GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, MARCH 7, 2023

- **US terminal rate could reach 6% on strong consumption growth scenario** (link)
- **ECB terminal rate now seen at 4.1%** (link)
- **Consumers' inflation expectations decline in Euro Area** (link)
- **The Reserve Bank of Australia delivers a dovish rate hike** (link)
- **China overhauls financial regulatory agency** (link)
- **Chilean peso appreciate on higher for longer rhetoric** (link)
- **Q4 GDP contracts sharply in South Africa** (link)

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Markets Cautious Ahead of Fed Chairman Powell's Testimony

Markets are cautious ahead of Fed Chairman Powell's two-day testimony to congress, starting later today. While he is expected to reiterate a "higher for longer" guidance on rates, markets will be looking for indications about the level of the terminal rate, and how it might differ from the December "dot plot" (5.1%). Markets are also wondering whether the Fed will stick to 25 bps hikes or go back to 50 bps hikes. In the Eurozone, bond yields eased today after an ECB survey showed consumer expectations for inflation easing in February. The move is in sharp contrast with the spike in yields yesterday on the back of hawkish comments from ECB officials, highlighting the extreme sensitivity of markets to data releases and other interventions. Elsewhere, the Reserve Bank of Australia hiked rates 25 bps as expected but somewhat surprised markets by signaling that its tightening cycle may be close to an end. In emerging markets, the Chilean peso appreciated as the central bank mentioned the need for higher for longer rates. South African assets sold off as Q4 GDP growth underperformed expectations significantly, against a background of increasing political uncertainty.

Key Global Financial Indicators

Last updated: 3/7/23 1:03 PM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		4048	0.1	2	-3	-4	5
Eurostoxx 50		4307	-0.1	2	2	23	14
Nikkei 225		28309	0.3	3	3	14	8
MSCI EM		39	-0.4	2	-3	-8	4
Yields and Spreads					bps		
US 10y Yield		3.94	-2.0	2	26	216	6
Germany 10y Yield		2.68	-6.9	3	33	270	11
EMBIG Sovereign Spread		442	-9	-3	12	-70	-10
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		50.6	-0.1	1	0	1	1
Dollar index, (+) = $ appreciation		104.5	0.1	0	1	5	1
Brent Crude Oil ($/barrel)		85.8	-0.5	2	2	-30	0
VIX Index (%, change in pp)		18.8	0.2	-2	0	-18	-3

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

Mature Markets

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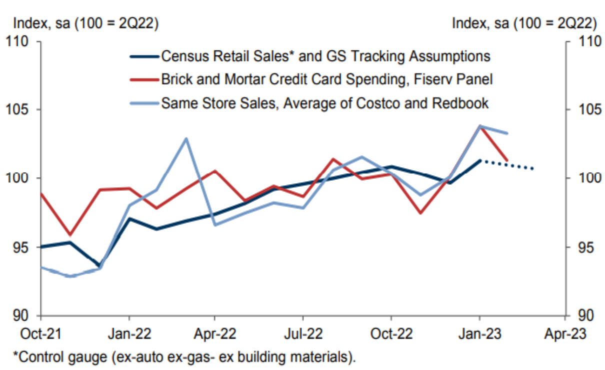
United States

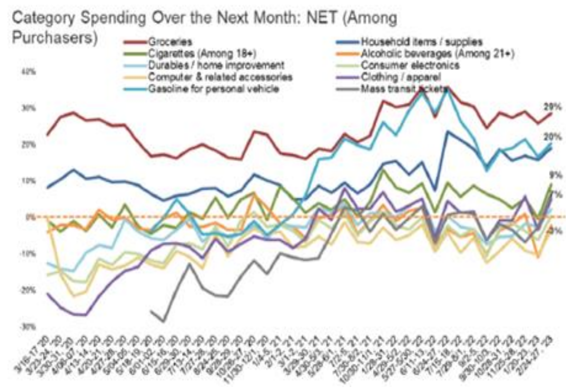
In late trading yesterday, the S&P 500 reversed earlier losses and closed marginally up while US Treasury bonds reversed gains and closed slightly down. The S&P 500 closed up (+0.07%), with the tech and communication sectors outperforming. US Treasury yields closed up 1−3 bps across tenors. The 3-month Libor rose above 5% for the first time since 2007, mainly driven by expectations for the Fed tightening.

