GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, JULY 11, 2023

- **Strong US economic data force repricing of Fed rate cuts** (link)
- **China extends stimulus measures for real estate sector** (link)
- **US corporate bond market outperforms** (link)
- **High profits and ample liquidity protect US companies against recession risk** (link)
- **German ZEW business sentiment survey weaker than expected** (link)
- **Stronger UK jobs data boosts pound** (link)
- **Bank of Israel delivers hawkish hold** (link)

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Markets remain cautious ahead of US inflation data

Most European equity markets posted modest gains and US equity futures are slightly higher ahead of tomorrow's key US CPI inflation report. Reports of further stimulative measures in China boosted sentiment, but this was tempered by hawkish statements from US and euro area central bank officials who indicated that policy rates may need to remain high for longer than originally expected. Steeper government bond yield curves in the US and Europe accentuated the risk that interest rates could rise further, providing more headwinds for risk assets. Despite a moderate rally in government bond prices this week, government bond yields are not far from cycle highs. Stocks in the UK were lower after stronger than expected wage data prompted speculation that the Bank of England will have to deliver multiple rate hikes to get inflation under control. Meanwhile, earnings season begins this week, with JP Morgan, Citi and Wells Fargo scheduled to report on their performance on Friday. Commodity prices were higher on hopes that the stimulus measures announced in China will increase demand.

Key Global Financial Indicators

Last updated: 7/11/23 8:06 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		4410	0.2	-1	3	14	15	4
Eurostoxx 50		4286	0.7	-2	0	23	13	8
Nikkei 225		32204	0.0	-4	-1	22	23	22
MSCI EM		39	0.1	0	-1	1	4	-17
Yields and Spreads				bps				
US 10y Yield		3.96	-3.0	11	22	97	9	197
Germany 10y Yield		2.62	-1.9	17	24	138	5	239
EMBIG Sovereign Spread		438	4	12	-18	-100	-14	25
FX / Commodities / Volatility				%				
EM FX vs. USD, (+) = appreciation		48.8	0.1	-1	-2	-1	-2	-8
Dollar index, (+) = $ appreciation		101.9	-0.1	-1	-2	-6	-2	6
Brent Crude Oil ($/barrel)		78.2	0.7	3	5	-27	-9	-19
VIX Index (%, change in pp)		14.9	-0.1	1	1	-11	-7	-16

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

Mature Markets

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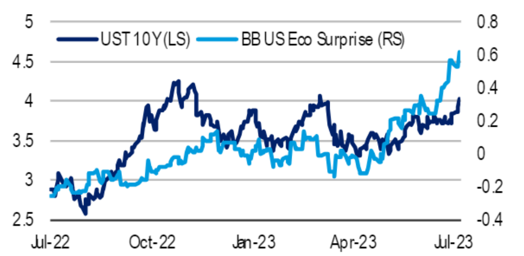
United States

With economic data coming in consistently stronger than economic forecasts, steadily rising interest rates, markets are gradually repricing their estimates of Fed rate cuts. The latest strong jobs report reinforced this trend as the widely followed Citi Economic Surprise Index surged to its highest level in three years. The US Treasury yield curve steepened sharply last week in expectations of higher long term interest rates, with the 2yr/10yr yield spread falling from 109 bps a week ago to 87 bps yesterday. The 5yr/30yr spread moved from -33 bps a week ago to -23 bps yesterday. Last week saw two and 10-year Treasury yields break above recent highs, although they have come down a bit since then. Markets had expected rate over 100 bps in rate cuts, but those expectations have moderated significantly.

Exhibit 4: US 10Y (%) & Bloomberg economic surprise index (ppts)

10Y UST is still lagging recent Bloomberg economic surprise index



Source: Bloomberg

BofA GLOBAL RESEARCH

Exhibit 5: Hike or cuts between the next 6 to 12 months

Market has been paring back cuts in next 6-12m, cuts could recede further

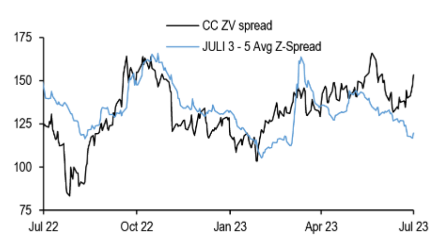
Source: Bloomberg

BofA GLOBAL RESEARCH

The US corporate bond market has outperformed other sectors in recent weeks. JP Morgan estimates that corporate investment grade (IG) spreads narrowed by 8 bps over the past few weeks, even as agency mortgage backed securities (MBS) spreads widened by 16 bps. Higher interest rates and rising interest rate volatility have weighed on the MBS market, but the IG corporate bond market has appeared immune to these pressures. Low supply and strong demand have kept credit spreads tight, and inflows to IG corporate bond flows have were close to the highest level in two years. The US IG market has also outperformed its European IG counterpart. The US high yield (HY) market has also done very well, with spreads tightening by 29 bps over the past two weeks. Lower supply played a role in keeping demand for HY bonds robust.

