GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

FRIDAY, JULY 15, 2022

- **Traders hold on to long US dollar position after rally** (link)
- **US bank earnings disappoint as volatility weighs on deal activities** (link)
- **Fed easing in 2023 could imply larger terminal Fed balance sheet** (link)
- **Italian spreads widen ahead of ECB meeting** (link)
- **Commodity prices sharply lower on recession fears** (link)
- **China's economy weaker than expected in 2022 Q2** (link)
- **Chinese homebuyers' boycott of mortgage payments keeps growing** (link)
- **Moody's declares Belarus in default** (link)
- **Chile announces $25bn FX intervention program** (link)
- **Argentina continues to see intense inflation pressures** (link)

Mature Markets | Emerging Markets | Market Tables

Another eventful week as attention turns to ECB

Core yields and the US dollar edged lower as investors assess the implications of lower-than-expected growth in China, political developments in Italy ahead of next week's ECB meeting and changes in the outlook for Fed interest rate and balance sheet policies. Positioning data show that traders have held on to long US dollar positions even after this year's substantial rally. US quarterly bank earnings disappointed but retail sales suggest resilience in consumer spending in June as investors await the release of U of Mich inflation expectations data. After the Chilean peso fell to a record low, the central bank announced a $25 bn FX intervention program.

Key Global Financial Indicators

Last updated: 7/15/22 12:52 PM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		3790	-0.3	-3	0	-13	-20
Eurostoxx 50		3437	1.2	-2	-3	-15	-20
Nikkei 225		26788	0.5	1	3	-4	-7
MSCI EM		38	-0.9	-4	-6	-29	-21
Yields and Spreads				bps			
US 10y Yield		2.94	-2.2	-14	-35	164	143
Germany 10y Yield		1.15	-2.5	-19	-49	149	133
EMBIG Sovereign Spread		594	10	54	113	246	227
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		49.2	0.1	-1	-5	-13	-6
Dollar index, (+) = $ appreciation		108.3	-0.2	1	3	17	13
Brent Crude Oil ($/barrel)		101.1	2.0	-6	-15	38	30
VIX Index (%, change in pp)		26.0	-0.4	1	-4	9	9

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

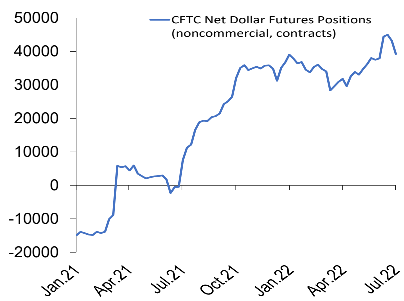
Mature Markets back to top

United States

Economic data pointed towards resilience in consumer spending, with retail sales beating expectations at 1% m/m (vs 0.9% expected). Excluding autos and gas, the beat was even larger at 0.7% (vs 0.1% expected).

Equities closed 0.3% lower yesterday after selling off as much as 2% in early trading. Futures markets retraced some of the hawkish move seen on Wednesday, with futures pricing in just over 80 bps of hikes for the July FOMC meeting (compared to over 90 after this week's CPI print), and a peak federal funds rate back under 3.6%.

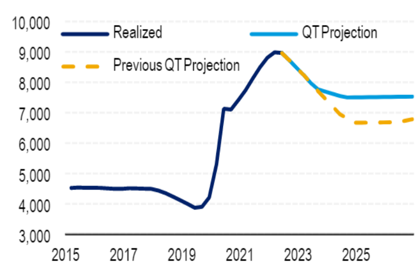
The US dollar index rallied 0.6% on Thursday for a total 2022 gain of 13%, driven primarily by hawkish Fed policy relative to other central banks, and safe haven flows from the sell off in global equities. BofA estimated the contribution of several factors on dollar appreciation through a regression of weekly changes, including 5y real yields, global equities, energy prices, and Chinese reflation sentiment. The analysis argues for further dollar strength in 2022, with persistent equity weakness, a tight energy supply/demand balance, and ongoing hawkishness providing support. **Positioning in futures markets also shows traders have held on to their dollar long positions after a substantial run up earlier in the year, according to CFTC data.**