Some market analysts see Fed terminal rates at 6% if activity data, in particular consumption growth, continues to be strong. With continued job gains and wage growth, Goldman Sachs analysts expect real wage growth to rise more than 3% in 2023, boosting real disposable incomes and leading to upward pressure on real consumer spending and GDP growth. High-frequency data such as credit card usage suggest that consumption remains well above Q4 levels. Indeed, the Morgan Stanley consumer survey shows an uptick in spending intentions across most categories, including durables. GS analysts expect the Fed to increase the policy rate much higher than currently anticipated, with the terminal rate peaking at the 5.75−6.0% range if consumption growth rises above 2% and GDP growth is tracking around 2%.

Exhibit 2: Alternative Data Indicates Strong Goods Spending So Far in 2023

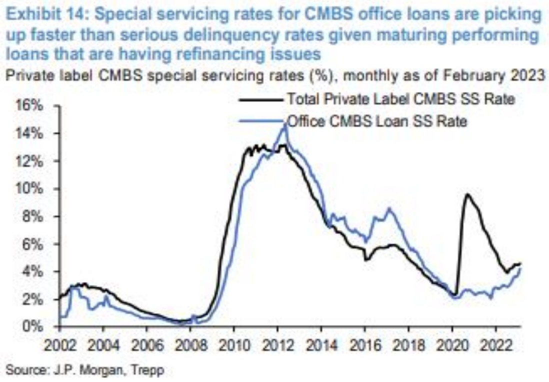


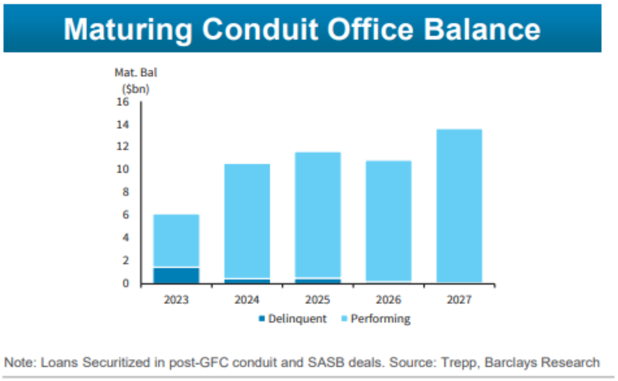
Source: Census Bureau, Company data, Goldman Sachs Global Investment Research



Source : Morgan Stanley

Analysts worry about refinancing for US office loans. After several negative headlines regarding high-profile defaults on office portfolios, the office market is getting increasing attention among market participants. Office market developments look gloomier as hybrid working has pushed office vacancies higher, and rising borrowing costs make business harder, especially for floating-rate loan borrowers. According to JPM analysts, office market fundamentals continued to show weakness, as office transaction volumes continued to decrease and the commercial property price index (CPPI) for offices fell by 0.7% yoy in January. Commercial mortgage-backed security (CMBS) office loan delinquency rates remain relatively low but are picking up, and special servicing rates for loans are increasing faster than serious delinquency rates, suggesting that some loans have refinancing concerns even if they are performing now. Barclays analysts note that 16% of office loans maturing in 2023 are already delinquent.

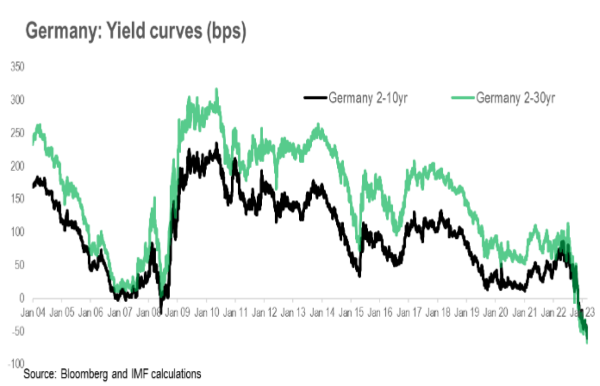


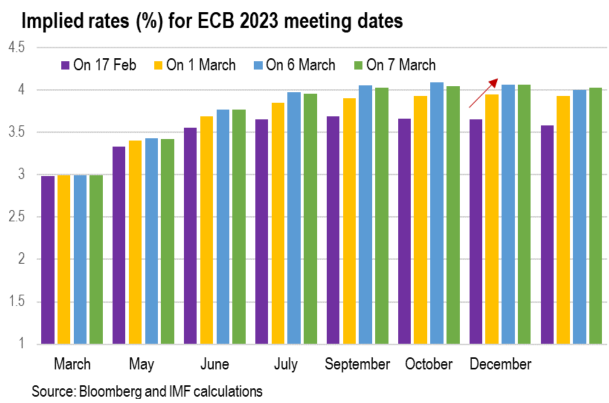


Euro Area

European equities edged higher (Stoxx 600 +0.15%) while sovereign yields eased (10-yr bund -6 bps) and the euro weakened (-0.2%) ahead of Federal Reserve Chair Powell's Congressional testimony. On the data front German factory orders surprised on the upside in January (-10.9%y/y vs expected -12.5%).

