GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, JULY 25, 2022

- **Nearly half of analysts expect a Fed rate cut by the second half of 2023** (link)
- **US investment-grade corporate spreads expected to widen to recession levels** (link)
- **Leading indicator for Germany highlights recession risk** (link)
- **Analysts warn Italian political uncertainty could see further euro weakness** (link)
- **China reportedly approved a fund to help troubled property developers** (link)
- **Wheat prices increase following reports of port attack** (link)
- **Chilean peso falls after announcement of lower volumes of FX interventions** (link)
- **EM funds record outflows** (link)

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Focus on the pace of rate hikes

European equities reversed earlier gains despite disappointing forward-looking data from Germany ahead of another busy week in global markets. The Fed is expected to hike 75 bps on Wednesday but focus will be on guidance on the hiking path as well as GDP and earnings data. US Secretary of Treasury Yellen said that she does not expect the NBER to formally declare a recession even if some economists expect the US economy to contract for a second quarter in a row. In Europe, IFO survey data suggest that Germany is on the tip of a recession, with the economy weighed down by gas shortage concerns and high energy prices. **Despite concerns on slowing global growth, the US dollar edged lower as some contacts argue that the Fed is unlikely to continue hiking at a pace of 75 bps going forward, providing some temporary relief for risk assets.**

Key Global Financial Indicators

Last updated: 7/25/22 12:27 PM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		3962	-0.9	3	1	-10	-17
Eurostoxx 50		3614	0.5	3	2	-12	-16
Nikkei 225		27699	-0.8	3	5	0	-4
MSCI EM		39	-1.0	2	-3	-25	-19
Yields and Spreads				bps			
US 10y Yield		2.81	5.8	-18	-32	153	130
Germany 10y Yield		1.05	2.0	-16	-39	147	123
EMBIG Sovereign Spread		562	0	-32	53	207	195
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		50.0	0.1	0	-3	-11	-5
Dollar index, (+) = $ appreciation		106.3	-0.4	-1	2	14	11
Brent Crude Oil ($/barrel)		104.1	0.9	-2	-8	40	34
VIX Index (%, change in pp)		23.8	0.8	-2	-3	7	7

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

Markets expect the Fed to raise its policy rate by 75bps (Wednesday) with hikes also expected Hungary (100 bps hike), Kenya (50 bps hike), and Colombia (150bp hike). Earlier today, Ghana unexpectedly left its benchmark interest rate unchanged at 19% (compared to an increase of 100 bps expected). Turning to data, focus will be on 2Q GDP data and monthly inflation data in the US and European countries. Canada's May GDP data and Australia's CPI data will also be released. It will also be a busy week for earnings reports, including Meta, Microsoft, Amazon, Apple, and Alphabet.

Mature Markets

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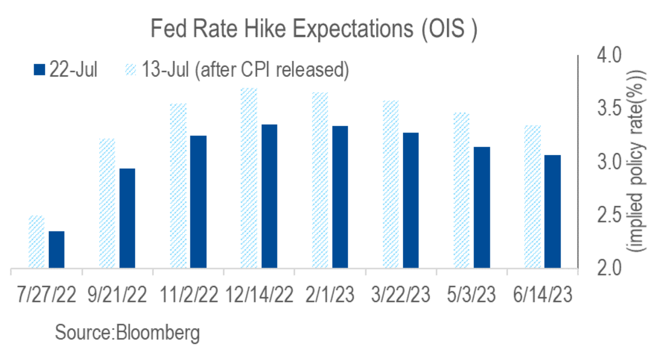
United States

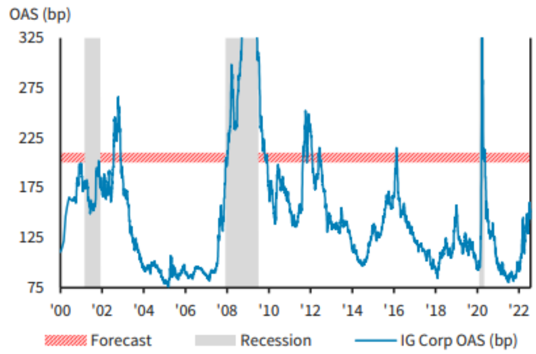
On Friday, the S&P 500 (-0.9%) closed lower as weak PMI data (composite PMI:47.5 vs. 52.4 expected) and disappointing earnings results weighed on sentiment. Despite Friday's losses, US equities experienced their best week in a month, with the S&P 500 gaining 2.5%. **US yields went lower decisively across the curve, mainly attributed to lower real yields, amid mounting growth concerns.** Volatility picked up as 2-year and 10-year Treasury yields declined more than 25 bps for the last two days.

