GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

FRIDAY, JUNE 23, 2023

- **Analysts expect high yield bond default rates to increase** (link)
- **European core yields fall on worse than expected PMI data** (link)
- **Expectations mount for another 50 bps BoE hike, while mortgage crisis fears intensify** (link)
- **Japan's core inflation outpacing forecasts** (link)
- **Zambia's Eurobond prices increase after debt agreement reached** (link)
- **Egypt leaves policy rate unchanged but some analysts expect more tightening** (link)
- **Mexico leaves benchmark rate unchanged at 11.25%** (link)

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Recession concerns intensify

Sovereign bond yields fall and equity markets were trading mostly lower after weaker than expected activity data from the euro area fueled recession concerns. PMI data released this morning surprised notably on the downside in the euro area, but also in the UK, intensifying concerns that higher policy rates could weigh on economic growth or push economies into a recession. Sovereign yields fell, with the 10y bund yield down 13bps and the 10y gilt yield down 5bps. Markets have further scaled up BoE hiking expectations following yesterday's larger-than-anticipated interest rate hike, and the sharp rise in UK interest rates in recent days has been also coined as the "mortgage crisis". In the meantime, core inflation data from Japan surprised on the upside. On the monetary policy front, rates were left unchanged both in Egypt and Mexico, in line with expectations. Elsewhere, Zambia's Eurobond prices have continued to increase – with a debt restructuring agreement now confirmed with official creditors under the G-20 Common Framework.

Key Global Financial Indicators

Last updated: 6/23/23 12:41 PM	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		4382	0.4	0	6	15	14	4
Eurostoxx 50		4288	-0.4	-2	-1	25	13	8
Nikkei 225		32782	-1.5	-3	6	24	26	24
MSCI EM		40	-0.4	-2	3	0	5	-16
Yields and Spreads					bps			
US 10y Yield		3.74	-5.6	-2	5	65	-14	175
Germany 10y Yield		2.37	-12.7	-11	-10	94	-20	214
EMBIG Sovereign Spread		441	-6	-9	-40	-69	-11	28
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		49.4	-0.3	-1	-1	-4	-1	-7
Dollar index, (+) = $ appreciation		103.0	0.6	1	0	-1	-1	7
Brent Crude Oil ($/barrel)		73.3	-1.1	-4	-5	-33	-15	-24
VIX Index (%, change in pp)		13.3	0.4	-1	-5	-16	-8	-18

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

Mature Markets

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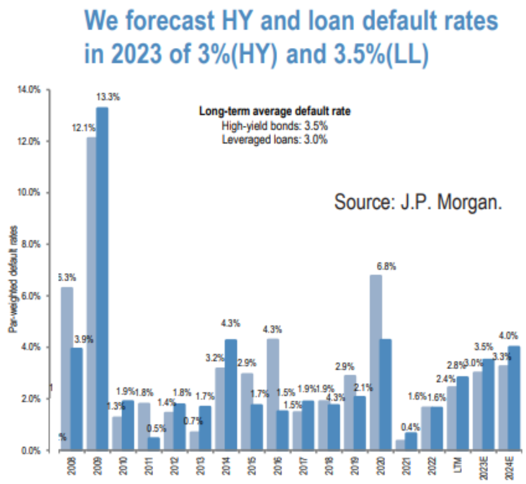
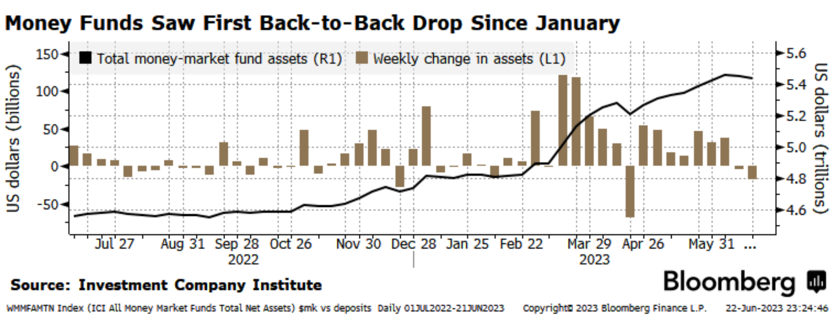
United States

