



- Impact of Fed balance sheet run-off on financial conditions remains uncertain ([link](#))
- Bank of Canada hikes 50 bps and signals readiness to act more forcefully if needed ([link](#))
- UK house price appreciation expected to slow amid higher interest rates ([link](#))
- China taps policy banks to provide infrastructure financing ([link](#))
- Ukraine's central bank hikes policy rate from 10 to 25% in first move since invasion ([link](#))
- Failure to pay event triggers Russian credit default swaps ([link](#))

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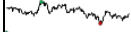

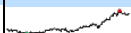






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Markets weigh inflation and central bank policy outlooks

Global markets are stabilizing this morning as investors continue to juggle growth and inflation concerns alongside its implication for central bank policies. Global equity markets have remained on edge despite some recently strong economic readings. The S&P 500 fell close to 1% yesterday though the risk-off mood is fading this morning as falling oil prices have eased some inflation concerns for the moment. European equity indices and US futures are posting modest gains. Investors seem to be interpreting the healthy economic data releases as a sign that central banks may need to accelerate their efforts to rein in inflation. Core sovereign bond yields have risen in response and curves have flattened as market expectations for policy rate hikes have continued to move higher this week with almost 200 bps and over 100 bps of rate increases priced for the Fed and ECB by year-end, respectively. Elsewhere on the central bank front, the Bank of Canada hiked its policy rate 50 bps for the second consecutive meeting while also reinforcing further tightening by suggesting the council is prepared to act more forcefully to combat inflation if needed. Oil prices are down close to 3% this morning following news reports that Saudi Arabia is prepared to boost its oil output to make up for any sanctions-related loss from Russia.

Key Global Financial Indicators

Last updated: 6/2/22 8:08 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		4101	-0.7	4	-1	-3	-14	-3
Eurostoxx 50		3792	0.9	1	2	-7	-12	-5
Nikkei 225		27414	-0.2	3	2	-6	-5	4
MSCI EM		42	-0.7	4	0	-25	-13	-11
Yields and Spreads			bps					
US 10y Yield		2.90	-0.2	16	-8	132	139	91
Germany 10y Yield		1.19	0.6	20	23	139	137	97
EMBIG Sovereign Spread		448	0	-23	9	118	81	35
FX / Commodities / Volatility			%					
EM FX vs. USD, (+) = appreciation		52.7	0.0	0	2	-9	0	-1
Dollar index, (+) = \$ appreciation		102.2	-0.3	0	-2	14	7	6
Brent Crude Oil (\$/barrel)		113.2	-2.6	-4	5	59	46	17
VIX Index (% change in pp)		25.6	-0.1	-3	-7	8	8	-5

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

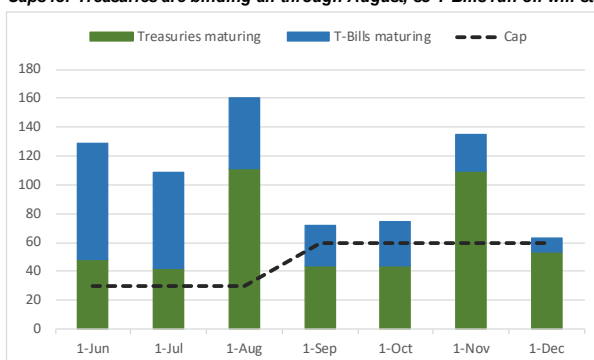
Mature Markets

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United States

Quantitative tightening (QT) officially commenced on June 1, but the impact on financial conditions remains unclear. The Federal Reserve deployed its second tool to curb inflation alongside higher interest rates on June 1. There is a total of \$48.25 bn Treasuries maturing in June, out of which \$18.25 bn will be reinvested, as they exceed the temporary \$30 bn run-off cap. Maturing T-Bills in June (and all the way to August) will be fully reinvested. The run-off process starts in practice on June 15th, when the first \$15bn batch matures. The Federal Reserve has stressed that the reduction will work in tandem with interest rate increases but, according to officials, estimates of the potential impact of QT on tightening financial conditions remains uncertain.

