GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

FRIDAY, MAY 27, 2022

- **Global central banks contend with persistently high inflation** (link)
- **Rising volatility boosts hedging costs across asset classes** (link)
- **Eurodollar futures market hints at potential Fed rate cut in 2023** (link)
- **Global ESG fund inflows slow down** (link)
- **Moody's changes Egypt's credit outlook to negative** (link)
- **Colombian bonds weaken ahead of Presidential election** (link)

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Global markets turn cautiously positive

US equity futures are higher this morning and European stocks are posting gains after Thursday's major rally helped risk sentiment improve. The S&P 500 is on course to end a historic seven week losing streak as strong consumption data showed that the US consumer sector remains robust. Equity funds are experiencing their largest inflows in 10 weeks, with the US being the most favored destination. The heavy losses sustained over the past nearly two months appear to have attracted dip buyers looking for bargains. The battered technology sector is attracting special interest, with China's Alibaba and Baidu announcing stronger than expected earnings and US tech stocks also catching a bid. However, stocks in the energy and utility sectors lagged in the UK after the authorities announced a temporary windfall tax on the profits of oil and gas companies. Meanwhile, US and euro area government bond yields trended lower again as 2022's interest rate spike gradually unwinds. Yield curves have started a flattening trend after steepening during the bond market selloff.

Key Global Financial Indicators

Last updated: 5/27/22 8:05 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		4058	2.0	4	-3	-3	-15	-4
Eurostoxx 50		3771	0.8	3	1	-7	-12	-5
Nikkei 225		26782	0.7	0	0	-8	-7	1
MSCI EM		42	1.6	1	0	-24	-15	-12
Yields and Spreads				bps				
US 10y Yield		2.73	-2.2	-6	-11	112	122	73
Germany 10y Yield		0.95	-4.9	1	15	112	113	72
EMBIG Sovereign Spread		462	-8	-24	29	129	96	50
FX / Commodities / Volatility				%				
EM FX vs. USD, (+) = appreciation		52.5	-0.1	0	1	-9	0	-1
Dollar index, (+) = $ appreciation		101.8	0.0	-1	-1	13	6	6
Brent Crude Oil ($/barrel)		117.1	-0.2	4	11	69	51	21
VIX Index (%, change in pp)		27.3	-0.3	-2	-4	11	10	-4

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

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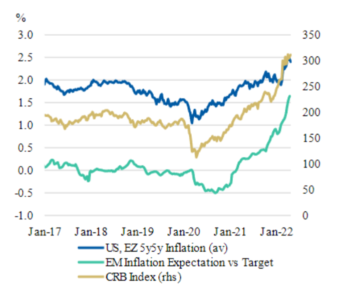
Global Central Banks

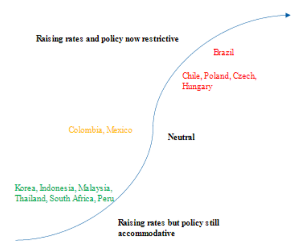
Sharply higher commodity prices have been a key driver of inflation expectations in both advanced economies (AEs) and emerging markets (EMs). This has put central banks across the globe into aggressive inflation fighting mode. However, AE central banks are only just getting started with their rate hikes while a number of EM central banks have been on the move for nearly two years and are closer to the end of their rate hike cycles. In some countries, policy rates are already in restrictive territory. The realization that AE central banks still have a long way to go has contributed to the growing pessimism among market participants as risk assets have sold off relentlessly all year. Elevated AE interest rates, the strong dollar and increasing risk aversion have now rebounded onto EMs, putting further pressure on their currencies and sparking investor outflows that threaten to make local financial conditions tighter. EM central banks face a dilemma, with persistent inflation on one side and weakening economies on the other.

Exhibit 16: Commodity prices and inflation expectations are correlated



Source: Bloomberg, Morgan Stanley Research; Note: For EM, we use Bloomberg consensus CPI forecasts, 12-month forward relative to central bank targets.

