GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

FRIDAY, JULY 14, 2023

- **Repricing of the commercial real estate market's vulnerable office segment will take time** (link)
- **Impact of higher rates on corporate balance sheets has only just started to materialize** (link)
- **ECB minutes confirm hawkish tone** (link)
- **Swedish inflation surprises on the upside** (link)
- **Reserve Bank of Australia to get Bullock as the first female governor** (link)
- **China signals more policy support and new structural policy tools** (link)

Mature Markets | Emerging Markets | Market Tables

Strong US bank earnings try to keep the rally going

While overall market moves are more subdued this morning compared to earlier in the week, equity markets are set to move higher for a fifth straight day. European equities are up only slightly this morning after having risen over 3% already on the week while futures on the S&P 500 are higher, helped in part to better than expected earnings from a few large US banks. This morning, JP Morgan, Wells Fargo and Citi all reported 2Q results better than what analysts had forecast helping pushing shares in those banks about 3% higher in pre-market trading. Bond yields meanwhile are somewhat higher following the sharp decrease earlier in the week after the lower than expected US CPI release. With the yield on the 2-year UST up 3 bp so far this morning, that still leaves the weekly decline at 29 bp. The dollar index meanwhile is slightly stronger on the day, following seven straight days of declines, leading to a more mixed picture for emerging market currencies. The Malaysian ringgit is leading gains among EM currencies thanks to portfolio inflows while the South African rand is the primary laggard

Key Global Financial Indicators

Last updated: 7/14/23 8:28 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		4510	0.8	2	3	19	17	7
Eurostoxx 50		4407	0.3	4	1	30	16	11
Nikkei 225		32391	-0.1	0	-4	21	24	22
MSCI EM		41	1.3	6	1	7	9	-13
Yields and Spreads				bps				
US 10y Yield		3.77	0.2	-30	-2	81	-11	177
Germany 10y Yield		2.48	-1.0	-16	2	130	-10	225
EMBIG Sovereign Spread		425	-3	-4	-20	-159	-27	12
FX / Commodities / Volatility				%				
EM FX vs. USD, (+) = appreciation		49.4	-0.2	2	-1	1	-1	-7
Dollar index, (+) = $ appreciation		99.9	0.2	-2	-3	-8	-3	4
Brent Crude Oil ($/barrel)		81.2	-0.1	4	11	-18	-5	-16
VIX Index (%, change in pp)		13.7	0.1	-1	0	-13	-8	-17

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

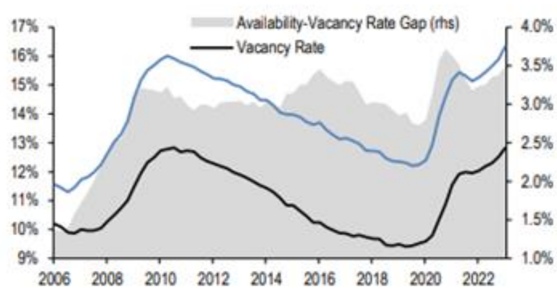
Mature Markets [back to top]

United States

The broad-based rally that started with Wednesday's lower-than-expected CPI print continued during Thursday's US trading session. Equities advanced further, led by the technology sector, with the NASDAQ Composite index increasing by 1.6%. US Treasury yields continued their decline, with the 2-year yield falling by another 13 bp to 4.61%, and now down 35 bp since the start of the week. Over the course of this week, the OIS implied terminal rate, priced for the November meeting, only declined by around 6 bp. In other words, this week's price action reflects mostly that a "higher-for-longer" scenario is now seen as less likely. The US dollar continued to weaken, with the US dollar index having declined by 3.3% this week-to-date, of which 0.7 ppt occurred on Thursday. Yesterday, it was also announced that Federal Reserve Bank of St. Louis President James Bullard has resigned. More recently, analysts considered him to be more on the hawkish side of the spectrum.

