GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

WEDNESDAY, MAY 31, 2023

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Debt ceiling deal remains key market focus

The US debt ceiling deal took the first step towards passage as it received a positive vote from the House Rules Committee late yesterday. Supporters are hoping for another positive vote in the House of Representatives tonight, after which the bill will move to the Senate ahead of next Monday's X-Date when the debt ceiling is expected to be triggered. However, even the most optimistic legislators acknowledge the difficulties that still lie ahead, with many on both sides unhappy with the compromises inherent in the deal. US equity index futures and European stocks were down across the board as investors took cover ahead of several days of potential market volatility as the debt ceiling negotiations continue. Weak manufacturing data from China also weighed on sentiment, as markets are coming to the realization that the hoped for economic boost in China from a post-lockdown recovery could be fading fast. Treasury and bund yields fell for a second day on safe haven buying, which also boosted the dollar. The move in bunds was accelerated by lower than expected inflation in France and Germany. Oil prices extended yesterday's steep declines.

Key Global Financial Indicators

Last updated: 5/31/23 7:59 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		4206	0.0	0	1	2	10	0
Eurostoxx 50		4270	-0.5	0	-2	13	13	7
Nikkei 225		30888	-1.4	1	6	12	18	17
MSCI EM		39	-1.2	-2	-1	-10	2	-19
Yields and Spreads				bps				
US 10y Yield		3.64	-4.4	-10	22	80	-23	165
Germany 10y Yield		2.26	-8.6	-22	-6	113	-32	203
EMBIG Sovereign Spread		476	-2	-7	-7	22	24	63
FX / Commodities / Volatility				%				
EM FX vs. USD, (+) = appreciation		49.6	-0.8	-1	-2	-6	-1	-7
Dollar index, (+) = $ appreciation		104.5	0.3	1	3	3	1	9
Brent Crude Oil ($/barrel)		71.8	-2.3	-8	-10	-42	-16	-26
VIX Index (%, change in pp)		17.9	0.5	-1	2	-8	-4	-13

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

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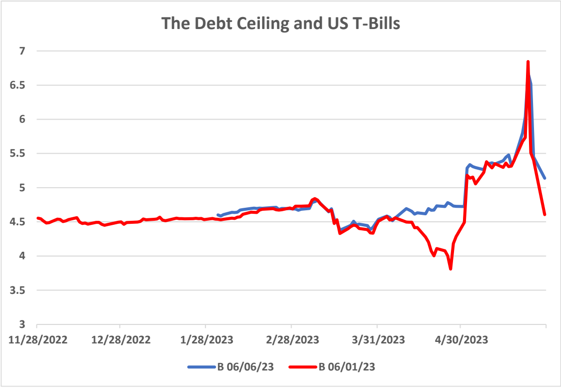
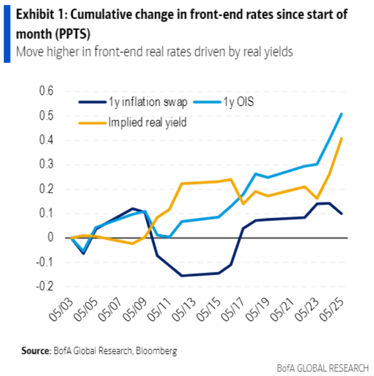
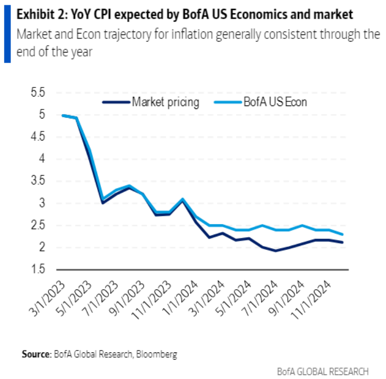
United States

The US House of Representatives is expected to vote on the debt ceiling deal later today. As written, the deal will raise the debt ceiling to January 1, 2025. Beyond that, a lot of the details are open to interpretation. The White House is saying that the deal will lower spending by $1 trillion over the next 10 years. The Republicans say that spending will be cut by $ 2 trillion over the next 10 years. There are press reports that lawmakers on both sides are unhappy with the deal. If the deal is not approved in the House today, the prospects for a Senate vote ahead of next Monday's X-Date become much more complicated. Furthermore, a number of Senate Republicans have already come out against the deal, and any single Senator can delay discussions on the deal for a long period. Some analysts think a shorter term debt ceiling extension is a more likely outcome. The yield on the T-Bill maturing on June 6 has come down sharply from 6.79% on May 24th to 5.27%. However, its yield still remains well above that of the T-Bill maturing on June 1.