Exhibit 17: Where are EMs in their tightening cycle?



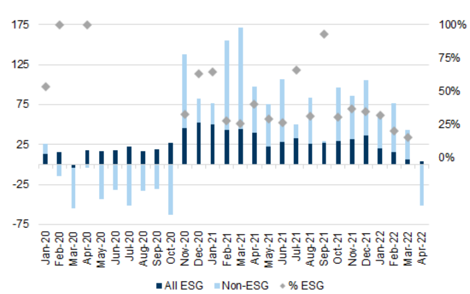
Source: Morgan Stanley Research

Global ESG Flows

Global ESG funds inflows remained positive in April but fell to the lowest monthly level since March 2020. Global ESG funds saw $4bn worth of inflows in April, while non-ESG funds saw outflows of $52bn. On a jurisdictional basis, the share of flows outside Europe and North America has increased in 2022, but funds domiciled in Western Europe still account for the largest share of ESG fund flows—making up 70% in April. Goldman Sachs analysts note that similar to March 2020, passive fund flows made up the largest share in ESG flows amid market volatility.

ESG flows have decelerated in 2022, but remained positive in April

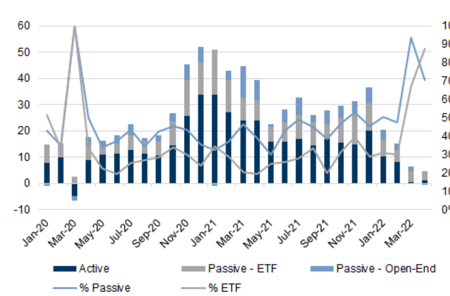
Monthly global ESG equity fund flows ($bn, LHS); ESG % of overall fund flows (if net positive, RHS)



Source: Morningstar, Goldman Sachs Global Investment Research

Passive spiked as a percentage of ESG flows in recent months

Monthly flows (LHS) and % of flows (RHS) by fund style; bnUSD



Source: Morningstar, Goldman Sachs Global Investment Research

United States

The latest economic data came in very close to market forecasts. Core PCE, the Fed's favored inflation measure, continued a modest downturn while personal spending was slightly stronger than expected. The market response was fairly muted, with Treasury yields moving up 1–2 basis points and the dollar fractionally stronger against the euro and the yen.

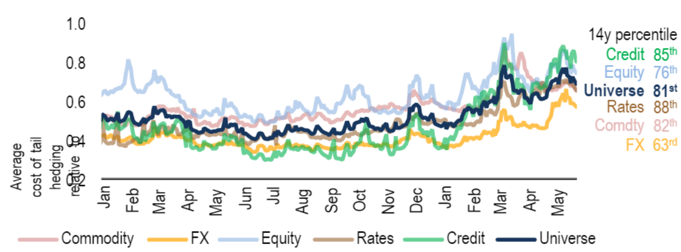
Key US Data Releases: 8.30 am EDT

Indicator	Consensus Forecast	Actual Data
PCE Deflator mom	0.2%	0.2%
PCE Deflator yoy	6.2%	6.3%
Core PCE Deflator mom	0.3%	0.3%
Core PCE Deflator yoy	4.9%	4.9%
Personal Income	0.5%	0.4%
Personal Spending	0.8%	0.9%

Rising volatility has raised the cost of tail risk hedging across all asset markets. While volatility in the bond and equity markets has been elevated for a while, other sectors such as foreign exchange that had been relatively quiet have also seen volatility rising. Investors seeking protection across extreme market moves have seen hedging costs rise sharply across the board. With the Fed in active inflation fighting mode, investors have come to realize that the large recent market declines will not deter policymakers from continuing with rate hikes. The *Fed put*, the notion that the market will step in to support markets if they suffer steep declines, is growing further *out of the money,* i.e., it will take much larger market declines to get the Fed to change its mind about further rate hikes. As a result, the demand for insurance has shot up even as hedging costs continue to rise.

