GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

WEDNESDAY, JUNE 7, 2023

- **Turkish lira plunges to record low but sentiment turns positive** (link)
- **Markets reduce expectations of central bank rate cuts in advanced economies** (link)
- **Stresses receding in US markets** (link)
- **Euro area wage growth expected to peak in H1 2023** (link)
- **UK house prices decline in annual terms** (link)
- **Latin American currencies outperform the rest of Emerging Markets year-to-date** (link)
- **Special Feature: EM and Frontier Markets Issuance Monitor for May** (attached)

Mature Markets | Emerging Markets | Market Tables

Markets Expect Shift in Turkish Economic Policies

The sentiment of normalization in financial markets continue on a fairly quiet day, with markets focusing again on core macro themes such as inflation and growth (globally), wages (euro area), housing prices (UK), political risk (EM), and of course monetary policy, where expectations of central banks cuts in advanced economies are receding. Turkish assets showed most remarkable price moves today, with the Turkish lira plunging to a record low vs the dollar (-6% to 23/$) as trading desks report that local state banks are relaxing the currency intervention program. This is intensifying speculation that newly appointed finance Minister Simsek will deliver a material shift in economic policies in Türkiye, leading CDS spreads to tighten. Please note today's special feature on EM and Frontier Markets issuance for May.

Key Global Financial Indicators

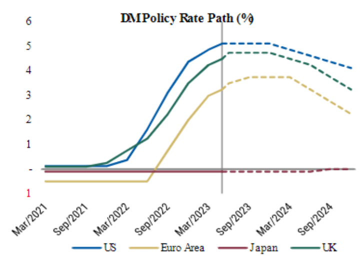
Last updated: 6/7/23 1:27 PM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		4284	0.2	2	4	3	12
Eurostoxx 50		4296	0.0	2	-1	13	13
Nikkei 225		31914	-1.8	3	10	13	22
MSCI EM		40	0.9	3	1	-7	5
Yields and Spreads					bps		
US 10y Yield		3.70	4.0	6	26	73	-17
Germany 10y Yield		2.38	0.7	10	9	109	-19
EMBIG Sovereign Spread		461	-3	-15	-27	18	9
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		49.7	-0.2	0	-3	-6	0
Dollar index, (+) = $ appreciation		103.9	-0.2	0	3	2	0
Brent Crude Oil ($/barrel)		77.0	0.9	6	2	-36	-10
VIX Index (%, change in pp)		14.0	0.0	-4	-3	-10	-8

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

Global Central Banks

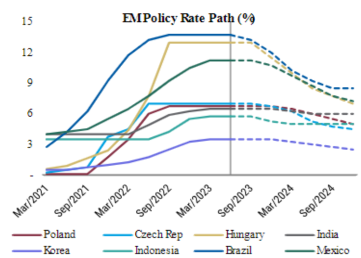
Markets are gradually dialing down their expectations for rate cuts from advanced economy (AE) central banks due to stubbornly high levels of inflation and in some cases stronger than expected economic data. In the US, markets had been expecting three rate cuts in 2023 as recently as two months ago, but now Fed Funds futures indicate that the probability of a single cut at the December 13 FOMC meeting is just 37%. Strong jobs data and other better than expected economic data as well as persistent inflation appear to have convinced markets that monetary policy will be tight for longer than originally expected. In the euro area and the UK, markets expect no cuts in 2023. In Japan, a rate hike is priced for the December 19 BOJ, and Morgan Stanley expects yield curve control to be removed in July. In contrast, most investors think emerging market (EM) central banks have reached their peaks for policy rates, although many are likely to stay on hold for an extended period of time. Asian EMs (ex-China) are the exception, with lower inflation giving their central banks more room to maneuver. Hopes for rate cuts this year in eastern Europe have also faded.

