GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

WEDNESDAY, JULY 5, 2023

- **Private equity faces challenges amid rising interest rates** (link)
- **The Leveraged loan sector looks vulnerable to rising credit risk** (link)
- **European equities drop as Euro Area final PMI data became further revised down** (link)
- **Weaker lira expected to add to Türkiye's price pressures** (link)
- **Chinese equities down as RMB depreciated on weaker Caixin services PMI** (link)

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Market Sentiment Sours Amid Weakening Data

European markets took a risk-off stance with the banking sector leading the equity declines, as a downward revision of final June PMI data amplified recession woes. Despite the initial softness of flash PMI estimates, the subsequent revision deepened the market's unease. On the positive side, latest ECB consumer expectations survey published today shows a decrease of consumer inflation expectations for the next month that further declined, albeit still well above the ECB's target while longer-term inflation expectations remain at 2.5%. The RBA yesterday left policy rates unchanged at 4.1% and Romania's central bank similarly maintained a 7.0% policy rate at its meeting today. In other CEE countries, the Hungarian forint depreciated for a seventh consecutive day as a notable decline in Hungary's manufacturing PMI sparks concerns that rate cuts by the central bank are weighing on the currency along with concern on the country's public finances while the Polish zloty traded weaker against the euro ahead of the National Bank of Poland's policy meeting tomorrow. In Asia, weak PMI data in China, India, Hong Kong SAR and Singapore dampened market sentiment while the Bank of Japan stated that it estimated Japan's real economic growth for the first quarter still below potential. In Sri Lanka, markets welcomed the debt restructuring plan, which was seen as for local commercial banks, thus easing market concerns about financial stability.

Key Global Financial Indicators

Last updated: 7/5/23 8:37 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		4456	0.1	3	4	16	16	5
Eurostoxx 50		4360	-0.7	0	2	30	15	10
Nikkei 225		33339	-0.3	0	3	28	28	26
MSCI EM		40	1.1	2	1	1	6	-16
Yields and Spreads					bps			
US 10y Yield		3.88	2.6	17	20	107	1	189
Germany 10y Yield		2.46	0.2	14	7	128	-12	223
EMBIG Sovereign Spread		426	-6	-16	-38	-113	-26	13
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		48.8	-0.4	-1	-2	-4	-2	-8
Dollar index, (+) = $ appreciation		103.1	0.1	1	-1	-3	0	7
Brent Crude Oil ($/barrel)		76.4	0.2	3	0	-26	-11	-21
VIX Index (%, change in pp)		14.5	0.8	1	0	-12	-7	-17

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

For the US, markets are attentive later this week to the release of the June labor market report with initial jobless claims and continuing claims tomorrow and non-farm payrolls on Friday. For survey data, ISM services readings tomorrow reflect the main upcoming release. Other parts of the world see CPI reports from Taiwan (Thursday) and then Mexico and Peru (Friday). European calendars are light and primarily focused on factory orders (Thursday). In terms of interest rate decisions, National Bank of Poland's will gather for a policy meeting tomorrow, where the expectation is that the policy rate remains unchanged at 6.75%. Furthermore, today's release of the minutes from the Fed's last meeting as well as those from Banxico and BanRep due tomorrow will shed further light on monetary policy transmission in the US, Mexico, and Colombia.