Yesterday, the S&P 500 rose by 0.4%, with a stark heterogeneity across sectors (consumer discretionary was 1.5% higher while real estate fell by 1.4%). US Treasury yields rose by 7-8 bps across the curve, mostly driven by real yields, which rose in response to major central banks' communication about the potential for additional policy rate hikes. The US dollar appreciated 0.3% versus major currencies.

Analysts forecast high-yield (HY) bond and leveraged loan (LL) default rates to double in 2023 to 3.0% and 3.5% respectively and see further increases in 2024. JPMorgan analysts note that HY spreads have so far been supported by strong balance sheets, fading macro risks, and improving capital market conditions. Despite expectations of erosion, HY balance sheets are in a good position to weather forthcoming corporate headwinds with leverage at a more-than-decade low (3.9x) and coverage metrics only slightly below an all-time high (5.7x). While JPMorgan analysts forecast HY bond and loan spreads to widen by year-end, they believe this will occur later in the year as the erosion in the economy and corporate fundamentals transpire on a lag, moreover analysts see near-term recession risks as low.



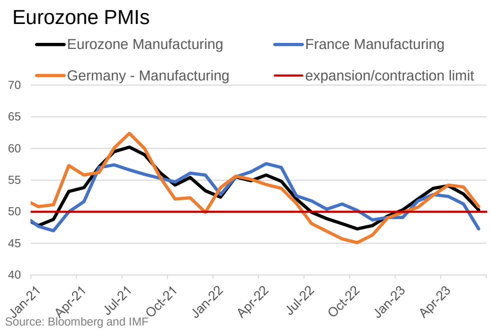
Bloomberg reports that US Money Market funds saw outflows for the second straight week, led by the departure of institutional money amid the recent quarterly tax date. As the Treasury is issuing more bills in the wake of the debt-ceiling suspension, companies with significant cash balances are opting to purchase securities directly, ranging from Treasuries to repurchase agreements and commercial paper. About $18.2bn left US money-market funds in the week to June 21, according to data from the Investment Company Institute. Total assets dropped to $5.43trn versus $5.45trn in the week to June 14.

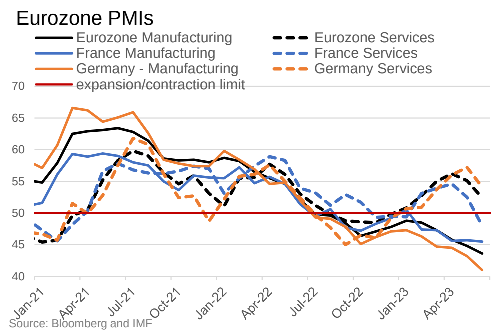


Euro Area

European markets are in a risk-off mode today, following the release of lower-than-expected PMI data for the region. While the equity market (Stoxx Europe 600) is broadly stable, banking stocks are suffering (-1.1%). The euro is sharply down vs. the dollar, weakening 0.8% to 1.09/$. German 10y bund yields are down 12 bps to 2.37%, and Italian spreads were broadly unchanged at 163 bps.

