GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

FRIDAY, MAY 26, 2023

- **US yields jump as macro data surprises to upside** (link)
- **Analysts argue that US debt-limit deal could result in less monetary tightening** (link)
- **Disappointing euro area data weigh on sentiment** (link)
- **ECB negotiated wage measure increases in Q1** (link)
- **South African rand weakens sharply after 50 bps interest rate hike** (link)
- **Brazil's annual inflation rate unexpectedly decelerated in early May** (link)
- **Government bonds in Indonesia and Philippines outperform regional peers** (link)
- **GMM Special Feature: US Debt ceiling impasse and the US sovereign CDS market** (attached)

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Stronger-than-expected US data and debt-limit negotiations in focus

A key takeaway of this week is that core yields can still reprice quickly higher depending on data and political developments. The market is now also pricing in another hike of 25 bps by the Fed by July, which is not that surprising in light of relatively strong US economic data and encouraging debt ceiling headlines. European equities underperformed this week as the recent string of disappointing data weighs on sentiment. Some contacts note that ECB signaling shifted from pushing for a higher peak rate compared to market expectations towards pushing back on rate cuts in 2024. The South African rand fell to its weakest level on record yesterday after the central bank hiked but highlighted that further rand weakness was likely.

Key Global Financial Indicators

Last updated:	Level		Change from Market Close				
5/26/23 1:25 PM	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		4151	0.9	-1	2	2	8
Eurostoxx 50		4293	0.5	-2	-1	15	13
Nikkei 225		30916	0.4	0	7	15	18
MSCI EM		38	-0.2	-2	0	-8	1
Yields and Spreads					bps		
US 10y Yield		3.78	-3.5	11	33	104	-9
Germany 10y Yield		2.52	-0.5	9	12	152	-5
EMBIG Sovereign Spread		474	-6	-10	-23	4	23
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		50.0	0.4	0	-1	-5	0
Dollar index, (+) = $ appreciation		103.9	-0.3	1	2	2	0
Brent Crude Oil ($/barrel)		76.7	0.6	2	-1	-35	-11
VIX Index (%, change in pp)		18.8	-0.3	2	0	-9	-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

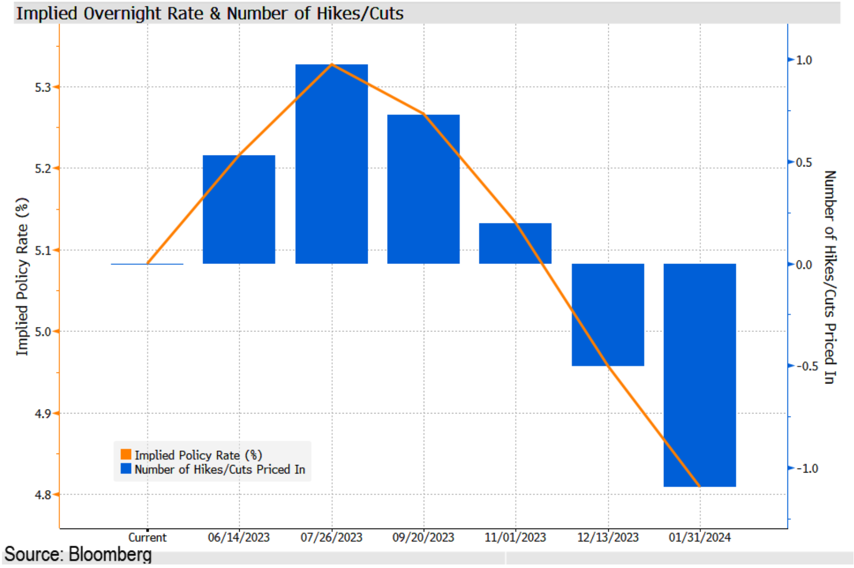
Macro data released this morning surprised the markets on the upside: April core PCE price index rose 4.7%yoy (4.6% expected); Personal spending increased 0.8%mom (0.5% expected); and Durable goods orders was 1.1%mom (-1.0% expected). In financial markets, 2-year Treasury yields jumped by 12bps following headlines. The dollar strengthened by 0.2% against the euro.

