GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

THURSDAY, MAY 5, 2022

- **Markets lower Fed rate hike expectations after dovish FOMC** (link)
- **China PMI plunges amidst Covid lockdowns** (link)
- **Bank of England hikes by 25 bps with guidance on gilt sales to follow** (link)
- **Brazil hikes 100 bps while signaling slowdown in tightening** (link)
- **Euro-Swiss exchange rate expected to fall below parity as Europe slows** (link)
- **Special Feature: China Monitor (attached)**

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Dovish Fed lifts global markets

US equity index futures are lower in pre-market trading today, but yesterday's dovish FOMC statement and press conference ignited a major global rally, with the S&P 500 posting its biggest FOMC-day gain in 10 years and stocks around the world joining the party. European stocks are also posting solid gains this morning. However, a series of negative economic reports highlighted the challenges facing the global economy. Chinese PMIs have fallen deep into contractionary territory, while factory orders in German were down sharply. There is also uncertainty about what effect the Fed's quantitative tightening will have on markets, with Fed Chair Powell acknowledging that estimating the impact is very difficult. The US April Challenger jobs report marked a strong recovery from the month before ahead of tomorrow's unemployment report, although the two are not highly correlated. Oil prices are slightly higher as today's OPEC+ meeting gets underway.

Key Global Financial Indicators

Last updated: 5/5/22 7:57 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		4300	3.0	3	-5	3	-10	2
Eurostoxx 50		3785	1.6	0	-3	-5	-12	-5
Nikkei 225		26819	-0.1	-1	-3	-7	-7	1
MSCI EM		43	1.1	4	-6	-20	-12	-9
Yields and Spreads					bps			
US 10y Yield		2.95	1.6	13	40	138	144	96
Germany 10y Yield		0.95	-1.8	5	34	118	113	73
EMBIG Sovereign Spread		446	2	14	54	104	79	33
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		52.6	-0.4	1	-1	-8	0	-1
Dollar index, (+) = $ appreciation		103.3	0.7	0	4	13	8	7
Brent Crude Oil ($/barrel)		111.3	1.1	3	4	61	43	15
VIX Index (%, change in pp)		26.1	0.7	-4	5	7	9	-5

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

Mature Markets

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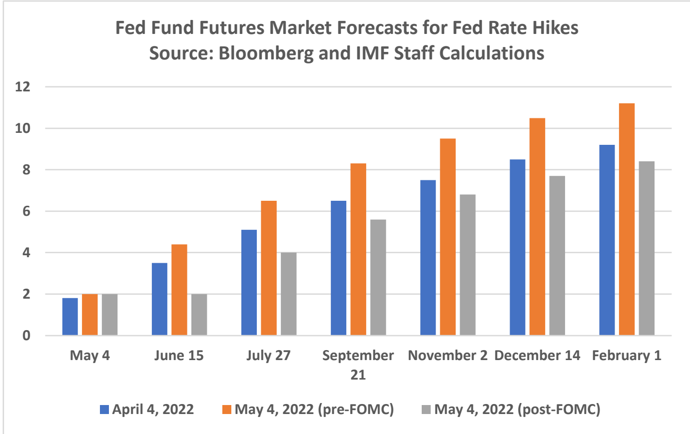
United States

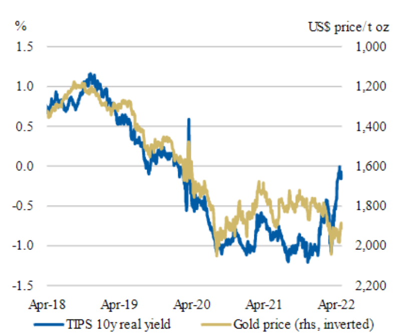
Fed Chair Powell's taking a 75 bps hike off the table led to a major rally in both equity and bond markets, with expectations for future rate hikes also being sharply reduced. The S&P 500 went from being up slightly prior to the FOMC statement to a strong 3% gain for the day, the best FOMC-day rally in a decade. The two-year Treasury yield fell from around 2.80% before the statement to 2.64% by the end of the day, an extremely large move by historical standards, and the yield curve steepened across the curve. The Fed Funds futures market marked down its rate hike expectations, from 11.2 moves of 25 bps by February 1, 2023 before the FOMC meeting to just 8.4 moves at the end of the day. The dovish rhetoric reinforced the market's longstanding optimistic take on Fed policy, with the expectation of a relatively short and shallow rate hike cycle, and the policy rate peaking near 3.25% in 2023. Fed Chair Powell said that there was a realistic possibility of pulling off *a softish landing* for the economy although he acknowledged that the challenges are considerable.