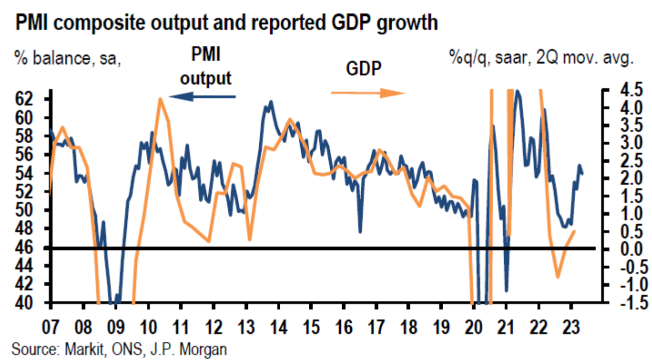
European core 10y yields are down 12 bps today to 2.37% on disappointing June PMI data from the eurozone, after yields increased 6 bps yesterday following the larger than expected hike from the BOE sent global yields upwards. The Eurozone composite PMI came in at 50.3, just on the cusp of the expansion/contraction limit, and sharply lower than expectations (52.5) as well as the May reading (52.8), reigniting recession fears. Services PMI disappointed (52.4 vs. 54.5 expected) but remained in expansionary territory, while the manufacturing PMI fell deeper into contraction (43.6 vs 44.8 expected). German PMI data showed similar trends, with manufacturing contracting further (41) and services still in expansion (54.1). In contrast, the French composite PMI dropped much more sharply than expected (47.3 vs 51 expected) and fell into contractionary territory due to a sharp downside surprise in services (48 vs. 52.1 expected), while manufacturing held up slightly better than expected. (45.5 vs. 45.3 expected).





United Kingdom

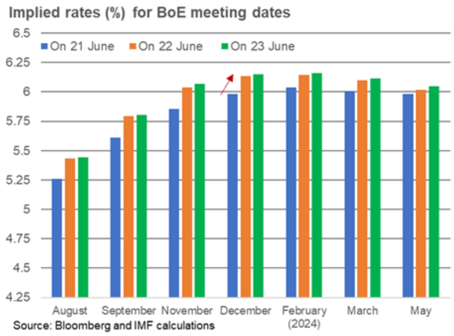
Activity data in the UK points at still resilient growth. The June flash PMI for the UK fell to 52.8 in June, down from May (54) and lower than expected (53.6) – but stronger than in the euro area. JPMorgan analysts point out that while the momentum is downward, the survey's past relationship with GDP is still pointing to growth of 1.6% for Q2/Q3 on their estimates. Retail sales rose 0.3%m/m in May (higher than the -0.2% expected), a small move, given the volatility of this series, but nevertheless a second consecutive rise that leaves the 3m/3m run rate at 1.1% annualized, according to JPMorgan analysts.

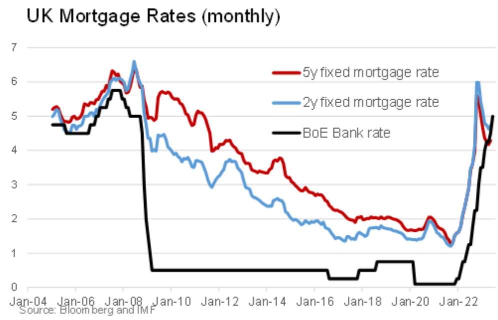


Expectations for another 50bps hike at the upcoming BoE meeting have increased and markets see a higher terminal rate after yesterday's larger-than-anticipated rate hike. After recent upside surprises in wages and services inflation, the BoE surprised markets and reaccelerated the pace of hikes to 50bps yesterday, to take the bank rate to 5%. Analysts had mostly expected a 25 bps hike. Analysts and markets have scaled up BoE tightening expectations but the pound ended the day weaker as recession concerns came back into focus. Analysts are divided on the magnitude of the next hike – with several now expecting a 50bps hike in August. Markets are now pricing the terminal rate at around 6.1%, with 45bps of tightening priced in for the August meeting.

The sharp rise in interest rates in recent days in the UK has been also coined as the "mortgage crisis". Since about 85% of mortgages in the UK are on 2y fixed or 5y fixed rates priced out of the 2y and 5 y swap rates, households are seeing their mortgage repayments increase sharply when their fixed deals are expiring. According to UK Finance, over the next year and a half, 2.4mn households will see their fixed deals expire, of which 800,000 will be in the coming six months. The Institute for Fiscal Studies estimates that at current rates, the cost of the average home loan will rise by GBP 280 per month. Bank of America analysts estimate that if the BoE bank rate were to reach 5.5% the impact through higher mortgage costs to consumption would be 0.5%, if taken on its own. All else equal, that would translate into a 0.3% hit to

GDP. Chancellor Jeremy Hunt is meeting today with the banking industry to discuss how to support struggling borrowers.

