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- Fed's quantitative tightening begins ([link](#))
- Investors moderate forecast for Fed rate hikes ([link](#))
- Expectations for a 50 bps ECB rate hike in July gain momentum ([link](#))
- Weak companies losing access to credit markets ([link](#))
- Markets in Colombia rally on election results ([link](#))

[Mature Markets](#)



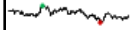

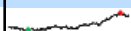

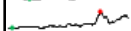




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Markets cautious as Fed quantitative tightening begins

US equity index futures are mixed and European stocks are mostly lower as the first trading day of June gets underway. Interest rates are up both in the US and Europe as markets position for Friday's US payrolls report. Today is the beginning of the Fed's quantitative tightening program (QT), where it will allow portions of its \$8.9 trillion portfolio to mature without reinvestment, and not reinvest coupon payments or prepayments, causing the balance sheet to shrink. The first maturity of \$15bn is due on June 15. The objective is to tighten financial conditions without upsetting the markets, but there is a lot of uncertainty about the potential impact. Volatility related to QT is believed to be a key reason behind the Fed's ending of rate hikes in 2018. Meanwhile, oil is in focus ahead of tomorrow's OPEC meeting to discuss July supply plans. Brent crude saw a surge of 12.4% in May. Expectations for a 50bps rate hike by the ECB in July are gaining momentum.

Key Global Financial Indicators

Last updated: 6/1/22 8:07 AM	Level		Change from Market Close				YTD	Since 23-Feb-22
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		
Equities			%				%	
S&P 500		4132	-0.6	4	0	-2	-13	-2
Eurostoxx 50		3787	0.0	3	0	-7	-12	-5
Nikkei 225		27458	0.7	3	2	-5	-5	4
MSCI EM		43	1.4	3	1	-24	-13	-10
Yields and Spreads			bps					
US 10y Yield		2.88	3.3	13	-6	127	137	89
Germany 10y Yield		1.14	1.6	19	20	132	132	91
EMBIG Sovereign Spread		447	-7	-35	9	116	80	35
FX / Commodities / Volatility			%					
EM FX vs. USD, (+) = appreciation		52.7	-0.1	-1	1	-9	0	-1
Dollar index, (+) = \$ appreciation		102.1	0.3	0	-1	14	7	6
Brent Crude Oil (\$/barrel)		116.6	0.8	2	7	66	50	20
VIX Index (% change in pp)		26.2	0.0	-3	-7	8	9	-5

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

Local equity markets posted fractional gains in the month of May after taking heavy losses in April and being sharply lower year-to-date. However, US technology stocks continued their losing streak. Last week saw the S&P 500 rally by 6.6%, the nineteenth largest weekly return since 1950, according to data from Goldman Sachs. Credit spreads stabilized after a turbulent previous month, and Treasury yields pulled back from post-pandemic highs set earlier in May.

Performance of Selected Market Variables in May 2022: US 4pm Close

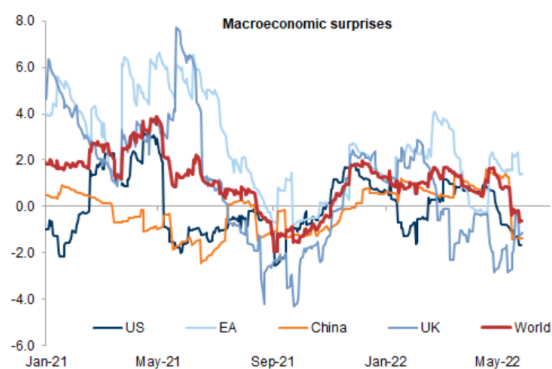
Source: Bloomberg

	Performance in May	Year-to-Date
US 10-Year Treasury	-9 bps	+136 bps
German 10-year Treasury	+18 bps	+130 bps
Euro	Euro stronger 1.7%	Euro 5.6% weaker
Yen	Yen 1% weaker	Yen 11.6% weaker
S&P 500	Unchanged	-13.30%
Euro Stoxx 600	-1.6%	-9.1%
China CSI 300	+1.9%	-17.2%
MSCI EM ETF	-1%	-13.6%
Brent Oil	+12.4%	+58% ^m

Investors are moderating their estimates of Fed rate hikes. The market's forecast for the Fed's terminal rate has fallen below 3% for the first time in several months. Interest rate futures markets are predicting a terminal rate of around 2.85% early next year. In fact, the eurodollar futures curve between December 2023 and December 2024 has become inverted, implying that markets expect policy rates to be lower in December 2024 than they will be in December 2023. Goldman thinks this has led to a mild recovery in market sentiment, as investors grow more hopeful that the Fed will not hike much above the 3% level. Increasing worries about growth have highlighted this possibility, and the correlation between bad economic news and the S&P 500 has been quite negative. Others are more skeptical, pointing to yesterday's euro area inflation report which showed that inflation was even higher than expected. This camp worries that the majority of the market still does not realize how far central banks will have to go to tackle inflation.