Yesterday, US Treasury 2-yr yields surged by 15 bps, as the market-implied probability of a 25 bps hike in June rose to 50%, reacting to solid macro data. Q1 GDP second release in the morning was revised higher, above expectations, and driven by stronger consumption growth and a smaller drag from inventories. **Initial jobless claims were also stronger than expected, and the levels of initial claims were revised lower over a previous couple of weeks as fraudulent filings from Massachusetts were removed from the statistics.**

Equities gained 0.9%, led by the technology sector. Nvidia shares soared 24% after its forecast related to AI surprised Wall Street analysts. Other sectors were mixed, with KBW regional banking index down 0.6% for the day.

The negotiations over spending cuts now focus on military spending and various domestic programs. Analysts view the likely outcome as a deal signed to law before the X-date, but the odds of passing the date without increasing the debt limit are rising. In this case, Treasury would prioritize principal and interest payments to avoid a technical default. Still, some adverse effects would be including a downgrade of the US credit rating. 1-year sovereign CDS spreads remain elevated at 165 bps.

Some analysts argue that a debt-limit deal may lead to one less hike of 25 bps. If there is a deal, from a macroeconomic perspective, the most critical bargaining point is the near-term reduction in federal outlays. The plan passed by the House GOP would reduce FY24 spending by $130 bn (0.5% of GDP), while the White House plan would reduce spending by about 0.1% of GDP. **With fiscal belt-tightening now doing that job, the Fed funds rate needs to be 10−50 bps less than would be the case without a change in the fiscal outlook, or one less 25 bps hike, based on a simple Taylor rule, according to JPMorgan analysts.** Currently, the OIS forwards discount terminal rates at 5.33% in July, followed by a total 50 bps rate cut by January 2024.

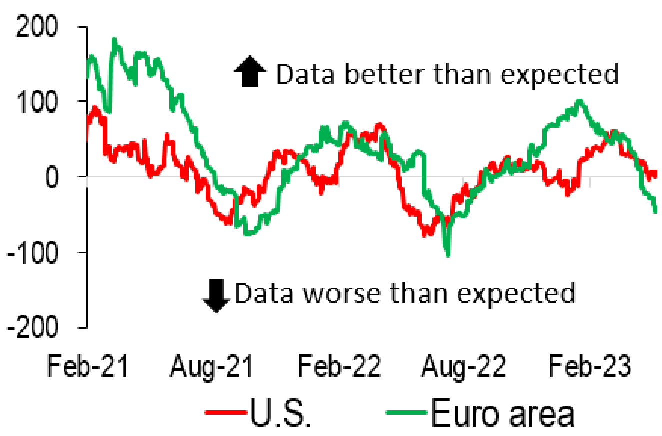


Source: Bloomberg

Europe

Equities (+0.1%) are set to close the week 2.9% lower as the recent string of disappointing data weights on sentiment. Bank equities (-1.2%) underperformed.

Citi Economic Surprise Indices: Euro area and U.S.