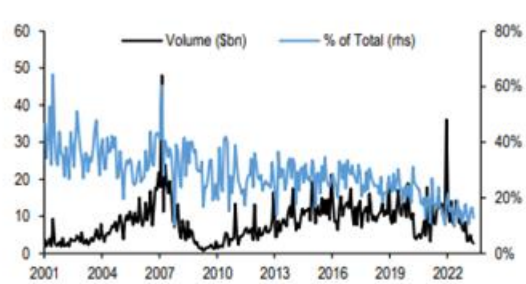
The office segment in commercial real estate (CRE) markets is vulnerable, but price adjustments likely take more time as transaction volumes are very low. JP Morgan (JPM) analyzed developments in the office segment and notes that rent growth continues to slow and turned negative in real terms. Vacancy and availability rates (12.8% and 16.3% in Q1 2023) are above their GFC peak, but there is heterogeneity between cities. For example, the availability rate for San Francisco tops the list at 22.8%, and this can in part be explained by low return-to-office rates as evidenced by subdued commuter rail activity. Weakness in the office segment is also reflected by higher delinquency and special servicing rates in the commercial mortgage-backed security (CMBS) market, and these are expected to increase further as borrowers, often temporarily shielded from higher rates through caps, will increasingly be exposed to the higher interest rate environment. Nonetheless, this does not necessarily imply that we will soon see a wave of liquidations, as the loan resolution process takes time.

Figure 3: Vacancy and availability rates are at or past GFC highs
National office vacancy and total availability rate (%), quarterly as of Q1 2023



Source: Costar, J.P. Morgan

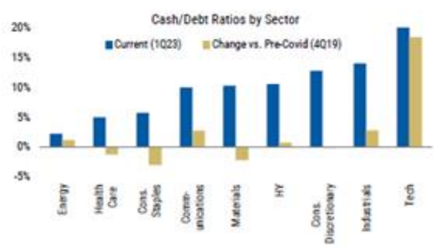
Figure 16: Office transaction volumes continued to dwindle
Office transaction volumes ($bn) and percentage of total, monthly as of April 2023



Source: MSCI Real Capital Analytics, J.P. Morgan

The impact of higher rates on leveraged and rate-sensitive corporate balance sheets has only just started to materialize. According to analysis by Morgan Stanley (MS), over the past 12 months the issuance of high yield (HY) corporate bonds for refinancing needs accounts for only 5% of the par amount outstanding. Another 12% will have to be refinanced before the end of 2024. In other words, the full impact of higher rates will be felt on corporate balance sheets more clearly with a significant lag. For this reason, MS remains defensive on HY credit, despite relatively tight spreads. This week, the CDX HY CDS index spread (5-year maturity) tightened by around 33 bp to 420 bp, which is well below its September 2022 peak of 627 bp. MS sees earnings growth falling, interest expenses rising, and interest coverage ratios and cash/debt ratios slowly weakening. MS believes that downside risk is not adequately priced in to current HY credit spreads.

Exhibit 28: Cash buffers fell below 2019 levels for staples, materials and health care



Source: Bloomberg, S&P Capital IQ, Morgan Stanley Research

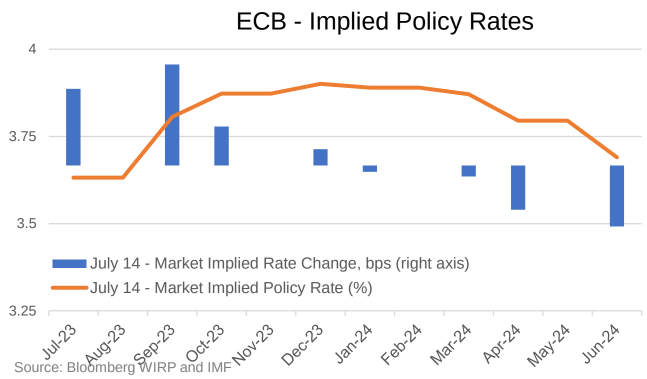
Exhibit 2: The gap between LTM interest expense (4.9%Q) and earnings growth (0.4%Q) reached a record high

Source: Bloomberg, S&P Capital IQ, Morgan Stanley Research

Euro Area

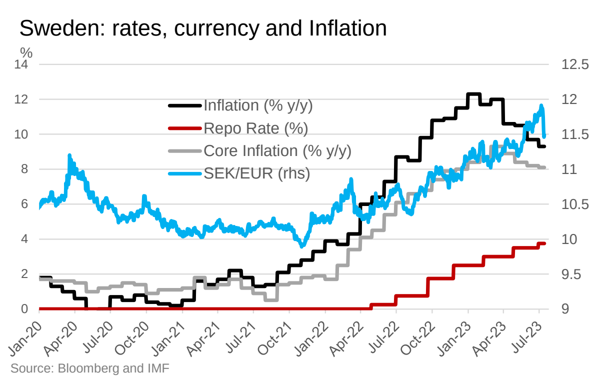
European markets are taking a pause after the wild swings of the past two weeks. The equity market (Stoxx Europe 600) is broadly unchanged from yesterday's close, and the euro is flat against the dollar. Core euro area yields are stabilizing at 2.48% and Italian spreads remain at 166 bp.