Slowing growth and Fed easing in 2023 could lead to a larger terminal balance sheet. With markets now pricing in about 80 bps of rate cuts in 2023, Bank of America (BofA) analysts expect the Fed to terminate the quantitative tightening program in September 2023, which would leave the balance sheet at least $1 tn larger than previously expected. In 2019, the Fed halted the QT process and shifted some MBS reinvestments into the US Treasury market, which could be an option this cycle as well, and have implications for bond market liquidity. **An earlier end to QT would also have implications for the amount of government borrowing the private sector would need to absorb.** BofA estimates that a Sep. 23 end date would reduce the private sector burden by about $780 bn through end 2024, with an additional $350 bn in demand for US Treasuries from MBS paydowns.

Exhibit 5: Updated Fed balance sheet projections ($bn)

A rate cut in '23 would likely mean a higher terminal Fed balance sheet



Source: BofA Global Research, Bloomberg

US Bank Earnings

JPMorgan's Q2 earnings missed estimate on lower investment bank revenues and temporarily suspended buyback. CET1 ratio rose 30bps to 12.2% through a reduction in RWA, and the pause in buyback is needed to meet the higher capital requirement of 12.5% by 2023Q1, due to higher systemic risk buffer and a harsher stress test result. SLR reached 5.3% vs the minimum of 5.25% which includes 25bps management buffer. Net income dropped 27% y/y to $8.6bn, with EPS at $2.76 vs $2.88 expected. Investment banking revenue dropped 54% y/y as market volatility stymied dealmaking, which more than offset the strong trading revenues (+15% y/y to $7.8bn). Lending continued to expand by 6.1% y/y with NIM rising more than expected to 1.8%. The bank added $428mn in loan loss reserves, reflecting a *modest deterioration in economic outlook.*

Morgan Stanley's Q2 earnings disappointed from lower deal activities and legal costs. Net income declined 28% y/y to $2.4bn, with EPS at $1.44, below the estimated $1.57. Investment banking revenues dropped 55% y/y to $1bn on lower M&A and underwriting activities, as well as a $280mn mark-to-market loss on corporate loans held-for-sale, though trading revenue was strong (FICC +49% y/y; equity +5% y/y). Wealth management revenue (+24% y/y) was supported by positive fee-based asset flows of $29bn but investment management revenue suffered (-17% y/y) as equity market declines led to lower AUM. Net interest income (+22% y/y) benefited from growth in lending volume and higher rates. CET1 ratio rose 70 bps over the quarter to 15.2%, 190 bps above its new CET1 requirement (starting October). The SLR ratio dropped 10 bps to 5.4%.

Japan

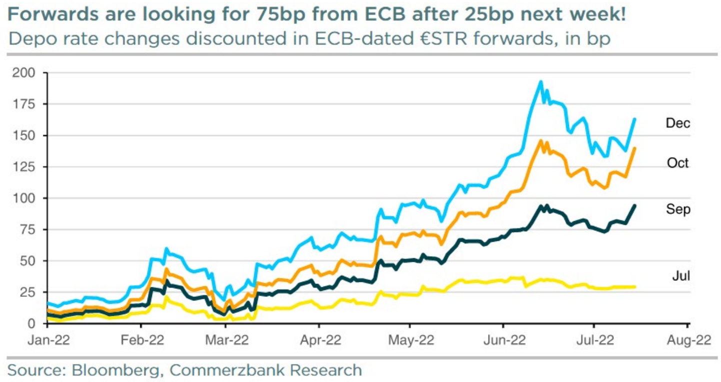
Japanese equities gained (NIKKEI: +0.5%), supported by firms' upward revision of their future profits. Tertiary industry activity increased 0.8% m/m in May, stronger than expected (consensus: +0.5%). PM Kishida wanted nine nuclear reactors to be brought online this winter to alleviate the expected power crunch. **Long-end JGB yields declined** (10-year: -0.1 bp; 30-year: -3.8 bps). Japanese yen appreciated (+0.1%) An increasing number of analysts now expect no changes in the Bank of Japan's policy framework during Governor Kuroda's term. On inflation, Japanese restaurants reportedly are raising prices for the first time in years, helping boost their revenues. The price increases do not appear to reduce the number of customers, potentially suggesting that a gradual re-shaping of the public's perception about inflation.