According to a Bloomberg survey, analysts expect a 75 bps hike in July, followed by a 50bps hike in September and two hikes of 25 bps, leading the policy rate to reach 3.5% by the end of this year. Nearly half of the analysts expect a rate cut by the second half of 2023, while 31% expect a cut in the first half of 2024 after the policy rate reaches a peak of 3.75% in early next year. **Regarding QT, analysts project that the Fed balance sheet will shrink to $6.5 trillion by the end of 2024.** As for the recession probability, analysts have mixed views, with 48% seeing a recession likely in the next 24 months, 40% seeing some time with zero or negative growth likely, and only 12% expecting that the US could manage a soft landing. **Meanwhile, market implied policy rates have declined; markets priced in a nearly 75 bps hike in September right after CPI released, but the odds are now leaning toward a 50 bps hike. Markets are pricing in 3.35% as the terminal rate in December and more than 80 % of the probability of a 25bp rate cut in May 2023.**



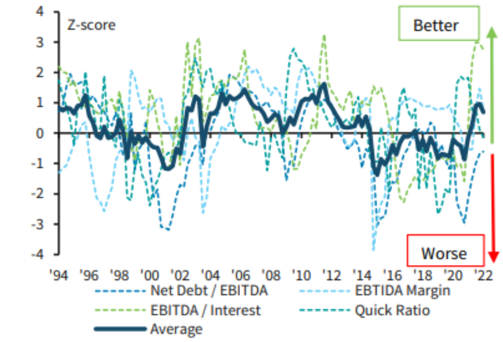
Barclay analysts expect the US investment-grade corporate spread to widen significantly to levels only seen during recessions, with the spreads hitting 200-210 bps (current level:140bps) within the next six months (left chart). They see that credit fundamentals remain in good shape (right chart) but will decline as the macro picture has deteriorated, and economic data has shown that forward-looking sentiment is the most negative in a decade for both companies and consumers. **They also noted that the spread levels do not necessarily mean the US will be in a recession in the next six months as spreads tend to price in recession ahead of time.**

FIGURE 1. **Our Investment Grade Spread Target versus History**



Source: Bloomberg, Barclays Research

FIGURE 12. **Aggregate Credit Metrics Indicator (Positive = Better, Negative = Worse)**



Note: Five-year rolling Z-score using the five-year rolling average and standard deviation for each metric.
Source: Factset, Compustat, Bloomberg Indices, Barclays Research

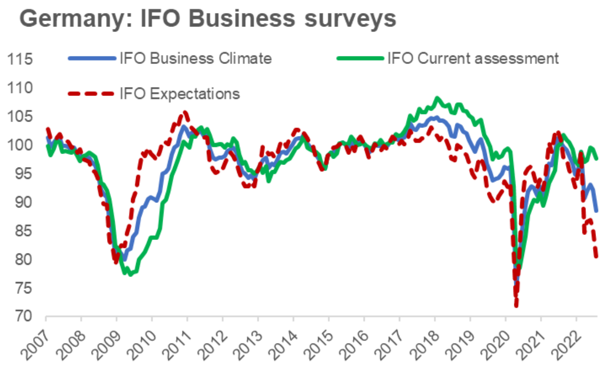
Euro Area

Opening losses were reversed in later trade despite disappointing forward-looking data from Germany. The banking sector (+1.5%) outperformed. Sovereign yields edged higher (10-yr bund +2 bps) with the Italian spread little changed, while the euro reversed opening losses (+0.1%).

ECB commentary following the 50 bps hike last week generally reinforced the message that future rate hike decisions will be data-driven. ECB Governing Council (GC) member Visco said that the ECB's approach would be step-by-step and dependent on data developments, echoing comments from GC Nagel last week. **Bundesbank president Nagel also added that the 50 bps hike last week limits the risk that stronger action would be required in future.** GC member Kazaks, however, opined that a rate increase in September should also be significant, adding that he did not have major objections to market expectations of 150bps of tightening by mid-2023, according to Bloomberg. Yesterday GC member Holzman said that policymakers might have to admit a moderate recession could be required to stabilize prices if inflation expectations are seen to continue gathering momentum.