Markets are now pricing in roughly 155 bps of additional ECB tightening by the end of this year, with the terminal rate at close to 4.1%. Following further hawkish ECB commentary yesterday, the euro reached a 2-week high against the dollar (at 1.067/$) and sovereign yields increased with the bund curve inverting further. ECB General Council (GC) member Holzmann said that he assumed "that core inflation will not weaken significantly in the first half of the year" and also spoke in favor of a further four 50 bps hikes in 2023, which would take the deposit rate to 4.5%. ECB Chief economist Lane in the meantime also spoke in favor of further tightening beyond the March ECB meeting, but said that decisions should depend on macroeconomic projections, as well as data on inflation and the monetary policy transmission mechanism operation. Markets have continued to price in more ECB tightening over the past few weeks, with a 50 bps hike in March fully priced in with an additional roughly 43 bps of tightening priced in for the May ECB meeting. BofA analysts expect the deposit rate to peak at 4% by July with interest rate cuts starting in June 2024 and argue that upside inflationary surprises would rather see a delay in rate cuts than a higher terminal rate. Yesterday 2-yr bund yields increased by 10 bps to a new post-2008 high of 3.315%, while the 10-yr bund yield closed roughly 3 bps higher at 2.749%, seeing the 10-2yr yield invert further.





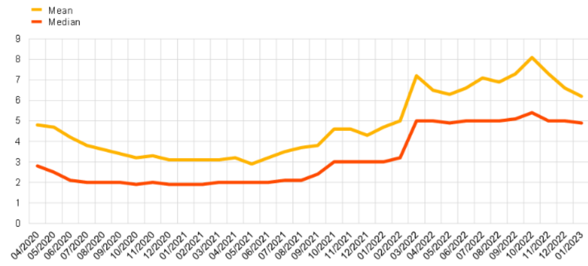
In contrast, the ECB's consumer expectations survey released this morning showed inflation expectations declining in the euro area, with median expectations for inflation one year ahead falling to 4.9% in January from 5% December and median expectations for inflation three years ahead falling to 2.5% from 3%. **In the meantime, 5y/5y inflation swaps eased 5 bps this morning to 2.49% after reaching**

2.59% last Friday, its highest level in in 10 years. Deutsche Bank analysts previously highlighted that the recent increase in market-based inflation expectations has not been carried over into consumer expectations, but caution that if this were to happen it could see even higher terminal rate prospects and further equities and bond selloffs.

Chart 7
Inflation expectations over the next 12 months – pooled

Quantitative measures of inflation expectations (forward-looking)

(percentage changes)



Source: CES.
Notes: Weighted estimates. The median is computed on the basis of a symmetric linear interpolation that accounts for rounding of responses. Mean values are winsorised at the 2nd and 98th percentiles of each survey round and country.

Australia

The Reserve Bank of Australia (RBA) delivered a dovish rate hike. The RBA raised its cash rate by 25 bps to 3.60% as expected but signaled that its tightening cycle may be close to an end. In particular, Governor Lowe said that the RBA will pay close attention to incoming economic data when assessing when and how much further interest rates need to go up. The Australian dollar depreciated (-0.8%), underperforming other currencies in the region. Long-end government bond yields dropped (10-year: -8.1 bps) and equities gained (+0.5%). Investors have positioned for a slowdown in the pace of future rake hikes by the RBA, with expectations for the RBA's terminal rate at around 4%, down from 4.1% previously.