The ECB minutes yesterday confirmed ECB president Lagarde's hawkish tone at the press conference following the June decision to hike rates 25 bp and did not change market pricing. Remember that ECB president Lagarde in the press conference made clear that another 25 bp hike was on the table in July. Interestingly, the minutes note that a preference was initially expressed for a 50 bp hike in June. Other noteworthy points are that the ECB is becoming increasingly focused on how long interest rates should be kept at their peak; that it is uneasy with expectations for a cut to materialize too soon; and that the ECB is clearly aware of the risk of overtightening as bank lending has slowed. Bloomberg analysts also point out that the minutes suggest the Governing Council's focus may be gradually shifting from broad-based measures of underlying inflation to services and wage pressures. JP Morgan analysts conclude that a hike in September is likely even though it was not mentioned explicitly in the minutes. This is because ECB staff projections show inflation above target in 2025 with a hike in July fully factored in through the technical assumptions.



Sweden

The Swedish krona was losing 0.3% to the euro this morning after June inflation surprised on the upside. This comes after the Swedish krona rallied 3.6% vs the euro earlier this week. Bond yields were up 5-7 bp across the curve (10y at 2.5%). June inflation came in at 9.3% y/y. down from 9.7% in May, but significantly above expectations of 9%. Momentum was also very strong with m/m inflation inching back to 1.1%, after falling to 0.3% in May. Core inflation (CPIF) fell to 6.4% y/y in June down from 6.7% in May but was also much above the 6% expectation. At its latest meeting on June 29, the Riksbank hiked rates 25 bp to 3.75% and pledged to raise



rates at least one more time this year. The press release added that it was still uncertain how much monetary policy tightening would be required for inflation to fall back and stabilize close to the target of 2% but said that the Riksbank would do what was needed. The Riksbank's inflation projection for 2023 is 7.4% y/y in 2023 and 2.8% in 2024.

Japan

The Bank of Japan (BoJ) may raise its inflation forecast later this month, local media reported. The outlook for this fiscal year ending March will likely be revised to more than 2% from the current 1.8%. Meanwhile, BOJ's former executive director Hayakawa said the BoJ could also tweak its yield curve control program as soon as this month, according to Bloomberg. Separately, **Japan's Government Pension Investment Fund bolstered US Treasuries holdings** to 43.3% of its foreign debt holdings in the 12 months through March from 40.8% previously, the highest since March 2020, according to Bloomberg calculations. Yields on 10Y rose 1.1bp, while the yen depreciated slightly by 0.1%. Japanese stocks receded 0.2%. Japan's retail investors purchased the most stocks since March and turned net buyers in first week of July, Bloomberg reported.

Australia

Australia's Treasurer announced that Michele Bullock will be the new Reserve Bank of Australia (RBA)'s Governor, replacing incumbent Philip Lowe once his term expires in September. She will be the first female RBA Governor. Bullock has been described as more dovish than Lowe, Bloomberg reported, however, markets expect a degree of continuity to monetary policy. JP morgan analysts stated that Bullock was seen as a continuity candidate and has demonstrated consistency of her remarks with Lowe's so far. They expect one more rate hike in August. Australian stocks were up +0.8%. 10Y yields dropped -5.4bp, Australian dollar weakened -0.2%.