With the Treasury yield curve nearly flat across the three-year and the 30-year maturities, the view seems to be that there is a very low risk premium for bonds, or that there is a chance of the Fed easing soon after ending its tightening cycle. Chairman Powell's characterization of the neutral rate being in the 2% to 3% range appears to validate this optimistic view. Many contacts dissented strongly from such optimism and are worried that the Fed is falling further and further behind the curve on inflation.

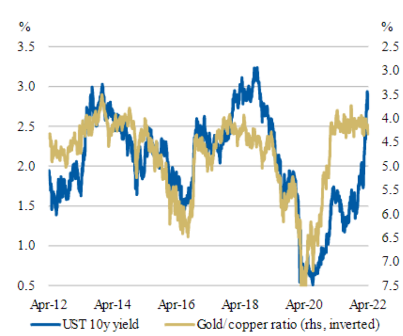
Strong inflation has been pushing investors into safe haven assets. However, the spectacular underperformance of the US Treasury market has lessened its allure, with investors buying gold and the dollar to hedge against inflation risk. Gold has been especially popular, with its price rising as real yields move higher. Nominal Treasury yields have done very badly relatively to widely followed valuation measures such as the gold/copper price ratio. Some investors think that the rapid rise in Treasury yields presents a buying opportunity, but others remain worried that interest rates still have room to go up even further.

Exhibit 3: TIPS 10y real yields vs. gold prices



Source: Morgan Stanley Research, Bloomberg

Exhibit 4: UST 10y yield vs. gold/copper price ratio



Source: Morgan Stanley Research, Bloomberg

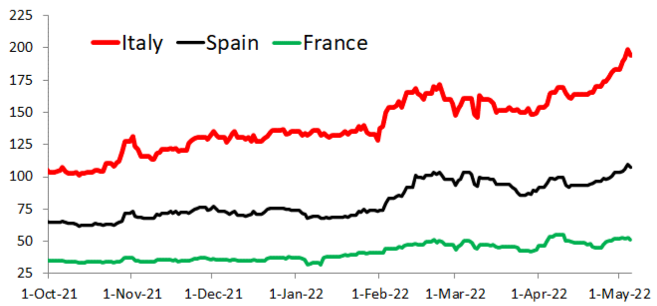
Euro area

Shares (+1.3%) rose in line with global markets. Bank stocks (+0.6%) outperformed as ECB data show that corporate front-book loan rates rose 10 bps mom in the euro area in March, and mortgage front-book rates rose 9 bps mom**. Shares in Unicredit (+6%) jumped after the bank confirmed a buyback of €1.6 bn—around 9% of its market cap—and said that the value of assets in Russia has been written down to zero in provisions.**

German 10-yr bund yield—+2 bps to 0.99%—traded just below 1% after ECB GC member Panetta warned that the euro area economy is *de facto stagnating.* He added that the euro area faces further *high costs* and said that it would be *imprudent* to act without first seeing GDP figures for the second quarter. The ECB's next rate meetings are on June 8–9 and July 20–21 while second-quarter GDP data are not officially published till July 29. **Industrial data for France and Germany were weaker than expected in March, highlighting downside risks to growth.** German factory orders fell 4.7% mom—drop of 1.1% expected—and French industrial production fell 0.5% mom in March.

