GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, JULY 2, 2024
LEAD EDITOR: SANJAY HAZARIKA

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- **Yen hits a new low versus dollar** (link)
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Markets turn cautious ahead of elections and US jobs data

Equity markets in Europe were down across the board as the positive reaction to the first round of the French election last Sunday was partially reversed. The changing dynamics of the US election, worries about next Sunday's final round in France, as well as Friday's US jobs report all added to the atmosphere of uncertainty. The UK election on July 4 is another potential risk factor. US equity futures were also lower, but stocks in Japan bucked the trend. Treasury and bund yields held steady and most currencies were weaker against the dollar as the Yen depreciated to yet another record low. Many analysts are growing uneasy about the strong dollar's potentially negative impact on emerging markets. Meanwhile, government bond yields in China were up after the central bank announced it would intervene in the market to arrest a steady decline in interest rates. Emerging market bond issuance has surged in recent weeks amidst strong investor demand.

Key Global Financial Indicators

Last updated: 7/2/24 7:49 AM	Level: Last 12m	Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		5475	0.3	0	4	23	14.79
Eurostoxx 50		4878	-1.1	-1	-2	11	8
Nikkei 225		40075	1.1	2	3	19	20
MSCI EM		43	0.2	0	2	8	6
Yields and Spreads					bps		
US 10y Yield		4.45	-0.8	21	-5	62	57
Germany 10y Yield		2.61	0.3	20	-5	22	59
EMBIG Sovereign Spread		395	5	-2	16	-36	12
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		45.6	-0.2	-1	-2	-7	-5
Dollar index, (+) = $ appreciation		106.0	0.1	0	1	3	5
Brent Crude Oil ($/barrel)		87.3	0.8	3	7	17	13
VIX Index (%, change in pp)		12.8	0.6	0	0	-1	0

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

Mature Markets

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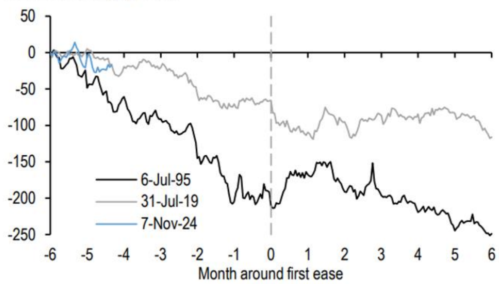
United States

Some analysts predict that the US economy is strong enough to allow the Fed to have a shorter rate cut cycle this time around. Previous short cycles such as 1995 and 2019 saw much more limited rate cuts than the more aggressive cycles of 2001 or the Global Financial Crisis. On average, five year yields declined by around 125 bps six months after the initiation of a short rate cut cycle. This is consistent with current money market pricing. The market currently expects the first Fed rate cut on November 7 and the forward overnight index swaps markets are pricing 140 bps of easing over the next 18 months. Other analysts are less optimistic about the economy. They point out that the widely followed Citi Economic Surprise Index is at its weakest level in 22 months, and that estimates for US GDP from institutions such as the Atlanta Fed are continually being marked down (the Atlanta Fed estimate was reduced to 1.7% from 3% just two weeks ago due to the string of negative US data surprises).

Figure 5: Yields have declined ahead of other shallow easing cycles in 1995 and 2019...

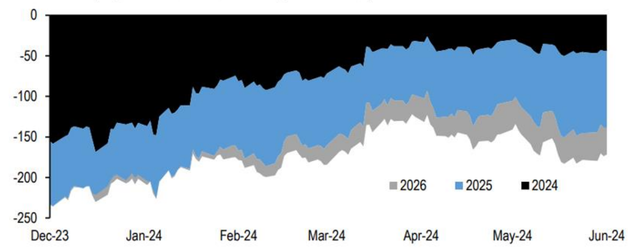
Cumulative change in 5-year Treasury yields in the months around the first ease in a shallow Fed easing cycle*; bp



Source: J.P. Morgan
*Dates used: 7/6/1995, 7/31/2019, 11/7/2024

Figure 6: ...but money markets are already priced for such an outcome, with OIS forwards pricing 140bp in easing over the next 18 months