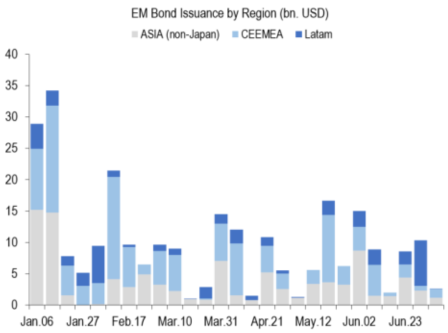
Emerging Markets back to top

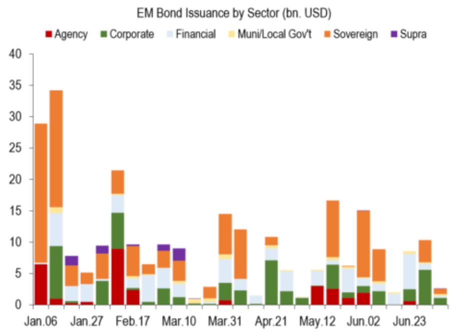
Asian equities rose 0.9%. Thailand equities gained 1.4%, followed by Malaysia (+1%) and Indonesia (+0.9%). **Thailand's** Move Forward Party's leader Pita Limjaroenrat failed to secure a majority vote to be Prime Minister, extending uncertainty over the country's political leadership. A revote on a new Prime Minister will be held on July 19. However, consumer confidence index rose to 56.7 in June, the highest since February 2020, amid a tourism revival. **Asian currencies broadly appreciated.** The Malaysian ringgit outperformed (+1.2%), amid stock and bond inflows. Singapore's Q2 GDP was stronger than expected at +0.7% y/y (previous: +0.4%, consensus: +0.5%). Indonesia will mandate exporters to repatriate part of their foreign currency-denominated earnings starting from 1 Aug. This regulation had been foreshadowed earlier in the year and was previously targeted for implementation in July, Citi noted. The retention period is 3 months and is applied to 30% of resource exports with a value over US$250K**.** 10-year bond yields were little changed. **EMEA equity markets were up**, led by Poland (+1%), closing a strong week in the region. Currencies were generally weakening against their reference currencies, with the South African rand and Turkish lira losing 0.8% and 0.6% to the dollar. Central and eastern European currencies were weakening slightly against the euro. After dropping sharply over the last two sessions in line with global trends, local bond yields were broadly unchanged in central and eastern Europe. **Latin American equity markets rose Thursday and currencies appreciated against the USD, while sovereign yields fell.** Brazilian stocks rallied +1.4% as new tax reform policies had more exemptions than initially expected. Peru decided to hold interest rates steady at 7.75% late on Thursday evening; market reaction is expected Friday morning

EM Bond Issuance

Emerging market bond issuance increased to $2.6bn during the week of July 13th. 42% of the issuance was from corporates. By region, CEEMEA issued 51% of the total while Asia (ex-Japan) and

LatAm issued 45% and 4%, respectively. Total issuance YTD is $267bn.

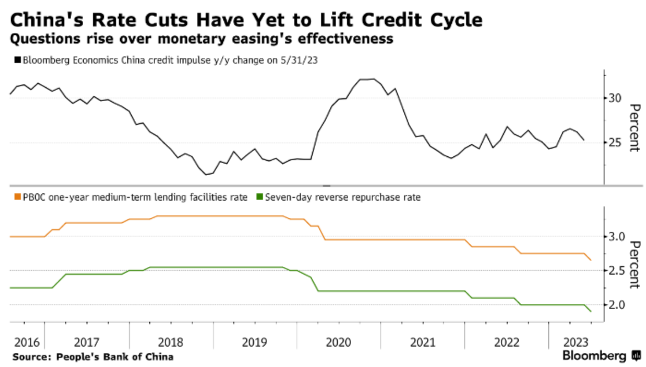




Sources: Bond Radar and IMF staff calculations

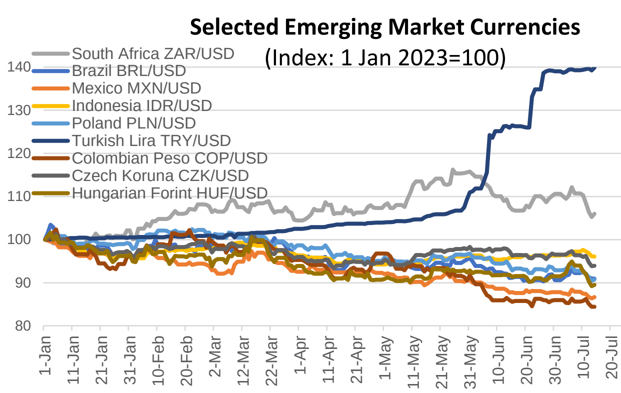
China

The People's Bank of China (PBOC) signaled more policy support and new structural policy tools. During the press briefing on the bank's semiannual results, Deputy Governor Liu said there is ample policy room to deal with unexpected challenges and changes. He further added that consumer prices will likely decline in July, before recovering, pointing to demand and base effects as factors for the drop. He brushed off deflationary risks, pointing to China's economic recovery and money supply growth. Meanwhile, Head of Monetary Policy department Zou said the PBOC is open to using its monetary policy toolbox, including RRR and medium-term lending facility to lower loan costs. He downplayed risks for banks and stated that PBOC will set up new structural policy tools when needed to provide targeted financial support; he also signaled more property market measures "tailored" to cities. Chinese stocks and 10Y bond yields were little changed. Renminbi appreciated +0.2%.



