GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

FRIDAY, JUNE 2, 2023

- **US Money Market Funds continued to see inflows through May** (link)
- **Bank reserves poised for decline amid replenishment of TGA account** (link)
- **Markets continue to expect two more 25 bps hikes from the ECB** (link)
- **Investors expect Brazil to begin its easing cycle in August amid positive signs** (link)
- **China's local government debt financing vehicles face repayment risks** (link)
- **Mexico's central bank signals a prolonged restrictive policy stance** (link)
- **Türkiye's assets react strongly to rumors of new finance minister appointment** (link)
- **Hungarian sovereign yields fall on government measures** (link)
- **Special Feature: Q1-2023 Corporate Earnings Monitor** (attached)

Mature Markets | Emerging Markets | Market Tables

Debt ceiling lifted, tech soars

Markets adopted a risk on mode after the US Senate passed legislation to suspend the debt ceiling. On the economic data front, the May ISM manufacturing index printed aligned with expectations, inducing minor change to the Atlanta Fed GDP nowcast for Q2, which currently stands at 1.96%. Fed speakers yesterday prompted a downward pressure on yields with Fed Philadelphia Fed President Patrick Harker (voter) stating that the Fed was close to a point where it could stop hikes. The ECB has released the minutes of its April meeting, which show a clear bias towards further rate hikes, following which several ECB officials have made statements to that effect. ECB executive board member Fabio Panetta stated that the ECB is not done raising rates and French governor Villeroy de Galhau stated that the effect of the interest rate hikes is starting to have an impact. Unexpected government measures prompted a rally of Hungarian sovereign bonds while rumors of a new finance minister appointment that could signal President Erdogan's willingness to reverse unconventional policies reverberated across Türkiye's financial markets.

Key Global Financial Indicators

Last updated: 6/2/23 8:35 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		4221	1.0	3	2	1	10	0
Eurostoxx 50		4301	1.0	-1	0	13	13	8
Nikkei 225		31524	1.2	2	8	14	21	19
MSCI EM		39	1.8	1	1	-10	3	-18
Yields and Spreads					bps			
US 10y Yield		3.62	2.5	-18	20	71	-25	163
Germany 10y Yield		2.29	4.3	-25	3	106	-28	206
EMBIG Sovereign Spread		481	4	6	8	33	29	68
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		49.9	0.0	0	-1	-6	0	-6
Dollar index, (+) = $ appreciation		103.5	0.0	-1	2	2	0	8
Brent Crude Oil ($/barrel)		75.5	1.6	-2	0	-36	-12	-22
VIX Index (%, change in pp)		15.5	-0.1	-4	-2	-9	-6	-16

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

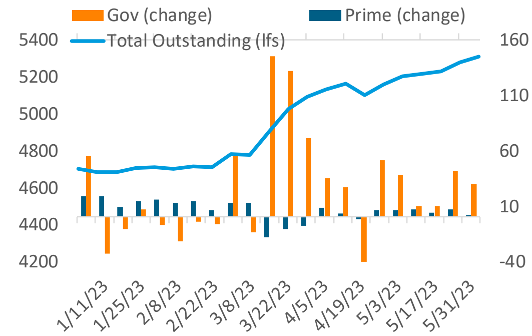
Mature Markets [back to top]

United States

This morning saw an overall stronger than expected nonfarm payrolls report. May non-farm payrolls printed 339k (expected 195k from upward revised 294k). The unemployment rate printed at 3.7% (expected 3.5% from 3.4% previously), which reflects the highest level since October last year. The labor participation rate held steady at 62.6%. Average hourly earnings increased by 0.3% m/m or 4.3% y/y, which was in line with expectations. US Treasury yields increased +6 bps to up to 4.4% at the 2-year tenor and the dollar strengthening against the euro and the yen, while some of the move retraced quickly.

Money Market Funds saw continued inflow in the week through May 31 amid uncertainty related to debt ceiling negotiation. The asset under management increased to a new record high of $5.4 tn. Government MMFs received $30 bn while prime funds increased by $1.4 bn. Weekly inflow to the MMF has continued at an average pace of $20 bn/week after the peak in March.