Italian 10-yr spreads (-4 bps to 194 bps) tightened today after some noteworthy widening in past weeks. Italy renewed its call on the EU to provide more detailed guidance on how natural gas buyers can pay for Russian gas supply without breaching sanctions

Euro area: 10-year spreads over German bunds (bps)



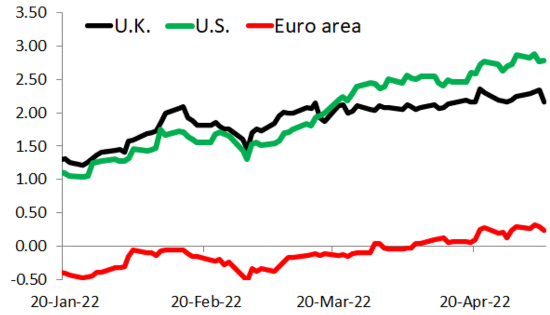
Source: Bloomberg and IMF staff

Brent oil prices and natural gas prices are little changed as EU governments continue to discuss the sixth round of sanctions against Russia. Hungary reportedly objected to the oil phase-out timing and Slovakia has asked the EU for a 3-yr exemption. **Greece, Malta, and Cyprus raised questions about banning transport of oil between third countries.**

United Kingdom

10-yr gilt yields (-10 bps to 1.87%) and the pound (-1.5%) fell after the Bank of England (BoE) hiked its policy rate 25 bps to 100 bps, as expected. No MPC members voted to keep rates unchanged. Six MPC members voted for a hike of 25 bps, and three for a hike of 50 bps. The BoE reiterated its guidance from March that *further modest tightening may be appropriate* and expected CPI to peak slightly above 10% in 2022Q4. **The MPC did not provide any detailed guidance on a potential sale of its U.K. government bond holdings but has asked Bank staff to work on a strategy for such sales with an update to be provided at the MPC meeting in August.** Money markets expect less tightening following the meeting, pricing a policy rate of 2.06% in December compared to 2.33% before the MPC meeting. **GDP growth is expected to slow sharply over the first half of the forecast period and even contract in 2022Q4** given the adverse impact of the sharp rises in global energy and tradable goods prices on most UK households' real incomes and many UK companies' profit margins.

Policy rates at end-2022 (%)

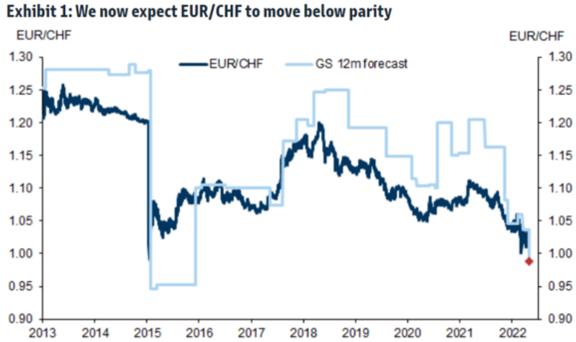


Source: Bloomberg and IMF staff

Foreign Exchange Markets

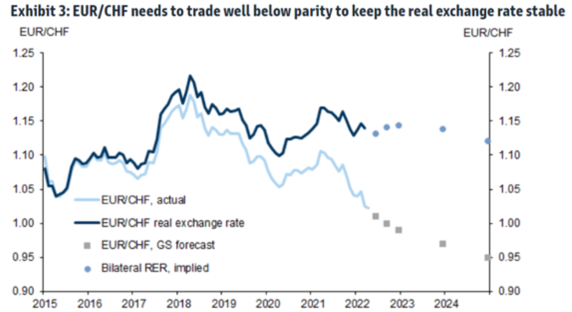
The Euro-Swiss exchange rate (EURCHF) is expected to fall below parity, according to forecasts from Goldman Sachs. The inflation differential between the euro area and Switzerland is getting worse, with euro area inflation expected to rise even further. In addition, economic prospects for the euro area are being downgraded, with the risk of a recession growing. The Swiss Franc is one of the global market's most important safe haven assets, and it tends to appreciate when a recession occurs in Europe or the US. Some are concerned that the Swiss National Bank (SNB) could intervene if the franc gets too strong, especially because the latest SNB statement flagged the currency as *highly valued*. However, the Goldman analysts think any intervention will merely slow the process of falling below parity rather than arresting the move. Given the SNB's highly conservative inflation target and rising euro area inflation, EURCHF will have to trade below parity if the real exchange rate is to hold steady.

