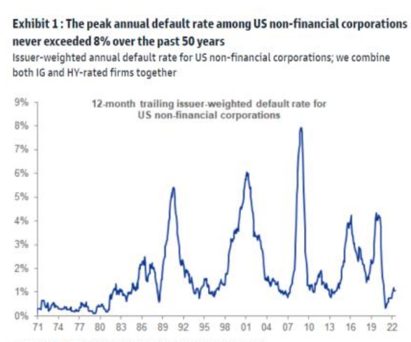
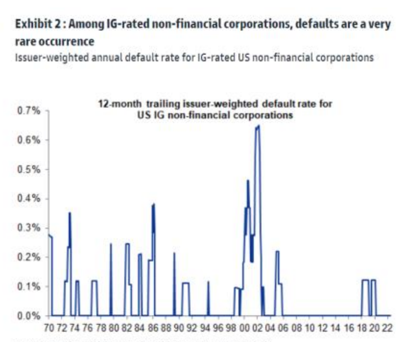
United States

Last week saw a marked steepening of the US yield curve, with the spread between the two-year and 10-year Treasury yields rising from -109 bps on Monday to -89 bps on Friday. Hawkish FOMC minutes and another strong jobs report seemed to convince investors that the Fed will have to stay tighter for longer, raise rates more than one more time or even both, increasing the chances that longer term interest rates may end up higher. The 10-year yield closed at 4.07% on Friday, not far from the current cycle high of 4.22% set on October 24, 2022. The two-year yield briefly hit 5.11% intra-day on Thursday, which is higher than the official cycle high of 5.07% set on March 8. The interest rate futures market is now predicting a terminal Fed Funds rate close to 5.40%, the highest level in the current rate hike cycle.



Corporations in the US reman resilient despite fears of a recession according to analysis by Goldman. A recent paper by Fed economists warns that higher interest rates have put US corporations at high risk of default. However, earnings in Q1 2023 were stronger than expected and corporate leaders have grown more optimistic in their outlooks than they were late last year. Equity markets agree, as the S&P 500 and the Nasdaq have both enjoyed a very strong performance this year, especially technology stocks that were punished severely in 2022. Apple recently became the first $3tn corporation. Goldman argues that the Merton distance-to-default model used by the economists potentially gives more weight to unrated firms without public debt. They point out that measures of debt sustainability for US corporations such as cash levels and interest coverage ratios remain strong. Finally, the highest default rate for US companies over the past half century was less than 8%, and that the highest default rate for investment grade companies was below 0.7%.





Euro Area

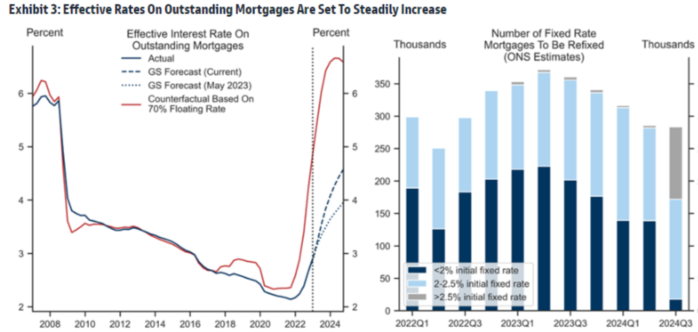
European equities retraced early morning losses and were little changed in later trade (Stoxx 600 -

0.2%) with the energy (+0.7%) and banking (+0.5%) sectors outperforming. The euro was little changed against the dollar. In the latest commentary from the ECB, Governing Council (CG) member Villeroy commented that he thinks rates would "soon" reach a high point but described it as a "high plateau" rather than a "peak." Separately, GC member Centeno noted expectations for eurozone inflation to ease to under 3% by the end of this year. **On the data front, the euro area Sentix investor confidence index came in lower than expected in July**, falling to -22.5 (vs expected -17.9 from -17). **Sovereign yields were marginally higher (10y bund yield +1bps to 2.64%).**

United Kingdom

Goldman Sachs analysts argue that short mortgage fixation periods make the UK relatively more vulnerable to mortgage refinancing risks than the euro area or the US. Analysts estimate that the effective rate on outstanding mortgages will increase to 4.6% in Q4 2024, from 2.9% in 2023 Q1. Market expectations for a higher BOE policy rate (now priced to peak at around 6.4% compared to roughly 5.5% a month ago) has seen quoted mortgage rates increasing sharply. Moreover, gilt yields have also increased markedly, with 10-year gilt yields trading around 4.67% earlier this morning, their highest level since 2008. Goldman Sachs analysts see a more aggressive BoE response to indications to inflation and forecast the BoE terminal rate at 6%.