Euro Area

European equities were trading higher (Stoxx 600 Europe index +0.7%) and sovereign yields eased (10y bund -3bps to 1.15%) as risk sentiment showed a tentative improvement despite weaker than expected growth data from China. On the data front Italy's final inflation data for June confirmed earlier estimates (EU harmonized measure 8.5%yoy). **The euro was trading stronger against the dollar (+0.4% at 1.005) despite political uncertainty in Italy.** BofA analysts attribute the recent move to below parity to dollar strength and highlight that the euro has been relatively steady against other major currencies.

European gas prices eased slightly this morning (1-m ahead Dutch natural gas -3% to €170) on reports that gas flows from Norway have normalized. Contacts have expressed concern over winter gas storage following a Bloomberg report that Germany's Uniper has started to use gas from storage sites. The drawdowns reportedly started on Monday.

Analysts expect a 25bps hike at the ECB meeting next week as their baseline but see the possibility of a larger hike. Several analysts have noted the possibility of a 50bps hike given the recent inflation prints and more hawkish moves by other central banks. **Markets are pricing in roughly 30bps of tightening by the meeting next week, 85 bps of tightening by September and roughly 150 bps of tightening by the end of the year (compared to 160bps yesterday).**

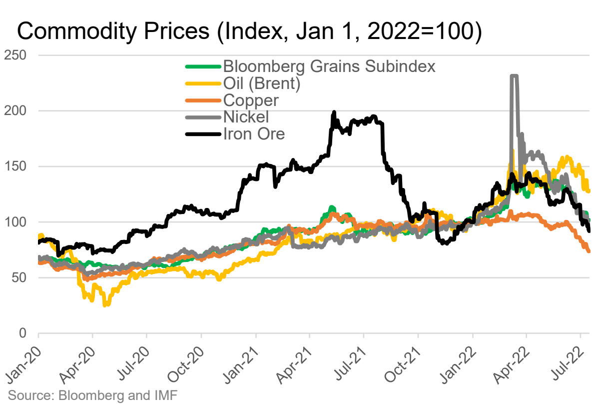


Markets also remain focused on announcements of the new anti-fragmentation tool expected at the ECB meeting next week with the majority of economists expecting a tool that is unlimited in size, according to a Bloomberg survey of economists. The survey also showed the majority of participants expect a tool with light conditions, all purchases are expected to be sterilized. Moreover, over 60% of participants think the ECB will use the tool once it is ready. Economists generally expect larger hikes after the July meeting. Against a backdrop of legal obstacles and political opposition Commerzbank analysts expect limited substance in the announcement next week, as it is seen as likely that governing council members will not agree on all specifications by then. **Similarly, analysts sees a partial announcement on the new tool as likely, with further details potentially announced at a later date, but caution that political developments in Italy could see the market testing the tool.**

10Y Italian yields were little changed with Italian 10y spread 3 bps higher at 210bps as political uncertainty remains. PM Draghi tendered his resignation to the President Mattarella yesterday, who rejected it, asking Draghi to address Parliament on July 20. Analysts note that this would likely be followed by a confidence vote. HSBC analysts sees a higher likelihood of early elections, but still expect this to be avoided as PM Draghi might be persuaded to stay if a clear majority of parliament supports the current government. Moreover, in a scenario of Draghi resigning analysts see a higher probability for a caretaker government and elections early next year than the parliament being dissolved and elections taking place in September. **Italian equities (+1.3%) outperformed this morning.**

Commodity Prices

With recession fears increasing, commodity prices continued their sharp drop. Since peaking around June 10 (earlier for nickel), Brent oil prices are down 18% (to 99.8/bbl), copper prices have lost 25% (to 7,170 $/ton), nickel prices 29%, Iron ore 28% and grain prices have lost 21%.