Analysts warn that political uncertainty in Italy and gas supply concerns could see the euro weakening to below parity against the dollar. While the election campaign kicked off over the weekend following PM Draghi's resignation last week, Citibank analysts argue that Italy is likely now faced with an extended period of political uncertainty that could see the spread between Italian and German yields increase by a further 50bps as the NGEU funding disbursement could be delayed. Given that higher spreads are due to fundamental developments, analysts see this as beyond the scope of the ECB's Transmission Protection Instrument (TPI). Such a widening in spreads is estimated to lead to a 1.1% euro depreciation against the dollar, without taking into consideration pressure that the currency could face amid higher energy prices or recession risk. **Analysts expect EURUSD to depreciate towards 0.95 in the coming months but caution that price action could be distorted by thin liquidity in the remainder of July and August.**

Germany's June IFO Institute business climate index, a leading indicator for Germany, disappointed with both the current assessment and expectations component dropping. The business climate index fell to 88.6 (vs expected 90.1 from 92.2), its lowest value since June 2020. Businesses are less satisfied with their current situation and in the coming months business is expected to become significantly more difficult (expectations index dropped to 80.3 vs expected 83.0 from 85.5). **The IFO release notes that Germany is on the tip of a recession, with the economy weighed down by gas shortage concerns and high energy prices. ING analysts caution that the data release suggests that Germany's economy might have already contracted in Q2.**



Source: Bloomberg and IMF calculations

European natural gas prices continued their upward trend (1-m ahead Dutch natural gas +3% to €166/MwH) as uncertainty over gas supplies from Russia remain. Gas flows via the Nord Stream 1 (NS1) pipeline are reportedly continuing at 40% of pipeline capacity, but a turbine from Canada remains stuck in transit and Russia has warned that flows could halve if this turbine is not received early this week. On the upside – Bloomberg reports that German gas storage is being filled again as gas flows from Russia has enabled German utility Uniper to stop utilizing gas from storage sites.

Japan

Equities slipped -0.7%. Ex-economy minster mulls large-scale stimulus ahead of 2nd extra budget discussions. Nishimura, who now serves on ruling party LDP's economic panel, cited Japan's large negative output gap of about ¥20 tn ($145 bn) and still-weak private sector demand, according to Bloomberg. Some extra budget funds could be spent on government digitalization and green transformation plans. Separately, **new Bank of Japan board member Takata said the current 10-year yield target is sustainable.** He noted, however, that market function and weak bank profitability should be considered, Bloomberg reports. Tamura, another new board member, said it is desirable for exchange rates to reflect economic fundamentals and that Japan's economy may be reaching a virtuous cycle. **Japanese yen weakened -0.2%, 10-year yields declined** touching the lowest level since mid-March. MUFJ noted that Japanese bonds offer superior yields relative to US Treasuries after favorable currency hedge premiums taken into account, this may convert overseas investors into net buyers of longer-term JGBs.