Exhibit 2: The cost of tail hedging rose to its 81st 14y percentile across asset classes

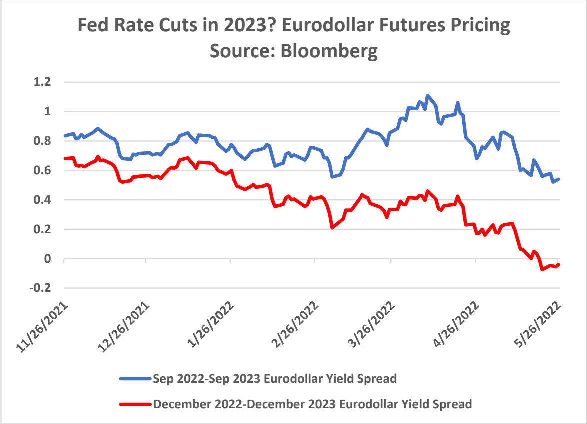
The average cost of tail hail hedging in our universe broken down by asset class



Source: Data from 1-Jan-08 to 24-May-22. *See source of Exhibit 3 for details on average cost per unit of hedge benefit

BofA GLOBAL RESEARCH

Markets predict that the Fed will hit its terminal rate close to 3% in 2023, but some parts of the bond market are actually predicting lower policy rates by the end of next year. The highly liquid and widely traded eurodollar interest rate futures market shows an inversion in the yield curve between the December 2022 and December 2023 contracts, implying that the Fed's policy rate will be lower in December 2023 than in December 2022. The spread between the September 2022 and September 2023 contracts is still positive but narrowing rapidly. These trends are in keeping with the consensus forecast that the current rate hike cycle will be short and shallow, and that the Fed will have to start cutting rates relatively soon after reaching the terminal rate.



Euro Area

European equity markets are participating in the global rally, with the Stoxx 600 index up nearly 1%. The financial services sector (+1.4%) saw the largest gains. **The euro reversed opening gains and sovereign yields edged lower (10-yr bund -2bps), while peripheral spreads were little changed.** ECB governing council member de Cos reiterated views that interest rate hikes should be gradual, with the first interest rate hike seen shortly after net asset purchases end, which is expected at the start of the third quarter. **Markets continue to price in roughly +32 bps of tightening in July and +100 bps of tightening priced in by the end of 2022.** On the data front, **Spain's retail sales surprised on the upside in April**, with seasonally adjusted sales increasing to +1.5% yoy vs an expected decline of -2.0% (from -4.2%).

United Kingdom

Expectations of additional fiscal support reinforced rate hike expectations. Chancellor Sunak yesterday announced a £15bn support package, including cost-of-living payments targeted towards more vulnerable households as well as universal energy rebates. A temporary levy on oil and gas sector firms will help finance the extra support. Goldman Sachs analysts have left 2022 GDP forecasts unchanged, estimating that the positive impact of the support package on economic growth would be countered by weak May data—notably the significant decline in services PMI. JPMorgan analysts, however, lifted growth forecasts by an average of roughly +0.5% annualized between Q3 2022 and Q1 2023. **Analysts expect the support package will spur inflation.** Goldman Sachs analysts see +25bps of hikes in each of the respective monetary policy meetings up to February 2023 to take the policy rate to +2.5% (from the current level of 1.0%), while J.P. Morgan analysts now forecast an additional +25bps hike in September and see the bank rate at 2% by end-2022. **Markets continue to fully price in a +25bps hike in June, with +125bps of tightening priced in for this year.**

Strategists see FTSE 100 Index becoming less attractive as valuations converge between the UK and euro area. According to a Bloomberg survey, strategists see no further upside in the FTSE 100 in 2022, while the Euro Stoxx 50 is expected to gain +9%. The FTSE 100 has outperformed so far in 2022 (+2% YTD), supported by strong commodity sector growth, while both the FTSE 250 and Stoxx 50 Europe indices have each lost almost 15%.