Amount of easing implied in 2024, 2025, and 2026 by OIS forwards; bp

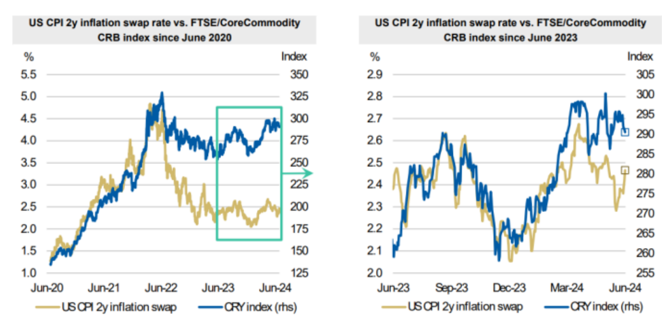


Source: J.P. Morgan

Markets are pricing lower levels of inflation risks in the US. Despite higher commodity costs, US two-year inflation swap rates have held steady. Although absolute Treasury yields are up around 50 bps across the yield curve, real yields on Treasury Inflation Protected Securities (TIPS) have remained in the 2–2.5% range across all maturities. Interest rate volatility has also remained low and inflation data have trended down, giving markets more confidence about inflation risk. The Fed is expected to deliver its first rate cut in November, with less than two price cuts now being priced for this year. Many oil analysts think oil prices are unlikely to rise much further in 2024, further anchoring inflation expectations.

Markets Price Subdued Risk of an Inflation Reacceleration

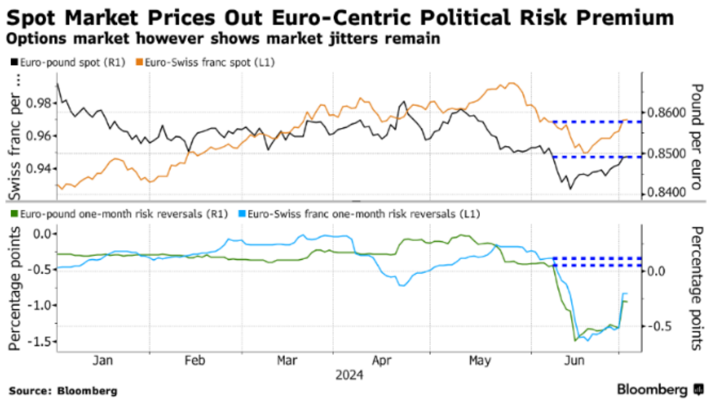
Breakeven inflation rates disconnected from commodity prices two years ago and continue to trade below commodity-implied levels.



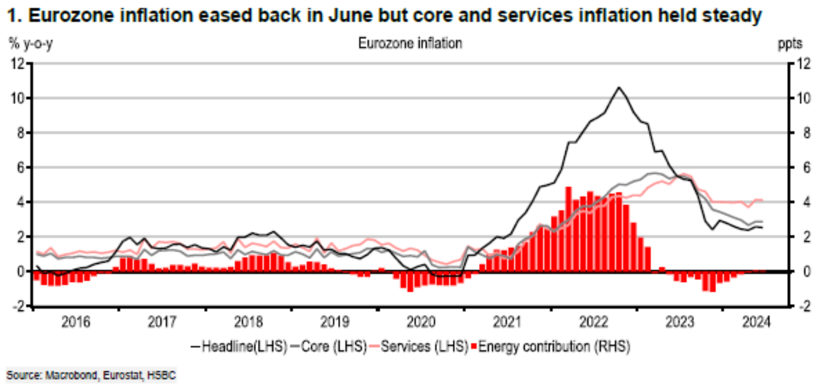
Source: Bloomberg, Morgan Stanley Research   Source: Bloomberg, Morgan Stanley Research

European equities were lower (Stoxx 600 index -0.6%) with the majority of sectors trading in the red as yesterday's relief rally ran out of steam amidst uncertainty ahead of the second-round French elections. In the aftermath of the first round of the French election results, where the Rassemblement

National (RN) party received somewhat less of the vote than had been indicated by polls, a form of a relief rally was seen in markets. Today, however, the mood has changed. Rabobank analysts highlight the inherent uncertainty of France's two round election process and point out that the RN's support was only slightly weaker than anticipated. **The 10y bund yield was little changed this morning**, **trading at around 2.60%, but other European government bond spreads widened again.** French 10-year yields edged higher, widening the 10-year French-German spreads (+2bps) to 76bps, while the 10-year Italian-German spread also widened (+3bps) to around 153bps.