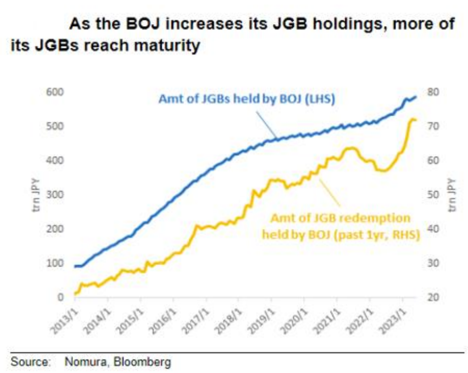




Japan

Japan inflation remains sticky with core prices outpacing forecasts. National consumer price inflation slowed in May to 3.2% y/y (previous: 3.5%) as expected. Core inflation softened as well to 3.2%y/y, but came in slightly higher than expected (vs expected 3.1% from 3.4%), while CPI excluding fresh food and energy surprised on the upside at 4.3% y/y (previous: 4.1%), increasing to the highest level since 1981. Analysts are expecting inflation to remain sticky and Bank of Japan to upgrade their inflation forecasts in July. **Private sector output softened in June.** A separate data release showed Jibun Bank's purchasing managers index (PMI) of activity in Japan's service sector falling to 54.2 (previous: 55.9) in June. **Manufacturing PMI slipped back into contraction**, declining to 49.8 (previous: 50.6), as output and new orders shrank.

Separately, the Bank of Japan (BoJ) could reduce annual purchases by just over 10% of the current value and still fulfill its inflation-overshooting commitment, according to Nomura. In September 2016, the BOJ issued its inflation-overshooting commitment wherein it committed itself to "expanding the monetary base until the year-on-year rate of increase in the observed CPI exceeds 2 percent and stays above the target in a stable manner". The monetary base mainly consists of deposits in BOJ current accounts, and most of these deposits were deposited in response to increased purchasing of JGBs by the BOJ. If the BOJ wants to avoid a decline in its JGB holdings, it must purchase at least enough JGBs to offset the JGBs in its portfolio that reach maturity. **Japanese stocks receded -1.3%,** amid growing expectations that domestic pension funds will rebalance their portfolios by paring equity positions prior the end of the quarter, Bloomberg reported. **The yen was little changed and yields on 10y bonds were marginally lower.**



Emerging Markets

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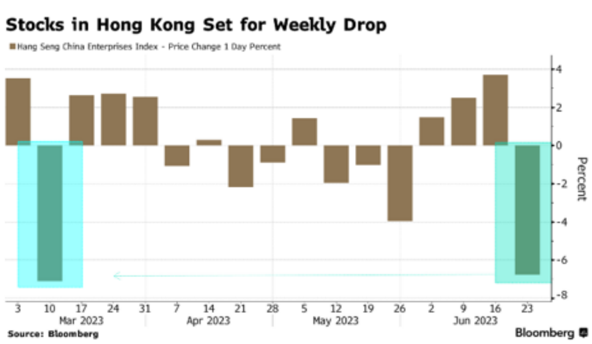
Asian equities fell further -1.3%, losing -3.8% this week. While China markets remained closed for holiday, Hong Kong SAR-listed Chinese shares extended the selloff (-1.7%). South Korea declined -0.9%, and India was down -0.5%. **South Korea** remained on MSCI's emerging markets list following an annual review. The decision was widely expected after MSCI earlier this month said South Korea still faced nine market accessibility issues, flagging concerns similar to 2022's review. **India**'s Adani Group erased nearly $5.3bn in market value, the most since March 28, as all 10 stocks of the conglomerate declined after Bloomberg reported that US authorities have opened an inquiry into statements made by the group during its meetings with investors in the US. **Asian currencies depreciated amid a stronger dollar**. South Korean won weakened -0.7%. Thai Baht, Singapore dollar and Malaysian ringgit fell -0.5%. **Philippines**' central bank Governor Medalla said that the bank has done enough in the monetary policy to tame inflation and will likely keep its benchmark interest rate unchanged for the rest of the year, Bloomberg reported. **10-year bond yields rose.** Malaysia yields added +3.8bps, followed by Singapore (+3.2bps) and South Korea (+2.4bps). **Malaysia** CPI eased to a 1-year low at 2.8%y/y in May (previous: 3.3%), falling below expectations (3%). Separately, both Kelantan and Selangor dissolved their state assembly this week, paving way for state polls to be held. Inflation in **Singapore** decelerated to +5.1% (previous: +5.7%) in May, with the data print coming in below expectations.