Caps for Treasuries are binding all through August, so T-Bills run-off will start in September



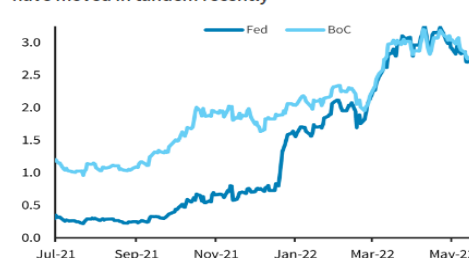
Source: NY Fed and Staff Calculations

In data releases this morning, ADP employment data showed US firms added 128k jobs in May, below expectations for a 300k gain and a decline from last months revised increase of 202k. Initial jobless claims declined to 200k compared to expectations for claims to remain flat at 210k. Continuing claims also fell to 1309k from 1343k. Markets were little changed following the data releases.

Canada

The Bank of Canada remained hawkish after the second consecutive 50 bp policy rate hike. The Bank of Canada raised its benchmark interest rate by a half percentage point to 1.5%, as expected, citing rising risks of elevated inflation becoming entrenched. The move came on the back of a previous 50 bp hike last meeting and while quantitative tightening is ongoing. The decision was reinforced by a hawkish statement noting the bank's readiness to be "more forceful" on inflation. The statement resulted in mixed opinions from markets as to how it could be implemented. It stoked bets of a 75 bp hike in some corners of the market, though most analysts appear to be sticking with a 50 bp pace in the July meeting and possibly beyond, leading to a higher terminal rate. Following the announcement, bond yields moved higher, led by the short-end, and the Canadian dollar fluctuated.

Figure 2. Market expectations of hikes in the US and Canada have moved in tandem recently



We show December 2023 pricing for the Fed and June 2024 pricing for the BoC.

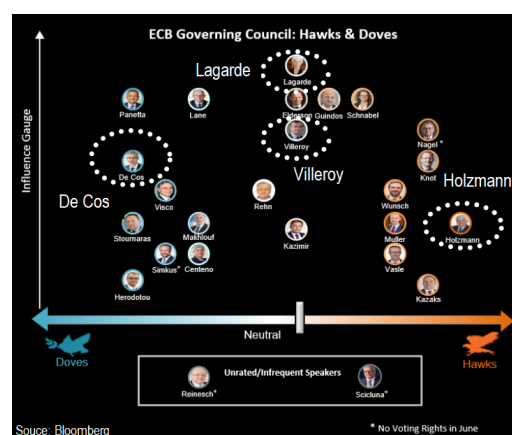
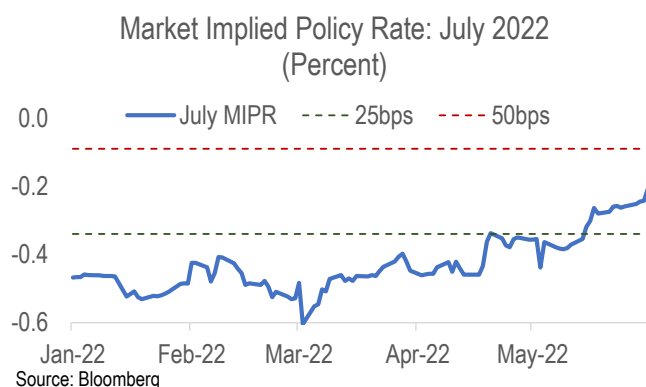
Euro Area

European equity markets rebounded today, with the Euro Stoxx 600 0.4% higher. The consumer discretionary (+0.9%) and capital goods (+0.9%) sectors saw the largest gains, while the energy sector (-1.0%) underperformed as oil prices went lower following a headline that Saudi Arabia is ready to

increase supply if Russian output were to decline substantially. The monthly OPEC+ meeting is scheduled later today, and investors expect a modest increase in output for July.