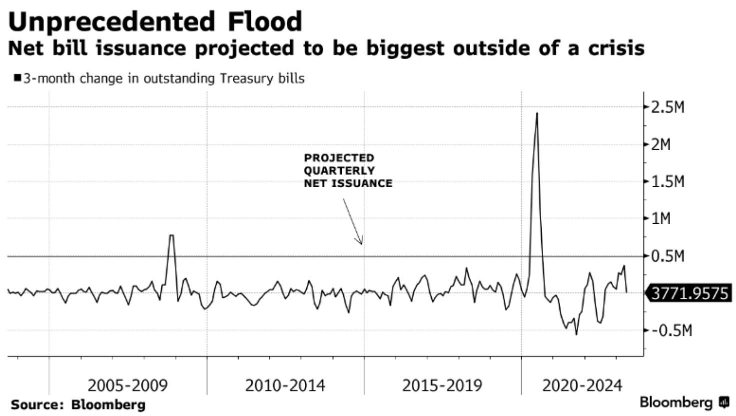


The market for inflation swaps remains very optimistic, predicting lower inflation. Despite recent strong data on inflation and the US economy more broadly, and a surge in short term interest rates (the two-year Treasury yield is up around 55 bps in May), one year inflation swap yields moved in the opposite direction. Breakeven yields on US Treasury Inflation Protected Securities (TIPS), a key market gauge of inflation expectations, also remain subdued across the yield curve. Bank of America analysts think that the inflation markets are vulnerable to a correction, as inflation is likely to remain higher than expected. TIPS breakeven markets are highly influenced by oil prices and especially gasoline prices, and this year's extended decline in oil prices may have suppressed TIPS breakeven yields. However, the analysts predict that oil prices could rise by 25% by the end of 2023, which could push breakeven yields and inflation swap yields much higher.



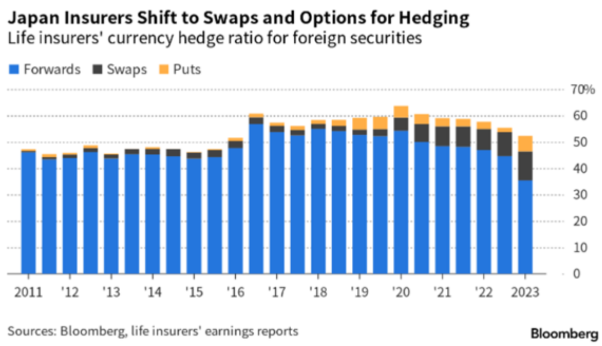


If a debt ceiling agreement is reached, analysts expect the US Treasury to issue a very large volume of T-Bills, which could be highly disruptive for markets. Treasury is expected to issue $600–700 of new T-Bills in order to replenish its cash holdings in its Treasury General Account (TGA) at the Fed. This would be one of the largest volumes ever seen. Analysis by Bloomberg shows that such large bursts of T-Bill issuance are associated with significant declines. If the new issuance is bought up mainly by money market funds (MMFs), then main impact will be a decline in holdings at the Fed's Overnight Reverse Repo (RRP) facility, which will be a relatively benign outcome. However, if the MMFs decide to by fewer T-Bills and it is bank depositors, corporations and other entities who do not have access to the RRP who buy the T-Bills, then bank reserves will decline sharply and such rapid declines in reserves are associated with a negative outcome for US stocks.