Exhibit 3 : Investors' focus has shifted to growth as macro data started to disappoint in May

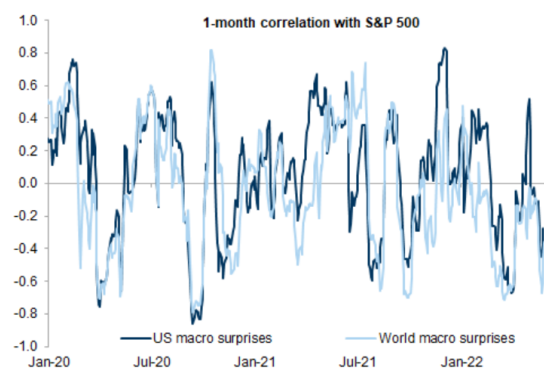
MAP: Macro-data assessment Platform



Source: Goldman Sachs Global Investment Research

Exhibit 4 : Bad news has not been bad news (for markets)

Correlation of weekly returns

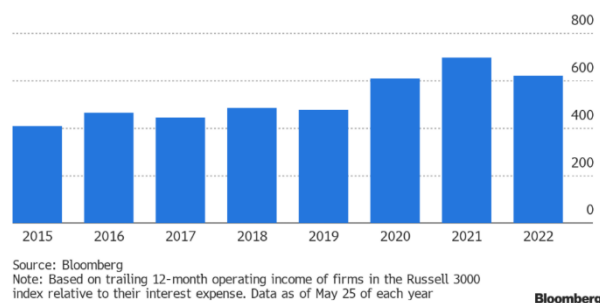


Source: Bloomberg, Goldman Sachs Global Investment Research

Companies with weak balance sheets and low credit ratings are gradually losing access to credit markets. They had free access to markets in the age of zero to negative policy rates and quantitative easing, but demand for their debt is sharply lower as central banks raise rates and the chances of a recession get higher. For example, in the US the issuance of high yield debt is down 75% from last year. The fear is that these weak companies will be unable to meet their interest payments as funding costs go up. Bloomberg estimates that approximately 20% of the US's 3000 largest publicly traded companies are in so-called zombie status, and these companies of \$900 bn of debt outstanding. Analysts have been flagging this problem for a while, but central banks have stepped in repeatedly over the past 13–14 years to support credit markets. The difference this time is that inflation is approaching crisis levels and central banks may have to keep raising rates regardless of the impact on high yield borrowers. Rising default rates and bankruptcies are a distinct possibility.

Zombies Rise

The count of zombie firms remains significantly higher than pre-Covid



Euro Area

European equity markets were mixed, with the Stoxx 600 Europe -0.3% lower. The automotive (+1.1%) and banking (+0.4%) sectors saw the largest gains, while the mining sector (-1.4%) underperformed. Deutsche bank shares were trading higher this morning (+0.3%) despite reports that DWS and Deutsche Bank were raided by police following greenwashing allegations.

The euro (-0.2%) edged lower as markets are reassessing the European economic outlook in the aftermath of the announced Russian oil ban. ING analysts expect further weakening and highlight that the currency already embeds a substantial amount of monetary policy tightening. **Sovereign bond yields and peripheral spreads were little changed.**

ECB Governing Council (GC) member Holzmann said that the recent inflation data increases the case for a +50bps hike in July. Holzmann cautioned that inflation expectations could become unanchored without *decisive action*, and also commented that a weak euro is not helping the inflation outlook. ECB GC Member Kazimir expects a +25bps hike in June but noted that a +50bps hike is possible in September, according to media reports. Deutsche Bank analysts now expect a 50bps hike in one of the Q3 meetings, according to Bloomberg. Markets are still pricing in roughly +34bps priced in for July and Commerzbank analysts highlight that the forward curve for December is close to discounting +125bps, thus indicating one +50bps hike this year.