Exhibit 14: DM central banks will likely aim to ease gradually as inflation moves to target



Source: Haver Analytics, Morgan Stanley Research forecasts

Exhibit 15: Many EM central banks have already reached peak rates



Source: Haver Analytics, Morgan Stanley Research forecasts

Mature Markets

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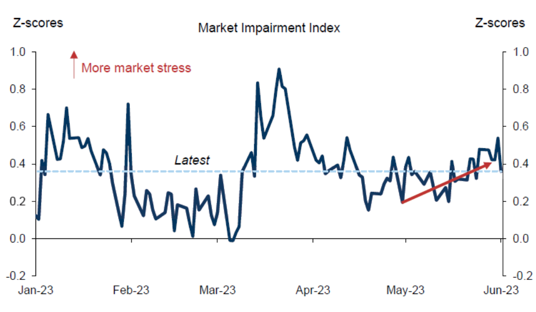
United States

Market stress levels in the US are going down, according to analysis by Goldman Sachs analysts. The firm's proprietary market impairment index has fallen significantly from the levels seen during the US regional bank crisis triggered by the collapse of Silicon Valley Bank. The MOVE interest rate volatility index is back to its trend level over the past year and the VIX equity volatility index is back below 14 at its lowest level in almost five years, suggesting that investor sentiment has improved. The debt ceiling was resolved, and corporate earnings were better than expected, sending stocks to their highest levels since October. Markets appear to have taken the recent surge in interest rates at the short end of the yield curve in their stride, despite the two-year yield rising by over 50 bps since the end of April. The short term interest rate markets are gradually reducing their expectations for Fed rate cuts in the face of strong economic data and sticky inflation, but this has not undermined the optimistic mood of recent weeks.

Exhibit 1: Modest uptick over May, but well below SVB stress levels

Net Market Impairment Index



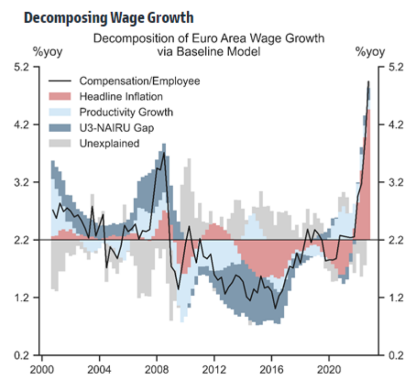
Source: Goldman Sachs Global Investment Research

Euro Area

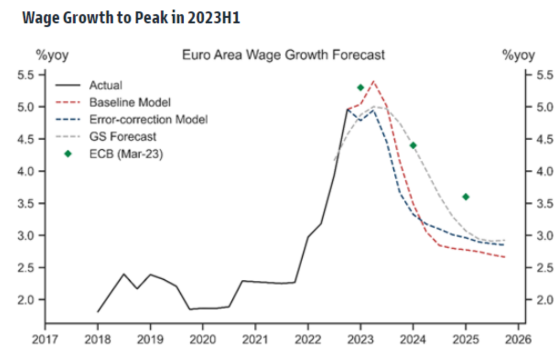
European equities were mostly trading lower while the euro strengthened against the dollar (+0.2%) in later trade and sovereign yields were marginally higher. On the data front, Germany's industrial production data disappointed in April, and Italian retail sales in April were marginally weaker than expected.

ECB executive board member Schnabel argued that the ECB will have to further increase interest rates, noting that incoming data would determine the extent of tightening necessary. Schnabel emphasized the persistence of underlying inflation, and the role of services as a result of strong wage costs in these sectors. ECB Governing Council member Knot separately said he is not convinced that the current tightening is sufficient, but cautioned that “prolonged monetary tightening might still lead to stress in financial markets”.

Analysts forecast euro area wage growth to peak at 5.5%y/y in Q2 and argue that the ECB would likely not need to tighten monetary policy as much as the Fed or the BoE. Goldman Sachs analyses indicate that high headline inflation in 2022 was a key driver of wage growth across the euro area, with a tight labor market also a notable, but smaller, driver. Given that the primary wage-growth driver is the ‘catch-up’ with high headline inflation, wage growth could slow sharply once headline inflation eases: analysts see wage growth peaking in H1 2023 and ease to 3% by 2025. As such they argue that the ECB would likely not need to hike rates to the same extent as the Fed or the BoE, where analysts see strong labor markets as a relatively more important driver of wage growth. Goldman Sachs analysts continue to forecast two additional 25bps ECB hikes to reach the terminal rate of 3.75% in July.