Emerging Markets

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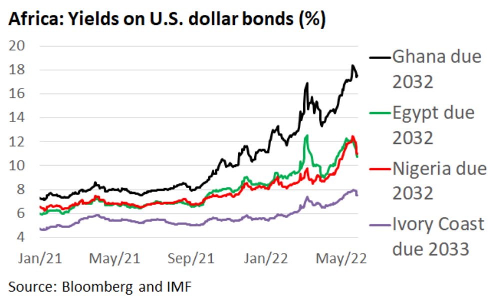
Emerging markets are up as sentiment improves following yesterday's strong US rally. However, markets in EMEA were mixed. The Hungarian forint consolidated at lower levels after a drop of 2% this week with the central bank expected to hike its policy rate to 50 bps on Tuesday (to 5.90%). African Eurobond prices gained with contacts pointing to a broader improvement in risk sentiment in line with the recent drop in the U.S. dollar and U.S. interest rates. Asian markets were up and currencies were generally stronger. Hong Kong SAR partially reversed earlier losses on strong earnings from Alibaba and Baidu. Latin America did especially well as US markets rose.

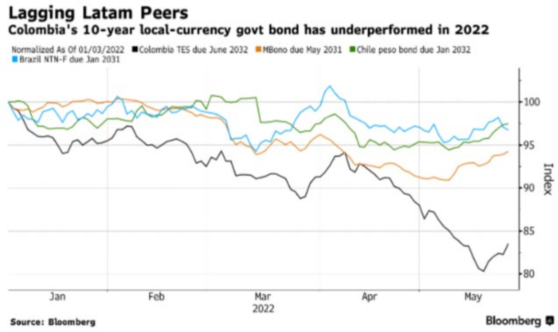


China

Industrial profits fell -8.5% yoy in April, with foreign companies taking the biggest hit. This is the first decline in two years amid COVID lockdowns. Profits of foreign industrial firms declined -16.2% yoy in the January-April period, private firm profits slipped -0.6%, while state-owned firm profits grew +13.9% yoy. In other news, Premier Li continued to urge officials to move decisively to avoid an economic contraction. He called for a balance between Covid control and growth strategies.

Colombia

Colombian government bonds weaken ahead of a crucial presidential election. Since the beginning of the year, Colombian local-currency government bonds have been underperforming relative to their regional peers. The 10-year local-currency bond price plunged to a record low of 73 points (last week) before a slight rebound up to 76 points yesterday, only three days before a crucial presidential election. The rise of the leftist candidate Petro, who pledged to phase out oil and gas production, has unsettled Colombian assets and investors.



Egypt

Moody's lowered Egypt's outlook of B2 to negative, citing a significant narrowing in the FX reserve buffer needed to meet upcoming external debt service payments. The credit agency believes that immediate balance of payment risks are mitigated by $22 bn in financial commitments by GCC sovereigns, of which $11 bn are already deposited in support of FX reserves, and the remainder pledged as FDI and asset purchases and by the prospect of a new IMF program. Moody's argues that Egypt will depend on continued inflows from abroad given external debt service payments over the next three years of about $25-30 bn (including short-term plus medium/long-term external debt maturities).