Market expects close to 125bp over four meetings!

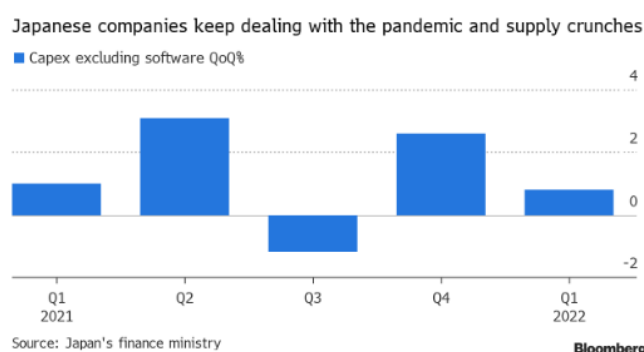
Cumulative ECB depo rate hike expectations derived from ECB-dated €STR forwards, in bp



This morning data showed eurozone unemployment unchanged at 6.8% in April, in line with expectations. Analysts note that the strong labor market data should serve as additional confirmation for the ECB that monetary policy tightening is appropriate. Separately, final Eurozone manufacturing PMI for May was marginally higher than preliminary estimates (54.6 vs 54.4), while **manufacturing PMI for Spain surprised on the upside in May**, increasing to 53.8 (vs expected 52.0 from 53.3). **Manufacturing PMI in Italy disappointed**—falling to 51.9 in May (vs expected 53.6 from 54.5) amid reports of production being limited by material shortages.

Japan

Equities rallied 1.4%. Bank of Japan (BOJ) Deputy Governor Wakatabe reiterated the need for dovish policy. The Bank of Japan stands out from other central banks in the dovishness of its stance. Separately, **Q122 capital spending growth slowed to 3% yoy** (previous: 4.3%). Company profit growth moderated to 13.7% yoy (previous: 24.7%). The yen depreciated by 0.6%, losing 1.7% over the last three sessions and weakening back to 130.



Emerging Markets

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In **EMEA**, most markets were weaker in keeping with the negative overall market tone. In South Africa, the rand appreciated on news that a fuel subsidy was to be extended. In **Asia**, PMIs declined in the wake of the China slowdown. Currencies were mixed. Inflation in Sri Lanka rose above 39% as the economic crisis continued. According to press reports, the country is in talks with the IMF. South Korea and Indonesia were closed today. In **Latin America**, the main outperformer was **Colombian assets** as markets rallied following Sunday's election results. Other local currencies were mixed.

China

Shanghai may face a lengthy post-lockdown recovery. The city's truck traffic remains below 30% of pre-pandemic levels and subway rides remain far below the 9.8mn 2021 daily average, according to Bloomberg. On **data releases**, Caixin manufacturing PMI firmed in May to 48.1 (previous: 46) alongside the official reading, aided by slower production declines. Supply chain delays remained severe, with input price inflation moderating but still strong. Youth unemployment rose to a record 18.2% in April, three times the national rate, and is projected to rise further.

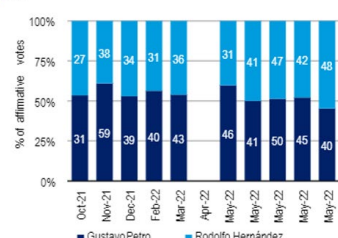
Meanwhile, local stock market remain mired in a bear market despite promises of help from the official sector. Some analysts are calling for investors to buy on the theory that a bottom has been reached, while others are more cautious. China has seen two consecutive years of very heavy losses.



Colombia

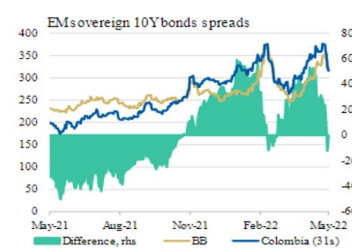
Markets reacted positively to Sunday's first round election results in Colombia. Gustavo Petro (40%) will compete against Rodolfo Hernandez (28%) in the June 19 runoff. Analysts highlighted that the positive market reaction was driven by market worries that Petro would represent a break with Colombia's tradition of market-friendly policies. Sunday's results reduced some of these worries given Hernandez's second round polling (LHS chart) compared to other candidates. Following the market holiday on Monday, the peso appreciated by 4.3%—its biggest daily rally since 2010. 10 year USD spreads closed 19bps tighter on the back of substantial outperformance in May (RHS chart), in part as polls had started to favor Hernandez according to market analysts. Morgan Stanley notes that there is limited room for further tightening given Colombia's wide double deficits despite high oil prices and points out potential governability issues as neither candidate has a majority in congress.