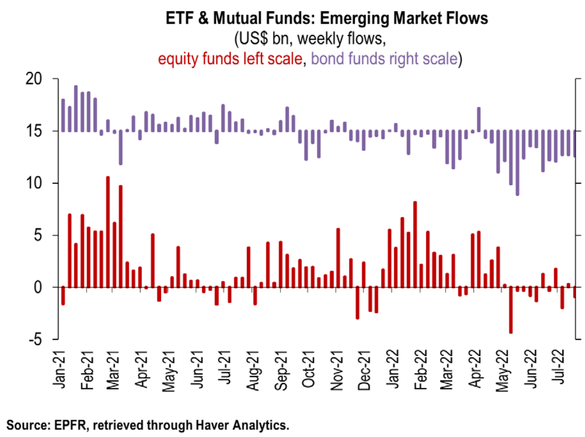
Emerging Markets back to top

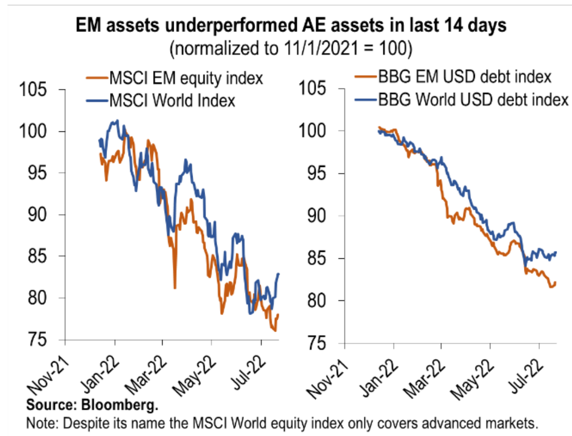
Asian equities mostly slipped, declined -0.2% on net. Sri Lanka lost -1.1%, the Philippines fell -0.9%, Thailand gained +0.6%, South Korea firmed +0.4%. Asian currencies were mixed, Philippine peso appreciated +0.4%. 10-year yields mostly fell along US Treasury yields. Sri Lanka dived -46 bps. Singapore inflation accelerated to 6.7% y/y in June (previous: 5.6%), lifted by a surge in transport inflation (+18.8%), which hit a 40-year high. Core inflation firmed to 4.4% y/y (previous: 3.6%). **EMEA equities and currencies were mixed. Equities in Moscow were up (+1.2%) while the Russian ruble continued to weaken** (-0.3% to 58.3 against the dollar) after the central bank rate cut last week. **The Turkish lira (-0.6%) also continued weakening.** The **Hungarian forint was trading stronger (+0.5%)** against the euro while equities fell (-1.1%) ahead of the central bank meeting tomorrow where 100bps hike is expected. Elsewhere on the central bank front, **Ghana left its benchmark interest rate unchanged at 19% earlier today, while consensus had expected a 100bps increase. Latin American assets were mixed on Friday. Equities gained in Argentina (1.7%) and Peru (+1.1%) and retreated in Colombia (-2.4%). The Mexica**n peso strengthened (+0.5%), as inflation for the first half of July came in at 8.2% y/y, virtually as expected. The Colombian peso weakened (-0.9%) as well, contributing to mounting expectations for additional rate hikes, with a 150 bps hike at this week's monetary policy meeting now firmly priced in. **U.S. dollar yield curves**

shifted down (10 bps in Brazil and 11 bps in Mexico, both at 10-year maturity), following closely a similarly sized move. The central bank of Paraguay lifted its monetary policy rate by 25 bps to 8%.

EM Funds

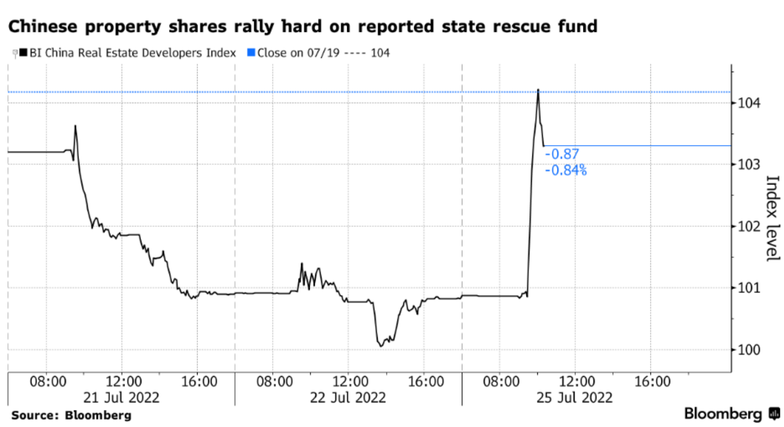
Emerging market (EM) funds experienced outflows, as EM assets underperformed their AE peers. Investors withdrew over the last week $0.9 bn (0.1% of assets) from EM equity funds, overwhelmingly from funds with a global EM focus. EM bond funds saw $2.4 bn (0.5% of assets) leaving, predominantly from local currency funds, with funds focused on China losing $0.9 bn alone. Investors withdrew from funds traded and not traded on exchanges alike, with the former, however, attracting $0.6 bn of new capital in the equity segment.





China

China has reportedly approved a fund to help 12 troubled property developers and a few real estate firms, Evergrande included. The fund secured 50 bn yuan ($7.4bn from China Construction Bank and 30 bn yuan re-lending facility from People's Bank of China). It could expand to 300 bn yuan. The fund will finance purchases and completions of unfinished homes, which will be rented to individuals as part of the government's rental housing push.