Japan

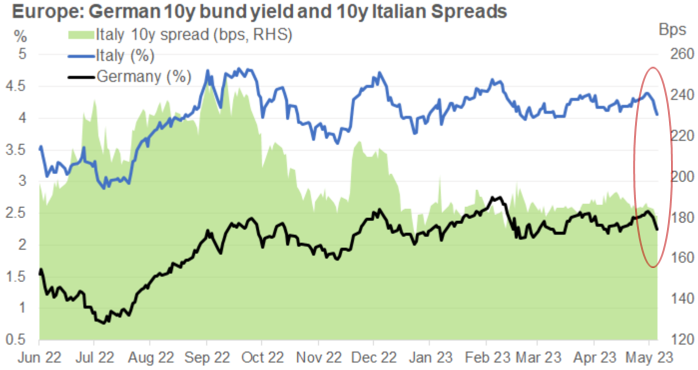
Japanese stocks fell -1.3%. Industrial production and retail sales disappointed, contracting by -0.4% m/m (previous: +1.1) and -1.2% m/m (previous: +0.3%) on a seasonally adjusted basis in April. Separately, Japan's biggest life insurers stepped up their use of longer-dated currency hedges. Currency swaps protected more than 11% of overseas securities owned at the end of fiscal year to March, Bloomberg estimated. Conversely, the use of foreign-exchange forwards fell to a new low in data back to 2011.



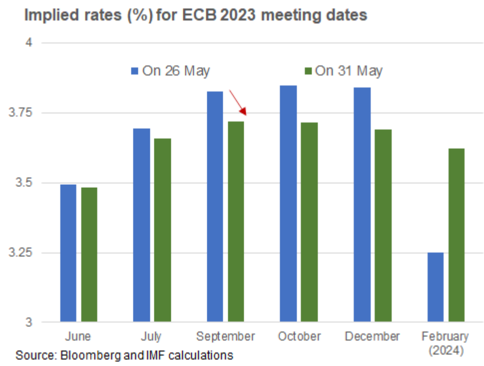
Euro Area

European equities were edging lower (Stoxx 600 -0.3%) and the euro depreciated against the dollar (-0.6%) as disappointing manufacturing PMI data from China weighed on risk sentiment.

Sovereign bond yields continued to decline (10-yr bund -9bps to 2.25%) as traders scaled back ECB hiking expectations following lower than expected preliminary May country-level inflation data. Regional inflation prints from Germany signaled a quicker than anticipated deceleration in the national print, due later today, and France's preliminary May inflation data released this morning also surprised on the downside (6.0% y/y versus the expected 6.4%), but inflation eased less than anticipated in Italy (8.1% y/y versus the expected 7.5%). This follows a downside surprise in preliminary Spanish inflation data released yesterday. The euro area flash inflation data are due tomorrow, where consensus sees headline inflation easing to 6.3% y/y (from 7.0%) and core inflation easing to 5.5% (from 5.6%). Markets scaled back ECB hiking expectations and are now pricing in a cumulative 48bps of tightening by September, compared to 57bps of tightening at the end of last week. In the meantime, **ECB General Council (GC) member Muller said that there would likely be more than one 25bps ECB hike, as underlying inflation is yet to show signs of slowing, while GC member Visco cautioned that the ECB should continue "with the right degree of graduality".**



Source: Bloomberg and IMF calculations

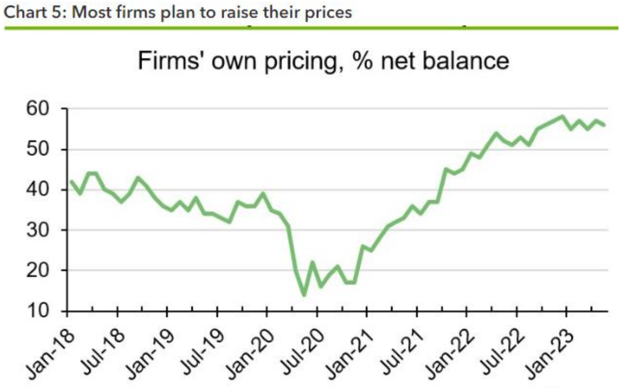


Source: Bloomberg and IMF calculations

United Kingdom

Gilt yields were trading lower (10y -7bps to 4.17%) while the pound weakened against the dollar (-0.4%) in line with global trends. On the data front **UK business confidence declined for the first time in three months**, with business sentiment weighed down higher-than-expected inflation data according to a survey by Lloyds Banking Group Plc. However, confidence levels remain in line with the long-term average. The net balance of businesses that expect to raise prices in the next year declined marginally to 56% (from 57%) but remain well above the pre-pandemic average (36% in 2019).