Exhibit 1: Second round (run-off) polls, Petro vs. Hernandez scenario
Hernandez is the only candidate with strong upward momentum in the polls



Source: CNC, Delicco, Guarumo, Inverim, La Gran Encuesta, Yanhual, Sempra, BofA GLOBAL RESEARCH

Exhibit 32: Colombia credit does have further tightening potential yet we see this limited to around 30bp



Source: Bloomberg, Morgan Stanley Research

Hungary

The Hungarian forint closed weaker against the euro (-0.9%) yesterday after the central bank increased the base rate by +50bps to +5.9%. In the press release the central bank noted its determination to combat inflation, with interest rate hikes set to rise at a gradual pace until the inflation outlook stabilizes around the central bank's target. ING analysts see the terminal rate at 8.25% with risks skewed to the upside. The forint is one of the worst performing emerging market currencies this year, and Morgan Stanley analysts describe the forint as the *least preferred* currency in CEE, with a higher risk premium partly attributable to the debate with the European Commission over the rule of law.

EMEA: Currencies, 1 Jan 2022 = 100

















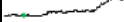

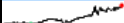




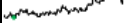



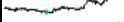


Source: Bloomberg and IMF calculations

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Global Financial Indicators

Last updated: 6/1/22 8:10 AM	Level		Change				YTD	Since 23-Feb-22
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		
Equities			%				%	%
United States		4138	-0.6	5	0	-2	-13	-2
Europe		3787	0.0	3	0	-7	-12	-5
Japan		27458	0.7	3	2	-5	-5	4
China		4083	-0.2	3	2	-23	-17	-12
Asia Ex Japan		72	1.6	3	1	-25	-13	-9
Emerging Markets		43	1.4	3	1	-24	-13	-10
Interest Rates			basis points					
US 10y Yield		2.88	3.3	13	-6	127	137	89
Germany 10y Yield		1.14	1.6	19	20	132	132	91
Japan 10y Yield		0.24	-0.5	3	1	16	17	4
UK 10y Yield		2.12	2.0	21	22	130	115	64
Credit Spreads			basis points					
US Investment Grade		151	-0.6	-11	-5	61	39	8
US High Yield		430	-3.4	-58	19	93	93	24
Europe IG		88	0.2	-7	-2	38	40	16
Europe HY		439	0.5	-27	10	195	197	87
Exchange Rates			%					
USD/Majors		102.05	0.3	0	-1	14	7	6
EUR/USD		1.07	-0.2	0	2	-12	-6	-5
USD/JPY		129.5	0.6	2	-1	18	12	13
EM/USD		52.7	-0.1	-1	1	-9	0	-1
Commodities			%					
Brent Crude Oil (\$/barrel)		117	0.8	5	11	78	55	28
Industrials Metals (index)		184	-1.1	0	-8	14	6	-2
Agriculture (index)		76	0.3	-2	-2	27	24	8
Implied Volatility			%					
VIX Index (% change in pp)		26.2	0.0	-3.2	-7.2	8.3	9.0	-4.8
US 10y Swaption Volatility		107.6	0.6	-0.2	-22.7	41.8	28.5	13.3
Global FX Volatility		9.6	0.0	-0.6	-1.0	2.5	2.2	2.1
EA Sovereign Spreads			10-Year spread vs. Germany (bps)					
Greece		247	1.1	-15	6	146	95	7
Italy		198	-2.0	-2	14	90	63	26
Portugal		114	0.5	-1	6	50	50	22
Spain		110	-0.1	-1	7	45	36	7