MMF Outstanding and Weekly Chage ($ bn)

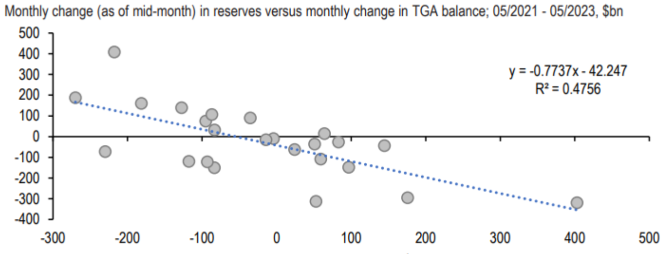


source:ICI, Bloomberg

Replenishing Treasury's checking account at the Fed (TGA) will drain bank reserves. As legislative developments to break the debt ceiling impasse end, analysts are increasingly focused on the implications of this episode for funding markets. Monetary accounting mechanics prescribe that if Treasury issues securities to replenish its TGA, banks need to absorb the new issuance supply by depleting bank reserves. Past episodes confirm empirically that a TGA cash balance increase indeed goes hand in hand with a decrease of bank reserves (left chart). Right now, the TGA cash balance is at its lowest level since 2017 and expected to be replenished by about $600bn from its current balance of less than $40bn (right chart). Partly, the rising issuance supply of T-bills is seen to be absorbed by investors other than US banks (such as MMFs and foreign investors). However, the drainage of bank reserves could be further accelerated by continued shifts from deposits to MMFs for the reasons outlined in the current GFSR. Hence, JP Morgan analysts see a decline of bank reserves declining by $600 bn to $2.6tn by the end of September. They expect bank reserves to approach the Fed's estimated minimum ample supply level still this year.

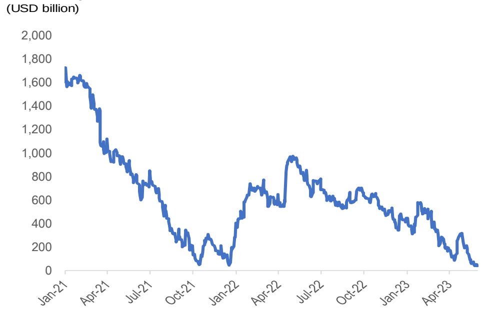
Figure 4: A sharp ramp up in TGA will likely be accompanied by a corresponding decline in reserve

Monthly change (as of mid-month) in reserves versus monthly change in TGA balance; 05/2021 - 05/2023, $bn



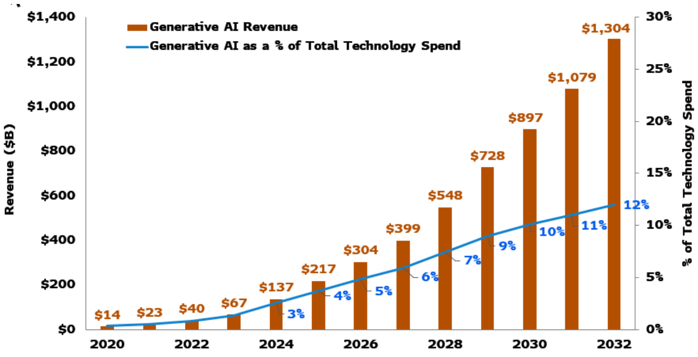
Source: J.P. Morgan, Federal Reserve H.4.1.

US Treasury Cash Balance
(USD billion)



Source:Bloomberg

Over the next decade, the market for generative AI could substantially grow. During this timeframe, Bloomberg analysts expect a 42% growth to 1.3tn from last year's $40bn, driven by training infrastructure in the near-term and specialized software and services in the medium- to long-term. Estimates suggest that the share of generative AI in terms of total technology spending (including hardware, software, services, advertisement, and gaming) could surpass 10% by 2032 from less than 1% last year. The largest driver of this is seen in infrastructure used for training, which involves creating a machine learning model using large datasets generating additional needs of semiconductor accelerators, servers, and storage, and revenue from training infrastructure is expected to grow $500 bn in 10 years. Bloomberg analysts anticipate that Amazon, Alphabet, Nvidia, and Microsoft are likely to be leading the AI boom.