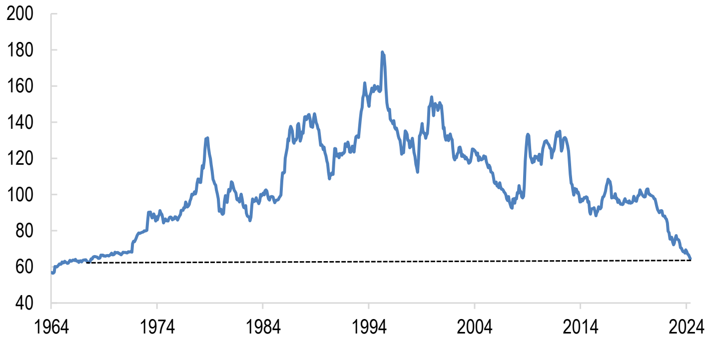
Preliminary June euro area headline inflation eased in line with expectations, while core inflation was marginally higher than expected. The euro area June inflation flash print this morning showed headline inflation easing to 2.5% y/y, as expected, from 2.6%, while core inflation remained unchanged at 2.9% y/y (versus expectations to ease to 2.8%). On the ECB commentary front, **ECB President Lagarde's comments at the ECB's forum on Central Banking yesterday was seen to strike a slightly more hawkish tone.** President Lagarde noted that there is not yet enough evidence that inflation threats have passed. Moreover, ECB chief economist Lane also commented that June's inflation data does not answer questions on services inflation. In separate remarks, Governing Council (GC) member Simkus noted that if the economy develops in line with expectations, two additional ECB rate cuts this year are possible. **Market expectations for ECB rate cuts were little changed compared to yesterday, with roughly 39bps of ECB easing priced for this year.**



Japan

The Yen hit a new all-time low of 161.74 versus the dollar. A measure of the real effective exchange rate compiled by the BIS also hit an all-time low, raising fears about inflation. BOJ data showed that import prices denominated in Yen went up by 6.9% yoy in May. Separately, in a rare unscheduled revision, Q1 2024 GDP was revised downward to -2.9% (q/q annualized) from the initial estimate of -1.8% y/y, reflecting a correction made in construction order data. Analysts believe the revision may lead to a cut of BoJ's growth projection due later this month, while Bloomberg reported that two economists flipped their forecast to predict a full year contraction for 2024 from a slight expansion. **Japanese equities gained** (Nikkei +1.1%) and **long-end JGB yields rose** (10-year: +2.6 bps; 30-year: +1.2 bps).

Real Effective Exchange Rate, Japan
Index, 2020=100

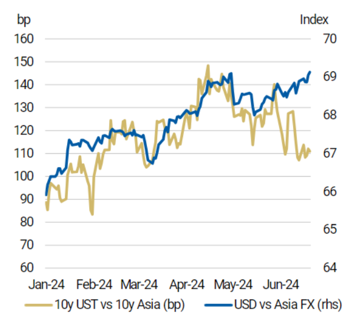


Sources: BIS, CEIC.

Foreign Exchange Markets

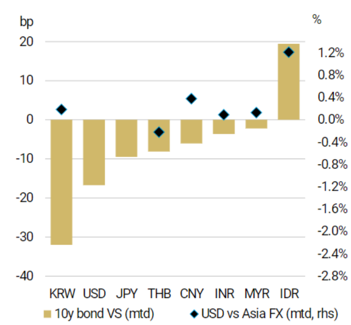
The continuously strengthening dollar could create problems for emerging markets, weakening their currencies, pushing up inflation and forcing their central banks to delay or reverse rate cuts. In Asia, where local equity markets have done well so far in 2024, the dollar has appreciated despite a narrowing interest rate differential between US Treasuries and local government bond markets. Further appreciation could put pressure on local markets. Several contacts expressed worries about the US imposing widespread tariffs if former President Trump wins the election and noted that such tariffs would almost certainly result in further dollar appreciation and tighter financial conditions for EMs.