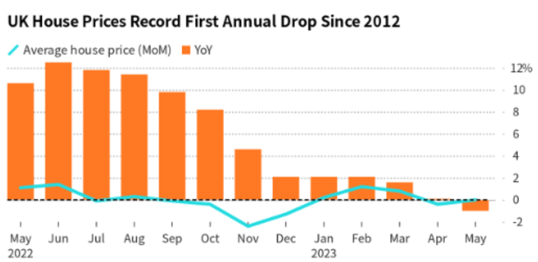
Source: Goldman Sachs Global Investment Research, Haver Analytics



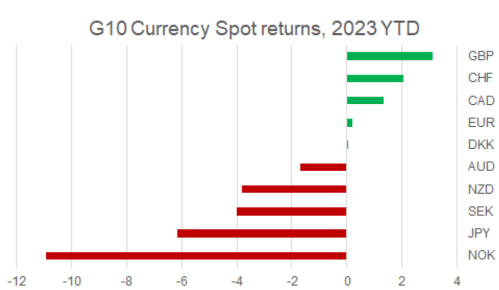
Source: Goldman Sachs Global Investment Research, Haver Analytics

United Kingdom

Halifax data show UK house prices contracting in annual terms, while mortgage affordability is expected to deteriorate further. House prices contracted by 1%y/y in May, according to data from mortgage provider Halifax, with the director of Halifax mortgages pointing to the gradual feed-through of higher interest rates to household budgets. In the meantime, **the pound is again the leading performer among G10 currencies this year, with analysts attributing recent gains to expectations for more BoE tightening.** Following the upside surprise in inflation data, markets are expecting roughly 100bps of additional BoE tightening this year. Rabobank analysts caution that further monetary tightening could weigh on the economic growth outlook, and forecast that the pound could weaken to 1.22/$ in the coming three months. **This morning the pound was marginally stronger against the dollar (+0.2% to 1.25).**



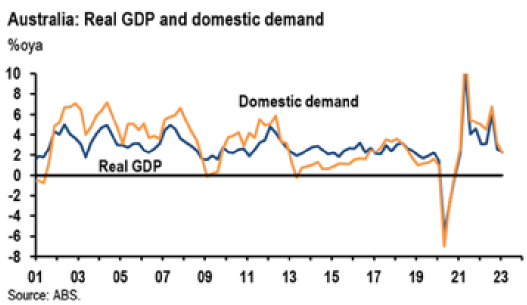
Source: Halifax



Source: Bloomberg and IMF calculations

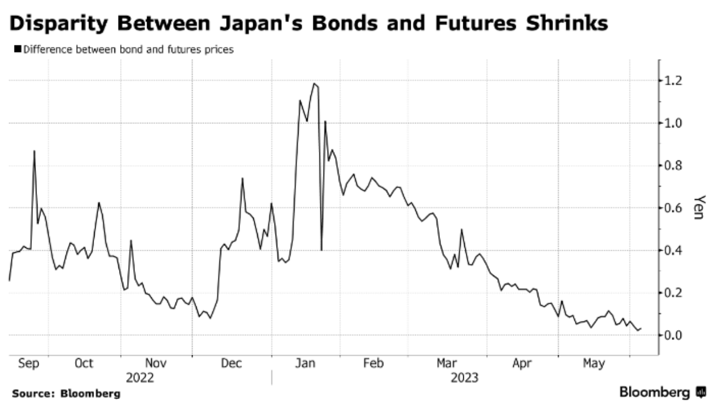
Australia

Australia's economic growth moderated to 2.3% y/y in Q1 (consensus: 2.4%, previous: 2.6%). Despite the weakening of both private and public demand, **analysts are pushing the Reserve Bank of Australia (RBA) easing bets to a later date and some calling for higher terminal rate**. Goldman Sachs expects peak rate at 4.85% in September, following RBA's hawkish stance and a surprise acceleration in unit labor costs in the GDP data. **Australian stocks declined -0.2%, the Australian dollar strengthened +0.3%, and 10Y bond yields rose +2.4bps.** The spread between yields on 10Y and 3Y bond futures narrowed to 13bps following the GDP release, on track for its lowest closing level since 2010.