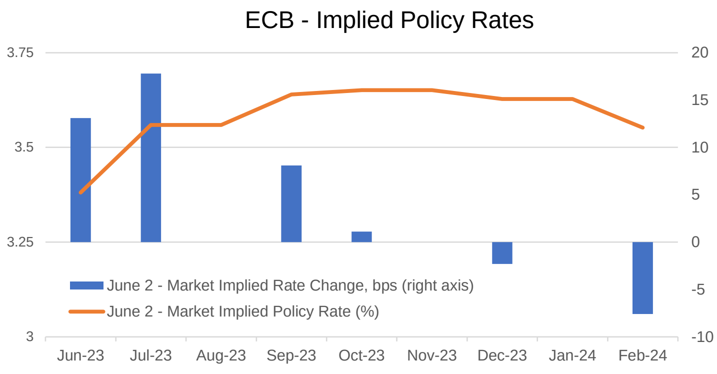
Source: Bloomberg Intelligence, IDC

Euro Area

European markets were in a risk on mode, with equities and the euro gaining, and core bond yields increasing. The equity market (Stoxx Europe 600) was up +1.0%, with banking stocks gaining +1.4%. The euro was strengthening marginally +0.1% vs. the dollar to 1.08/$. German 10y bund yields were up +4 bps to 2.29%, and Italian spreads were down -6 bps to 178 bps.

The April ECB meeting minutes indicate further rate hikes. Following yesterday's release of the minutes, Goldman Sachs analysts note three takeaways, namely that 1) the ECB governing council saw the latest core inflation developments as broadly worrisome, 2) that the April meeting featured an extensive discussion on wages with some disagreement about whether a wage-price spiral is underway, and 3) uncertainty around the speed and strength of monetary policy transmission having played a key role in motivating a downshift to a "*prudent*" 25bps rate hike increment (from 50 bps previously). Overall, "*a number*" of member wanted a 50bp hike, but "*most*" could accept a 25-bps rate hike increment, which eventually saw support by "*almost all*" members if the ECB's communication conveyed a clear directional bias to underline that there is more ground to cover.

Markets continue to expect two more 25 bps hikes in June and July, for a terminal rate of 3.75%. Goldman Sachs analysts maintained their forecast for two more 25bp hikes to 3.75% in July with no cuts until 2024Q4. Likewise, JP Morgan analysts continue to expect two more 25bp hikes. They note that inflation-related news creates some upside risk to this forecast but argue that the caution revealed by the ECB recently and their forecast of a US recession later this year work against this upside risk. HSBC analysts lean more hawkish and expect that the ECB will remain on a firm hiking mode through the summer, raising rates three more times in June, July and September, to a terminal rate of 4%. Given that the minutes note "*a strong preference against returning to outright forward guidance*", they expect no explicit guidance on how long rates might stay at the peak but note that we could get firmer language once closer to a pause.



Source: Bloomberg WIRP and IMF

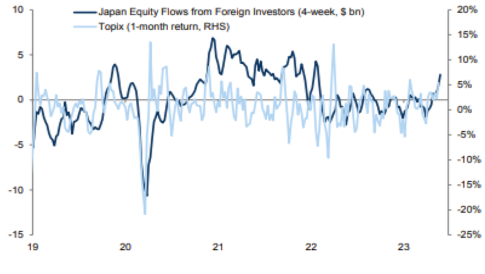
Japan

In local currency, Japan is the best-performing regional equity market year-to-date. Supported by the combination of domestic macroeconomic strength, a still accommodative monetary policy stance and Tokyo Stock Exchange reforms, Japan's stock market has materially decoupled from the rest of Asia (left chart). From a positioning point of view, Japanese equities have attracted foreign investors in Q2, which provided a tailwind to performance. Recently, flows from foreign investors have picked up and have been closely correlated with Topix performance. Goldman Sachs analysts point out that in absolute terms and relative to history, these flows could further endure (right chart), suggesting there is scope for further increases in positioning given strong corporate fundamentals and still attractive valuations.