A Softer Touch
RBA peak rate drops, while Fed is seen staying aggressive

Source: Bloomberg Bloomberg

Japan

Labor cash earnings increased 0.8% y/y in January, weaker than expected (consensus: +1.8%). As a result, labor cash earnings fell 4.1% y/y in real terms, the most since 2014. Some analysts noted that firms attempted to respond to inflation with one-time measures such as lump-sum payments rather than increases in base wages. The stagnant salary data may mean that significant pay increases would be less likely for the upcoming wage negotiations in the spring. This will likely support the Bank of Japan's continued monetary policy easing. The market impact was limited with the yen was little changed, equities (NIKKEI) up 0.3%), and 10-year JGB yield little changed at 0.5%.

Emerging Markets

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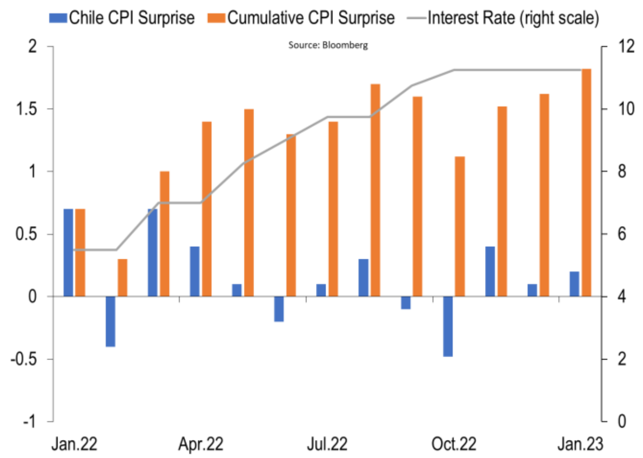
Asian markets lacked a clear direction. Asian equities declined 0.4% on net. Share prices rose in most Asian markets, led by Thai (+0.7%) and Taiwanese (+0.6%) equities. In contrast, Chinese (CSI 300: -1.5%) and Indonesian (-0.6%) equities declined. Asian currencies were and long-end government bond yields were mixed, with 10-year yields rising in Indonesia (+4.9 bps) while falling in the Philippines (-7.2 bps) and Thailand (-6.1 bps) supported by lower-than-expected February PCI inflation in the latter two countries. **China has given assurance that it will support Sri Lanka's debt restructuring, paving the way for the approval of the IMF-supported program. EMEA equities and currencies were mixed.** Turkish equities continued to outperform (+1.2%) while those in Hungary saw the largest losses (-1.4%) after industrial production data disappointed (-3.2%y/y vs expected +4.3% from +5.6%). Most EMEA currencies were weaker against the dollar, while CEE currencies were little changed against the euro. Local currency yields were mostly lower, with the exception of South Africa. **Latin American stocks were mixed yesterday,** with notable gains in Argentina (+2.76%), Colombia (+1.74%), and Brazil (+1.03%). The Colombian peso appreciated (+1.69%), outperforming peers after a February inflation came in slightly lower than expected (13.28% y/y vs. 13.36% expected). The Chilean peso appreciated (+0.68%) after central bank president Costa said that rates will remain higher for longer.

Chile

The Chilean peso appreciated (+0.68%) after the central bank president said that rates will remain higher for longer, as the economy has not yet adjusted as expected. CB President Rosanna Costa outlined that inflation and growth have been consistently higher than expected and said that policy makers need to hold the key interest rate at 11.25% until there are clear signs inflation is heading back down to the 3% target (inflation was 12.3% y/y in January).

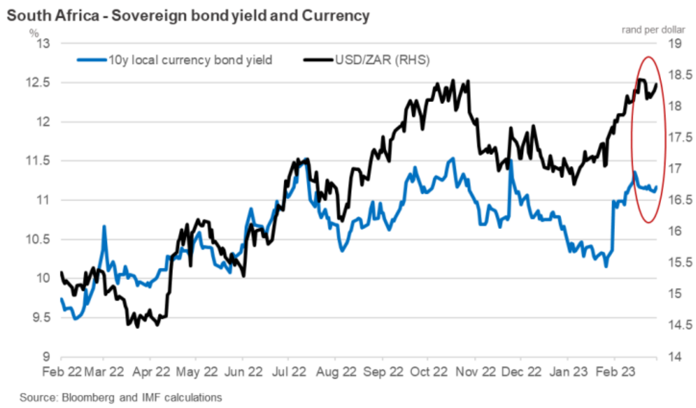


China

At the National People's Congress, China announced plans to tighten financial oversight by setting up a new financial regulatory agency that will oversee the entire financial sector, with the exception of the securities industry. The new agency will absorb the role of the China Banking and Insurance Regulatory Commission, the consumer/investor protection functions from the People's Bank of China (PBC) and the China Securities Regulatory Commission, and the regulation of financial holding companies from the PBC. China also plans to cut the number of employees at central government bodies by 5%, set up a national data bureau, and expand the role of the Ministry of Science and Technology in orchestrating strategic policies.