Japan

Japanese stocks receded -1.3% following a 4-day rally after **PM Kishida proposed a list of policy targets for this year amid speculations of early elections.** The plans, ranging from childcare, labor, supply chains to climate change, will be discussed by the cabinet mid-June according to Bloomberg. Separately, **FM Suzuki suggested the government consider purchasing the Bank of Japan (BoJ)'s large ETF holdings at book value** amid calls to use distribute proceeds to the younger generation. The BOJ's ETF holdings as of March 2023 stood at ¥37 tn in book value, and ¥53 tn in market value. Governor Ueda told the parliament that ETFs holdings talks are premature, and specifics should only happen when its 2% inflation target is in sight. **The yen strengthened +0.1%. Yields on 10Y bond yields slipped slightly -0.2bps.** The spread between the June contract for 10Y futures and the CTD securities narrowed to the lowest level, as analysts suggested there is liquidity for traders to arbitrage between bonds and futures after the BOJ reduced its debt purchases.



Emerging Markets

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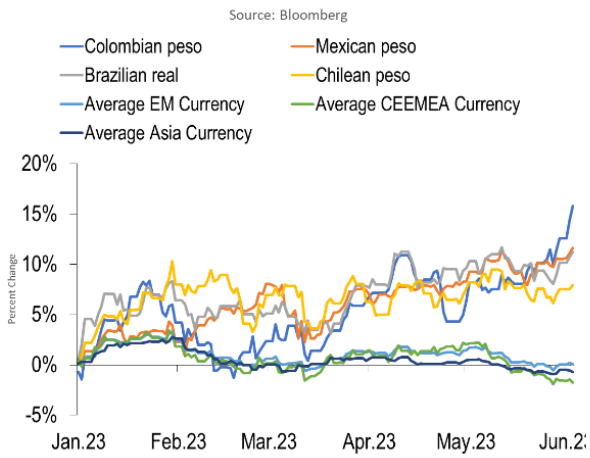
In Asia, equities rose +0.5%, currencies broadly gained and 10-year bond yields were little changed The Chinese renminbi weakened -0.1% and Chinese stocks fell -0.5% after China's exports fell below expectation -7.5% y/y (previous: +8.5%) in May. Double digit declines were seen to United States (-18.2%) and across Asia. Relatedly, China's foreign reserves fell -$28.3bn in May to $3,2tn (previous: +$20.9bn), pulled down by valuation effects and a shrinking trade surplus.

In EMEA, the focus was on Türkiye. The lira lost over 6% to the dollar to an all-time low but equities (+3.8%) and U.S. dollar bonds rose as contacts expect a material shift in economic policies. In contrast, Polish equities (-1%) fell as the European Commission will open infringement proceedings over Poland's creation of a body probing "Russian influence," which is seen as targeting the opposition.

Latin American equities outperformed and most currencies appreciated against the dollar Tuesday. The top two performing equity indexes yesterday were the Argentine MERVAL Index (+5.52%) and the Colombian COLCAP Index (+3.66%). Stocks in Brazil (+1.70%), Mexico (+1.67%), and Chile (+1.06%) followed close behind. Currencies across the region outperformed the rest of emerging markets, with the Colombian peso (+1.26%) leading the advance.

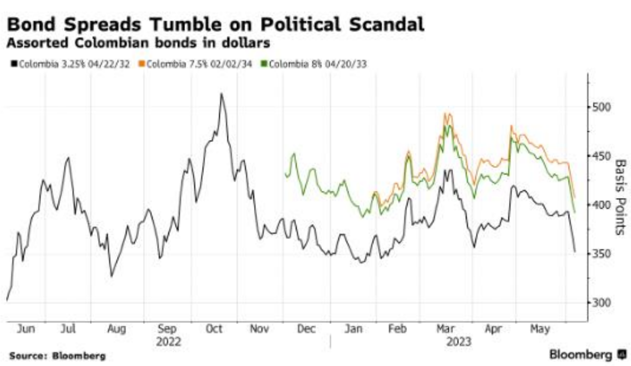
Latin America

Latin American currencies continue to outperform the rest of Emerging Markets year-to-date. 4 of the top 5 performing EM currencies are from Latin America. The Colombian peso (+14.8%) and Mexican peso (+12.1%), lead all emerging market currencies, with the Brazilian real (+7.5%) and Chilean peso (+6.9%) at number 4 and 5. The only non Latin American currency in the top 5 is the Hungarian forint (+8.5%). The average CEEMEA and Asian currency have depreciated this year, while the average EM currency is virtually unchanged.