Exhibit 1: We now expect EUR/CHF to move below parity



Source: Goldman Sachs Global Investment Research

Exhibit 3: EUR/CHF needs to trade well below parity to keep the real exchange rate stable



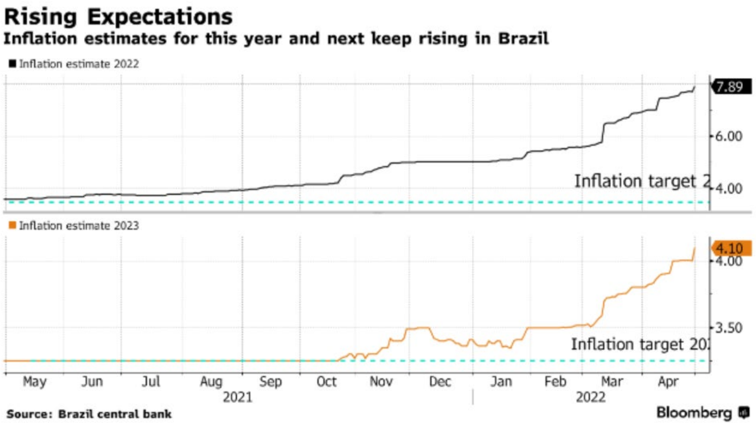
Source: Swiss National Bank, Goldman Sachs Global Investment Research

Emerging Markets back to top

EMEA equities were mostly higher in the wake of yesterday's US rally. Hungary stayed on hold at 6.45% as expected. Poland is expected to hike by 100 bps later today, while rates in the Czech Republic are expected to be raised by 50 bps. **Asian equities were mixed, up +0.5% on net. China opened with modest gains after the Labor Day holidays—Shanghai +0.7%, Shenzhen +0.7%.** The Hong Kong Monetary Authority (HKMA) raised its policy rate by 50 bps to 1.25% in tandem with the Fed's 50 bps rate hike yesterday, as the HK dollar is pegged to the US dollar. Retail sales in Hong Kong SAR fell due to continued Covid restrictions. **Most Latin American equities** followed the US higher, **while most currencies printed mixed.** The Mexican government and major companies agreed to cap the prices of 24 essential items for an initial period of six months to contain inflation.

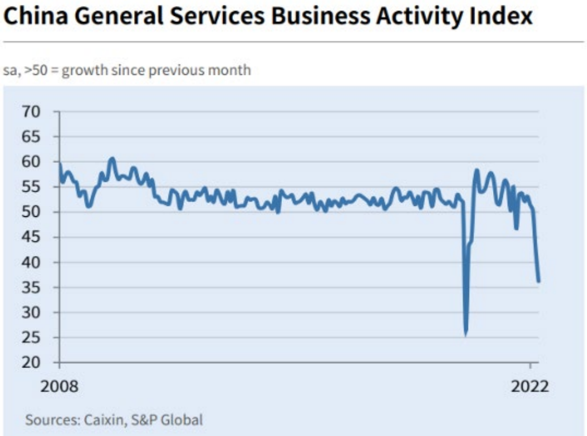
Brazil

Brazil lifted the policy rate but signaled that the tightening cycle might slow. Yesterday, Brazil's central bank raised the benchmark rate by 100bps to 12.75% but signaled *an adjustment of lower magnitude* for its upcoming meeting. Like many countries in the region, Brazil is struggling to curb inflation that reached 12% yoy last month, despite a cumulative 10.75 percentage point increase in interest rate since March 2021. However, some analysts doubt that a 12.75% key rate would be enough to bring down inflation and predict that inflation will stay above the 3% target this year and next.