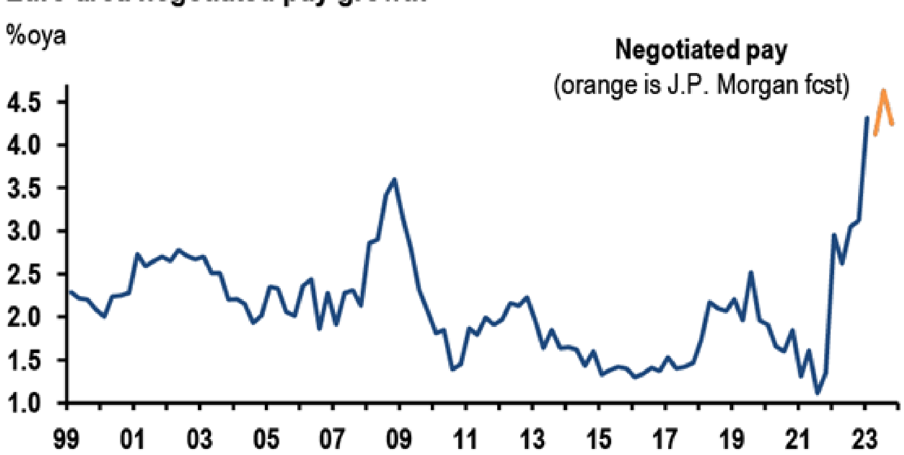


Source: Bloomberg and IMF

Euro area 10-yr yield are 2−3 bps lower as contacts note that ECB communication has arguably shifted away from pushing for a higher peak rate towards questioning rate cuts. Dutch central bank governor Knot said that “ECB analysis will show that two more 25bp rate hikes will be necessary” but warned that markets are “too optimistic about rate cuts.”

The ECB negotiated wages measure rose to 4.3% yoy in Q1 of 2023, from 3.1% yoy in 4Q. Analysts at Citi had a sharper increase to 4.6%. In contrast, the increase was very close to JP Morgan’s expectations. **JP Morgan expects euro area wage growth to accelerate to 5% in 2Q and to remain at around that level for the remainder of 2023.**

Euro area negotiated pay growth



Source: ECB, Eurostat, J.P. Morgan

Emerging Markets

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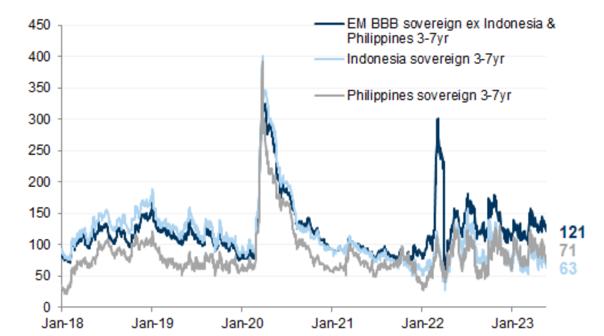
Chinese equities (+0.4%) closed higher but are still 3% lower in May. EMEA equity markets were trading higher, while currencies were mixed, and bonds traded in a narrow range. Equity markets in Türkiye (+0.9%) and Poland (+0.5%) outperformed. The Polish zloty weakened against the euro (-0.4%) and the South African rand firming against the dollar (+0.5%). Local bond yields were broadly unchanged. **Latin American asset prices fell, as traders ramped up bets that the Fed will press on rate hike**. Stocks lost in Colombia (-1.09%), Peru (-0.76%) and Chile (-0.41%), while Brazil and Mexico equity markets gained 1.15% and 0.66%, respectively. Currencies depreciated in Brazil (-1.63%), Colombia (-1.04%), Mexico (-0.30%) and Chile (-0.18%), while the Peruvian sol (0.13%) slightly strengthened.

Asian Government Bond Markets

Local government bond markets in Indonesia and the Philippines have outperformed regional peers over the past few months. These markets are viewed as less sensitive to global risks such as the US debt ceiling standoff and US-China tensions and are very popular among international investors. They offer attractive carry income in currencies that have remained fairly stable this year, with the Indonesian rupiah actually appreciating versus the dollar in 2023 while the Philippines peso has held steady. Both countries also have a strong domestic investor base. Goldman analysts point to the flatness of their yield curves as evidence of robust investor demand for longer maturity bonds in these markets.

Exhibit 1 : Indonesia and Philippines sovereign have outperformed EM BBB sovereigns in recent months

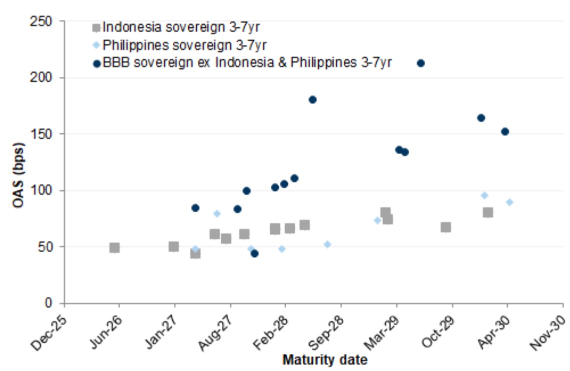
OAS for EM BBB, Indonesia and Philippines 3-7yr sovereign credit (bps)