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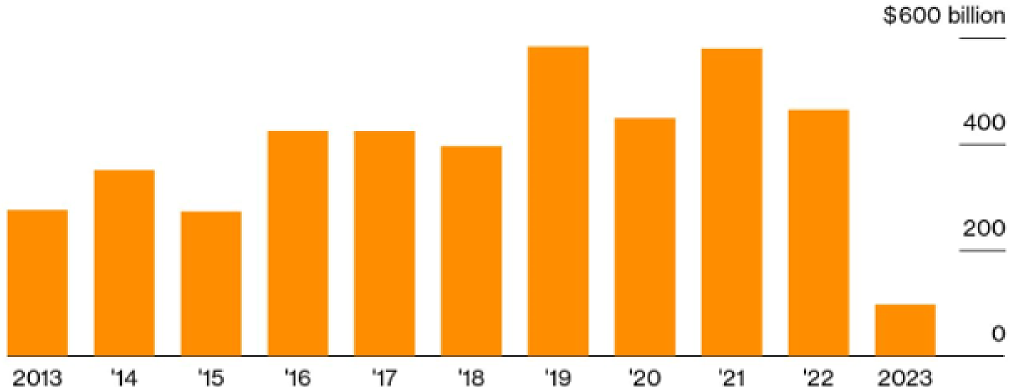
United States

Private equity is one area where the Fed's interest rate hikes are showing an impact. The momentum in private equity has stalled with new deals and exit sales dropping significantly and initial public offerings on stock markets becoming scarce. One of the main challenges facing private equity investors is the imbalance between capital calls and distributions. Asset management companies ask investors to put in more cash while investors might be reticent to do so as they anticipate receiving little in return. Consequentially, the headwinds that public stock and bond markets have been facing from rising interest rates have also started to spill over into private equity as evidenced by tempered investors' risk appetite.

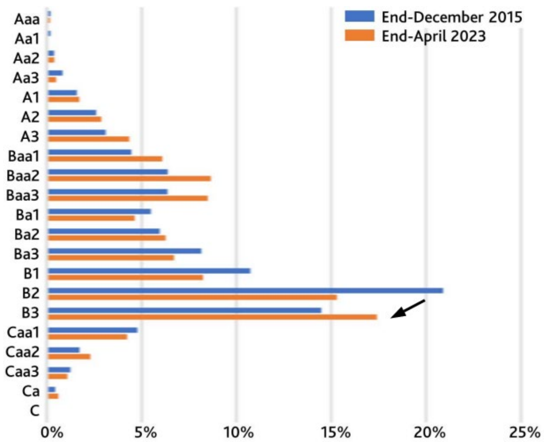
Private Equity is Raising New Funds at Slowest Rate in Years
(Global total of money committed to new buyout funds)



Source: Bloomberg, Pitchbook

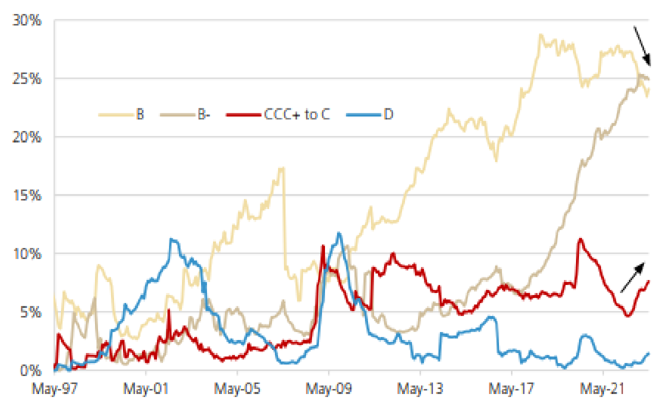
Lower-rated corporate issuers and leveraged loans face rising credit risks. Recent data from Moody's shows that the weak tail of corporates with low creditworthiness has increased compared to year-end 2015 (left chart below). Market contacts see leveraged loans as one asset class within corporate debt that looks particularly vulnerable. For example, the share of leveraged loan issuers with a *B* rating has been declining, while the share with a *CCC+* to *C* ratings -which are the rating notches just above a credit default- has been increasing (right chart below). This trend could go hand in hand with increased bankruptcies. Leveraged loans are vulnerable to both higher floating rates and a pick-up in defaults. As interest rates remain high, debt sustainability becomes more challenging for lower-rated borrowers. Historically, this has been consistent with higher defaults, wider credit spreads, and lower equity valuations and higher equity volatility. UBS analysts expect this trend to continue, with a widening of about 225bps in high-yield spreads between now and the end of Q3.