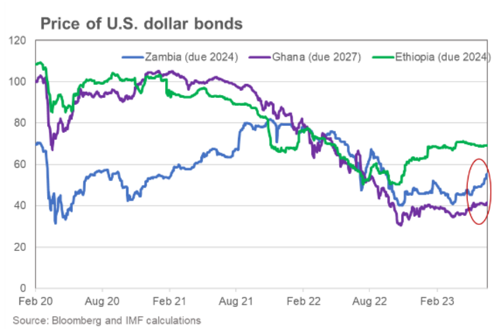
EMEA markets were mixed, with equities mostly lower and currencies weakening against the dollar. Equity markets were underperforming in Romania (-1.6%) while equities in Türkiye saw strong gains (+2.8%) in the aftermath of the smaller-than-expected policy rate hike yesterday. The Turkish lira is continuing its weakening trend, depreciating a further 2.7% this morning, now 7.9% weaker than on Wednesday. CEE currencies were mostly trading weaker against the euro with both the Polish zloty (-0.4% to 4.44/€) and Hungarian forint (-0.3% to 370.52/€) weakening ahead of their respective sovereign rating reviews by Fitch Ratings. S&P is also set to publish its review for Poland.

Latin American equities retreated while currencies were mixed. The Ibovespa index experienced a -1.2% decline mainly from consumer stocks and banks, following the decision of Brazil's central bank to leave interest rates unchanged and refrain from endorsing immediate reductions. Equity markets also dropped in Mexico (-0.9%), Colombia (-0.9%), Peru (-0.4%) and Chile (-0.3%). Currencies depreciated in Mexico (-0.3%), Chile (-0.1%) and Brazil (-0.1%), while the Colombian peso (+1%) and the Peruvian sol (+0.2%) strengthened against the US dollar.



Zambia

Zambia's Eurobonds prices rose after the finance ministry confirmed that an agreement was reached on debt treatment with official creditors, under the G-20's Common Framework. The agreement to restructure roughly $6.3bn of debt with bilateral lenders sets out that official creditors will provide a debt treatment that would be adjusted if there is sufficient improvement in conditions to merit an upgrade from 'weak' to 'medium' debt carrying capacity. In this scenario principal reimbursements would be accelerated and interest payments increased. Official creditors and the government have agreed that local-currency denominated debt would be excluded from any treatment. The ministry noted in a statement that the agreement 'entails significant maturity extensions and reduction in interest rates' and is a noteworthy step 'towards restoring



Zambia's long-term debt sustainability'. Zambia's Eurobonds prices have gained since the start of the month and was an additional 3 points higher this morning.