Chart 5: Most firms plan to raise their prices



Source: Lloyds Bank Business Barometer (May 2023), BVA BDRC

Emerging Markets

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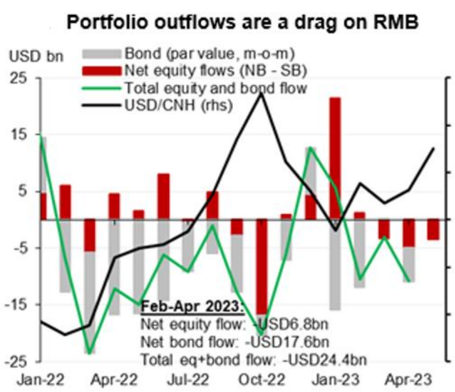
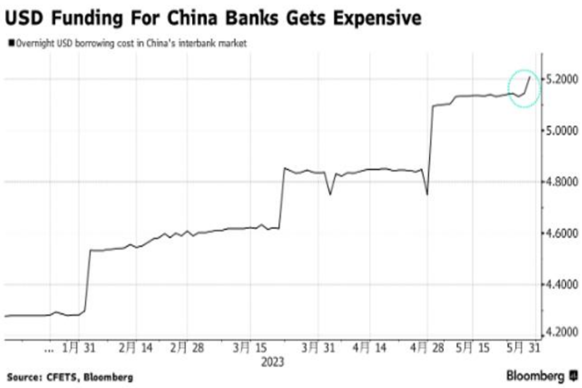
In EMEA, bonds were gaining and currencies were generally losing while equity markets were mixed. **Asian equities slumped -1.5%** amid weakness in China's PMI data. The Philippines Senate approved creation of Maharlika Investment Fund (MIF), the country's first-ever sovereign investment fund, aiming to promote economic development by making strategic and profitable investments in key sectors.

The Bank of Thailand (BoT) raised its key policy rate by +25bps to 2% as expected. The BoT cut its 2023 inflation outlook to 2.5% from 2.9% previously, while growth forecasts were kept at 3.6% and 3.8% for 2023 and 2024, respectively. **Most Latin American markets saw sharp losses.** The unemployment rate in Chile unexpectedly fell in April, partly due to a lower participation rate. Credit growth in Brazil decelerated in April together with rising non-performing loans. **Lower-than-expected inflation data triggered a depreciation of the Brazilian real.**

China

Chinese stocks fell by 1% as manufacturing activity slipped further into contractionary territory. The official manufacturing PMI fell below expectations to 48.8 in May (consensus: 49.5; previous: 49.2). Non-manufacturing PMI remained largely resilient at 54.5 (previous: 46.4). Citi cited insufficient demand as the major concern, while goods deflation is weighing on profitability and related demand. **The Renminbi weakened (offshore: -0.5%, onshore: -0.4%).** Nomura expects gradual yuan depreciation to continue given weak capital flows. The recent pickup in onshore FX volumes suggests there could have been some, probably limited, actions by authorities or state banks. **Separately, the dollar shortage in China's onshore borrowing market is worsening.** US dollar borrowing costs breached 5.2% at the interbank market at the end of May, Bloomberg reported, and Chinese banks have been aggressively offering attractive rates on dollar deposits.

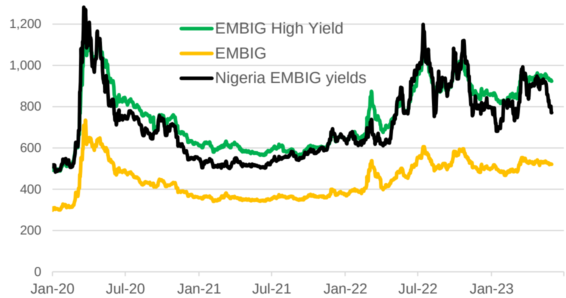




Nigeria

Spreads on Nigeria's dollar Eurobonds have dropped about 30 bps following the inauguration of Bola Tinubu, who was elected president in February. In his inauguration speech, he asked the central bank to work towards a unified exchange rate and announced that he would scrap fuel subsidies. Yesterday, he met with the governor of the central bank Emefiele and Nigerian National Petroleum Company (NNPC) CEO Kyari to strategize on how to engage with labor unions on the removal of fuel subsidies. While he had pledged to remove the subsidy during the campaign, there were reports of panic buying across the country after the speech. Some trade unions have also asked for extensive consultations on subsidy removal.