Figure 3: High grade corporates have outperformed mortgages on the back of supportive technicals and resilient economic data

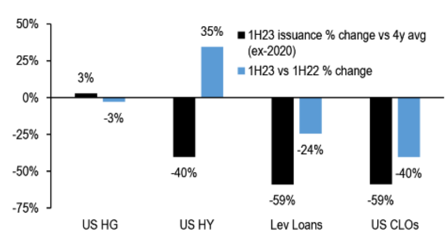
3-5yr JULI ex-EM Z-Spreads versus Current Coupon MBS ZV spread to Treasuries; bp



Source : J.P. Morgan

Figure 4: 1H23 HG supply is similar to last year while HY, LL, and CLO supply has lagged their historical trend

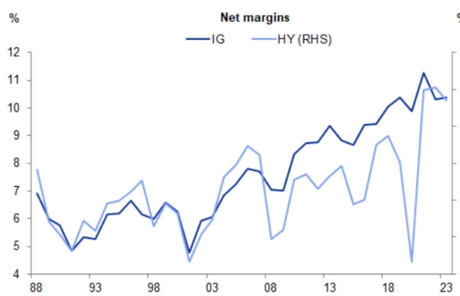
Issuance across HG, HY, LL, and CLO markets in 1H23 versus their levels in 1H22 and their 4y averages (ex-2020); %



Source : J.P. Morgan, Dealogic

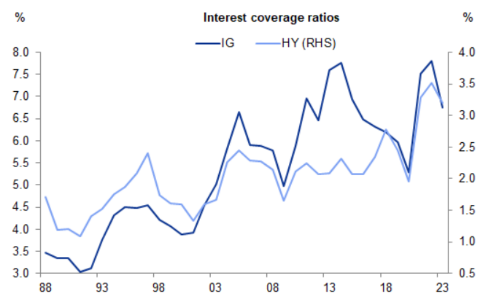
High profit margins and ample liquidity help protect US corporations from potential recession risks, according to research by Goldman. Compared to long term trends, US companies have profit margins close to all-time highs, providing strong support in the face of economic headwinds. Despite a slight recent down tick, interest coverage ratios also are very high, showing that companies are easily able to manage their outstanding debt. As a further boost to liquidity, US companies have large cash balances. This accounts for the fact that credit spreads for both IG and HY issuers remain tight. Although spreads have scope to widen from these relatively expensive levels, especially if interest rates move higher than current market forecasts, the extent of repricing for corporate bonds is expected to be moderate. The very strong equity market performance so far this year also supports this view. Meanwhile, default rates have never exceeded 8% in the past 50 years and the highest IG annual default rate was less than 0.7%.

Exhibit 5 : Net profit margins for the median IG and HY-rated non-financial corporations more than doubled over the past three decades
Net margins for the median HY and IG-rated US non-financial corporations



Source: FactSet, Goldman Sachs Global Investment Research

Exhibit 6 : The same holds true for interest coverage ratios
Interest coverage ratios for the median HY and IG-rated US non-financial corporations

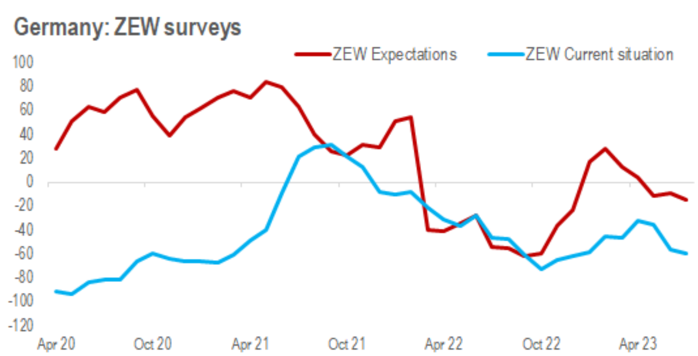


Source: FactSet, Goldman Sachs Global Investment Research

Euro Area

European equities were higher (Stoxx 600 +0.5%) while the euro was little changed against the dollar, trading at around 1.10/$. According to an FT article, hedge funds are rotating their exposure from US equities to European equities with better valuations, a factor that ING analysts note could be partially contributing to euro strength. **Sovereign yields were edging lower, with the 10y bund yield (-2bps) trading at around 2.61%.**