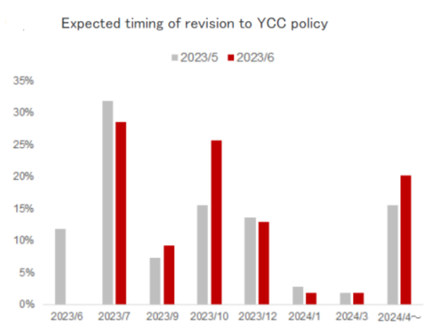
Exhibit 3: Effective Rates On Outstanding Mortgages Are Set To Steadily Increase



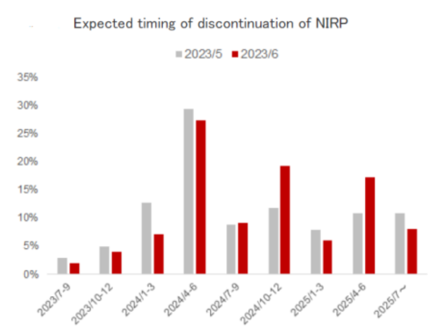
Source: Goldman Sachs Global Investment Research, FCA, ONS

Japan

The Bank of Japan (BOJ) injected liquidity to ease pressure on interbank rates. It offered to buy ¥3tn ($21.1bn) of government bonds via repo, the first such operation since March 2022, Bloomberg reported. It also increased the amount of debt purchase in a separate operation for tenors between 5-10 years. Separately, **investors are likely to be hesitant to purchase Japanese bonds until the BOJ revises its yield curve control (YCC) policy**, according to Nomura. Many bond market participants expected a YCC revision July or October 2023, the Nomura survey showed. In addition, the largest number of respondents expected a discontinuation of the BoJ's negative interest rate policy (NIRP) to come in April-June 2024. Meanwhile, **Japan's 10-year break-even inflation rate, climbed to 1.16%, the highest level since November 2014**.



Source: Nomura, QUICK



Source: Nomura, QUICK

Emerging Markets back to top

EMEA markets were mixed. Equity markets were generally down with South Africa leading losses (-1.2%), while Turkish stocks were up (+1.2%). Currencies were weakening vs. their reference currencies except in Hungary and South Africa). **Asian equities also were mixed, and little changed on net.** China stocks rose +0.5%, while South Korean equities fell -0.8%. **Most Asian currencies depreciated. Hong Kong SAR** announced on July 7 that residential mortgage rules will be eased, the first time since 2009, to support its weakening property market. **Latin American markets rallied as inflation prints reveal falling inflation.** Late last week, a series of Latin American economies released inflation data prints that shows inflation in the region is falling in Mexico, Brazil, Guatemala, Chile, and Costa Rica. Equities also jumped in Brazil (+1.25%), Chile (+2.59%), and Colombia (1.62%).

EM Fund Flows

For the week ending July 7, hard currency fund outflow slowed. In the EM bond fund market, hard currency fund outflows fell to -$15mn, compared to -$739mn the previous week, after 20 weeks of strong outflows. Local currency funds saw a rise in outflows of -$369mn (-235mn previous). For equity funds, outflows sharply increased to -$1.6bn, the largest outflow in 29 weeks.

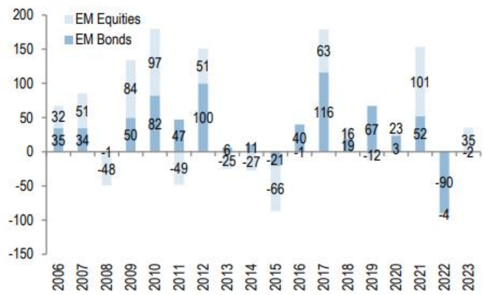
Figure 1: Weekly cross-asset flows

USD billion

	Asset	8w flows (8w ago → current)	This wk	YTD
Fund Flows	EM Bonds and Equities		-2.0	32.8
	EM Bonds		-0.4	-2.2
	Hard Ccy		0.0	-3.4
	Local Ccy^		-0.4	1.2
	o.w. EM ex-China		-0.3	3.1
	o.w. China		-0.1	-3.1
	EM Equities		-1.6	35.0
	US HG		6.6	164.4
	US HY		0.1	-4.8
	Global Equities		12.3	-42.1
	EM Bond and Equity ETFs		-0.2	32.7
	EM Bond ETFs		0.4	1.3
	EM Equity ETFs		-0.6	31.4
	Non-resident EM flows*		1.7	35.3