The euro (+0.4%) managed to rebound after the sharp decline Wednesday as market participants await the US job report Friday. The Swiss franc strengthened against the euro after consumer prices in Switzerland increased more than expected. **Sovereign bond yields and peripheral spreads were little changed.**

Markets are increasingly pricing a 50 bp ECB policy rate hike in July. According to ECB Governing Council member Holzmann, seen as a hawk, the latest all-time high for euro-zone inflation strengthens the case for the ECB to hike rates by 50 bps in July. ECB President Lagarde has previously indicated an imminent end to bond purchases followed by 25 bp hikes in July and September, and Governing Council member Villeroy has echoed her comments. Meanwhile, another member, De Cos, said the rate increase process must be gradual and rely on data.



The prospect of lower earnings may add to investors' concerns. Analysts see that expected downward revisions in corporate earnings estimates would be headwinds for equities. Despite worries over a slowdown, EPS expectations for this year and the next have barely changed in Europe, implying the market will remain vulnerable to further downside.

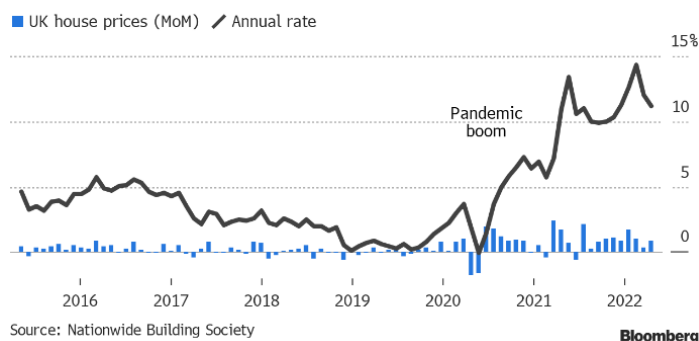


United Kingdom

BoE Deputy Governor Cunliffe said that the housing market is starting to slow and will be dragged down by rising interest rates and slower economic growth. His remarks followed a tenth consecutive monthly increase in house prices, though the annual rate has slowed from recent peaks.

Defiant Housing Market

Price momentum continued in May despite the growing cost of living crisis



Japan

Equities slipped -0.6%. Japan will hike the minimum wage to at least ¥1,000 per hour (current: ¥930) as part of PM Kishida's *New Capitalism* plan, according to Bloomberg. Separately, **Bank of Japan (BOJ)'s Board Member Adachi said it is too early to tighten monetary policy.** While the underlying inflation trend may approach 2% amid stronger than expected wage growth momentum, the BOJ is only halfway to its price stability goal, he stated. Separately, **foreign net buying of Japan assets deteriorated for week ended May 27.** Net stock flows dived to +¥0.9 bn (+\$6.9 mn, previous: +\$32.3 mn) while bonds suffered outflows of -¥26.2 bn (-\$0.2 bn, previous: +\$9.9 bn). **Japanese yen gained +0.2%, 10-year yields were up +0.6bps.** Barclays estimates 10-year yields at about 1.5% without the BOJ's yield curve control, with even gradual policy revisions likely to weaken the cap on long-term yields.

Figure 9. 10y JGB yields - actual versus BoJ model estimates



Note: The core CPI used in the estimates incorporates the BoJ's own revisions and may differ from our estimation results.