Separately, capital outflow continued in June. Domestic firms remitted a record $37.5 bn in June, offset by trade inflows. SAFE spokesperson Wang said higher remittances do not indicate capital withdrawal but have likely resulted from increased investment revenue by multinationals, Bloomberg reported. Meanwhile, foreign holdings of China bonds reduced by $13.9bn last months. The net reduction of foreign holdings continued for the fifth month in June 2022, though the magnitude of outflow was smaller than the $16–18bn in the past few months, Citi noted. **Equities slipped (Shanghai: -0.6%, Shenzhen: -0.9%).** Developer shares rallied up to +3.4% on reported fund help, Bloomberg reported. **Renminbi and 10-year yields were broadly unchanged.**

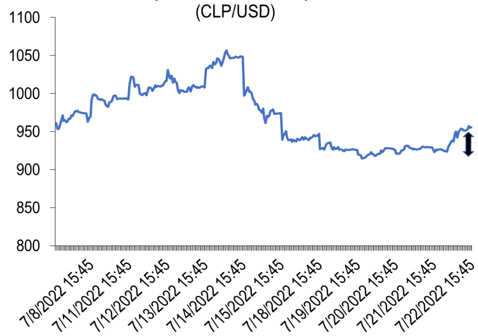
Ukraine

Wheat futures increased (+3%) amid reports that Russia attacked the port city of Odessa over the weekend, despite the agreement reached on Friday between Russia and Ukraine to allow for the export of Ukrainian grain from Black Sea ports. Ukraine is reportedly continuing to move ahead with preparations to resume grain exports while Russia said plans for exports will not be impacted by the strike. Analysts from Oxford economics previously expressed doubt over the success of the deal, highlighting that Russia's incentives are unclear. Moreover, analysts highlighted that Ukraine would need international security guarantees prior to the opening of Odessa as it could render the city vulnerable to a Russian invasion.

Chile

The peso tumbled after lower volumes of FX interventions were announced. After appreciating 9% since mid-July, the Chilean peso depreciated last Friday for a consecutive second day, closing 3% weaker. The brunt of Friday's depreciation materialized after the central bank announced a $1 bn reduction in the planned weekly volume of its FX interventions, down from $3.5 bn in the past week. Analysts see potential for FX volatility as long as traders continue to adjust expectations concerning the volume of the intervention program. Local fixed-income swap yields fell slightly, particularly around the one-year maturity.

Chilean peso resumes to depreciate...
(CLP/USD)



Source: Bloomberg.

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Global Financial Indicators

Last updated: 7/25/22 12:28 PM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		3962	-0.9	3	1	-10	-17
Europe		3615	0.5	3	2	-12	-16
Japan		27699	-0.8	3	5	0	-4
China		3250	-0.6	-1	-3	-6	-11
Asia Ex Japan		68	-1.3	1	-4	-25	-18
Emerging Markets		39	-1.0	2	-3	-25	-19
Interest Rates					basis points		
US 10y Yield		2.81	5.8	-18	-32	153	130
Germany 10y Yield		1.05	2.0	-16	-39	147	123
Japan 10y Yield		0.20	-1.9	-4	-3	18	13
UK 10y Yield		1.95	0.9	-21	-35	136	98
Credit Spreads					basis points		
US Investment Grade		171	0.8	-3	0	80	59
US High Yield		529	3.2	-32	-10	197	191
Europe IG		102	-2.6	-18	-7	56	55
Europe HY		521	-11.7	-70	-16	286	279
Exchange Rates					%		
USD/Majors		106.27	-0.4	-1	2	14	11
EUR/USD		1.02	0.3	1	-3	-13	-10
USD/JPY		136.4	0.2	-1	1	24	19
EM/USD		50.0	0.1	0	-3	-11	-5
Commodities					%		
Brent Crude Oil ($/barrel)		104	1.0	-2	-8	41	34
Industrials Metals (index)		150	0.3	3	-5	-6	-13
Agriculture (index)		63	1.1	-5	-10	9	3
Implied Volatility					%		
VIX Index (%, change in pp)		23.8	0.8	-1.5	-3.4	6.6	6.6
US 10y Swaption Volatility		118.2	0.0	-2.6	-8.1	35.3	39.2
Global FX Volatility		11.2	0.1	-0.4	0.3	4.5	3.8
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		203	-19.1	-23	-30	95	52
Italy		229	-0.1	22	26	125	94
Portugal		114	-2.1	-1	6	53	50
Spain		121	-1.3	-2	10	52	47