Exhibit 1: USD/Asia continues to rise despite the drop in 10-year UST-Asia yield differentials



Source: Bloomberg, Morgan Stanley Research

Exhibit 2: In June, USD has risen against most Asia FX even as UST yields have dropped more than most



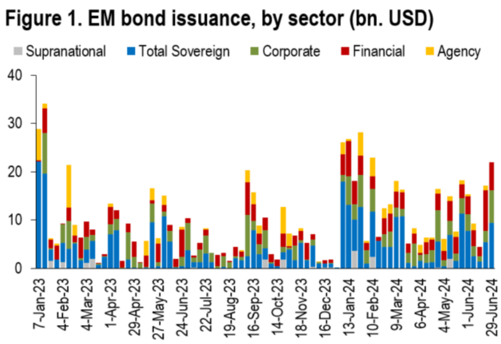
Source: Bloomberg, Morgan Stanley Research

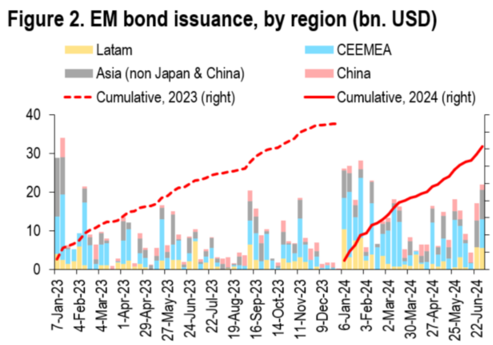
Emerging Markets back to top

EMEA markets were lower and currencies were weaker. The ruble depreciated significantly (-1.7%) after the central bank weakened the official exchange rate. **Asian currencies depreciated against USD as investors are in risk-off mode ahead of votes in UK and France, led by Indonesia rupiah (-0.5%) and Korean won (-0.4%).** Asian equities were mostly down (EM Asia: -0.6%). In Korea, the government officially announced extension of trading hours of the won until 2am from 3:30pm on Monday, in a bid to get its stocks and bonds included in more global indexes. **In Latin America, most major regional currencies fell, led by the Brazilian real (-1.2%).** However, the Peruvian sol bucked the trend and saw small gains. The country also reported its June inflation at 2.29% y/y, which was in line with the market expectations.

Emerging Market Bond Issuance

EM bond issuance came surged to $22 bn for the week ending on June 28th, up from the $17.2 bn volume seen in the week before. Sovereigns emerged as the largest issuer ($9.8 bn), followed by non-financial corporates ($6.9 bn), and financials ($5.8 bn). On the regional distribution, Asia ex-Japan saw the largest volumes of $7.7 bn, while CEEMEA and LATAM accounted for $7.3 bn and $5.6 bn, respectively. Issuance activity in China was subdued during the week and was dominated by the non-financial corporates, and financials. With this, the cumulative bond issuance in EMs now stands at $356 bn for the year, vs. about $258 bn for the corresponding period of last year.

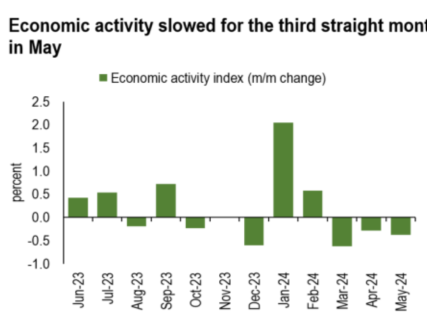


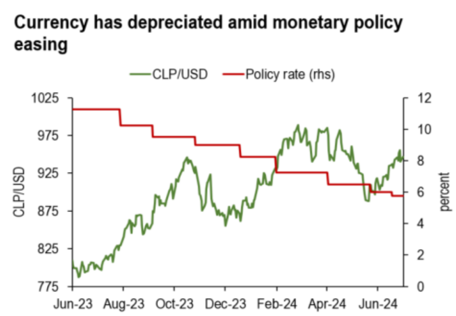


Sources: Bond Radar, and IMF staff calculations.

Chile

Weaker than expected economic activity data exerts further pressure on the Chilean peso. The country experienced its third straight month of contraction (-0.4% m/m) in economic activity in May, which market analysts believe could put pressure on the Central Bank to continue to ease policy rates. The Central Bank recently (June 18th) delivered a 25bps cut in its policy rate, the smallest move since it started the easing cycle in July 2023. Local markets closed lower in response to the data print, with the currency depreciating another 0.7% and taking its YTD losses against the US dollar to 7.8%.