Source: BoJ, MHLW, MIC, Bloomberg, Barclays Research

Emerging Markets

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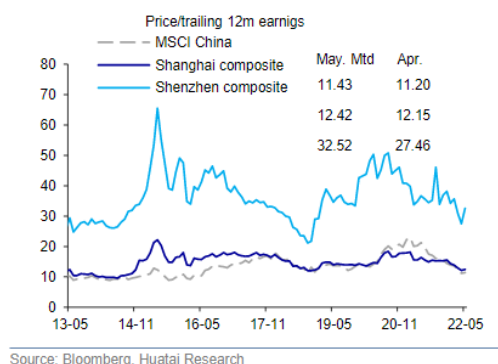
In Latin America, currencies depreciated as strong US data boosted the US dollar. The **Brazilian real** was the main underperformer depreciating by 1.7% without any notable headlines. The **Chilean peso** was

flat on the day as the Finance Ministry announced it that USD sales would remain discontinued in June. Local rates were pressured by higher US rates, **long end rates in Brazil, Colombia, and Mexico all increased by 10–15 bps. Asian equities fell -0.7% pulled by the technology sector.** Hong Kong SAR and South Korea slipped -1%. Indonesia firmed +0.7%. Asian currencies were mixed and 10-year yields mostly climbed. **More regional Asian manufacturing PMIs declined in May.** Indonesia fell to 50.8 (previous: 51.9) and South Korea to 51.8 (previous: 52.1). **In EMEA, equity and currency markets were trading mixed.** Hungarian stocks led gains (+1.8%) following a 30 bp increase to the central banks' one-week deposit rate that also helped the currency appreciate close to 1%. The Russian ruble appreciated by 1.6%. **Ukraine's central bank raised its policy rate from 10% to 25%,** reactivating its policy tools for the first time in 4 months to prevent further deterioration of inflation expectations and dollarization of the economy.

China

China taps policy banks to provide 800 bn yuan (\$120 bn) in infrastructure financing. Premier Li announced during the State Council meeting that the stimulus could finance much of the year's infrastructure costs and assist local governments struggling with falling revenues, Bloomberg reports. Relatedly, **China's local governments may issue a record 1.5 tn yuan (\$224 bn) of bonds in June.** Considering such volumes, the central bank may boost liquidity via open market operations or even reserve ratio cuts, some analysts note. Recently, the bank affirmed it will step up policy to keep China's economy within a reasonable range. **Equities gained (Shanghai: +0.4%, Shenzhen: +0.7%). Renminbi and 10-year yields were broadly unchanged.**

Fig.54: Shanghai composite, Shenzhen composite and MSCI China PEs all rebounded in May



Russia

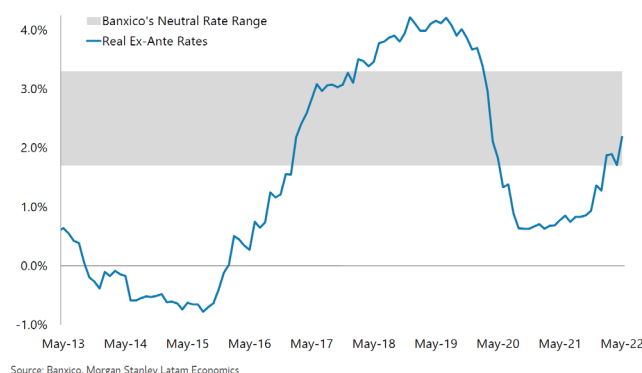
The International Swap Dealers' Association (ISDA), an industry entity which governs global derivatives markets, declared Russia to have missed a bond payment yesterday. As a result, ISDA's Credit Derivative Determination Committee declared that credit default swaps (CDS) on Russian debt are triggered, so that holders of CDS must receive compensation from CDS sellers. Russia missed a \$1.9 mn interest payment. Despite the small amount, the missed payment will trigger all outstanding CDS. The market for Russian CDS has essentially been frozen for weeks, and Russia's dollar bonds are trading at distressed levels. However, with just \$1.5 bn of CDS outstanding compared to \$3.2 bn at the end of April, the market impact of the trigger is expected to be limited. Moreover, the missed payment cannot trigger cross default of other Russian debt, with \$75 mn the minimum payment.