Emerging Markets

back to top

Asian equities were mixed, falling 0.8% on net. Share prices declined in Hong Kong SAR (-2.2%), China (CSI 300: -1.7%), and Thailand (-1.0%), while Taiwan equities gained (+0.8%). Asian currencies depreciated, led by Korean won (-1.1%), Philippine peso (-0.5%), and Thai baht (-0.5%). Long-end government bond yields were mixed, with 10-year yields rising in India (+3.3 bps) while falling in Singapore (-1.0 bp). **Equities were up in Central and Eastern Europe (CEE) and Russia and currencies were gaining vs. the euro.** South African stocks and the rand were slightly down (-0.5% and -0.2% to 17.2/$ respectively). Markets are closed in Turkey today. **In Latin America, local markets suffered another day of selloff yesterday.** Equity markets saw heavy losses led by Colombia (-3.5%) and Peru (-2.9%), and Brazil and Mexico down by over 1.5%. Local currencies weakened modestly, except a 3.8% depreciation in Chilean peso to record low, after the 75bps rate hike fell short of market expectations.

China

China's economy was weaker than expected in 2022Q2. Real GDP contracted 2.6% q/q (consensus: -2.0%), implying a 0.4% y/y growth. Shanghai's economy shrank 13.7% y/y due to the lockdown. **June activity data came out broadly in line with expectations,** with the exception of much stronger-than-expected retail sales. Industrial production increased 3.9% y/y (consensus: 4.0%); retail sales grew 3.1% (consensus: 0.3%); fixed assets investment expanded 6.1% y/y (consensus: 6.0%); the unemployment rate dropped to 5.5% (consensus: 5.7%). However, the youth unemployment rate surged to 19.3%, a new high record. **The People's Bank of China made no changes to its medium-term lending facility (MLF) operations.** The MLF rate was kept unchanged at 2.85%, and maturing MLF funds were fully rolled over, with no additional liquidity injection. The key interbank repo rate (DR007) edged up to 1.56 (+2.3 bps), still well below the policy rate (2.1%). RMB depreciated (-0.1%).

Equities declined (CSI 300: -1.7%; HKASR-listed: -2.4%). Market sentiment was weakened by weaker-than-expected GDP number as well as renewed concerned about the regulatory crackdown. Chinese tech stocks declined (HangSeng Tech: -3.2%), led by Alibaba. Reportedly, Alibaba's executives (in the cloud division) were facing an inquiry linked to the data theft of a massive police database. While analysts noted that the inquiry may simply be about facilitating the police's investigation, markets negatively reacted to the news.

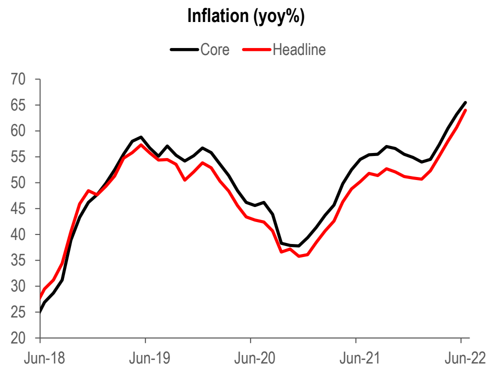
Homebuyer boycotts of mortgage payments keeps growing. According to media reports, homebuyers of over 230 projects in 86 cities have joined force to collectively refuse to make mortgage payments. Share prices of property developers declined (onshore: -5.2 bps; HKSAR-listed: -5.0%) across the board, with no differentiation between state-owned and private firms. **Banks' equities also fell (onshore: -2.2%; HKSAR-listed: -1.6%).**

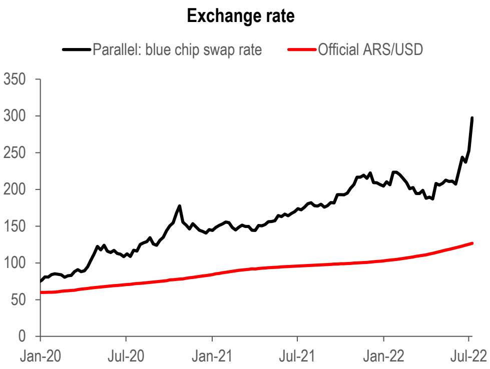
Belarus

Moody's decision to declare Belarus in default yesterday, has limited market implications, as the bonds had been trading at around 15 cents since March. Yesterday, Moody's said that Belarus defaulted on its dollar bonds as the country's bondholders had not received a payment in dollars, after the grace period for a $22.9 mn coupon payment on $600 million in dollar bonds due 2027 expired on July 13. Belarus had offered to pay in rubles instead of dollars, but this is considered an event of default by the rating agency.