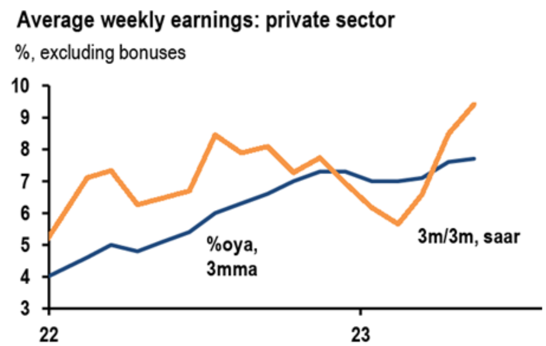
The German ZEW expectations index disappointed, falling to -14.7 in July (versus the consensus forecast of -10.6 from -8.5 the month before). The current assessment component also weakened to -59.5 from -56.5 in June but came in marginally above the expected -62. Elsewhere on the data front Germany's final inflation print for June was in line with earlier estimates (EU harmonized measure 6.8% y/y) while Italy's May industrial production data were better than expected.



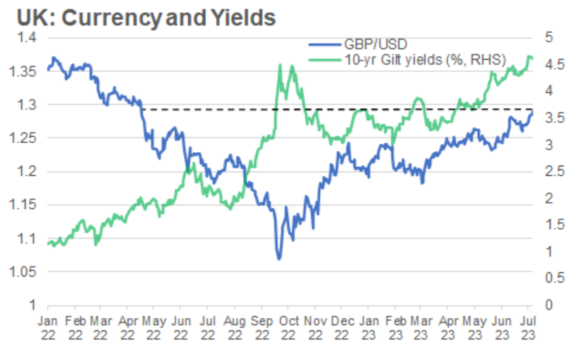
Source: Bloomberg and IMF calculations

United Kingdom

The pound appreciated (+0.4% to 1.29/$) after a labor market report delivered an upside surprise in wage growth but also an unexpected increase in the unemployment rate. Average weekly earnings accelerated in May to 6.9% (versus the expected 6.8%), and non-bonus average weekly earnings increased to 7.3% (versus the expected 7.1%). Employment increased by 102,000 jobs in the three months to May, which JPMorgan analysts note is firm but shows a slowing from recent months. Moreover, the unemployment rate in the three months up to May increased to 4% (versus expectations to remain unchanged at 3.8%). Several analysts continue to expect a 25bps hike in August but argue that the upside surprise in wage data has increases the odds of another 50bps move. Markets are pricing in roughly 45bps of tightening. The magnitude of the possible BoE hike in August is nevertheless expected to be heavily dependent on June's inflation data print, due next week. The pound has appreciated by about 7% against the dollar this year and is now trading at levels last seen in April 2022.



Source: ONS



Source: Bloomberg and IMF calculations

Emerging Markets

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EMEA stocks rallied on news that China announced measures to boost its economy. Currencies traded in a narrow range. **Asian equities rose +1.4%.** South Korean equities rose 1.7% and China added +0.7%. **Asian currencies appreciated,** amid a weaker dollar and risk-on sentiment. **Markets in Latin America were little changed.** Inflation declined further in Colombia, boosting the Colombian peso which is one of the best performing emerging market currency this year.

Brazil

Sugar futures fell as the outlook in Brazil's sugarcane production improves. Weather conditions in Brazil's primary sugar producing region, the center south, has improved in the recent days which has allowed harvesting to resume. Unforeseen rainfall had previously caused delays during the harvesting season, which runs from April to December. Drier weather has led to upward revisions of Brazil's sugar output by 500,000 tons to 38.2mn tons, a significant improvement from the 33.7mn ton yield in 2022. In addition, Brazilian port delivery times are better than anticipated.