Exhibit 1: Japan equities have decoupled from the rest of Asia
Total return in local ccy

Source: Datastream, Goldman Sachs Global Investment Research

Exhibit 2: Topix performance has been more closely related to inflows from foreign investors than usual
3-month flows ($bn)



Source: EPFR, Datastream, Goldman Sachs Global Investment Research

Emerging Markets

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In Asia, stock markets gained, and most currencies appreciated. China, Philippines, and Thailand led stock market gains, up 1.4%, 1.3% and 0.6%, respectively. In currencies, the Thai baht, Malaysian ringgit, and Philippine peso appreciated the most, up +0.8%, +0.8% and +0.7%. Only the Indonesian Rupiah fractionally lost, down -0.1%.

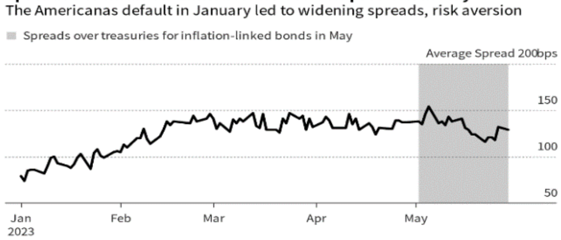
In EMEA, stock markets saw gains and currencies were trading fractionally stronger. Stock market gains were led by stock markets in Türkiye, Poland and South Africa, which increased by +3.5%, 2.0% and 2.0%, respectively. Currency appreciation against the dollar was led by the South African rand, which gained +0.8% to 19.47/dollar. Central and eastern European currencies were broadly flat versus the euro, except for the Polish zloty, which appreciated +0.3% to 4.51/euro. Local bond yields were mixed.

Latin American markets mostly gained. Except for Mexico, stock markets traded higher in Brazil, Colombia, and Peru, up +1.5%, +1.7% and +2.1%, respectively. Among currencies, the Peruvian sol depreciated by -0.7%, while the Colombian peso, Brazilian real and Chilean peso gained +1.2%, +0.8% and +0.8%, respectively. In Peru, May headline inflation printed on Thursday at +0.3% m/m, which was in line with expectations.

Brazil

Brazilian debt markets could see the beginning of the easing cycle in August. A positive sign of the country's inflation outlook leads to a sense of relief in credit markets. In addition, 2023Q1 GDP data released on Thursday printed at 1.9% q/q (expected 1.2% from -0.2% previously) leading to a 4.0% y/y growth pace. Following the data release, Brazil's Planning and Budget Minister stated to journalists that the economy

Spreads For Inflation-Linked Notes See Compression in May
The Americanas default in January led to widening spreads, risk aversion



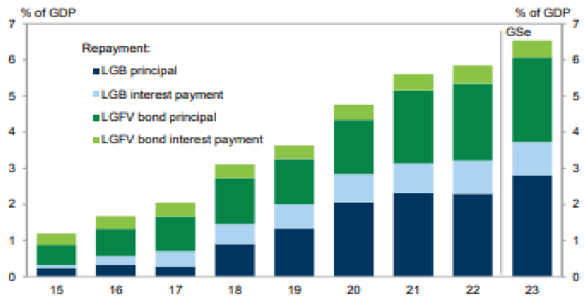
Source: ABC Bank Research, B3
Bloomberg

could expand by more than 2% during 2023 and that there was no reason interest rates should not start falling, according to a Bloomberg news article. The extra yield demanded to hold local inflation-linked bonds over US treasuries narrowed slightly in May, according to the data from ABC Bank Research. In the nation's primary debt markets, there are also signs of thawing.