Colombia

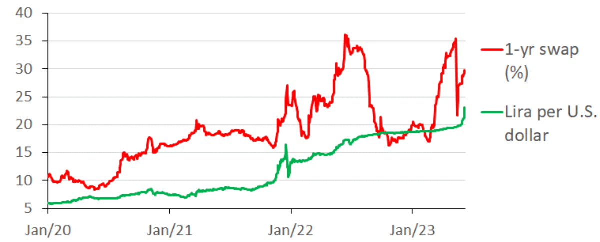
Colombian assets rally after leaked recordings related to his campaign financing are seen to undermine president Petro's reform agenda, which is unpopular among investors. The Colombian peso (+1.26%) was the best performing emerging market currency on Tuesday, equities (+3.66%) outperformed peers, and Colombia's dollar bond spreads tightened more than any EM country with a rating of BB or higher this week.



Türkiye

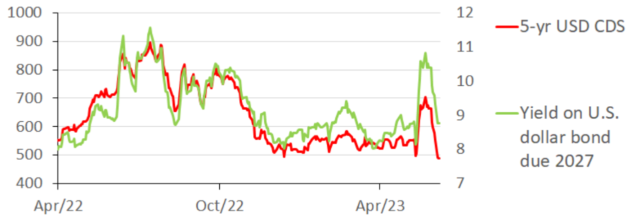
The Turkish lira plunged to a record low vs the dollar (-6% to 23/$) but CDS spreads tightened as speculation intensified that FM Simsek will deliver a material shift in economic policies. Contacts also expect a change in leadership at the central bank. Trading desks report that local state banks are relaxing the currency intervention program with some speculating that Turkey may bring back an interest rate corridor, potentially in a 20-40% range, as a large FX adjustment could be very costly given the FX-linked deposits scheme currently around $130 bn. There are also some reports that official reserve data may have improved somewhat - official reserve data will be released tomorrow.

Türkiye: Interest rates (%) and currency



Source: Bloomberg and IMF staff

Türkiye: 5-yr U.S. CDS (bps) and yield on U.S. dollar bond (%)



Source: Bloomberg and IMF staff

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), Reinout De Bock (Senior Economist-London Representative), 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), Tom Piontek (Senior Financial Sector Expert) 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), Shoko Ikarashi (Externally Financed Appointee), Phakawa Jeasakul (IMF Resident Representative in Hong Kong SAR), Harrison Kraus (Research Assistant), Yiran Li (Research Assistant), 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) Olga Lefebvre (Staff Assistant), and Srujana Sammeta (Staff Assistant) are responsible for the word processing and production of this monitor.

Global Financial Indicators

	Level		Change				
6/7/23 1:28 PM	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		4286	0.2	3	4	3	12
Europe		4296	0.0	2	-1	13	13
Japan		31914	-1.8	3	10	13	22
China		3789	-0.5	0	-7	-10	-2
Asia Ex Japan		67	0.7	3	0	-7	4
Emerging Markets		40	0.9	3	1	-7	5
Interest Rates					basis points		
US 10y Yield		3.70	4.0	6	26	73	-17
Germany 10y Yield		2.38	0.7	10	9	109	-19
Japan 10y Yield		0.43	0.1	-1	1	18	1
UK 10y Yield		4.20	-1.2	1	41	198	52
Credit Spreads					basis points		
US Investment Grade		163	-1.0	-2	-4	13	4
US High Yield		472	-5.0	-27	-32	32	-9
Exchange Rates					%		
USD/Majors		103.91	-0.2	0	3	2	0
EUR/USD		1.07	0.2	0	-3	0	0
USD/JPY		139.4	-0.1	0	3	5	6
EM/USD		49.7	-0.2	0	-3	-6	0
Commodities					%		
Brent Crude Oil ($/barrel)		77.0	0.9	6	3	-23	-8
Industrials Metals (index)		143	0.8	2	-7	-24	-13
Agriculture (index)		66	0.1	3	-4	-14	-5
Implied Volatility					%		
VIX Index (%, change in pp)		14.0	0.0	-3.9	-3.2	-10.0	-7.7
US 10y Swaption Volatility		104.1	3.6	-20.6	-17.2	1.1	-21.6
Global FX Volatility		8.4	0.0	-0.5	-0.7	-1.7	-2.3
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		133	-4.3	-17	-42	-119	-72
Italy		179	1.0	-1	-11	-21	-35
Portugal		70	0.8	-4	-15	-46	-32
Spain		101	0.9	-4	-8	-11	-8