Argentina

Intense inflation pressures continue in June. Headline inflation rose to 5.3% m/m, with annual rate accelerating to 64% y/y; core inflation was 5.1% mom and 65.5% y/y. High inflation is deeply entrenched, with 10 of the 12 CPI groups showing annual inflation above 50%. Inflation expectations also see no sign of relief, with 1-year ahead expectation up to 70% for both headline and core, and up to 60% for the 2-yr horizon. Analysts noted that the underlying inflation dynamics are even more concerning than the headlines, given significant and growing levels of repressed inflation due to widespread controls over currency, price and export, in addition to below-cost public tariffs. **Expectations of a meaningful one-off devaluation are also growing, which could lead to another leg higher in inflations**.





Chile

After the peso fell to a record low, the central bank announced a $25bn currency intervention program during July 18 to September 30, including spot dollar sales and FX hedge sales, each up to $10 bn. The bank will also offer currency swaps of up to $5bn complemented by a discount window repo peso liquidity program.

This monitor is prepared under the guidance of Ranjit Singh (Assistant Director), Nassira Abbas (Deputy Division Chief), Charles Cohen (Deputy Division Chief), and Antonio Garcia-Pascual (Deputy Division Chief). Fabio Cortes (Senior Economist), Reinout De Bock (Economist-London Representative), Sanjay Hazarika (Senior Financial Sector Expert), Esti Kemp (Financial Sector Expert-London Representative), Tom Piontek (Financial Sector Expert) and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Yingyuan Chen (Financial Sector Expert), Mohamed Diaby (Economist, EP), Dimitris Drakopoulos (Senior 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), Aurelie Martin (Senior Economist- London Representative), Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), Patrick Schneider (Financial Sector Expert), Dmitry Yakovlev (Senior Research Officer), Akihiko Yokoyama (Senior Financial Sector Expert), and Xingmi Zheng (Research Assistant). 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: 7/15/22 12:52 PM	Level Last 12m	Latest	Change 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		3790	-0.3	-3	0	-13	-20
Europe		3437	1.2	-2	-3	-15	-20
Japan		26788	0.5	1	3	-4	-7
China		3228	-1.6	-4	-3	-9	-11
Asia Ex Japan		67	-0.6	-4	-4	-28	-19
Emerging Markets		38	-0.9	-4	-6	-29	-21
Interest Rates					basis points		
US 10y Yield		2.94	-2.2	-14	-35	164	143
Germany 10y Yield		1.15	-2.5	-19	-49	149	133
Japan 10y Yield		0.24	-0.1	-1	-2	22	17
UK 10y Yield		2.09	-1.4	-15	-38	142	112
Credit Spreads					basis points		
US Investment Grade		176	1.2	1	14	86	64
US High Yield		567	6.7	-1	75	248	230
Europe IG		125	-1.6	8	19	77	77
Europe HY		617	-9.6	40	90	379	375
Exchange Rates					%		
USD/Majors		108.28	-0.2	1	3	17	13
EUR/USD		1.01	0.4	-1	-4	-15	-11
USD/JPY		138.7	-0.2	2	4	26	21
EM/USD		49.2	0.1	-1	-5	-13	-6
Commodities					%		
Brent Crude Oil ($/barrel)		101	2.0	-6	-15	38	30
Industrials Metals (index)		138	-1.0	-8	-21	-12	-20
Agriculture (index)		64	0.3	-6	-15	12	5
Implied Volatility					%		
VIX Index (%, change in pp)		26.0	-0.4	1.4	-3.6	9.0	8.8
US 10y Swaption Volatility		129.7	-0.3	-6.8	5.1	60.7	50.7
Global FX Volatility		12.2	0.0	1.1	0.6	5.6	4.8
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		233	0.9	-1	-26	129	82
Italy		210	2.9	16	-7	105	75
Portugal		116	-3.3	9	-5	55	52
Spain		115	-0.4	8	-9	51	41