China

China's local government debt risk has drawn increasing scrutiny from market participants. The local government fiscal conditions and recent headlines highlight the repayment risks of cash-constrained local government financing vehicles (LGFVs). News on the last-minute bond repayment of a LGFV in Yunnan and Guizhou seeking state aid has heightened concerns over LGFV debt risks. Falling local government revenues and the intensified cash shortage of LGFVs over the past few years have exacerbated the stresses of LGFV debt repayment in some of the most vulnerable provinces. In the near term, many analysts expect more debt swapping and debt restructuring/extension to defuse imminent risk events, while utilizing state-owned enterprises (SOE) hares/profits and idle assets are also seen as potentially alleviating short-term repayment pressures. However, the rising risks of LGFV bond defaults and consequent impact on market sentiment could pose downside risk to economic growth and financial markets via a slowing in infrastructure investment and decline in SOE share prices.

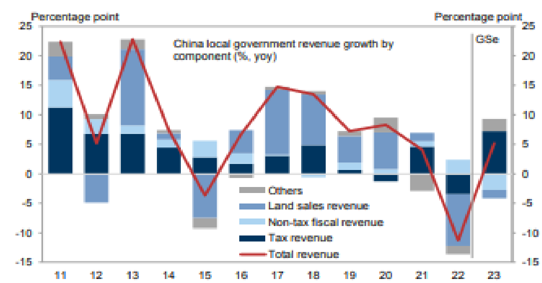
Exhibit 1: Local governments' bond repayment likely to reach a new high in 2023



LGB = Local Government Bond, LGFV = Local Government Financing Vehicle

Source: Wind, Goldman Sachs Global Investment Research

Exhibit 3: Local government revenue growth is expected to pick up this year, but remains below pre-Covid levels due to falling land sales



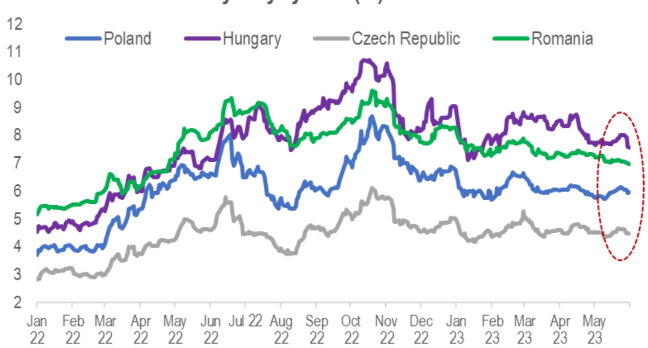
Local government revenue = general budget revenue + government managed fund revenue, excluding transfer payment from the central government

Source: Government websites, Wind, Data compiled by Global Investment Research

Hungary

An unexpected announcement to boost demand for government debt propels bond markets. On May 31, the Hungarian government unveiled a set of measures designed to stimulate the purchase of government debt by banks and impose regulations requiring investment funds to increase their holdings of state debt. The government anticipates that the measures would to generate a surge in demand for government bonds, estimated at HUF1.8trn (€4.8 bn), with banks potentially acquiring an additional HUF1.3 trn in government bond holdings. ING analysts broadly agrees with this estimate, and expect that banks would account for most of the volume at auctions. Following the announcement, Hungary's local currency bond yields rallied at the 10-year tenor by -33bps. This morning, 10y bond yields declined by further -5bps to 7.48% and are now roughly 40bps lower than at the start of the week.

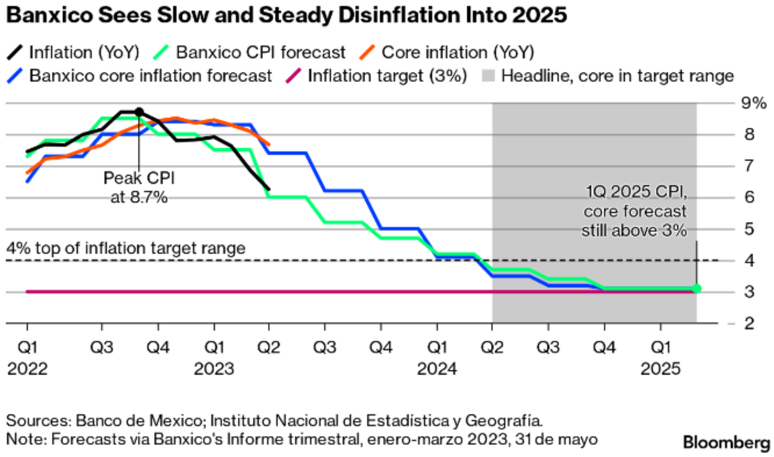
EMEA: Local Currency 10-yr yields (%)