Rating distribution of nonfinancial companies



Source: Moody's Investor Service

Rating share of lower rated corporate issuers in leveraged loans



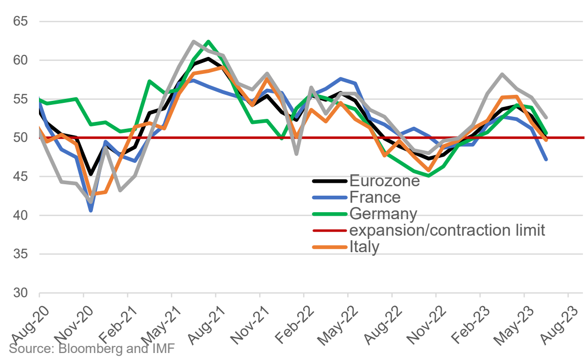
Source: UBS

Euro Area

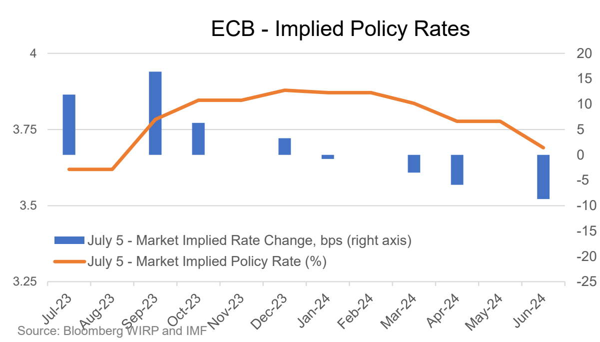
European markets entered a risk-off mode. The equity market declined -0.6%, led by the banking sector that contracted by -0.5%. The euro fractionally appreciated against the dollar at 1.09/$. German 10y bund yields declined -4 bps to 2.41% while the yield spread of Italian bonds narrowed by -2 bps to 173 bps.

Final June PMI data heightened recession fears in the Euro Area. Despite that even the initial flash PMI estimates missed expectations, the final June figures took yet another hit, painting a gloomier picture of slowing business activity in the Euro Area. The composite PMI data for June earlier today printed at 49.9 (expected 50.3 in line with the 50.3 flash estimate) and the services PMI printed at 52 (expected 52.4 in line with the 52.4 flash estimate). Readings for France and Germany were broadly in line with the flash estimates, but data for Italy and Spain came in significantly lower than expected. In Italy, all PMI reading came in below consensus, with composite in contractionary territory. While the composite PMI in Spain remained in expansionary territory, it similarly printed softer, missing consensus expectations.

Eurozone Composite PMIs



Markets estimates for the ECB terminal rate remained unchanged. Money markets continue to expect a terminal rate of 3.88% by January 2024, reflective of little ECB commentary during the last days. Bundesbank president Joachim Nagel has been one of the few ECB officials providing statements, clarifying today that the ECB will have to raise policy rates further while adding that the order of magnitude depends on the incoming data. Conversely, Italian governor Ignazio Visco advocated today for a "symmetric" attitude to the monetary policy reaction function, mirroring recent communication of ECB board member Isabel Schnabel.



Japan

The Japanese yen appreciated 0.2% to 144.3 yen per dollar. While FX traders kept an eye on potential FX interventions, current FX option pricing suggested that markets were not overly concerned about FX intervention risks. Implied volatility of Japanese yen remained low. Japanese equities declined (NIKKEI: -0.3%). Long-end JGB yields flattened (10-year: +0.9 bp; 30-year: -2.8 bps).

Emerging Markets

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Most Asian equities declined, and currencies depreciated. Stock markets declined in Hong Kong, China, Singapore, and Korea, down -1.6%, -0.8%, -0.6% and -0.6%, respectively. Indonesian ones rose, up +0.6%. The Chinese yuan and Philippine peso led the currency declines, down -0.4% and -0.3%, respectively. Long-end government bond yields posted mixed results, with 10-year yields rising in the Philippines by +9.6 bps while falling in Indonesia by -1.3 bps.