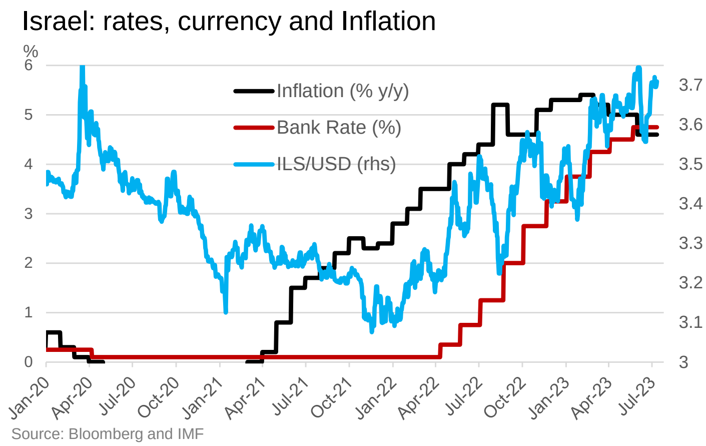
Source: ICE Futures US

China

China extended measures to support the property market to the end of 2024. Banks are now allowed to ease their credit restrictions on certain types of home lending. Nomura noted that the package covers a wide range of areas, including property development loans, trust loans, mortgage loans, loans to construction companies, bond financing, rental housing, and special loans to ensure the completion of pre-sold homes with delivery delays. State media signaled that more support measures are imminent. In other news, a Bloomberg Intelligence stock index of Chinese lenders has tumbled -14% from this year's high in May, erasing $77 bn of market capitalization. In recent days, a slew of bearish analyst reports downgrading some major lenders to sell ratings triggered a rout in bank shares, Bloomberg reported.

Israel

The central bank of Israel (BOI) left interest rates unchanged as expected at 4.75% yesterday, for the first time in over a year, but issued hawkish rhetoric. The statement noted that there was a real possibility of further rate hikes if the inflation does not continue to moderate as expected. The statement highlighted that while inflation is slowing (4.6% y/y in May) in the prices of both tradable goods and non-tradables, it is still high over a wide range of CPI components. The BOI also highlighted that the main risk to their forecast is the materialization of a scenario in which the legislative and institutional changes with regard to the judicial system are accompanied by an increase in the country's risk premium and continued depreciation of the shekel. JP Morgan analysts think that the BOI will keep rates at 4.75% through the end of the year but that higher rates in advanced markets and potential surprises keep risks skewed to the upside. They therefore moved their estimated date for the first rate cut to Q2 2024 from Q1 2024.



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Global Financial Indicators

7/11/23 8:07 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4416	0.2	-1	3	15	15
Europe		4286	0.7	-2	0	23	13
Japan		32204	0.0	-4	-1	22	23
China		3869	0.7	-1	1	-10	0
Asia Ex Japan		66	0.2	0	-2	-1	2
Emerging Markets		39	0.1	0	-1	1	4
Interest Rates					basis points		
US 10y Yield		3.96	-3.0	11	22	97	9
Germany 10y Yield		2.62	-1.9	17	24	138	5
Japan 10y Yield		0.46	-0.3	7	3	21	4
UK 10y Yield		4.63	-0.8	22	39	245	96
Credit Spreads					basis points		
US Investment Grade		150	0.7	4	-13	-24	-8
US High Yield		439	0.4	10	-23	-120	-41
Exchange Rates					%		
USD/Majors		101.87	-0.1	-1	-2	-6	-2
EUR/USD		1.10	-0.1	1	2	9	3
USD/JPY		140.3	-0.7	-3	1	2	7
EM/USD		48.8	0.1	-1	-2	-1	-2
Commodities					%		
Brent Crude Oil ($/barrel)		78.2	0.7	3	5	-13	-6
Industrials Metals (index)		142	0.3	0	-2	-5	-14
Agriculture (index)		68	1.0	1	1	1	-2
Implied Volatility					%		
VIX Index (%, change in pp)		14.9	-0.1	1.4	1.1	-11.2	-6.7
US 10y Swaption Volatility		110.0	0.0	5.7	1.8	-28.9	-15.7
Global FX Volatility		8.2	0.0	0.1	0.1	-3.3	-2.5
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		143	-1.9	9	14	-93	-63
Italy		175	0.2	0	1	-22	-40
Portugal		74	0.0	-1	2	-35	-28
Spain		106	0.3	4	7	-3	-3