Source: ICE-BAML, Goldman Sachs Global Investment Research

Exhibit 2 : Flatter curves for Indonesia and Philpines sovereign versus EM BBB

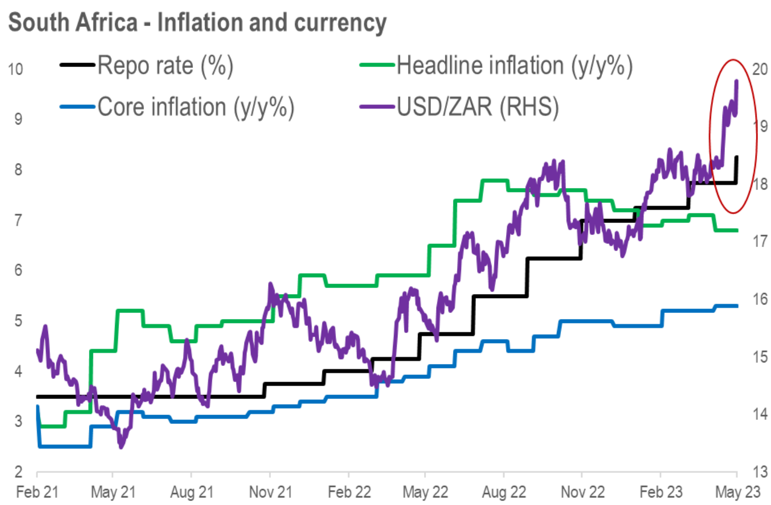
Scatter plot for DXEM BBB sovereigns (bps)



Source: ICE-BAML, Goldman Sachs Global Investment Research

South Africa

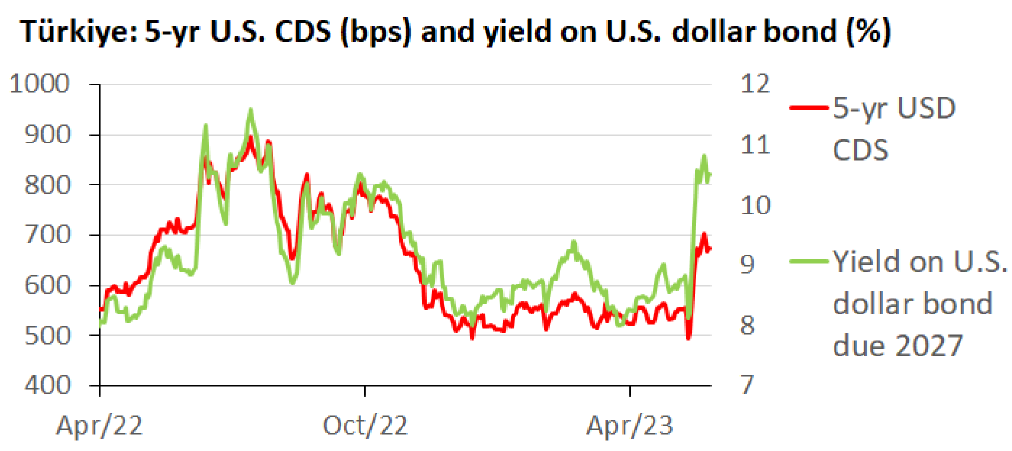
The rand (-2.8%) fell to the weakest level on record, after the central bank hiked the repurchase rate by 50bps to 8.25% in a unanimous decision and noted expectations for further currency weakness given upside risks to inflation, larger domestic and external financing needs, and load-shedding. The rand retraced some losses against the dollar (+0.5% to 19.71/$) this morning but remains roughly 13.5% weaker than at the start of the year. While Goldman Sachs analysts as a baseline expect that the hiking cycle has now come to an end, JPMorgan analysts see the SARB in a “credibility bind,” and expect at least another hike of 25 bps in July.