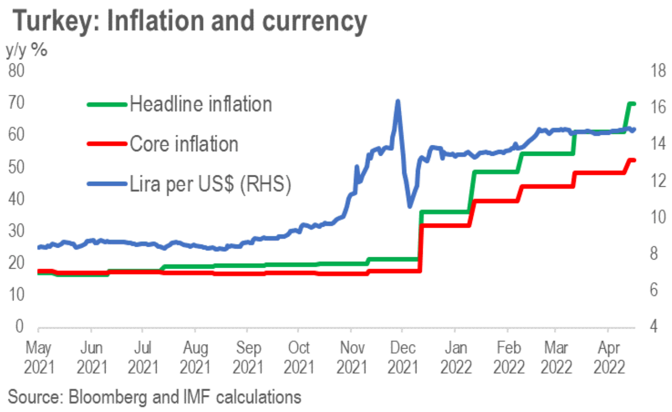
China

The People's Bank of China signaled additional support for technology firms. The bank also pledged *normalized* supervision of platform companies, echoing hints of eased clampdowns on the sector from China's Politburo meeting last week, according to Bloomberg. Separately, **almost 40% of Chinese corporate sustainability-linked loans (SLLs) were syndicated in Hong Kong SAR in 2021.** According to Bloomberg, mainland firms obtained $6.7 bn of SLLs last year. SLLs accounted for 9% of the city's $65.4 bn of corporate loans in 2021, and this year this share increased to 27% amidst sluggishness in the loan market. Meanwhile, **the Caixin services PMI dived in April to 36.2 from 42 as COVID lockdowns continued to bite.** Activity and new orders underwent their second sharpest ever decline during the month, with COVID-related disruptions often linked by businesses as the cause, according to Caixin. Tourism spending over the 5-day Labor Day period crashed by 43% on a year on year basis. Additionally, rail trips declined 80% and cinema ticket sales were down 81%.



Turkey

Turkey's core inflation rose to 52.4% yoy (52.9% expected) in April, while headline inflation increased to 70% (vs expected 67.8% from 61.1%), the highest level since March 2002. Price increases were mainly driven by higher food and transportation costs. **Goldman Sachs analysts see the annual rate of inflation remaining above 70% for the remainder of 2022.** Separate data releases show Turkey's PPI increasing to 121.8% in April from 115%, while PMI manufacturing fell to 49.2 in April from 49.4, with analysts noting that manufacturers are facing a challenging environment amid high price pressures and continued supply-chain disruptions. Preliminary trade balance numbers showed a trade deficit of $6.1bn in April. **The Turkish lira (-0.8%) depreciated, while equities in Turkey (+1.9%) rallied.**



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Global Financial Indicators

Last updated: 5/5/22 7:58 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		4300	3.0	3	-5	3	-10	2
Europe		3785	1.6	0	-3	-5	-12	-5
Japan		26819	-0.1	-1	-3	-7	-7	1
China		4010	-0.2	5	-6	-21	-19	-13
Asia Ex Japan		72	1.0	4	-6	-22	-13	-9
Emerging Markets		43	1.1	4	-6	-20	-12	-9
Interest Rates					basis points			
US 10y Yield		2.95	1.6	13	40	138	144	96
Germany 10y Yield		0.95	-1.8	5	34	118	113	73
Japan 10y Yield		0.23	0.0	0	1	13	16	3
UK 10y Yield		1.85	-11.7	-3	20	103	88	37
Credit Spreads					basis points			
US Investment Grade		154	0.4	-1	20	62	42	11
US High Yield		419	1.0	10	61	89	82	13
Europe IG		88	-2.4	-1	15	38	40	17
Europe HY		422	-9.9	4	77	170	179	70
Exchange Rates					%			
USD/Majors		103.29	0.7	0	4	13	8	7
EUR/USD		1.06	-0.7	0	-3	-12	-7	-7
USD/JPY		130.0	0.7	-1	5	19	13	13
EM/USD		52.6	-0.4	1	-1	-8	0	-1
Commodities					%			
Brent Crude Oil ($/barrel)		111	1.1	4	6	73	47	23
Industrials Metals (index)		192	-0.3	-4	-11	22	11	2
Agriculture (index)		77	0.7	-1	3	28	26	9
Implied Volatility					%			
VIX Index (%, change in pp)		26.1	0.7	-3.9	5.0	6.9	8.9	-5.0
US 10y Swaption Volatility		121.7	3.3	-4.8	10.0	50.0	42.6	27.4
Global FX Volatility		10.5	0.0	-0.4	1.7	3.3	3.1	3.1
EA Sovereign Spreads					10-Year spread vs. Germany (bps)			
Greece		240	-4.3	10	35	120	89	0
Italy		192	-7.1	10	27	79	57	20
Portugal		109	-4.0	5	19	40	45	17
Spain		106	-4.1	5	7	38	31	2