Mexico

Banxico presented its quarterly inflation report and confirmed concerns about inflation expectations de-anchoring and the level of real rates. Inflation forecasts were unchanged from those published after the May 12 decision, but 2022 and 2023 growth forecasts were revised down. Board

members highlighted the possibility of more aggressive hike increments (i.e., more than 50 bps) remains on the table. There was broad consensus that real rates remain low given Banxico's estimates of neutral rates (see chart) and the upside risks to the inflation outlook. Morgan Stanley expects that Banxico will deliver two 75 bp increases, in the next two meetings, followed by a 50 bp hike in September and a final 25 bps increase in November to reach a terminal rate of 9.25%. The TIIE curve is pricing the policy rate ending the year above 9.5%.

Exhibit 2: Mexico: Ex-ante real interest rate (policy rate deflated by 12-month CPI expectations)



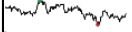

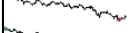
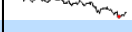
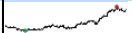











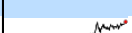






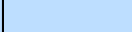




Source: Banxico, Morgan Stanley Latam Economics

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Global Financial Indicators

Last updated: 6/2/22 8:10 AM	Level		Change					Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
Equities			%				%	%
United States		4106	-0.7	3	-1	-2	-14	-3
Europe		3792	0.9	1	2	-7	-12	-5
Japan		27414	-0.2	3	2	-6	-5	4
China		4090	0.2	2	2	-22	-17	-12
Asia Ex Japan		71	-0.8	4	0	-26	-14	-10
Emerging Markets		42	-0.7	4	0	-25	-13	-11
Interest Rates			basis points					
US 10y Yield		2.90	-0.2	16	-8	132	139	91
Germany 10y Yield		1.19	0.6	20	23	139	137	97
Japan 10y Yield		0.24	0.3	0	1	16	17	4
UK 10y Yield		2.16	5.4	25	25	133	118	68
Credit Spreads			basis points					
US Investment Grade		151	-0.4	-6	-7	61	39	8
US High Yield		427	-0.7	-34	5	91	90	21
Europe IG		89	0.0	1	-1	40	42	18
Europe HY		446	0.0	7	18	202	204	94
Exchange Rates			%					
USD/Majors		102.16	-0.3	0	-2	14	7	6
EUR/USD		1.07	0.4	0	2	-12	-6	-5
USD/JPY		129.7	-0.4	2	0	18	13	13
EM/USD		52.7	0.0	0	2	-9	0	-1
Commodities			%					
Brent Crude Oil (\$/barrel)		113	-2.6	-1	7	71	50	25
Industrials Metals (index)		186	1.1	2	-5	17	8	-1
Agriculture (index)		75	0.7	-2	-1	26	24	7
Implied Volatility			%					
VIX Index (% change in pp)		25.6	-0.1	-2.8	-6.8	8.1	8.3	-5.5
US 10y Swaption Volatility		103.6	-5.0	1.5	-27.5	35.6	24.6	9.3
Global FX Volatility		9.7	0.0	-0.4	-1.2	2.7	2.3	2.3
EA Sovereign Spreads			10-Year spread vs. Germany (bps)					
Greece		248	1.3	-6	6	147	97	8
Italy		204	2.4	14	15	96	69	33
Portugal		117	2.4	7	8	53	53	26
Spain		113	1.7	7	9	48	39	10