South Africa

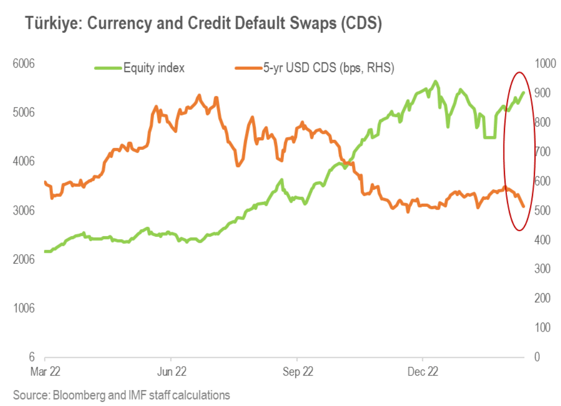
The South African rand continued to weaken against the dollar (-0.4%) while local currency yields increased (10-year +6 bps) after Q4 GDP contracted significantly more than expected. Q4 GDP growth came in at -1.3%q/q vs an expectation -0.4% (from an upwardly revised +1.8% in Q3), as the electricity crisis weighed on activity. The rand has depreciated by roughly 7% so far this year, and the one-month implied volatility yesterday increased the most since early February as political uncertainty has also increased with some analysts warning that the President could face another call for impeachment. The cabinet reshuffle has also failed to support to rand or local currency bonds so far. News that the central bank's stock of government bonds declined to 33.6bn rand ($1.8bn) in February most likely weighed on yields.



Source: Bloomberg and IMF calculations

Türkiye

Credit default swaps declined to the lowest level in a month and Eurobonds rallied following reports that the opposition is set to endorse the chairman of the Republican's People's Party Kilicdaroglu as its presidential candidate and the popular mayors of Ankara and Istanbul as vice presidents. This would end the impasse within the opposition over selecting a joint candidate for the May presidential election. Yields on the 2047 Eurobond declined by roughly 40 bps since the start of this week, while 5-yr CDS swaps eased to the lowest level in a month. Equities also gained this morning (+1.2%) and are now up roughly 9% since the start of February with Bloomberg pointing to supportive government policies including a routing of pension funds' investments toward stocks.



Source: Bloomberg and IMF staff calculations

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Global Financial Indicators

	Level		Change				
3/7/23 1:04 PM	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		4050	0.1	2	-3	-4	5
Europe		4307	-0.1	2	2	23	14
Japan		28309	0.3	3	3	14	8
China		4049	-1.5	-1	-1	-5	5
Asia Ex Japan		67	-0.5	2	-3	-6	4
Emerging Markets		39	-0.4	2	-3	-8	4
Interest Rates					basis points		
US 10y Yield		3.94	-2.0	2	26	216	6
Germany 10y Yield		2.68	-6.9	3	33	270	11
Japan 10y Yield		0.50	-0.2	0	0	36	8
UK 10y Yield		3.83	-4.0	0	51	252	15
Credit Spreads					basis points		
US Investment Grade		143	0.5	-2	5	-13	-16
US High Yield		414	1.8	-25	-4	-22	-66
Europe IG		75	0.4	-5	-1	-13	-16
Europe HY		387	1.5	-27	-11	-33	-87
Exchange Rates					%		
USD/Majors		104.50	0.1	0	1	5	1
EUR/USD		1.07	-0.1	1	-1	-2	0
USD/JPY		136.2	0.2	0	4	18	4
EM/USD		50.6	-0.1	1	0	1	1
Commodities					%		
Brent Crude Oil ($/barrel)		85.8	-0.5	3	3	-12	1
Industrials Metals (index)		160	-1.1	-1	-5	-33	-4
Agriculture (index)		68	-0.3	1	-1	-10	-1
Implied Volatility					%		
VIX Index (%, change in pp)		18.8	0.2	-1.9	0.1	-17.6	-2.9
US 10y Swaption Volatility		134.0	6.0	11.3	30.1	8.2	8.3
Global FX Volatility		9.8	0.0	0.0	-0.6	-0.3	-0.9
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		178	3.0	-1	-7	-63	-27
Italy		180	-2.6	-3	-8	19	-34
Portugal		85	-0.6	-1	0	-4	-16
Spain		101	6.1	6	7	-1	-8