EMEA Currencies

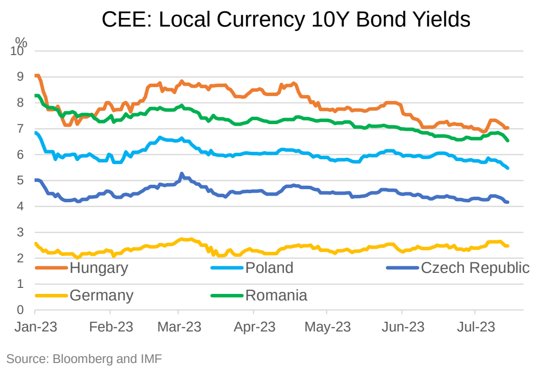
EMEA currencies are both among the top performing and worse performing emerging market currencies so far in 2023. While the Colombian and the Mexican peso are the best performing emerging market currencies vs. the dollar year-to-date (+18.5% and +15.6% respectively), the Hungarian forint and Polish zloty come third and fourth, appreciating 12.1% and 10.5% respectively. At the other end of the spectrum, the Turkish lira has lost 28% vs the dollar, most of it since end-May and the change in the country's economic team. Note that the Argentine peso (not on the chart below) has underperformed further, losing 33% vs. the dollar in 2023.



Source: Bloomberg and IMF

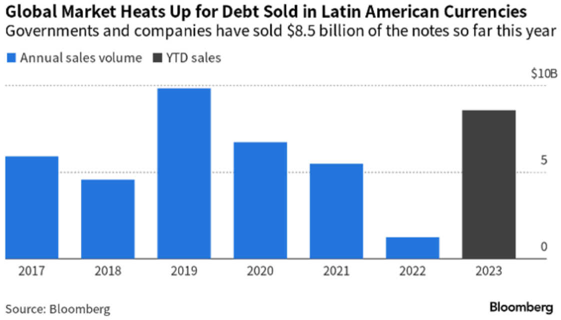
Central and Eastern European local bond yields

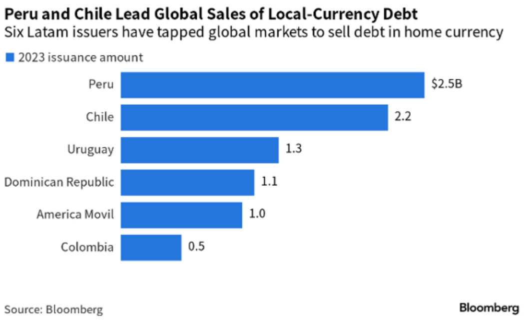
Yields on central and eastern European local bonds have come down significantly since the start of the year. While 10y German bund yields have dropped 9 bp to 2.47% since January 1st, Hungarian yields have dropped 201 bp to 7.03%, Romanian yields dropped 174 bp to 6.54%, Polish yields dropped 136 bps to 5.47% and Czech yields dropped 85 bps to 4.16%



Latin America

Sales of global bonds denominated in local currencies have soared so far this year for Latin American issuers. As LatAm currencies continue to outperform, demand from international investors for locally denominated bonds has increased. Sales of these global notes have increased to $8.5bn in 2023, a significant jump from $1bn the prior year. The dual impact of strong performing currencies and high interest rates in the region continue to attract investors. Additionally, some sovereign bonds issued in Peru and Chile have been earmarked for green and social projects, attracting ESG investors.





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Global Financial Indicators

7/14/23 8:29 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4515	0.8	3	3	19	18
Europe		4407	0.3	4	1	30	16
Japan		32391	-0.1	0	-4	21	24
China		3899	0.0	2	-2	-8	1
Asia Ex Japan		69	1.4	6	1	4	7
Emerging Markets		41	1.3	6	1	7	9
Interest Rates					basis points		
US 10y Yield		3.77	0.2	-30	-2	81	-11
Germany 10y Yield		2.48	-1.0	-16	2	130	-10
Japan 10y Yield		0.48	0.6	5	5	24	6
UK 10y Yield		4.38	-4.2	-27	-1	228	71
Credit Spreads					basis points		
US Investment Grade		147	-0.6	-1	-12	-28	-11
US High Yield		420	-4.8	-13	-30	-147	-60
Exchange Rates					%		
USD/Majors		99.94	0.2	-2	-3	-8	-3
EUR/USD		1.12	0.0	2	4	12	5
USD/JPY		138.7	0.4	-2	-1	0	6
EM/USD		49.4	-0.2	2	-1	1	-1
Commodities					%		
Brent Crude Oil ($/barrel)		81.2	-0.1	4	11	-3	-2
Industrials Metals (index)		147	-0.2	4	0	6	-11
Agriculture (index)		68	1.1	3	2	8	-1
Implied Volatility					%		
VIX Index (%, change in pp)		13.7	0.1	-1.2	-0.2	-12.7	-8.0
US 10y Swaption Volatility		106.1	-3.9	-12.1	4.3	-23.9	-19.6
Global FX Volatility		8.0	0.0	-0.2	0.1	-4.2	-2.7
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		147	4.4	13	15	-86	-59
Italy		166	0.6	-6	2	-41	-48
Portugal		71	-0.2	-3	2	-49	-31
Spain		102	0.9	-3	6	-14	-7