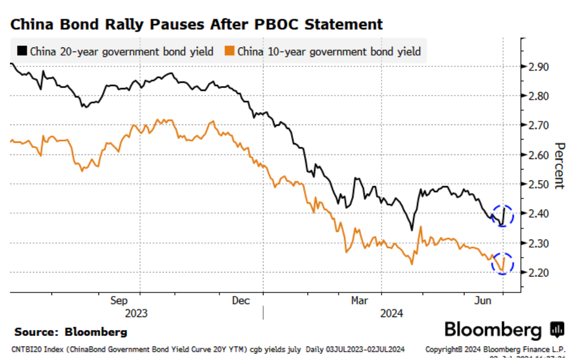




Source: Bloomberg

China

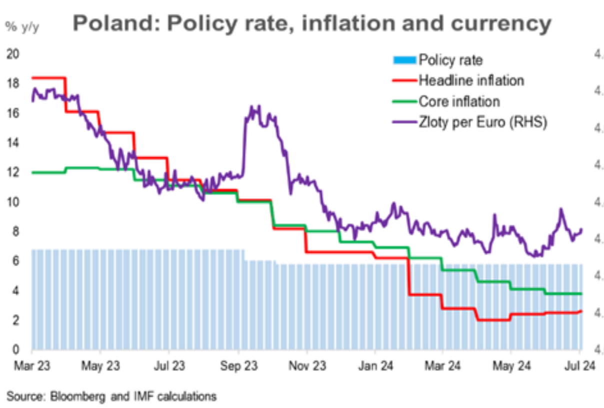
The People's Bank of China (PBOC) said it would intervene in the government bond market by borrowing bonds from primary dealers in order to help stabilize interest rates. The move came amidst a continued decline of yields despite repeated oral warning from the authorities on duration mismatches and the interest rate risks of some nonbank entities holding a large amount of medium and long-term bonds. The announcement triggered a selloff in government bonds that sent yields higher. 10-year and 30-year yields rose 4



bps and 5 bps respectively on Monday to 2.24% and 2.47% before stabilizing today, with all eyes on further action from the central bank. Some analysts believe the PBOC may target 2.2% as a soft red line for 10-year yields and 2.4% for 30-year yields, Bloomberg reported. On the data front, the Caixin PMI in June reached its highest level since June 2021, beating expectations (51.8 vs. the consensus of 51.2).

Poland

The zloty weakened (-0.3%) against the euro this morning, to trade at PLN4.33/€, as the **central bank of Poland (NBP) is expected to keep the benchmark repo rate unchanged at 5.75% at its MPC meeting tomorrow.** The preliminary June inflation figure released last Friday (June 28) was 2.6% y/y, in line with expectations and close to NBP's 2.5% y/y target, but marginally higher than the 2.5% y/y printed in April. The increase was due to acceleration of food prices, which suggests that retailers have passed April's VAT hike on to customers. JP Morgan sees core inflation (to be released on 16 July) running at about 3.5% y/y in June, at the upper limit of NBP's tolerance range (2.5%y/y +/- 1%). Market participants reduced bets on rate cuts last Friday after the June inflation data, with the 9-12m forward rate agreement at 5.41% today, from 5.27% on June 27.



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Global Financial Indicators

7/2/24 7:51 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		5475	0.3	0	4	23	15
Europe		4878	-1.1	-1	-2	11	8
Japan		40075	1.1	2	3	19	20
China		3472	-0.2	0	-3	-11	1
Asia Ex Japan		72	0.2	0	3	9	8
Emerging Markets		43	0.2	0	2	8	6
Interest Rates					basis points		
US 10y Yield		4.45	-0.8	21	-5	62	57
Germany 10y Yield		2.61	0.3	20	-5	22	59
Japan 10y Yield		1.09	2.5	8	2	69	47
UK 10y Yield		4.26	-2.4	18	-6	-13	72
Credit Spreads					basis points		
US Investment Grade		126	-1.6	-2	10	-22	-8
US High Yield		358	0.2	-6	7	-75	-27
Exchange Rates					%		
USD/Majors		105.96	0.1	0	1	3	5
EUR/USD		1.07	-0.2	0	-2	-2	-3
USD/JPY		161.6	0.1	1	4	12	15
EM/USD		45.6	-0.2	-1	-2	-7	-5
Commodities					%		
Brent Crude Oil ($/barrel)		87.3	0.8	4	8	20	15
Industrials Metals (index)		152	0.4	1	-5	8	7
Agriculture (index)		57	0.0	0	-6	-14	-8
Implied Volatility					%		
VIX Index (%, change in pp)		12.8	0.6	-0.1	-0.1	-0.8	0.3
Global FX Volatility		7.5	0.0	0.1	0.7	-0.9	-0.6
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		117	-0.1	-5	15	-10	14
Italy		152	2.3	0	21	-16	-15
Portugal		69	0.0	-5	9	-5	6
Spain		87	0.1	1	14	-13	-10