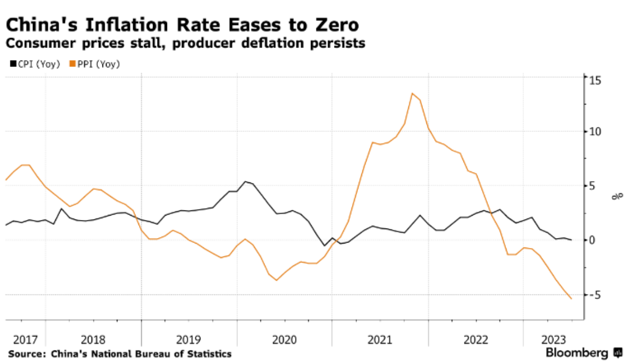
Figure 2: EM bond and equity fund flows

USD billion



China

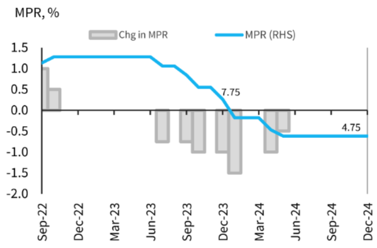
China's consumer price inflation eased further to 0% y/y in June (consensus: +0.2, previous: +0.2%). Produce prices fell -5.4% y/y (previous: -4.6%) in June, the biggest fall in seven years. Analysts expect CPI inflation to slip further in July partly due to high base effects, looking for the central bank to continue with policy rate cuts and lower reserve requirements. Some noted that the Chinese market continued to trade around expectation on stimulus beyond the monetary policy. US Treasury Secretary Janet Yellen stated during her four-day visit to Beijing, that US and China ties are on "surer footing," Bloomberg reported. The People's Bank of China lent support to the renminbi, as it set a stronger than expected RMB fixing.



Chile

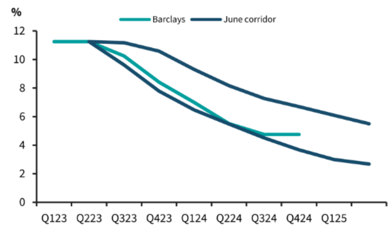
Lower than expected inflation in Chile raised expectations for rate cuts. Chilean headline CPI released late last week came in at 7.6% y/y in June (compared to 8.7% a month ago) and -0.2% m/m, lower than forecasts. Core CPI also fell from 7.9% to 6.9% y/y. The central bank decided to hold their overnight target rate at 11.25% during their June 19 meeting, but market participants are now expecting a 75bps cut during their July 28 meeting. The recently released June 19 meeting minutes revealed that members were open to cut 25bps or even 50bps last month, signaling they are soon ready to lower rates for the first time since 2020. Barclays now expect the Chilean target rate to fall to 7.75% by the end of the year.

Figure 5. We expect a 75bp cut in the July meeting followed by additional cuts, taking the policy rate to 7.75% by year-end



Source: Barclays Research

Figure 6. We continue to think the monetary policy path will be closer to the lower bound of the corridor

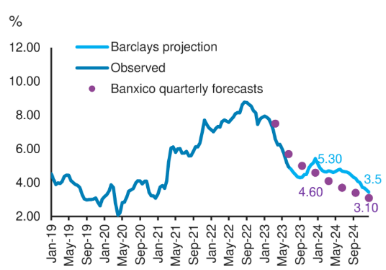


Source: BCCh, Barclays Research

Mexico

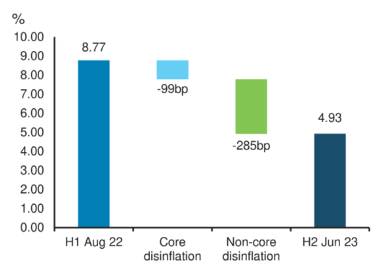
Core inflation in Mexico remains sticky, although headline inflation continues to fall. Headline inflation in Mexico fell from 5.8% to 5.1% y/y in June, although price changes did not meet market expectations. Barclays expected inflation to rise 0.07% m/m and it came in at 0.10% while core prices rose 0.30% m/m, also above 0.26% market expectations. Overall, inflation is falling in line with the Mexican central bank's forecasts thus far (Figure 1), although disinflation has mainly been driven by noncore CPI components. Investors expect Mexican headline inflation to rise slightly by the end of the year due to higher agricultural prices caused by negative El Nino weather effects. According to Barclays, the likelihood of central bank rate cuts is low. Banxico's policy rate is set at 11.25% and is expected to remain steady for the rest of the year, until eventually falling to 7.5% by the end of 2024.