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

Emerging Market Financial Indicators

Last updated: 6/7/2023 1:29 PM	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		7.11	0.1	-0.1	-3	-6	-3		2.8	-2.0	-3	-22	-8	-28
Indonesia		14878	-0.1	0.8	-1	-3	5		6.3	-1.8	-3	-11	-70	-60
India		83	0.1	0.2	-1	-6	0		7.4	-5.0	2	12	(42.8)	-10
Philippines		56	0.2	0.1	-1	-6	-1		5.9	0.0	0	6	46	-9
Thailand		35	0.2	0.2	-3	-1	0		2.6	4.5	-3	5	-32	-2
Malaysia		4.60	0.2	0.3	-3	-4	-4		3.7	-0.1	-2	-3	-55	-35
Argentina		243	-0.3	-1.8	-6	-50	-27		110.8	22.4	155	1443	5465	2255
Brazil		4.92	-0.2	2.8	2	-1	7		11.2	-2.0	-45	-114	-155	-137
Chile		796	0.4	1.1	0	3	7		5.2	-2.5	-9	-7	-103	-17
Colombia		4228	1.3	3.9	7	-10	15		8.4	0.0	-25	-40	-39	-138
Mexico		17.36	0.2	1.9	3	13	12		8.4	0.0	7	4	-46	-34
Peru		3.7	-0.2	-0.4	1	1	3		7.3	0.1	7		-41	-68
Uruguay		39	-0.4	-0.7	-1	2	2		10.0	0.0	0	-4	-50	-67
Hungary		345	0.0	0.6	-2	5	8		7.8	-2.0	-23	-15	60	-185
Poland		4.17	0.2	1.4	-1	2	5		5.3	-1.5	-7	6	-137	-88
Romania		4.6	0.2	0.3	-3	0	0		6.8	-3.1	-7	-32	-134	-92
Russia		81.7	-0.1	-0.5	-5	-24	-9							
South Africa		19.0	0.9	3.6	-4	-19	-11		10.0	-2.0	-35	64	134	79
Turkey		23.13	-6.5	-10.2	-16	-28	-19		14.9	47.0	576	207	-892	502
US (DXY; 5y UST)		104	-0.2	-0.4	3	2	0		3.86	5.3	11	45	87	-14

	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		3789	-0.5	0	-7	-10	-2		189	-2	-11	-9	12
Indonesia		6620	0.0	-1	-2	-8	-3		149	4	3	-26	9
India		63143	0.6	1	2	15	4		142	-1	-22	-24	0
Philippines		6565	1.3	1	-1	-3	0		119	3	0	1	22
Thailand		1533	0.3	0	-2	-6	-8		0	0	0	0	0
Malaysia		1379	-0.3	-1	-4	-10	-8		96	2	-8	-27	-4
Argentina		380757	5.5	11	28	319	88		2404	-167	-185	496	199
Brazil		114610	1.7	5	9	4	4		261	-1	-20	-45	-13
Chile		5714	0.0	4	4	7	9		135	1	-4	-12	3
Colombia		1194	3.7	9	3	-25	-7		373	-32	-53	39	1
Mexico		54432	1.7	2	-1	9	12		398	2	-5	16	17
Peru		22051	0.5	4	0	7	3		178	-4	-7	7	-2
Hungary		48537	0.5	3	5	20	11		234	-1	13	32	12
Poland		66315	-0.4	6	6	16	15		141	4	5	63	68
Romania		12212	0.4	-1	0	-2	5		246	-11	-12	5	-9
South Africa		76988	0.2	3	-1	9	5		437	-18	5	60	70
Turkey		5556	3.1	14	26	110	1		484	-93	-44	-86	44
Ukraine		507	0.0	0	0	-2	-2		5014	55	-340	1689	935
EM total		40	0.2	3	1	-7	5		402	-19	-21	27	27

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

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