In EMEA, equities inched lower, and currencies weakened against the dollar. South African markets came under pressure as analysts noted the strong trading links to China, whose economic recovery became called into question, prompting a -0.5% correction of South African equity markets and a -0.6% depreciation of the rand against the dollar. CEE currencies were mostly trading weaker against the euro, with the Hungarian forint depreciating -1% to 378.69/€ and the Polish zloty -0.4% weaker against the euro. The Romanian leu was marginally stronger against the euro this morning (+0.1% to 4.95/€) ahead of the central bank's policy meeting later today for which consensus is for the policy rate to remain unchanged at 7%.

Latin American markets posted mixed results in a tepid trading session. Regional government bond yields were broadly higher while the rise in oil prices supported most regional currencies. The Colombian peso appreciated the most, up +0.8% against the dollar while the Brazilian real was the worst performing currency, weakening -0.7% against the dollar.

EM Fund Flows

For the week ending in June 28, EM bond funds flow reversed while EM equities inflows persisted. EM bond fund outflows amounted to -$971 mn, driven by hard currency fund outflows of -$739 mn, reflecting a twentieth consecutive weekly streak of outflows. EM local currency funds similarly recorded outflows, contracting by -$232 mn, driven by an acceleration of China-focused funds that declined by -$239 mn. Unlike EM bonds, EM equity fund flows recorded the largest inflows in 7 weeks, up +$503 mn, driven by non-ETF inflows that increased by +$471 mn.

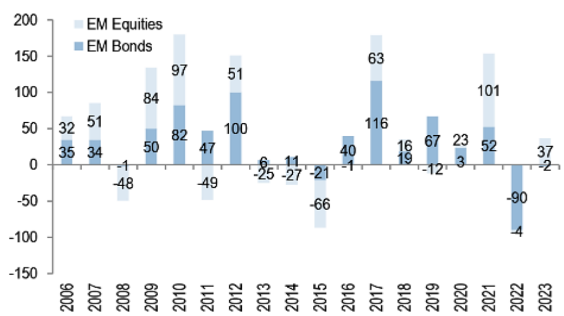
Weekly Cross-asset Flows

USD billion

	Asset	8w flows (8w ago → current)	This wk	YTD
Fund Flows	**EM Bonds and Equities**		-0.5	34.8
	EM Bonds		-1.0	-1.8
	Hard Ccy		-0.7	-3.3
	Local Ccy^		-0.2	1.6
	o.w. EM ex-China		0.0	3.4
	o.w. China		-0.2	-3.0
	EM Equities		0.5	36.6
	US HG		3.0	157.9
	US HY		-0.1	-4.9
	Global Equities		-2.7	-54.4
	EM Bond and Equity ETFs		0.2	32.8
	EM Bond ETFs		0.1	0.9
	EM Equity ETFs		0.0	32.0
	Non-resident EM flows*		-2.5	34.0

EM Bond and Equity Fund Flows

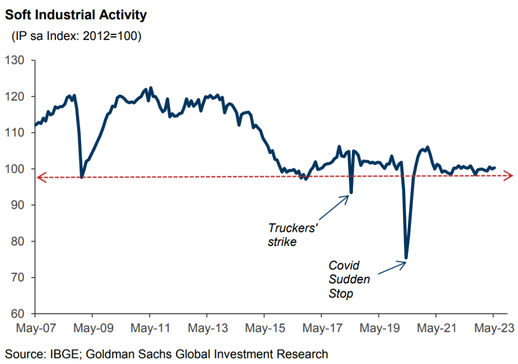
USD billion



*High frequency non-resident EM portfolio flow data where available. ^Local ccy split is retail only. All charts and data in this report: J.P. Morgan, EPFR Global, Bloomberg Finance L.P.