Figure 1. 12-month headline inflation



Source: INEGI, Banxico, Barclays Research

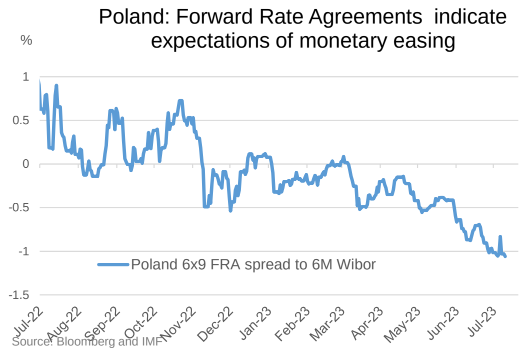
Figure 2. Contributions of core and noncore to the reduction of headline inflation from recent peak



Source: INEGI, Barclays Research

Poland

Polish Central Bank Governor Glapinski surprised markets during his press conference on Friday by saying that a 25 bps cut in September was possible if inflation continued to fall. Forward rate agreements indicate expectations of 105 bps of monetary policy easing in the next 6 months, compared to 83 bps on Thursday. The previous day, the MPC had left rates unchanged at 6.75% as expected after preliminary inflation for June came in at 11.5% y/y, down from 13% in May, and below expectations (11.8%). In somewhat confusing communication, today, the central bank said in its inflation report that Polish inflation will return to its 2.5% (+/- 1%) inflation target only at the end of the projection horizon in 2025, assuming that interest rates remain unchanged. The report sees inflation at 11.9% in 2023, 5.2% in 2024 and 3.3% in 2025.



This monitor is prepared under the guidance of Jason Wu (Division Chief), Charles Cohen (Deputy Division Chief), Nassira Abbas (Deputy Division Chief), and Antonio Garcia-Pascual (Deputy Division Chief). Fabio Cortes (Senior Economist), Sanjay Hazarika (Senior Financial Sector Expert), Esti Kemp (Financial Sector Expert-London Representative), Johannes Kramer (New York Representative), Aurelie Martin (Senior Economist-London Representative), and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Benjamin Mosk (Senior Financial Sector Expert), Yingyuan Chen (Financial Sector Expert), Deepali Gautam (Research Officer), Shoko Ikarashi (Externally Financed Appointee), Phakawa Jeasakul (IMF Resident Representative in Hong Kong SAR), Harrison Kraus (Research Assistant), Yiran Li (Research Assistant), Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), Mustafa Oguz Caylan (Research Officer), 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) and Srujana Sammeta (Staff Assistant) are responsible for the word processing and production of this monitor.

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Global Financial Indicators

7/10/23 8:05 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		4397	-0.3	-1	2	13	15
Europe		4264	0.6	-3	-1	22	12
Japan		32190	-0.6	-5	0	20	23
China		3844	0.5	-1	0	-12	-1
Asia Ex Japan		66	0.9	0	-2	-4	2
Emerging Markets		39	1.1	0	-1	-2	4
Interest Rates					basis points		
US 10y Yield		4.04	-2.6	18	30	96	16
Germany 10y Yield		2.64	0.1	20	26	129	7
Japan 10y Yield		0.46	3.4	6	4	22	4
UK 10y Yield		4.63	-1.8	19	39	240	96
Credit Spreads					basis points		
US Investment Grade		147	-1.1	1	-16	-23	-11
US High Yield		438	5.4	9	-24	-114	-42
Exchange Rates					%		
USD/Majors		102.43	0.2	0	-1	-4	-1
EUR/USD		1.10	-0.1	0	2	9	2
USD/JPY		142.1	-0.1	-2	2	3	8
EM/USD		48.7	0.1	-1	-2	-2	-2
Commodities					%		
Brent Crude Oil ($/barrel)		78.1	-0.5	5	4	-12	-6
Industrials Metals (index)		141	-0.4	0	-3	-7	-15
Agriculture (index)		67	0.8	1	0	-1	-3
Implied Volatility					%		
VIX Index (%, change in pp)		15.4	0.6	1.8	1.6	-9.2	-6.3
US 10y Swaption Volatility		118.3	8.3	18.3	13.5	-22.3	-7.4
Global FX Volatility		8.2	0.1	0.0	0.2	-2.9	-2.5
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		145	11.1	18	16	-90	-60
Italy		174	1.6	4	0	-21	-41
Portugal		73	-0.3	-2	1	-34	-29
Spain		105	0.3	5	7	-2	-4