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

Emerging Market Financial Indicators

Last updated: 7/2/2024 7:52 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		7.27	0.0	-0.1	0	0	-2		2.2	-2.5	-1	-6	-53	-34
Indonesia		16396	-0.5	-0.1	-1	-8	-6		7.1	4.9	3	20	86	64
India		84	-0.1	-0.1	0	-2	0		7.3	0.1	6	-3	(10.6)	11
Philippines		59	-0.3	-0.1	0	-6	-6		5.3	-2.5	-15	-24	-55	-35
Thailand		37	-0.3	-0.3	-1	-5	-7		2.8	2.5	3	-9	1	7
Malaysia		4.72	-0.2	-0.3	0	-1	-3		3.9	1.1	2	-1	4	15
Argentina		914	-0.2	-0.5	-2	-72	-11		44.3	18.9	62	403	-5567	-4205
Brazil		5.66	-1.2	-4.7	-7	-15	-14		12.3	5.0	42	47	165	195
Chile		945	-0.5	0.0	-4	-16	-7		5.4	0.3	2	18	37	51
Colombia		4148	0.0	-1.4	-7	0	-7		8.3	0.0	5	-12	93	69
Mexico		18.40	-0.2	-1.6	-4	-7	-8		9.5	0.6	17	4	145	108
Peru		3.8	0.1	-0.8	-3	-5	-3		7.1	3.2	-6	3	20	43
Uruguay		40	-0.5	-1.3	-3	-6	-2		9.7	1.2	22	47	5	13
Hungary		369	-0.5	0.0	-3	-7	-6		6.6	2.0	11	2	-34	85
Poland		4.04	-0.4	-0.6	-3	1	-2		5.3	4.4	21	6	31	81
Romania		4.6	-0.2	0.0	-2	-2	-3		6.7	0.1	1	4	-2	46
Russia		88.6	-2.0	-0.6	1	1	1							
South Africa		18.5	-0.6	-1.3	0	1	-1		9.3	3.5	13	-50	-34	16
Türkiye		32.70	-0.1	0.8	-2	-21	-10		28.3	15.0	-52	66	1141	153
US (DXY; 5y UST)		106	0.0	0.3	1	3	5		4.41	-1.6	13	-10	25	56

	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		3472	-0.2	0	-3	-11	1		138	-5	6	-44	-20
Indonesia		7125	-0.2	4	1	6	-2		98	-12	1	-38	2
India		79441	0.0	2	4	22	10		100	3	9	-27	-16
Philippines		6359	-0.6	1	-2	-2	-1		82	-11	-4	-28	2
Thailand		1289	-0.8	-2	-4	-14	-9		0	0	0	0	0
Malaysia		1598	0.0	1	0	14	10		87	0	9	-2	2
Argentina		1594733	-1.0	2	-3	274	72		1515	67	169	-540	-398
Brazil		124718	0.7	2	2	6	-7		230	-4	17	-21	15
Chile		6407	-0.1	-1	-3	11	3		119	-7	3	-9	-6
Colombia		1381	0.3	0	-1	22	16		316	-4	13	-56	45
Mexico		52884	0.8	1	-4	-1	-8		322	6	24	-51	-12
Peru		29720	-0.6	-1	-2	33	14		143	-7	-7	-17	-1
Hungary		71844	-0.6	2	6	42	19		147	-13	2	-63	-2
Poland		87579	-0.9	0	1	30	12		98	-7	3	-35	1
Romania		18170	0.0	-1	3	46	18		185	-14	8	-40	-15
South Africa		79384	-0.6	0	3	4	3		311	-14	-27	-101	3
Türkiye		10302	-0.4	-4	-1	79	38		288	-11	10	-192	-26
EM total		43	-0.5	0	2	8	6		410	22	40	20	65

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

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