Source: Bloomberg and IMF calculations

Turkey

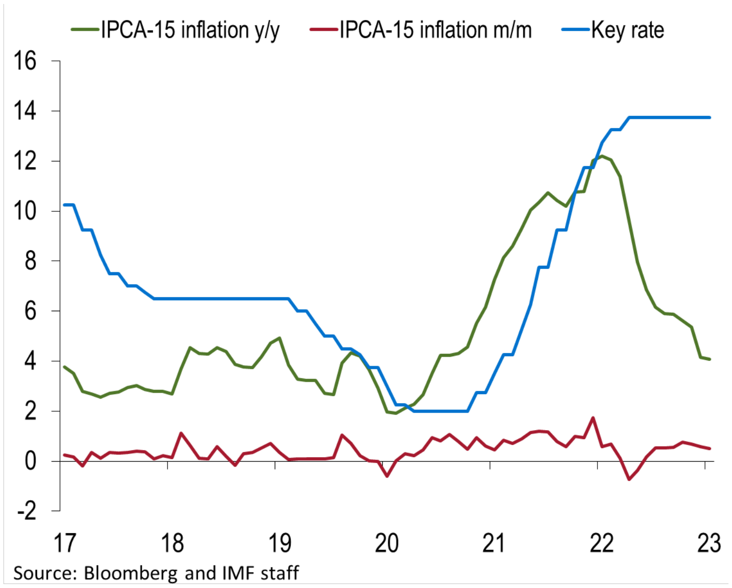
CDS spreads and US dollar bond yields were little changed going into the second round of the presidential elections on Sunday, May 28. Contacts generally expect President Erdogan to win. Citi writes that all eyes are on the composition of the new economic team and the credibility of the initial policy response after elections.



Source: Bloomberg and IMF staff

Brazil

Annual inflation rate unexpectedly decelerated in early May, marking the 12th consecutive month of declines and strengthening President Lula da Silva's case for interest rate cuts. Official data revealed that consumer prices rose by 4.07% compared to the previous year, lower than median estimate of 4.21%. **Despite this positive development, central bank President Campos Neto remains cautious, expressing concerns about core inflation and elevated forecasts indicating a potential pickup in price increases later this year.** The benchmark interest rate has been maintained at 13.75%. While the high interest rate has helped control inflation, it has also contributed to economic stagnation. Ibovespa stock index gained1.15% accordingly and once reached 111,000 in the morning after the data release.



Source: Bloomberg and IMF staff

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Global Financial Indicators

5/26/23 1:52 PM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4155	0.9	-1	2	2	8
Europe		4293	0.5	-2	-1	15	13
Japan		30916	0.4	0	7	15	18
China		3851	0.0	-2	-4	-4	-1
Asia Ex Japan		65	-0.2	-2	-1	-7	0
Emerging Markets		38	-0.2	-2	0	-8	1
Interest Rates					basis points		
US 10y Yield		3.78	-3.5	11	33	104	-9
Germany 10y Yield		2.52	-0.5	9	12	152	-5
Japan 10y Yield		0.42	-0.6	2	-4	18	0
UK 10y Yield		4.34	-3.8	34	61	237	66
Credit Spreads					basis points		
US Investment Grade		166	1.5	-3	4	10	7
US High Yield		493	2.5	-4	1	31	13
Europe IG		82	-1.0	-1	-4	-7	-9
Europe HY		434	-3.0	0	-19	-5	-40
Exchange Rates					%		
USD/Majors		103.90	-0.3	1	2	2	0
EUR/USD		1.08	0.3	0	-3	0	0
USD/JPY		139.7	-0.2	1	5	10	7
EM/USD		50.0	0.4	0	-1	-5	0
Commodities					%		
Brent Crude Oil ($/barrel)		76.7	0.6	2	-1	-20	-9
Industrials Metals (index)		143	1.6	-2	-6	-22	-14
Agriculture (index)		65	1.0	1	-3	-16	-6
Implied Volatility					%		
VIX Index (%, change in pp)		18.8	-0.3	2.0	0.0	-8.7	-2.9
US 10y Swaption Volatility		128.1	0.8	11.5	9.7	25.9	1.5
Global FX Volatility		8.8	0.0	0.2	-0.6	-1.3	-1.9
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		140	1.7	-19	-42	-114	-65
Italy		188	0.5	4	1	-2	-26
Portugal		75	-1.3	-5	-9	-36	-27
Spain		107	0.2	2	2	1	-2