Source: Bloomberg and IMF calculations

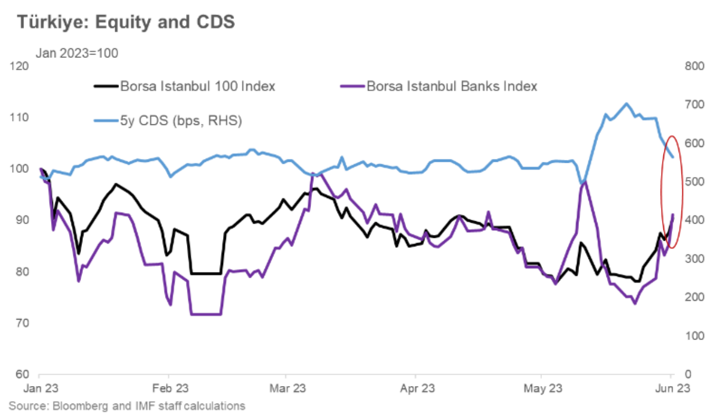
Mexico

Banxico signals a restrictive policy stance to hold tighter monetary policy for longer. The country's central bank published minutes from the May 18 Monetary Policy Committee meeting on Thursday. The minutes stated that "*It will be necessary to maintain the reference rate at its current level for an extended period*". Moreover, amid continued uncertainty about the inflation outlook, the meeting minutes also suggested that none of the Board members gave a clear indication as to when interest rate cuts would be on the table. On the contrary, if inflation does not subside, some members even pondered the possibility of an additional rate hike. According to a Citi survey, Banxico's official overnight rate is expected to remain at its current level of 11.25% for the remainder of the year.



Türkiye

President Erdogan is set to appoint Mehmet Simsek as the new treasury and finance minister. President Erdogan is expected to unveil his new cabinet tomorrow, which sparked media rumors citing people familiar with the matter pondering on the appointment of Mehmet Simsek. Market contacts anticipate that his appointment could signal President Erdogan's willingness to reverse unconventional policies. This morning Turkish stocks outperformed (+3.5%), with large gains seen in the banking sector (+6.6%) while CDS spreads declined (-15bps). Yields 10y on local currency bonds increased (+73bps to 11.6%), while Eurobond yields fell by roughly -20bps.



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Global Financial Indicators

	Level		Change				
6/2/23 8:35 AM	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		4229	1.0	2	3	1	10
Europe		4301	1.0	-1	0	13	13
Japan		31524	1.2	2	8	14	21
China		3862	1.4	0	-4	-6	0
Asia Ex Japan		66	1.6	1	0	-9	2
Emerging Markets		39	1.8	1	1	-10	3
Interest Rates					basis points		
US 10y Yield		3.62	2.5	-18	20	71	-25
Germany 10y Yield		2.29	4.3	-25	3	106	-28
Japan 10y Yield		0.41	-1.0	-1	-1	17	-1
UK 10y Yield		4.14	2.6	-19	47	199	47
Credit Spreads					basis points		
US Investment Grade		162	-2.3	-2	-1	12	3
US High Yield		488	-8.7	4	-6	61	7
Exchange Rates					%		
USD/Majors		103.55	0.0	-1	2	2	0
EUR/USD		1.08	0.0	0	-2	0	0
USD/JPY		138.8	0.0	-1	2	7	6
EM/USD		49.9	0.0	0	-1	-6	0
Commodities					%		
Brent Crude Oil ($/barrel)		75.7	1.9	-2	1	-22	-9
Industrials Metals (index)		145	1.4	3	-6	-23	-12
Agriculture (index)		65	-0.1	0	-2	-15	-6
Implied Volatility					%		
VIX Index (%, change in pp)		15.5	-0.1	-3.6	-2.3	-9.2	-6.2
US 10y Swaption Volatility		110.6	-1.8	-19.5	-13.9	12.0	-15.1
Global FX Volatility		8.7	0.0	-0.1	-0.4	-0.9	-2.0
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		141	-6.9	3	-53	-106	-64
Italy		178	-5.8	-7	-13	-28	-36
Portugal		70	-2.2	-4	-14	-47	-31
Spain		102	-1.5	-5	-5	-12	-7