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

Emerging Market Financial Indicators

Last updated: 7/10/2023 8:07 AM	Exchange Rates: Level Last 12m	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Local Currency Bond Yields (GBI EM): Level Last 12m	Latest	Change (in basis points) 1 Day	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.					
China		7.24	-0.2	0.1	-1	-7	-5		2.7	-0.2	-1	-5	-21	-35
Indonesia		15205	-0.4	-1.2	-2	-2	2		6.3	1.7	2	-8	-101	-68
India		83	0.2	-0.7	0	-4	0		7.5	-5.9	6	7	(1.0)	4
Philippines		56	-0.1	-0.7	1	1	0		5.9	1.3	1	1	28	-8
Thailand		35	0.0	-0.3	-1	3	-1		2.8	2.5	2	4	15	14
Malaysia		4.67	-0.1	-0.1	-1	-5	-6		3.9	0.6	5	19	-23	-13
Argentina		261	-0.2	-1.6	-7	-52	-32		92.0	0.9	-797	-1896	2215	382
Brazil		4.86	0.2	-1.0	0	11	9		10.8	0.9	8	-52	-250	-180
Chile		808	-0.6	-0.8	-2	18	5		5.1	-8.0	6	-4	-139	-23
Colombia		4164	1.6	0.2	1	5	16		7.5	-1.5	13	-55	-211	-225
Mexico		17.11	0.2	-0.3	1	21	14		8.3	6.0	21	-12	-50	-43
Peru		3.6	0.2	-0.5	1	7	5		6.8	0.0	5	-46	-118	-117
Uruguay		38	-0.8	-2.0	2	5	4		9.5	-1.7	-6	-47	-150	-114
Hungary		349	0.5	-1.8	-2	16	7		7.1	-13.0	9	-38	-132	-255
Poland		4.06	0.0	0.1	2	18	8		5.1	-1.5	9	-11	-95	-110
Romania		4.5	-0.1	0.5	2	9	2		6.6	3.5	-3	-11	-225	-105
Russia		91.4	-0.1	-2.4	-8	-32	-19							
South Africa		18.8	0.1	-0.6	-1	-9	-10		9.8	1.1	19	-4	58	63
Turkey		26.09	-0.1	-0.6	-9	-33	-28		16.6	-28.0	-6	110	-238	676
US (DXY; 5y UST)		102	0.1	-0.5	-1	-4	-1		4.30	-5.7	12	39	118	30

	Equity Markets: Level Last 12m	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Bond Spreads on USD Debt (EMBIG): Level Last 12m	Latest	Change (in basis points) 7 Days	30 Days	12 M	YTD
									basis points				
China		3844	0.5	-1	0	-12	-1		177	-5	-9	-29	0
Indonesia		6731	0.2	1	1	0	-2		130	-6	-8	-88	-10
India		65344	0.1	0	4	20	7		128	1	-11	-84	-14
Philippines		6380	0.0	-2	-2	0	-3		104	-6	-5	-56	7
Thailand		1497	0.4	-1	-4	-4	-10		0	0	0	0	0
Malaysia		1383	0.4	-1	1	-3	-8		89	0	-5	-51	-11
Argentina		423580	1.4	-1	11	300	110		2105	50	-244	-539	-100
Brazil		118898	1.3	1	2	19	8		243	-8	-10	-116	-31
Chile		5942	2.6	2	4	16	13		121	-7	-9	-51	-11
Colombia		1133	1.6	0	-4	-16	-12		370	-2	1	-59	-2
Mexico		53904	0.9	1	-1	13	11		366	-7	-26	-74	-15
Peru		22519	1.1	1	2	21	6		155	-5	-18	-40	-25
Hungary		49870	0.0	-1	1	25	14		206	-4	-19	-22	-16
Poland		67084	-0.1	-1	1	23	17		131	-2	-1	53	58
Romania		12596	-0.3	0	3	3	8		222	-3	-17	-109	-34
South Africa		74037	-1.1	-3	-4	8	1		407	-5	-11	-105	40
Turkey		6249	1.0	4	11	157	13		480	0	4	-253	40
Ukraine		507	0.0	0	0	-2	-2		4262	98	-749	-1229	183
EM total		39	-0.7	0	-1	-2	4		390	0	-4	-68	14

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

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