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

Emerging Market Financial Indicators

Last updated: 26/05/2023 1:54 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		7.06	0.3	-0.7	-2	-5	-2		2.8	-1.8	-9	-27	4	-24
Indonesia		14955	0.0	-0.2	-1	-2	4		6.4	0.1	-1	-9	-74	-51
India		83	0.2	0.1	-1	-6	0		7.3	2.2	14	9	(24.7)	-14
Philippines		56	0.5	-0.2	0	-6	0		5.9	2.5	6	-6	46	-9
Thailand		35	-0.1	-1.0	-2	-1	0		2.7	-1.0	3	16	-8	10
Malaysia		4.60	0.6	-1.4	-3	-4	-4		3.8	-1.1	3	5	-33	-25
Argentina		236	-0.3	-1.7	-7	-49	-25		107.5	0.0	473	1715	5164	1928
Brazil		5.01	0.7	-0.2	1	-5	6		11.8	7.1	-21	-65	-36	-77
Chile		806	0.3	-1.0	0	2	5		5.4	0.5	8	16	-72	3
Colombia		4493	-1.0	0.9	0	-12	8		8.8	0.0	3	11	35	-95
Mexico		17.70	0.9	0.5	3	12	10		8.6	4.8	24	21	18	-15
Peru		3.7	0.1	0.3	2	0	3		7.3	-0.3	-4	-11	-10	-66
Uruguay		39	-0.2	0.3	0	3	3		10.0	0.1	-2	-17	-14	-67
Hungary		346	0.4	0.5	-2	6	8		8.2	-2.0	39	34	133	-143
Poland		4.23	-0.7	-0.6	-2	2	3		5.5	3.0	11	12	-60	-66
Romania		4.6	0.0	-0.2	-3	0	0		6.9	-7.0	-5	-34	-89	-84
Russia		80.0	0.1	0.5	3	-19	-7							
South Africa		19.6	1.2	-0.6	-6	-20	-13		10.2	-4.7	8	83	201	107
Turkey		20.04	-0.5	-1.1	-3	-18	-7		9.1	0.0	-76	-320	-1529	-74
US (DXY; 5y UST)		104	-0.1	0.9	3	2	1		3.87	3.9	22	45	124	-5

	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		3851	0.0	-2	-4	-4	-1		191	-3	-5	-22	14
Indonesia		6687	-0.3	0	-3	-5	-2		140	0	-19	-71	0
India		62502	1.0	1	2	14	3		148	-8	-12	-46	6
Philippines		6530	-0.5	-2	-1	-3	-1		112	-2	-20	-41	15
Thailand		1531	-0.3	1	0	-7	-8		0	0	0	0	0
Malaysia		1403	0.0	-2	-1	-9	-6		96	-2	-7	-36	-4
Argentina		341669	0.3	4	13	274	69		2598	2	-57	682	393
Brazil		110054	1.2	0	8	-2	0		257	-7	-27	-57	-17
Chile		5620	0.0	-1	6	7	7		128	0	-16	-46	-4
Colombia		1099	-1.1	-3	-7	-27	-15		405	-2	2	46	33
Mexico		53745	0.7	-3	-1	3	11		395	-4	2	13	14
Peru		21242	-0.8	-2	-3	3	0		180	1	-5	-11	0
Hungary		47361	0.5	2	9	21	8		226	-7	-7	4	4
Poland		64064	1.1	-1	4	13	12		128	-7	39	109	55
Romania		12286	0.8	0	-1	0	5		249	-4	-13	-21	-7
South Africa		75802	-0.1	-3	-3	10	4		451	-22	23	49	84
Turkey		4485	2.1	0	-6	84	-18		617	-33	82	3	177
Ukraine		507	0.0	0	0	-2	-2		4945	-193	-304	1679	866
EM total		38	0.8	-2	0	-8	1		420	-8	-8	15	44

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

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