This monitor is prepared under the guidance of Ranjit Singh (Assistant Director), Nassira Abbas (Deputy Division Chief), Charles Cohen (Deputy Division Chief), and Antonio Garcia-Pascual (Deputy Division Chief). Fabio Cortes (Senior Economist), Reinout De Bock (Economist-London representative), Sanjay Hazarika (Senior Financial Sector Expert), Tom Piontek (Financial Sector Expert) and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Sergei Antoshin (Senior Economist), Yingyuan Chen (Financial Sector Expert), Mohamed Diaby (Economist, EP), Dimitris Drakopoulos (Senior Financial Sector Expert), Torsten Ehlers (Senior Financial Sector Expert), Deepali Gautam (Research Officer), Frank Hespeler (Senior Financial Sector Expert), Shoko Ikarashi (Externally Financed Appointee), Phakawa Jeasakul (IMF Resident Representative in Hong Kong SAR), Esti Kemp (London Representative), Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), Patrick Schneider (Research Officer), Dmitry Yakovlev (Senior Research Officer), Akihiko Yokoyama (Senior Financial Sector Expert), and Xingmi Zheng (Research Assistant). 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

Last updated: 5/27/22 8:08 AM	Level Last 12m	Level Latest	Change 1 Day	Change 7 Days	Change 30 Days	Change 12 M	YTD	Since 23-Feb-22
Equities				%			%	%
United States		4060	2.0	4	-3	-3	-15	-4
Europe		3771	0.8	3	1	-7	-12	-5
Japan		26782	0.7	0	0	-8	-7	1
China		4001	0.2	-2	0	-25	-19	-13
Asia Ex Japan		70	1.6	1	0	-26	-16	-12
Emerging Markets		42	1.6	1	0	-24	-15	-12
Interest Rates				basis points				
US 10y Yield		2.73	-2.2	-6	-11	112	122	73
Germany 10y Yield		0.95	-4.9	1	15	112	113	72
Japan 10y Yield		0.23	-0.7	-1	-1	15	16	4
UK 10y Yield		1.89	-8.0	-1	8	108	92	41
Credit Spreads				basis points				
US Investment Grade		158	1.0	-15	3	66	46	15
US High Yield		459	-3.1	-51	48	117	121	52
Europe IG		88	-2.9	-12	0	37	40	16
Europe HY		435	-13.5	-51	21	184	192	83
Exchange Rates				%				
USD/Majors		101.79	0.0	-1	-1	13	6	6
EUR/USD		1.07	-0.1	1	2	-12	-6	-5
USD/JPY		126.9	-0.2	-1	-1	16	10	10
EM/USD		52.5	-0.1	0	1	-9	0	-1
Commodities				%				
Brent Crude Oil ($/barrel)		117	-0.2	4	12	80	54	29
Industrials Metals (index)		185	1.0	0	-9	15	7	-2
Agriculture (index)		77	-0.1	-1	0	33	27	10
Implied Volatility				%				
VIX Index (%, change in pp)		27.3	-0.3	-2.2	-4.4	10.5	10.0	-3.8
US 10y Swaption Volatility		102.3	-2.2	-9.7	-25.1	37.0	23.2	8.0
Global FX Volatility		10.2	0.0	-0.4	0.0	3.2	2.7	2.7
EA Sovereign Spreads				10-Year spread vs. Germany (bps)				
Greece		255	0.2	-23	31	150	103	15
Italy		190	0.2	-16	13	79	55	19
Portugal		110	-0.7	-9	5	45	46	18
Spain		106	-0.3	-8	7	40	31	2