Egypt

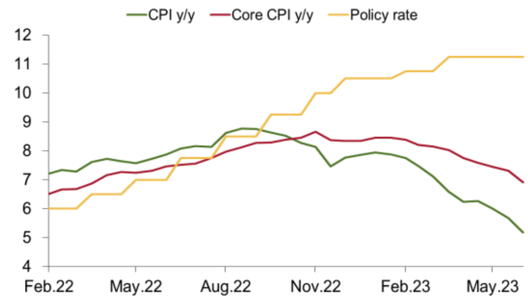
The central bank left its policy rate unchanged at 18.25% yesterday, in line with expectations, but some analysts expect further tightening. This was the second consecutive meeting where rates were left unchanged, despite the May inflation print showing broad-based increase in inflationary pressures with headline inflation increasing to 32.8%y/y and core inflation accelerating to 40%y/y. While JPMorgan analysts expect headline inflation to remain largely above 30% until late Q4 and only expect inflation to only fall back to target in Q3 2024, analysts do not expect further rate hikes in the interim amid economic growth considerations**.** Deutsche bank analysts, however, have kept their terminal rate expectations unchanged at 21.25% by end 2023, arguing that the tightening cycle should proceed later on to weigh on inflation and stop inflation expectations from becoming de-anchored. Nevertheless, analysts note that the magnitude of tightening is likely to depend on currency developments.

Figure 1: Egypt CPI headline and CBE O/N deposit rate

Source: CBE, J.P. Morgan - Shaded area indicates JPM forecast

Mexico

Mexico's central bank kept the benchmark rate at 11.25%, as expected. The bank stated that it would be necessary to maintain the current interest rate for an extended period to achieve the desired convergence of inflation to its 3% target. Mexico's inflation rate unexpectedly decelerated to its lowest level in over two years. The bi-weekly CPI data released earlier in the morning showed a 5.18% rise y/y in the first two weeks of June, further supporting the rate hold decision by the central bank. Along with Brazil and Chile, which have also held rates steady at recent respective policy meetings, some analysts expect Latin America's major economies to begin easing monetary policy in the second half of 2023.



Source: Bloomberg and IMF staff

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Global Financial Indicators

6/23/23 12:44 PM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4382	0.4	0	6	15	14
Europe		4288	-0.4	-2	-1	25	13
Japan		32782	-1.5	-3	6	24	26
China		3864	-1.5	0	-3	-10	0
Asia Ex Japan		67	-0.1	-3	2	-2	3
Emerging Markets		40	-0.4	-2	3	0	5
Interest Rates					basis points		
US 10y Yield		3.74	-5.6	-2	5	65	-14
Germany 10y Yield		2.36	-13.3	-11	-11	93	-21
Japan 10y Yield		0.37	-1.0	-4	-4	13	-5
UK 10y Yield		4.30	-6.9	-11	14	198	63
Credit Spreads					basis points		
US Investment Grade		155	-1.1	-3	-13	-16	-4
US High Yield		457	-2.0	6	-31	-82	-23
Exchange Rates					%		
USD/Majors		102.95	0.6	1	-1	-1	-1
EUR/USD		1.09	-0.7	-1	1	3	2
USD/JPY		143.3	0.1	1	3	6	9
EM/USD		49.3	-0.3	-1	-1	-4	-1
Commodities					%		
Brent Crude Oil ($/barrel)		73.5	-0.8	-4	-4	-19	-12
Industrials Metals (index)		144	-1.3	-3	1	-11	-13
Agriculture (index)		70	-1.8	1	8	1	2
Implied Volatility					%		
VIX Index (%, change in pp)		13.3	0.3	-1.3	-5.3	-15.8	-8.4
US 10y Swaption Volatility		95.9	-0.2	-0.1	-24.2	-25.1	-29.8
Global FX Volatility		8.0	0.0	0.1	-0.7	-3.2	-2.7
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		126	1.8	-5	-16	-109	-80
Italy		163	-0.6	7	-22	-33	-51
Portugal		68	-0.8	4	-10	-38	-34
Spain		96	0.2	4	-9	-13	-14