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

Emerging Market Financial Indicators

Last updated: 6/1/2022 8:12 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)									
	Level		Change (in %)				YTD	Since 23-Feb-22	Level		Change (in basis points)				YTD	Since 23-Feb-22	
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M			Last 12m	Latest	1 Day	7 Days	30 Days	12 M			
	vs. USD		(+)= EM appreciation						% p.a.								
China		6.68	-0.2	0.2	-1	-5	-5	-6		2.9	0.6	3	-2	-31	1	0	
Indonesia		14534	0.3	0.6	0	-2	-2	-1		7.0	1.2	-19	6	62	66	54	
India		78	0.1	0.0	-1	-6	-4	-4		6.3	0.0	0	9	75	0		
Philippines		52	-0.2	-0.3	0	-9	-3	-3		5.5	0.0	0	15	105	98	48	
Thailand		34	-0.1	-0.2	0	-9	-3	-6		3.0	1.0	13	12	107	112	75	
Malaysia		4.38	-0.1	0.3	-1	-6	-5	-5		4.2	6.1	10	-11	103	66	58	
Argentina		120	-0.2	-0.9	-4	-21	-15	-11		56.3	21.1	49	384	1042	577	838	
Brazil		4.73	0.1	2.0	7	9	18	6		11.7	-69.3	-64	-57	246	97	13	
Chile		824	0.8	0.8	5	-12	3	-4		6.1	0.0	8	-24	227	67	18	
Colombia		3774	1.0	5.3	6	-2	8	4		8.2	0.0	-29	-51	240	182	35	
Mexico		19.68	-0.1	0.8	4	1	4	3		8.5	0.0	11	-52	169	96	64	
Peru		3.7	-1.0	-0.3	3	3	8	1		7.5	0.2	-8	-31	270	163	153	
Uruguay		40	0.4	0.1	3	10	12	6		10.3	0.0	14	19	204	153	210	
Hungary		369	0.4	-0.3	-1	-23	-12	-13		7.0	1.5	36	22	431	251	221	
Poland		4.29	-0.4	0.5	4	-15	-6	-5		6.4	2.4	33	40	447	282	245	
Romania		4.6	-0.2	0.2	2	-13	-6	-5		7.8	4.1	-9	100	507	296	263	
Russia		62.7	-0.3	-3.9	13	17	20	30		8.2	6.0	-122	-424	85	-60	-301	
South Africa		15.5	0.9	1.5	4	-11	3	-2		8.5	6.0	27	-2	114	104	88	
Turkey		16.45	-0.3	-0.6	-10	-48	-19	-16		22.5	-9.0	-188	121	391	-182	8	
US (DXY; 5y UST)		102	0.3	0.2	-1	14	7	6		2.85	3.1	13	-11	204	159	94	

	Equity Markets							Bond Spreads on USD Debt (EMBIG)								
	Level		Change (in %)				YTD	Since 23-Feb-22	Level		Change (in basis points)				YTD	Since 23-Feb-22
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M			Last 12m	Latest	7 Days	30 Days	12 M			
									basis points							
China		4083	-0.2	3	2	-23	-17	-12		205	-8	4	-6	2	-3	
Indonesia		7149	0.0	5	-1	20	9	3		185	-32	-2	13	20	0	
India		55381	-0.3	3	-3	7	-5	-3		167	-27	-1	18	35	13	
Philippines		6712	-0.9	2	0	-2	-6	-9		130	-31	-11	36	29	-7	
Thailand		1660	-0.2	2	0	3	0	-2		0	0	0	0	0	0	
Malaysia		1553	-1.1	1	-3	-3	-1	-2		124	-10	4	4	7	-9	
Argentina		92288	-1.0	2	5	51	11	1		1917	-17	114	431	237	180	
Brazil		111351	0.3	1	3	-13	6	-1		302	-26	4	57	-9	-29	
Chile		5350	-0.7	3	12	22	24	22		151	-32	-19	9	11	-23	
Colombia		1603	4.6	8	3	31	14	6		335	-46	-37	85	-13	-57	
Mexico		51753	-0.8	1	1	2	-3	1		365	-31	-14	38	33	-5	
Peru		20719	-1.3	1	-9	-1	-2	-11		168	-33	-32	5	18	-22	
Hungary		40495	2.8	-2	-7	-13	-20	-15		212	-12	17	72	88	59	
Poland		57421	0.0	2	-1	-13	-17	-9		9	-14	8	-29	-23	-7	
Romania		12510	0.0	2	-2	9	-4	-5		249	-25	10	73	57	17	
Russia		2385	1.2	2	-2	-37	-37	-23		3411	-577	938	3228	3234	2897	
South Africa		71420	-0.9	6	-1	4	-3	-5		383	-32	-8	71	28	-6	
Turkey		2575	1.1	6	6	80	39	28		586	-26	72	114	8	23	
Ukraine		519	0.0	0	0	-2	-1	0		3280	39	-454	2805	2521	1807	
EM total		43	-0.3	3	1	-24	-13	-10		378	-37	-16	26	-9	-80	

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

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