Brazil

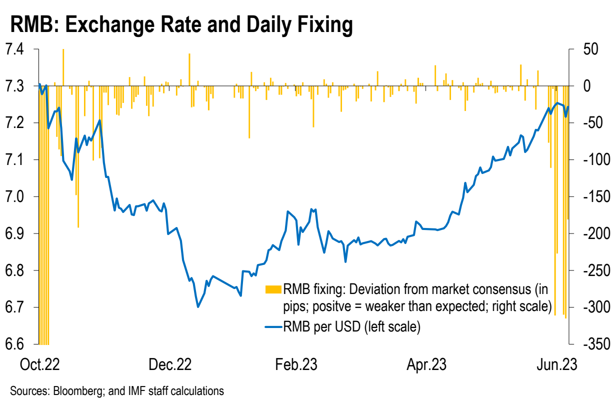
Brazil's industrial production data in May proved resilient to higher policy rates. May industrial production data rose +0.3% m/m (expected 0% from -0.6%), defeating expectations that tight monetary policy -with policy rates the highest in 6 years at 13.75%- could pose a headwind to the real economy. The expansion in the production of capital (+4.2% m/m) and durable goods (+9.8% m/m) drove the upside surprise, while production of consumer goods declined by -0.8% m/m. On a y/y basis, industrial production gained +1.9%, but overall production remained unchanged at 1.5%, which is below the pre-Covid level (February 2020), and significantly below the production cyclical high recorded in May 2011.



China

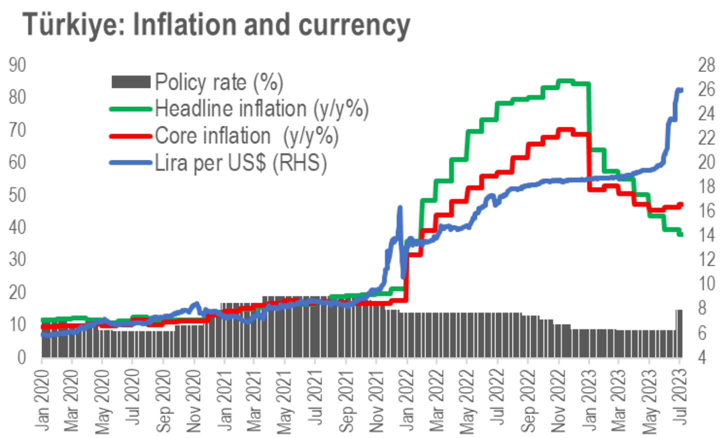
Chinese equities declined and RMB depreciated on growing that the economic recovery is fading. A miss in the June Caixin services PMI data, which printed at 53.9 (expected 56.2 from 57.1) in conjunction with a weakening Caixin manufacturing PMI that printed at 50.5 (expected 50.0 from 50.9) reignited concerns on the shape of the Chinese economy. As a result, Chinese equities declined (CSI 300: -0.8%; Hong Kong SAR-listed: -1.9%) and RMB depreciated to 7.24 yuan per dollar (-0.4%).

The People's Bank of China (PBC) continued setting the daily RMB fixing stronger, today in the order of 181 pips (see chart below). Meanwhile, large banks lowered interest rates on their dollar deposits for the second time in a matter of weeks, now offering 5.7% for 1-year dollar deposits, down from 6% about a month ago, for their corporate clients. Retail depositors saw even larger reductions, with current 1-year dollar deposit rate at about 2.8% from 4.5%−5.0% earlier. Some market participants viewed this as efforts of Chinese authorities to support the weakening RMB. The PBC continued withdrawing liquidity, today in an amount of 212 bn yuan ($29.3 bn) as quarter-end funding pressures eased. The key interbank repo rate (DR007) edged up to 1.78%, below the policy rate at 1.9%, while spreads between exchange-traded and interbank repo rates have narrowed.