Emerging Market Dollar Bond Spreads (bps)

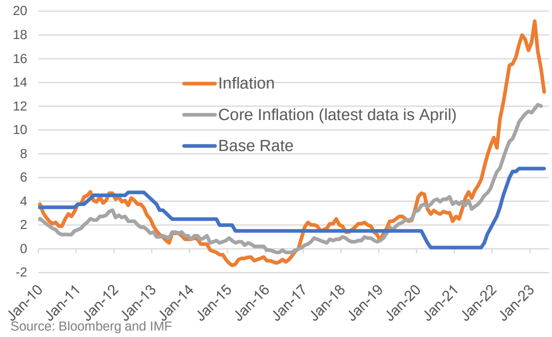


Source: Bloomberg and IMF

Poland

Yields on Polish 10y bonds fell 5 bps to 6%, after May inflation data surprised on the downside. The flash inflation data release for May showed inflation at 13% y/y, significantly below expectations (13.4% y/y), and sharply down from April (14.7% y/y). There is no official core inflation data in the flash release but Goldman Sachs analysts estimate that core inflation was softer compared to previous months. They acknowledge that today's data is more likely to support the dovish side of market pricing, but nonetheless think that sticky core, especially in services, as well as ongoing strength in wage growth, will limit the extent and speed at which inflation will return to the NBP's +2.5% +/- 1pp target. They therefore continue to project a prolonged inflation target overshoot in Poland. The Q1 GDP final reading was also released today and showed a slightly stronger contraction in Q1 than suggested by the flash release earlier (-0.3% y/y vs -0.2% y/y previously).

Poland: Inflation and Policy Rate



Source: Bloomberg and IMF

This monitor is prepared under the guidance of Jason Wu (Division Chief), 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 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) and Srujana Sammeta (Staff Assistant) are responsible for the word processing and production of this monitor.

Global Financial Indicators

5/31/23 8:03 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4206	0.0	0	1	2	10
Europe		4270	-0.5	0	-2	13	13
Japan		30888	-1.4	1	6	12	18
China		3799	-1.0	-2	-6	-7	-2
Asia Ex Japan		65	-1.2	-2	-2	-9	1
Emerging Markets		39	-1.2	-2	-1	-10	2
Interest Rates					basis points		
US 10y Yield		3.64	-4.4	-10	22	80	-23
Germany 10y Yield		2.26	-8.6	-22	-6	113	-32
Japan 10y Yield		0.44	0.1	2	4	19	1
UK 10y Yield		4.17	-7.4	-4	45	207	50
Credit Spreads					basis points		
US Investment Grade		164	0.4	-3	3	10	5
US High Yield		490	5.7	-4	9	45	9
Exchange Rates					%		
USD/Majors		104.45	0.3	1	3	3	1
EUR/USD		1.07	-0.5	-1	-3	-1	0
USD/JPY		139.7	-0.1	0	2	9	7
EM/USD		49.6	-0.8	-1	-2	-6	-1
Commodities					%		
Brent Crude Oil ($/barrel)		71.8	-2.3	-8	-11	-25	-15
Industrials Metals (index)		140	-1.1	-2	-9	-25	-15
Agriculture (index)		63	-1.5	-4	-6	-17	-9
Implied Volatility					%		
VIX Index (%, change in pp)		17.9	0.5	-0.6	2.1	-8.3	-3.8
US 10y Swaption Volatility		126.4	0.3	7.3	10.5	19.8	0.7
Global FX Volatility		8.9	0.0	0.2	-0.1	-0.7	-1.8
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		150	4.2	7	-37	-96	-55
Italy		181	-0.1	-6	-6	-19	-34
Portugal		74	1.9	-2	-8	-40	-28
Spain		106	0.9	-1	1	-5	-4