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

Emerging Market Financial Indicators

Last updated: 3/7/2023 1:05 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		6.94	-0.1	0.0	-2	-9	-1		3.2	-1.5	-4	5	32	15
Indonesia		15350	-0.4	-0.7	-1	-6	1		7.0	4.6	8	26	22	4
India		82	0.1	1.1	1	-6	1		7.8	0.0	3	42	122.7	32
Philippines		55	-0.3	0.6	0	-5	1		6.0	2.5	3	10	108	0
Thailand		35	0.4	2.3	-3	-5	0		2.7	-10.5	-12	-1	46	2
Malaysia		4.47	0.1	0.3	-4	-7	-2		4.0	-0.8	12	21	38	-1
Argentina		199	0.0	-1.1	-5	-46	-11		88.1	-28.1	-20	252	3976	-11
Brazil		5.18	-0.4	1.1	1	-2	2		13.7	-2.3	29	28	142	112
Chile		794	0.5	4.1	0	2	7		5.7	3.8	12	45	-18	38
Colombia		4705	1.7	1.2	2	-19	3		9.7	0.0	-46	82	154	-11
Mexico		18.01	0.0	1.6	5	18	8		9.0	1.5	12	73	84	31
Peru		3.8	-0.1	0.6	2	-2	1		8.2	0.2	7	21	150	18
Uruguay		39	0.0	-0.5	0	9	2		10.2	0.0	37	26	206	-43
Hungary		354	-0.1	1.1	3	3	6		8.3	-2.5	-3	23	268	-133
Poland		4.40	-0.1	1.2	1	4	0		5.8	-10.8	-18	27	171	-40
Romania		4.6	-0.1	1.0	-1	-1	0		7.4	-4.0	0	15	171	-26
Russia		75.7	-0.2	-0.9	-5	84	-2		10.6	2.7	0	13	-1973	-128
South Africa		18.4	-0.6	0.0	-4	-16	-7		9.2	1.5	3	43	124	8
Turkey		18.92	-0.1	-0.2	-1	-24	-1		11.9	0.0	170	18	-1414	203
US (DXY; 5y UST)		104	0.1	-0.4	1	5	1		4.24	-1.8	5	40	253	23

	Equity Markets								Bond Spreads on USD Debt (EMBIG)					
	Level		Change (in %)					Since	Level		Change (in basis points)			
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22	Last 12m	Latest	7 Days	30 Days	12 M	YTD
									basis points					
China		4049	-1.5	-1	-1	-5	5	-12		165	-3	-8	-59	-12
Indonesia		6767	-0.6	-1	-2	-1	-1	-2		137	-9	4	-75	-3
India		60224	0.0	2	0	14	-1	5		143	-6	0	-44	1
Philippines		6705	0.5	2	-3	-4	2	-9		111	-10	3	-46	14
Thailand		1619	0.7	-1	-3	0	-3	-5		0	0	0	0	0
Malaysia		1459	0.4	0	-1	-6	-2	-8		93	-5	-6	-54	-7
Argentina		253019	2.9	1	3	188	25	177		2051	80	122	125	-154
Brazil		104700	0.8	0	-3	-6	-5	-7		259	-1	5	-81	-15
Chile		5426	0.0	1	3	18	3	24		134	-4	3	-55	2
Colombia		1236	1.7	4	-3	-20	-4	-18		389	-3	23	-20	17
Mexico		53924	-0.5	2	1	3	11	5		365	8	18	-20	-16
Peru		22129	-0.5	3	-1	-9	4	-5		178	-3	-4	-22	-2
Hungary		43409	-2.1	-3	-4	9	-1	-9		208	9	15	25	-14
Poland		61237	0.0	2	1	5	7	-3		65	-3	1	5	-8
Romania		12442	-0.3	1	1	13	7	-6		230	1	5	-40	-25
Russia		2296	0.1	2	1	-7	7	-26						
South Africa		78752	0.1	1	-1	7	8	5		345	-23	-6	-67	-22
Turkey		5408	0.3	3	20	171	-2	168		456	-41	-50	-207	16
Ukraine		507	0.0	0	0	-2	-2	-2		4702	51	500	-504	623
EM total		39	-0.5	2	-3	-8	4	-17		380	-4	14	-226	5

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

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