Türkiye

Headline inflation eased while analysts warn that a weaker lira could exacerbate price pressures. Türkiye's June inflation data sees headline inflation easing marginally more than expected with a print of 38.2% y/y (expected 38.9% from 39.6%). Conversely, latest core inflation data increased to 47.3% (expected 47.6% from 46.6%). Analysts argue that a weaker lira could be the main driving factor behind higher core inflation, and for this reason, Bloomberg economists expect inflation to further climb from here despite tighter monetary policy since the May elections, in which Türkiye's central bank increased the one-week repo rate to 15% from 8.5%. The lira was trading weaker against the dollar this morning (-0.3% to 26.09/$), reflecting a -28% currency depreciation year-to-date.



Source: Bloomberg and IMF calculations

This monitor is prepared under the guidance of Jason Wu (Assistant Director), Charles Cohen (Deputy Division Chief), Nassira Abbas (Deputy Division Chief), and Antonio Garcia-Pascual (Deputy Division Chief). Fabio Cortes (Senior Economist), Sanjay Hazarika (Senior Financial Sector Expert), Esti Kemp (Financial Sector Expert-London Representative), Johannes S Kramer (New York Representative), Aurelie Martin (Senior Economist-London Representative), and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Yingyuan Chen (Financial Sector Expert), Deepali Gautam (Research Officer), Phakawa Jeasakul (IMF Resident Representative in Hong Kong SAR), Harrison Kraus (Research Assistant), Yiran Li (Research Assistant), Xiang-Li Lim (Financial Sector Expert),Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), Mustafa Oguz Caylan (Research Officer), Silvia Ramirez (Senior Financial Sector Expert), Patrick Schneider (Financial Sector Expert), Ying Xu (Economist), Dmitry Yakovlev (Senior Research Officer), and Akihiko Yokoyama (Senior Financial Sector Expert). Javier Chang (Senior Administrative Assistant), Dalila Mujevic (Staff Assistant), and Srujana Sammeta (Staff Assistant) are responsible for the word processing and production of this monitor.

Global Financial Indicators

7/5/23 8:37 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4446	0.1	2	4	16	16
Europe		4360	-0.7	0	2	30	15
Japan		33339	-0.3	0	3	28	28
China		3869	-0.8	1	2	-13	0
Asia Ex Japan		67	1.2	2	1	-1	4
Emerging Markets		40	1.1	2	1	1	6
Interest Rates					basis points		
US 10y Yield		3.88	2.6	17	20	107	1
Germany 10y Yield		2.46	0.2	14	7	128	-12
Japan 10y Yield		0.39	0.6	0	-4	17	-3
UK 10y Yield		4.44	2.8	13	24	240	77
Credit Spreads					basis points		
US Investment Grade		147	0.8	-8	-16	-37	-12
US High Yield		432	2.8	-24	-46	-177	-48
Exchange Rates					%		
USD/Majors		103.13	0.1	1	-1	-3	0
EUR/USD		1.09	0.1	0	2	6	2
USD/JPY		144.5	0.0	0	4	6	10
EM/USD		48.8	-0.4	-1	-2	-4	-2
Commodities					%		
Brent Crude Oil ($/barrel)		76.4	0.2	3	0	-9	-8
Industrials Metals (index)		141	-0.7	-2	-2	-7	-15
Agriculture (index)		67	0.1	-1	3	1	-3
Implied Volatility					%		
VIX Index (%, change in pp)		14.5	0.8	0.8	-0.1	-12.2	-7.2
US 10y Swaption Volatility							
Global FX Volatility		8.2	0.0	-0.3	-0.3	-3.5	-2.6
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		133	-0.7	6	-3	-89	-72
Italy		173	-2.0	6	-3	-25	-42
Portugal		73	-1.8	2	5	-38	-29
Spain		107	5.1	9	7	-4	-3