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

Emerging Market Financial Indicators

Last updated: 7/11/2023 8:09 AM	Exchange Rates: Level, Last 12m	Exchange Rates: Level, Latest	Change (in %): 1 Day	Change (in %): 7 Days	Change (in %): 30 Days	Change (in %): 12 M	YTD	Local Currency Bond Yields (GBI EM): Level, Last 12m	Level, Latest	Change (in basis points): 1 Day	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.					
China		7.20	0.3	0.2	-1	-7	-4		2.7	0.8	-2	-4	-20	-34
Indonesia		15153	0.3	-1.0	-2	-1	3		6.2	-4.0	1	-12	-108	-72
India		82	0.3	-0.4	0	-4	0		7.4	-6.0	1	1	(7.1)	-2
Philippines		55	0.8	-0.1	1	1	1		5.9	1.3	1	1	28	-8
Thailand		35	0.9	0.4	0	4	0		2.8	0.0	1	4	15	14
Malaysia		4.66	0.2	-0.2	-1	-5	-5		3.9	-2.3	-1	15	-27	-16
Argentina		263	-0.6	-1.8	-6	-51	-33		92.4	35.0	-97	-1834	2197	417
Brazil		4.89	0.3	-0.9	0	10	8		10.8	-0.4	3	-49	-248	-178
Chile		813	-0.6	-1.8	-1	22	5		5.1	1.5	4	12	-166	-26
Colombia		4156	0.2	0.2	1	10	17		7.4	0.0	3	-64	-221	-235
Mexico		17.07	-0.1	-0.1	1	22	14		8.3	0.0	20	-5	-61	-45
Peru		3.6	0.1	0.0	0	9	5		6.8	-0.1		-45	-126	-116
Uruguay		38	0.4	-1.6	2	7	5		9.5	0.0	-5	-35	-150	-114
Hungary		345	0.1	-0.2	-1	17	8		7.0	-1.0	33	-39	-133	-256
Poland		4.05	-0.4	0.5	2	18	8		5.0	-3.3	8	-14	-97	-112
Romania		4.5	-0.1	1.1	2	9	3		6.7	0.5	0	-2	-228	-104
Russia		90.2	0.8	-0.5	-7	-31	-18							
South Africa		18.6	0.8	0.0	0	-8	-9		9.8	-4.8	13	-8	54	60
Turkey		26.11	-0.1	-0.4	-9	-33	-28		16.9	28.0	28	138	-210	704
US (DXY; 5y UST)		102	-0.1	-1.1	-2	-6	-2		4.21	-2.3	3	30	116	21

	Equity Markets: Level, Last 12m	Level, Latest	Change (in %): 1 Day	7 Days	30 Days	12 M	YTD	Bond Spreads on USD Debt (EMBIG): Level, Last 12m	Level, Latest	Change (in basis points): 7 Days	30 Days	12 M	YTD
								basis points					
China		3869	0.7	-1	1	-10	0		181	0	-7	-25	4
Indonesia		6797	1.0	2	1	1	-1		137	7	-10	-73	-3
India		65618	0.4	0	5	22	8		131	4	-5	-79	-11
Philippines		6399	0.3	-2	-2	1	-3		111	8	-7	-41	14
Thailand		1497	0.0	-1	-4	-3	-10		0	0	0	0	0
Malaysia		1391	0.6	0	0	-2	-7		91	0	-4	-44	-9
Argentina		420773	-0.7	-4	10	303	108		2043	27	-353	-611	-162
Brazil		117942	-0.8	-1	1	20	7		248	0	-7	-108	-26
Chile		5952	0.2	1	5	18	13		123	-2	-9	-46	-9
Colombia		1131	-0.2	0	-4	-16	-12		373	5	5	-50	1
Mexico		53655	-0.5	-1	-2	13	11		368	-1	-28	-70	-13
Peru		22768	1.1	1	3	23	7		155	-1	-19	-39	-25
Hungary		50428	0.6	0	2	29	15		210	5	-20	-14	-12
Poland		67775	0.4	0	2	25	18		137	9	-1	69	64
Romania		12839	1.8	2	5	5	10		227	5	-20	-97	-29
South Africa		74915	0.8	-2	-3	11	3		413	15	6	-100	46
Turkey		6343	1.2	6	13	161	15		484	5	-7	-247	44
Ukraine		507	0.0	0	0	-2	-2		4292	153	-769	-1375	213
EM total		39	0.6	0	-1	1	4		392	8	-6	-65	16

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

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