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

Emerging Market Financial Indicators

Last updated: 5/31/2023 8:05 AM	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	-0.4	-0.7	-3	-6	-3		2.8	-3.5	-4	-25	-3	-25
Indonesia		14994	-0.1	-0.6	-2	-3	4		6.4	-4.2	-5	-16	-67	-57
India		83	0.0	-0.1	-1	-6	0		7.3	-1.0	10	5	(31.3)	-12
Philippines		56	0.4	-0.7	-1	-7	-1		5.9	0.0	4	-4	46	-9
Thailand		35	-0.1	-0.3	-2	-1	0		2.6	-5.0	-9	1	-33	1
Malaysia		4.61	-0.2	-0.4	-3	-5	-5		3.7	-1.7	-5	0	-47	-32
Argentina		239	-0.2	-1.6	-7	-50	-26		109.2	169.8	399	1490	5309	2101
Brazil		5.07	-0.6	-2.1	-2	-7	4		11.8	18.4	4	-64	-51	-74
Chile		805	0.1	-0.4	0	3	6		5.3	0.0	-13	7	-84	-9
Colombia		4392	1.0	2.0	7	-13	10		8.7	0.0	-12	-40	45	-110
Mexico		17.72	-0.3	0.5	1	11	10		8.4	0.0	-17	0	-13	-38
Peru		3.7	0.0	0.4	1	0	4		7.2	-0.5	######	-32	-37	-81
Uruguay		39	0.0	0.0	0	3	3		10.0	0.3	1	2	-25	-67
Hungary		347	-0.7	-0.2	-2	7	8		7.9	-15.0	-28	7	90	-170
Poland		4.25	-0.5	-1.4	-1	0	3		5.3	-13.5	-13	-7	-101	-83
Romania		4.7	-0.5	-0.7	-4	-1	-1		6.8	-1.6	-5	-29	-91	-85
Russia		81.1	-0.3	-0.8	-1	-23	-9							
South Africa		19.8	-0.5	-2.8	-7	-21	-14		10.4	-2.0	33	103	197	121
Turkey		20.72	-1.2	-4.0	-6	-21	-10		9.1	0.0	-1	-380	-1350	-74
US (DXY; 5y UST)		104	0.3	0.9	3	3	1		3.75	-5.2	-6	27	94	-25

	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		3799	-1.0	-2	-6	-7	-2		191	-5	-3	-22	14
Indonesia		6633	0.0	-2	-4	-7	-3		145	-1	-8	-55	5
India		62622	-0.6	1	2	13	3		143	-10	-16	-37	1
Philippines		6477	-0.5	-2	-2	-3	-1		116	-5	-8	-26	19
Thailand		1534	-0.1	0	0	-8	-8		0	0	0	0	0
Malaysia		1387	-0.7	-2	-2	-11	-7		94	-5	-7	-36	-6
Argentina		343392	-0.9	1	15	272	70		2571	-24	-126	655	366
Brazil		108967	-1.2	-1	4	-2	-1		262	-3	-15	-44	-12
Chile		5593	-0.1	-1	3	5	6		134	0	-4	-27	2
Colombia		1093	-0.8	-2	-9	-32	-15		405	-4	-20	52	33
Mexico		53342	-1.6	0	-3	3	10		396	-2	5	28	15
Peru		21162	-0.6	-2	-3	2	-1		182	0	3	7	2
Hungary		47380	-0.3	2	6	20	8		235	-1	8	13	13
Poland		62914	-1.4	-2	0	10	9		137	0	0	120	64
Romania		12301	0.1	0	0	-2	5		257	2	-3	2	2
South Africa		76030	0.1	1	-3	5	4		455	0	36	74	88
Turkey		4964	0.2	12	7	95	-10		577	-69	71	-19	137
Ukraine		507	0.0	0	0	-2	-2		4959	156	-355	1716	880
EM total		39	-0.8	-2	-1	-10	2		421	-7	2	30	46

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

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