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

Last updated: 5/5/2022 8:02 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		6.62	-0.2	0.1	-4	-2	-4	-5		2.9	0.7	-3	4	-32	4	2
Indonesia		14415	0.3	0.5	0	0	-1	-1		7.0	2.0	3	26	47	60	49
India		76	0.2	0.3	-1	-3	-3	-2		6.3	0.0	0	9	75	0	
Philippines		52	0.2	-0.3	-2	-8	-3	-2		5.4	5.0	5	10	90	88	38
Thailand		34	-0.2	1.0	-2	-9	-3	-5		3.1	12.3	37	74	113	128	91
Malaysia		4.35	0.0	0.3	-3	-5	-4	-4		4.3	-5.1	-11	38	128	72	64
Argentina		116	-0.1	-0.9	-4	-19	-11	-8		52.8	-2.2	11	356	657	227	487
Brazil		4.95	-0.7	-0.2	-6	8	12	1		11.5	-70.8	-69	11	216	77	-7
Chile		854	0.2	-0.8	-9	-18	0	-8		6.3	0.0	2	18	281	92	43
Colombia		4065	-1.0	-2.6	-9	-6	0	-4		8.8	0.0	25	107	292	235	88
Mexico		20.11	-0.4	1.7	-1	1	2	1		8.9	0.0	-7	57	209	138	106
Peru		3.8	1.3	1.5	-3	2	6	-1		7.8	0.3	9	96	251	193	183
Uruguay		41	-0.4	0.0	0	7	8	3		10.1	0.0	20	104	266	134	191
Hungary		359	-1.3	0.3	-4	-17	-10	-11		7.0	-6.0	28	66	441	246	216
Poland		4.42	-1.0	1.1	-4	-14	-9	-8		6.1	-1.5	24	115	418	255	218
Romania		4.7	-0.7	0.5	-3	-12	-7	-7		7.1	-0.4	43	106	445	223	190
Russia		64.6	1.9	12.4	30	16	16	26		12.7	12.1	70	-63	536	388	147
South Africa		15.7	-1.6	2.1	-7	-9	1	-4		8.4	-1.5	5	51	85	99	83
Turkey		14.86	-0.9	-0.5	-1	-44	-10	-7		21.7	39.0	80	-392	341	-264	-74
US (DXY; 5y UST)		103	0.7	-0.3	4	13	8	7		2.94	2.9	10	25	215	168	104

	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		4010	-0.2	5	-6	-21	-19	-13		204	-7	-6	-5	1	-4
Indonesia		7229	0.0	-1	3	20	10	4		197	10	29	25	32	12
India		55702	0.1	-2	-7	14	-4	-3		174	-1	25	15	42	20
Philippines		6869	1.0	0	-3	9	-4	-7		150	7	32	53	49	13
Thailand		1643	-0.5	-2	-3	5	-1	-3		0	0	0	0	0	0
Malaysia		1583	-1.1	0	-1	0	1	0		127	4	11	5	10	-6
Argentina		89401	-0.2	-1	-3	82	7	-2		1763	-6	65	224	83	26
Brazil		108344	0.0	-1	-9	-9	3	-3		292	4	9	33	-19	-39
Chile		4888	0.0	2	-1	4	13	12		171	6	29	32	31	-3
Colombia		1614	1.3	1	-1	30	14	7		379	23	56	137	31	-13
Mexico		51433	0.7	-2	-7	6	-3	0		369	-1	33	32	37	-1
Peru		22469	-0.6	0	-10	15	6	-4		201	13	49	40	51	11
Hungary		43014	-0.4	-1	-2	-3	-15	-10		204	34	75	63	80	51
Poland		56736	0.1	-2	-13	-7	-18	-10		20	-10	9	-19	-12	4
Romania		12581	1.1	-1	-2	9	-4	-5		245	9	49	57	53	13
Russia		2406	1.3	4	-10	-34	-36	-22		3411	-577	938	3228	3234	2897
South Africa		70664	0.5	1	-6	5	-4	-6		395	24	43	49	40	6
Turkey		2483	2.2	0	10	78	34	23		528	14	0	39	-50	-35
Ukraine		519	0.0	0	0	-2	-1	0		3579	-124	788	3039	2820	2106
EM total		43	-0.5	4	-6	-20	-12	-9		396	-9	34	33	10	-62

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

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