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

Emerging Market Financial Indicators

Last updated: 6/2/2023 8:36 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		7.07	0.4	-0.1	-2	-6	-2		2.8	1.5	-1	-26	-5	-25
Indonesia		14993	-0.1	-0.6	-2	-3	4		6.4	-4.2	-5	-16	-67	-57
India		82	0.1	0.3	-1	-6	1		7.3	-5.0	-1	-1	(42.3)	-15
Philippines		56	0.7	-0.2	-1	-6	0		5.9	0.0	1	-3	48	-8
Thailand		35	0.8	0.4	-1	-1	0		2.6	-1.5	-12	-2	-34	-2
Malaysia		4.58	0.8	0.5	-2	-4	-4		3.7	-1.7	-9	-4	-55	-35
Argentina		240	-0.3	-1.8	-7	-50	-26		110.1	65.7	260	1578	5357	2188
Brazil		4.98	0.6	0.2	1	-4	6		11.7	6.2	1	-75	-85	-88
Chile		799	0.5	0.0	1	2	7		5.2	-4.5	-18	0	-94	-16
Colombia		4397	1.2	2.1	7	-14	10		8.6	0.0	-28	-61	23	-118
Mexico		17.49	0.3	0.8	3	12	11		8.4	2.0	-11	4	-23	-35
Peru		3.7	-0.7	-0.3	0	1	3		7.2	-1.9	-12	-33	-40	-80
Uruguay		39	0.0	0.2	0	3	3		10.0	-0.1	0	2	-25	-67
Hungary		345	-0.1	0.4	-1	6	8		7.8	0.0	-33	12	81	-176
Poland		4.18	0.5	1.1	0	2	5		5.3	1.6	-27	-1	-111	-88
Romania		4.6	0.0	0.2	-3	0	0		6.8	0.0	-6	-33	-100	-90
Russia		81.2	-0.3	-2.3	-1	-22	-9							
South Africa		19.5	0.8	0.9	-5	-21	-13		10.1	-6.0	-18	75	166	93
Turkey		20.88	-0.4	-4.4	-7	-21	-10		12.0	289.0	289	-89	-1052	215
US (DXY; 5y UST)		104	0.0	-0.7	2	2	0		3.74	3.8	-19	29	83	-27

	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		3862	1.4	0	-4	-6	0		195	4	1	-7	18
Indonesia		6633	0.0	-2	-4	-7	-3		155	15	14	-31	15
India		62547	0.2	0	2	12	3		147	-1	-12	-22	5
Philippines		6512	1.3	0	-3	-3	-1		126	14	14	-5	29
Thailand		1531	0.6	0	0	-7	-8		0	0	0	0	0
Malaysia		1381	-0.1	-2	-3	-10	-8		98	2	-3	-26	-2
Argentina		353374	3.3	4	20	286	75		2633	35	-50	721	428
Brazil		110565	2.1	0	8	-2	1		274	17	6	-29	0
Chile		5521	0.9	-2	3	3	5		138	10	6	-13	6
Colombia		1118	1.7	2	-3	-31	-13		412	7	-5	80	40
Mexico		52724	0.0	-2	-4	3	9		402	7	16	29	21
Peru		21495	1.5	1	-1	2	1		180	0	8	12	0
Hungary		47378	1.1	1	4	16	8		239	13	28	30	17
Poland		64979	2.1	0	3	14	13		146	18	23	135	73
Romania		12187	-0.3	0	-1	-3	4		258	9	12	8	2
South Africa		77144	1.8	1	-1	9	6		475	24	69	95	108
Turkey		5097	2.8	11	13	96	-7		565	-52	73	-17	125
Ukraine		507	0.0	0	0	-2	-2		5062	117	-259	1689	983
EM total		39	1.8	1	1	-10	3		423	3	13	45	47

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

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