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

Emerging Market Financial Indicators

Last updated: 15/07/2022 12:55 PM	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		6.75	0.0	-0.9	-1	-4	-6		2.9	0.5	-10	-1	-17	3
Indonesia		14997	0.2	-0.1	-2	-3	-5		7.4	3.1	11	-5	100	101
India		80	0.0	-0.8	-2	-7	-7		6.3	0.0	0	9	75	0
Philippines		56	-0.4	-0.8	-5	-11	-10		5.7	0.0	0	-3	165	118
Thailand		37	-0.2	-2.2	-5	-11	-9		2.5	-4.5	-9	-48	89	68
Malaysia		4.45	-0.1	-0.5	-1	-6	-6		4.0	-0.5	-10	-30	83	46
Argentina		128	-0.1	-1.1	-4	-25	-20		67.5	40.4	-238	660	2311	1694
Brazil		5.42	-0.6	-1.5	-6	-6	3		13.2	6.0	19	6	387	253
Chile		1049	-3.9	-9.3	-17	-29	-19		6.9	0.0	39	32	283	150
Colombia		4505	0.0	-2.7	-12	-16	-10		10.2	0.0	91	107	440	375
Mexico		20.75	0.2	-1.5	-2	-4	-1		8.9	3.0	11	-37	193	139
Peru		3.9	1.3	-0.3	-4	1	2		8.4	12.9	60	47	272	253
Uruguay		42	-1.6	-3.9	-4	5	6		11.4	32.6	38	49	355	270
Hungary		402	0.9	-0.8	-5	-24	-19		8.8	2.0	49	64	608	431
Poland		4.77	0.9	-1.6	-6	-19	-15		6.2	-8.5	-5	-128	446	266
Romania		4.9	0.4	-1.1	-4	-15	-11		9.1	-1.0	19	37	607	426
Russia		58.1	2.5	9.8	-4	28	29		8.3	0.0	7	-7	96	-49
South Africa		17.2	-0.1	-1.8	-8	-15	-7		9.3	0.5	26	47	204	191
Turkey		17.45	0.0	-1.1	-1	-51	-24		18.9	-6.0	-38	-74	156	-541
US (DXY; 5y UST)		108	-0.2	1.2	3	17	13		3.04	-2.8	-9	-33	226	177

	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		4249	-1.7	-4	-1	-17	-14		209	3	23	-1	6
Indonesia		6652	-0.6	-1	-4	10	1		231	13	48	51	66
India		53761	0.6	-1	5	1	-8		215	3	41	64	83
Philippines		6195	-0.8	-3	-2	-7	-13		174	14	48	62	73
Malaysia		1418	-0.1	0	-3	-7	-10		146	6	25	14	29
Argentina		100518	-1.7	-2	14	58	20		2763	119	634	1197	1083
Brazil		96121	-1.8	-5	-7	-25	-8		389	30	58	116	78
Chile		5136	0.4	1	0	24	19		200	28	34	52	60
Colombia		1273	-3.5	-6	-13	0	-10		470	41	74	198	122
Mexico		46741	-1.5	-1	-3	-7	-12		481	41	59	135	149
Peru		17753	-2.9	-5	-10	-5	-16		225	30	33	67	75
Hungary		39430	0.5	-1	0	-17	-22		256	28	40	114	132
Poland		51746	0.6	-5	-3	-23	-25		-20	-98	-89	-55	-52
Romania		12063	1.2	-2	0	0	-8		360	29	80	174	167
Russia		2086	1.1	-6	-10	-45	-45		3411	-577	938	3228	3234
South Africa		64565	-0.2	-6	-4	-4	-12		585	73	149	247	230
Turkey		2382	0.0	0	-6	74	28		802	69	127	329	224
Ukraine		519	0.0	0	0	-1	-1		7088	1597	3448	6587	6329
EM total		38	-0.2	-4	-6	-29	-21		499	41	85	136	113

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

back to top