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

Emerging Market Financial Indicators

	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		3864	0.0	0	-3	-10	0		184	-3	-11	-9	7
Indonesia		6640	-0.2	-1	-1	-6	-3		136	-11	-4	-68	-4
India		62979	-0.4	-1	1	19	4		130	-2	-25	-43	-12
Philippines		6394	-0.2	-2	-2	3	-3		107	-12	-8	-37	10
Thailand		1506	-0.3	-3	-2	-4	-10		0	0	0	0	0
Malaysia		1391	-0.3	0	-1	-3	-7		92	-1	-7	-38	-8
Argentina		415186	-3.4	9	22	399	105		2217	-157	-375	-51	12
Brazil		118934	-1.2	0	8	21	8		249	-3	-12	-97	-25
Chile		5763	0.0	0	1	17	10		127	-4	-4	-48	-5
Colombia		1142	-0.9	-3	2	-15	-11		366	2	-40	-46	-6
Mexico		53563	-0.9	-3	1	15	11		373	-13	-21	-59	-8
Peru		22423	-0.4	0	4	21	5		161	-9	-19	-41	-19
Hungary		50088	-0.1	0	8	26	14		210	-18	-21	-27	-12
Poland		66533	-1.1	-2	2	27	16		133	-8	3	34	60
Romania		11950	-1.3	-3	-3	-2	2		228	-14	-22	-97	-28
South Africa		74372	-1.0	-5	-3	14	2		415	11	-35	-49	48
Turkey		5541	2.1	1	24	118	1		496	24	-156	-153	56
Ukraine		507	0.0	0	0	-2	-2		4387	-540	-484	374	308
EM total		40	-1.1	-2	3	0	5		384	-10	-40	-51	9

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

Last updated:	Exchange Rates							Local Currency Bond Yields (GBI EM)						
6/23/2023	Level		Change (in %)					Level		Change (in basis points)				
12:58 PM	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		7.18	0.0	-0.2	-2	-7	-4		2.8	3.1	8	1	-10	-27
Indonesia		14994	-0.4	-0.4	-1	-1	4		6.3	1.1	0	-14	-111	-64
India		82	-0.1	-0.1	1	-5	1		7.4	3.0	-4	14	(22.3)	-5
Philippines		56	-0.2	0.2	0	-2	0		5.9	0.0	0	5	26	-9
Thailand		35	-0.5	-1.6	-2	1	-2		2.8	0.0	-2	4	3	15
Malaysia		4.68	-0.5	-1.4	-2	-6	-6		3.8	2.5	9	5	-38	-21
Argentina		253	-0.3	-1.6	-7	-51	-30		111.0	-115.3	-67	622	4921	2277
Brazil		4.77	-0.1	0.9	4	9	11		11.1	-1.7	-16	-88	-146	-148
Chile		804	-0.1	-1.3	-1	10	6		5.0	4.0	2	-30	-119	-31
Colombia		4101	1.1	1.3	10	-2	18		7.8	0.0	-20	-113	-121	-203
Mexico		17.25	-0.4	-0.9	4	16	13		8.2	0.0	-12	-28	-60	-54
Peru		3.6	0.2	0.5	2	3	5		7.0	3.6	-13	-44	-72	-100
Uruguay		38	0.5	1.2	3	6	6		9.9	12.3	0	-10	-87	-79
Hungary		340	-0.9	0.5	3	12	10		7.3	-7.0	-35	-81	-33	-227
Poland		4.07	-0.8	0.3	2	10	8		5.1	-12.0	-24	-38	-150	-106
Romania		4.6	-0.5	-0.5	1	3	1		6.5	-1.1	-12	-40	-256	-123
Russia		84.2	-1.2	-0.4	-5	-35	-12							
South Africa		18.7	-1.1	-2.9	2	-15	-9		9.8	-3.0	-5	-34	118	65
Turkey		25.30	-1.6	-6.6	-22	-31	-26		16.6	-14.0	-86	748	-307	675
US (DXY; 5y UST)		103	0.6	0.9	0	-1	-1		3.99	-5.5	0	24	84	-2

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