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

Emerging Market Financial Indicators

Last updated: 7/5/2023 8:38 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		7.24	-0.4	0.0	-2	-7	-5		2.7	-2.0	-5	-12	-28	-34
Indonesia		15015	-0.1	-0.1	-1	0	4		6.2	-3.2	-8	-21	-114	-76
India		82	-0.2	-0.2	1	-3	1		7.4	-4.0	2	-6	(1.3)	-7
Philippines		55	-0.3	-0.1	2	0	1		5.9	1.3	1	1	28	-8
Thailand		35	0.0	2.1	-1	3	-1		2.7	-3.3	-3	12	-5	10
Malaysia		4.65	0.0	0.4	-2	-5	-5		3.9	0.5	8	20	-31	-15
Argentina		259	0.0	-1.3	-6	-51	-32		90.4	-290.6	-1456	-1987	2566	224
Brazil		4.86	-0.4	-0.2	1	11	9		10.8	0.7	-23	-50	-225	-180
Chile		801	-0.2	0.0	0	19	6		5.0	0.0	2	-15	-120	-30
Colombia		4140	0.8	0.7	3	1	17		7.4	0.0	-9	-103	-138	-238
Mexico		17.04	0.1	0.3	3	20	14		8.1	-0.5	8	-34	-63	-65
Peru		3.6	0.2	0.2	1	6	5		6.7		-25	-61	-105	-130
Uruguay		38	-0.2	-0.1	3	6	6		9.6	0.0	-29	-41	-111	-108
Hungary		348	-0.8	-2.1	-1	14	7		6.7	3.0	-25	-109	-145	-286
Poland		4.09	-0.3	0.3	2	13	7		5.0	2.3	-9	-30	-143	-117
Romania		4.5	0.1	0.0	2	6	2		6.6	-3.2	3	-18	-205	-108
Russia		90.5	-0.9	-4.7	-11	-30	-18							
South Africa		18.7	-0.5	-0.5	3	-12	-9		9.6	-3.0	5	-40	53	44
Turkey		26.09	-0.3	-0.2	-19	-35	-28		16.7	14.0	-14	329	-231	690
US (DXY; 5y UST)		103	0.1	0.6	-1	-3	0		4.19	0.4	22	37	137	19

	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		3869	-0.8	1	2	-13	0		181	-6	-8	-26	4
Indonesia		6719	0.6	1	2	1	-2		130	-10	-14	-99	-10
India		65446	-0.1	3	4	22	8		127	-5	-15	-70	-15
Philippines		6512	0.0	0	1	1	-1		103	-10	-10	-74	6
Thailand		1509	-0.4	3	-1	-2	-10		0	0	0	0	0
Malaysia		1390	-0.2	0	0	-2	-7		91	-2	-5	-46	-9
Argentina		441469	1.1	6	22	376	118		2016	-100	-549	-330	-189
Brazil		119076	-0.5	1	6	21	9		248	-6	-15	-120	-26
Chile		5894	0.7	4	4	18	12		125	-5	-6	-56	-7
Colombia		1134	0.1	0	-2	-15	-12		368	-5	-29	-71	-4
Mexico		53931	-0.9	0	1	14	11		369	-7	-25	-76	-12
Peru		22410	-0.1	1	2	23	5		156	-8	-17	-50	-24
Hungary		49912	-0.6	-1	4	27	14		205	-5	-20	-33	-17
Poland		66755	-1.1	0	2	28	16		128	-9	-8	33	55
Romania		12735	1.4	4	5	4	9		222	-4	-21	-124	-33
South Africa		75784	-0.6	1	-1	17	4		398	-23	-39	-118	31
Turkey		5990	-0.2	7	11	153	9		479	-19	-50	-239	39
Ukraine		507	0.0	0	0	-2	-2		4139	18	-858	-789	60
EM total		40	-1.0	2	1	1	6		384	0	-23	-74	9

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

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