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

Emerging Market Financial Indicators

Last updated: 6/2/2022 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		6.67	0.2	1.0	-1	-4	-5	-5		2.9	0.4	8	-2	-32	1	0
Indonesia		14483	0.7	1.0	0	-1	-2	-1		7.0	-2.6	-16	3	60	63	52
India		78	-0.1	0.0	-1	-6	-4	-4		6.3	0.0	0	9	75	0	
Philippines		53	-0.6	-0.7	-1	-9	-3	-3		5.5	0.0	0	15	105	98	48
Thailand		34	0.0	-0.5	0	-9	-3	-6		3.0	-2.0	14	10	105	110	73
Malaysia		4.39	-0.1	0.1	-1	-6	-5	-5		4.2	1.9	13	-12	104	65	58
Argentina		120	-0.1	-1.0	-4	-21	-15	-11		56.5	18.6	67	402	1093	596	856
Brazil		4.80	0.3	-0.7	6	6	16	4		11.6	-89.1	-57	-63	249	91	7
Chile		824	0.0	0.9	4	-12	3	-4		6.1	0.0	4	-21	230	70	21
Colombia		3800	-0.7	3.6	6	-4	7	3		8.4	0.0	-11	-37	262	196	50
Mexico		19.63	0.3	0.7	4	1	5	3		8.6	-1.5	18	-42	180	106	74
Peru		3.7	-0.4	-1.1	3	4	7	0		7.5	-0.2	11	-37	263	163	153
Uruguay		40	-0.3	0.1	3	9	12	5		10.3	0.0	11	19	213	153	210
Hungary		369	0.9	-0.7	-2	-23	-12	-13		7.0	0.0	19	23	431	252	222
Poland		4.28	0.6	0.3	4	-15	-6	-5		6.4	0.3	20	41	451	284	247
Romania		4.6	0.4	-0.2	2	-13	-6	-5		7.8	0.0	5	100	507	296	263
Russia		62.4	1.3	3.2	13	17	20	31		8.2	3.6	9	-422	83	-58	-299
South Africa		15.5	0.2	1.1	4	-13	3	-3		8.4	-6.0	18	-8	107	98	82
Turkey		16.47	-0.5	-0.8	-10	-48	-19	-16		22.5	0.0	-188	121	367	-182	8
US (DXY; 5y UST)		102	-0.3	0.1	-2	14	7	6		2.92	0.5	21	-8	213	166	102

	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		4090	0.2	2	2	-22	-17	-12		202	-11	1	-9	-1	-6	
Indonesia		7149	0.0	3	-1	17	9	3		186	-25	-1	16	21	1	
India		55818	0.8	3	-2	7	-4	-2		169	-25	1	17	37	15	
Philippines		6687	-0.4	1	-1	-2	-6	-9		131	-22	-10	39	30	-6	
Thailand		1648	-0.7	1	0	2	-1	-3		0	0	0	0	0	0	
Malaysia		1550	-0.2	1	-3	-3	-1	-2		124	-8	4	3	7	-9	
Argentina		91370	-1.0	0	4	46	9	0		1912	-4	109	436	232	175	
Brazil		111360	0.0	1	4	-14	6	-1		303	-11	5	59	-8	-28	
Chile		5299	-1.0	1	11	21	23	21		151	-23	-19	9	11	-23	
Colombia		1605	0.1	8	1	29	14	6		332	-27	-40	83	-16	-60	
Mexico		51506	-0.5	0	-1	1	-3	0		373	-9	-6	50	41	3	
Peru		20704	-0.1	2	-8	-2	-2	-11		168	-23	-32	6	18	-22	
Hungary		41368	2.1	5	-3	-11	-18	-13		209	-13	14	71	85	56	
Poland		56984	-0.1	0	0	-15	-18	-9		11	-8	10	-27	-21	-5	
Romania		12377	-1.1	1	-3	8	-5	-6		249	-20	9	74	56	17	
Russia		2345	-1.2	-3	-4	-39	-38	-24		3411	-577	938	3228	3234	2897	
South Africa		71119	0.4	2	-2	3	-4	-5		380	-22	-11	70	25	-9	
Turkey		2593	0.9	6	7	81	40	29		582	-32	68	113	4	19	
Ukraine		519	0.0	0	0	-2	-1	0		3373	107	-361	2906	2614	1900	
EM total		42	0.5	4	0	-25	-13	-11		378	-27	-16	28	-9	-80	

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

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