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

Emerging Market Financial Indicators

Last updated: 7/14/2023 8:30 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		7.14	0.2	1.2	0	-5	-3		2.7	0.5	1	2	-15	-34
Indonesia		14959	0.0	1.2	0	0	4		6.2	-0.1	-6	-8	-118	-76
India		82	-0.1	0.7	0	-3	1		7.4	-3.0	-19	-9	(8.1)	-9
Philippines		54	0.2	2.2	3	3	2		5.9	1.3	1	1	28	-8
Thailand		35	-0.3	1.4	0	6	0		2.7	2.0	0	1	17	12
Malaysia		4.53	1.2	3.1	2	-2	-3		3.8	-5.1	-13	5	-28	-26
Argentina		264	-0.1	-1.5	-7	-52	-33		91.7	41.0	-28	-1976	2464	354
Brazil		4.79	0.2	1.6	0	13	10		10.7	-13.3	-7	-67	-253	-189
Chile		811	0.1	-0.9	-1	24	5		5.0	-0.5	-7	8	-188	-30
Colombia		4101	0.9	3.1	2	10	18		7.6	0.0	5	-42	-257	-219
Mexico		16.89	-0.3	1.5	1	23	15		8.1	0.3	-22	-24	-83	-65
Peru		3.6	0.3	2.1	2	11	7		6.8	0.0	-3	-38	-158	-121
Uruguay		38	-0.2	-0.6	1	8	5		9.5	0.0	-5	-38	-158	-117
Hungary		334	-0.2	5.2	3	21	12		6.7	-7.0	-47	-68	-209	-289
Poland		3.96	-0.1	2.5	4	21	10		4.7	-11.0	-39	-58	-161	-146
Romania		4.4	-0.2	2.4	4	12	5		6.5	-11.8	-15	-19	-263	-123
Russia		90.2	0.0	1.4	-7	-34	-18							
South Africa		18.0	-0.5	4.8	2	-5	-5		9.5	1.0	-33	-33	12	29
Turkey		26.19	-0.5	-0.5	-10	-33	-29		17.0	0.0	15	-72	-189	719
US (DXY; 5y UST)		100	0.2	-2.3	-3	-8	-3		3.96	1.2	-40	-3	89	-4

	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		3899	0.0	2	-2	-8	1		187	9	2	-24	10
Indonesia		6870	0.9	2	3	3	0		141	18	2	-93	1
India		66061	0.8	1	4	23	9		136	9	2	-79	-6
Philippines		6625	0.7	4	2	7	1		116	19	7	-65	19
Thailand		1518	1.6	2	-3	-1	-9		0	0	0	0	0
Malaysia		1412	1.1	2	2	0	-6		92	3	-2	-52	-8
Argentina		451139	4.5	8	19	349	123		2049	-19	-264	-688	-156
Brazil		119264	1.4	2	0	24	9		246	3	0	-139	-28
Chile		6062	-0.3	2	6	18	15		126	5	0	-67	-6
Colombia		1173	0.9	4	0	-8	-9		345	-24	-9	-116	-27
Mexico		54244	0.5	2	-2	16	12		361	-6	-25	-110	-20
Peru		22893	1.1	3	2	29	7		155	2	-10	-63	-25
Hungary		51650	0.2	4	3	32	18		203	-2	-17	-34	-19
Poland		70494	1.1	5	5	37	23		128	-1	-4	115	55
Romania		13074	0.8	3	9	10	12		222	0	-14	-129	-34
South Africa		77625	0.4	4	-1	20	6		394	-17	2	-174	27
Turkey		6420	0.8	4	20	169	17		455	-35	-14	-342	15
Ukraine		507	0.0	0	0	-2	-2		3742	-501	-1282	-3628	-337
EM total		41	-0.1	6	1	7	9		379	-8	-7	-115	4

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

back to top