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

Emerging Market Financial Indicators

Last updated: 25/07/2022 12:34 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	0.1	-0.1	-1	-4	-6		2.8	-2.4	-2	-12	-15	0
Indonesia		14993	0.1	-0.1	-1	-3	-5		7.4	-9.2	1	6	109	101
India		80	0.1	0.3	-2	-7	-7		6.3	0.0	0	9	#VALUE!	0
Philippines		56	0.4	0.5	-2	-10	-9		5.7	0.0	0	0	168	118
Thailand		37	-0.1	0.0	-3	-10	-9		2.5	-8.5	-2	-35	96	68
Malaysia		4.45	0.0	0.0	-1	-5	-6		4.0	-4.7	-5	-22	84	38
Argentina		130	-0.1	-1.2	-5	-26	-21		69.0	-4.3	140	728	2443	1848
Brazil		5.50	0.0	-1.6	-6	-5	1		13.5	-13.0	27	89	416	276
Chile		954	-2.8	2.4	-7	-21	-11		7.0	-1.8	30	75	295	154
Colombia		4462	-0.9	-2.0	-10	-13	-9		9.8	0.0	-11	76	423	343
Mexico		20.41	0.6	0.3	-2	-2	1		8.6	-21.0	-29	-38	170	106
Peru		3.9	0.0	-0.3	-5	1	2		8.4	-16.2	-8	63	289	245
Uruguay		42	0.1	1.0	-5	5	7		11.4	-17.9	0	67	352	270
Hungary		387	0.4	2.3	-2	-21	-16		8.3	-16.0	-47	13	579	382
Poland		4.60	0.9	2.9	-4	-15	-12		5.7	-7.0	-45	-131	414	216
Romania		4.8	0.3	1.1	-3	-13	-10		8.7	-17.1	-33	-31	571	389
Russia		58.4	-0.4	-0.8	-7	26	29		8.1	-16.8	-17	-14	103	-69
South Africa		16.8	0.4	2.2	-5	-12	-5		8.8	-11.0	-60	-10	165	133
Turkey		17.84	-0.6	-2.1	-7	-52	-25		17.4	0.0	-148	-210	-6	-689
US (DXY; 5y UST)		106	-0.5	-1.1	2	14	11		2.88	3.9	-22	-30	217	162

	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		4213	-0.6	-2	-4	-14	-15		215	6	22	3	12
Indonesia		6858	-0.4	3	-3	12	4		226	-13	22	40	61
India		55766	-0.5	2	6	6	-4		199	-14	26	43	67
Philippines		6210	-0.9	-1	0	-3	-13		160	-23	16	44	59
Malaysia		1469	0.2	3	2	-3	-6		147	0	17	7	30
Argentina		113851	1.6	9	38	76	36		2897	135	629	1316	1217
Brazil		98925	-0.1	2	0	-21	-6		353	-32	7	72	42
Chile		5220	0.3	3	5	25	21		194	-5	19	39	54
Colombia		1260	-2.5	-1	-8	0	-11		436	-38	24	160	88
Mexico		47265	-0.3	0	-1	-6	-11		442	-41	10	86	110
Peru		19245	1.1	8	2	4	-9		215	-12	13	46	65
Hungary		41858	-1.1	4	6	-12	-17		247	-15	10	105	123
Poland		54153	0.1	2	2	-19	-22		34	57	-65	-2	2
Romania		12215	-0.1	1	-2	3	-6		343	-22	18	149	150
Russia		2122	1.2	1	-11	-43	-44		3411	-577	938	3228	3234
South Africa		68062	0.0	2	3	0	-8		500	-69	36	153	145
Turkey		2543	1.0	4	0	88	37		746	-49	97	268	168
Ukraine		519	0.0	0	0	-1	-1		6578	54	2565	6063	5819
EM total		39	0.3	2	-3	-25	-19		471	-26	36	102	85

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

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