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

Emerging Market Financial Indicators

Last updated: 5/27/2022 8:10 AM	Exchange Rates								Local Currency Bond Yields (GBI EM)							
	Level		Change (in %)					Since	Level		Change (in basis points)					Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
		vs. USD	(+) = EM appreciation							% p.a.						
China		6.70	0.6	-0.1	-2	-5	-5	-6		2.8	0.0	-8	-13	-38	-7	-8
Indonesia		14567	0.3	0.5	-1	-2	-2	-2		7.1	-9.0	-14	12	65	70	59
India		78	0.0	0.0	-1	-6	-4	-4		6.3	0.0	0	9	75	0	
Philippines		52	0.2	-0.2	0	-8	-3	-2		5.5	0.0	3	15	105	98	48
Thailand		34	0.3	0.8	1	-8	-3	-5		2.9	6.0	-19	13	97	102	65
Malaysia		4.38	0.4	0.2	0	-5	-5	-4		4.1	-0.1	-25	-17	91	53	45
Argentina		119	-0.3	-0.9	-4	-21	-14	-10		56.0	11.2	128	317	1022	540	800
Brazil		4.75	0.4	2.7	5	10	17	5		11.8	-38.7	-26	-39	246	109	26
Chile		823	1.1	1.7	2	-11	3	-4		6.1	0.0	1	-27	230	66	17
Colombia		3925	0.5	3.3	0	-5	4	0		8.5	0.0	-27	10	260	207	61
Mexico		19.70	0.3	0.8	4	1	4	3		8.4	0.5	-5	-50	157	89	57
Peru		3.7	0.8	2.1	5	5	9	2		7.4	-1.1	-39	-47	261	150	140
Uruguay		40	0.4	1.2	3	10	12	6		10.1	-2.4	1	26	225	139	197
Hungary		366	0.1	-0.7	-2	-22	-11	-13		6.9	7.0	31	16	419	240	210
Poland		4.28	0.5	2.5	4	-14	-6	-5		6.2	7.0	38	54	430	270	233
Romania		4.6	0.0	1.6	2	-13	-6	-5		7.8	1.8	-22	125	504	294	261
Russia		65.4	-1.5	-5.0	13	12	15	25		8.1	3.8	-233	-449	73	-64	-305
South Africa		15.6	0.6	1.4	2	-12	2	-3		8.3	3.5	4	2	89	84	68
Turkey		16.40	-0.3	-3.0	-10	-48	-19	-16		23.6	-75.0	-83	250	526	-69	121
US (DXY; 5y UST)		102	0.0	-1.3	-1	13	6	6		2.70	-1.0	-10	-13	188	144	80

	Equity Markets								Bond Spreads on USD Debt (EMBIG)						
	Level		Change (in %)					Since	Level		Change (in basis points)				Since
	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	23-Feb-22
										basis points					
China		4001	0.2	-2	0	-25	-19	-13		213	1	0	3	10	5
Indonesia		7026	2.1	3	-3	20	7	2		207	-9	15	35	42	22
India		54885	1.2	1	-4	7	-6	-4		193	-2	22	43	61	39
Philippines		6726	1.2	0	0	1	-6	-9		148	-12	0	53	47	11
Thailand		1639	0.3	1	-2	4	-1	-3		0	0	0	0	0	0
Malaysia		1547	0.4	0	-3	-3	-1	-2		131	-6	8	11	14	-2
Argentina		93711	2.7	3	4	63	12	3		1927	-18	143	434	247	190
Brazil		111890	1.2	5	2	-10	7	0		309	-14	19	60	-2	-22
Chile		5269	1.5	6	10	27	22	20		167	-13	-3	22	27	-7
Colombia		1509	1.2	3	-5	28	7	0		356	-49	-2	101	8	-36
Mexico		52143	0.8	2	0	5	-2	2		372	-30	-1	44	40	2
Peru		20569	0.9	2	-8	3	-3	-12		185	-14	-5	20	35	-5
Hungary		39145	-0.2	-6	-7	-15	-23	-18		224	3	62	82	100	71
Poland		56394	-0.9	1	-3	-14	-19	-10		19	-5	-11	-21	-13	3
Romania		12410	0.7	3	-2	10	-5	-6		262	-24	31	83	70	30
Russia		2410	-0.1	2	-1	-36	-36	-22		3411	-577	938	3228	3234	2897
South Africa		70112	0.9	4	0	5	-5	-7		390	-51	22	74	35	1
Turkey		2448	-0.1	3	0	73	32	21		604	-14	86	136	26	41
Ukraine		519	0.0	0	0	-2	-1	0		3291	188	-397	2811	2532	1818
EM total		42	0.9	1	0	-24	-15	-12		398	-21	-9	45	12	-60

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

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