GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

THURSDAY, NOVEMBER 10, 2022

- **US inflation lower than expected** (link)
- **BOJ's Kuroda will not seek another term** (link)
- **South Korea expands support for real estate sector** (link)
- **ECB increases lending limit for cash collateral** (link)
- **Surprise decline in Czech inflation causes yields to plunge** (link)
- **Both stocks and bonds face greater risks in high inflation environment** (link)

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Markets grapple with uncertain outlook

After a day of sharp losses in the US following the uncertain election outcome and turmoil in the crypto market following the FTX collapse, investors are in a cautious mood this morning, with Europe giving ground and US equity futures markets yet to establish a firm trend. Political uncertainty in the US is likely to continue until at least December 6 and the Senate runoff election in the state of Georgia. Yesterday's US selloff extended to Asia, which saw heavy losses overnight, especially in the technology sector in China. News of further Covid-related lockdowns in China continued to weigh on sentiment, while South Korea expanded its efforts to support a real sector viewed as highly vulnerable. The bad news on China's Covid situation pushed oil markets into a fourth consecutive day of declines. However, Europe provided some more positive news. Several local bourses were in positive territory, and swap spreads in the euro area narrowed as the ECB increased cash collateral limits. In the Czech Republic, an unexpectedly large decline in inflation pushed interest rates sharply lower.

Key Global Financial Indicators

Last updated: 11/10/22 8:23 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		3749	-2.1	0	4	-19	-21	-11
Eurostoxx 50		3732	0.1	4	11	-14	-13	-6
Nikkei 225		27446	-1.0	-1	4	-6	-5	4
MSCI EM		36	-1.7	4	2	-30	-27	-24
Yields and Spreads					bps			
US 10y Yield		4.07	-2.1	-8	19	252	256	208
Germany 10y Yield		2.16	-1.3	-9	-18	241	234	193
EMBIG Sovereign Spread		515	7	-18	-31	163	148	103
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		49.4	-0.2	1	2	-10	-6	-7
Dollar index, (+) = $ appreciation		110.8	0.2	-2	-2	17	16	15
Brent Crude Oil ($/barrel)		92.6	0.0	-2	-4	12	19	-4
VIX Index (%, change in pp)		26.4	0.3	1	-6	8	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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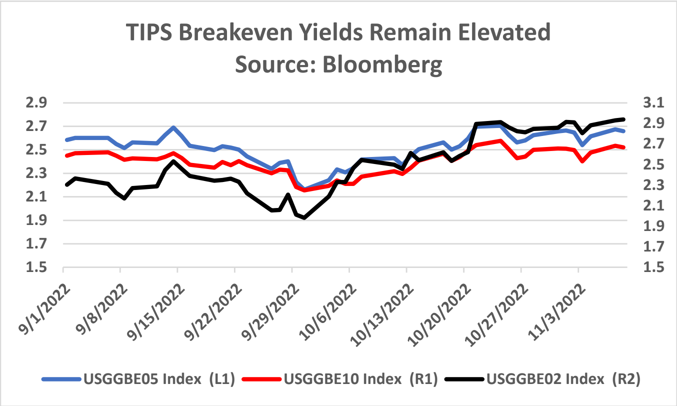
United States

The latest US CPI data for October provided some much needed relief for US markets as the numbers came in lower than expected. The market response was immediate, with the two-year yield plunging by 15 bps and the 10-year yield falling by an equal amount. The euro surged above parity and US equity index futures moved higher.

US October CPI
Source: Bloomberg

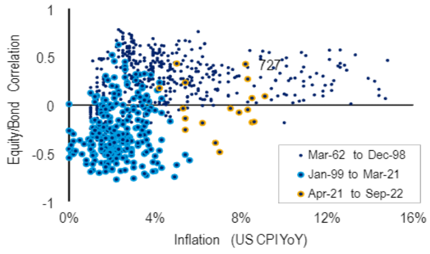
Data Point	Consensus Forecast	Actual Outcome
CPI month-on-month	0.6%	0.4%
Core CPI mom	0.5%	0.3%
CPI annualized	7.9%	7.7%
Core CPI annualized	6.5%	6.5%

Inflation expectation remain elevated despite a hawkish Fed. At the November 2 press conference, Fed Chair Powell dashed any last hopes of a dovish pivot by stating that the terminal Fed Funds policy rate is likely to be higher than originally anticipated. This implies that September's dot plot was probably too optimistic. Breakeven yields for US Treasury Inflation Protected Securities (TIPS) have remained high despite the hawkish rhetoric. Yields are 30–100 bps higher than the September lows, depending on the tenor of the bond. Although technical considerations sometimes blur the signals from the TIPS market, it remains clear that overall market expectations are that inflation will continue to be a challenge. Based on pricing in the Fed Funds futures markets, the forecast for the terminal rate has gone up to 5.11% in June 2023, up from 4.6% just a month ago.



Both stocks and bonds face greater risks in a high inflation environment. Since the Global Financial Crisis (GFC) and prior to 2022, both stocks and bonds enjoyed strong performances due to factors such as quantitative easing, very low interest rates a revering economy and robust corporate profits. Bond and equity prices were negatively correlated, allowing investors to hedge their equity exposures with bonds. However, the current high inflation environment is hostile to both asset classes. Research by Bank of America finds that equity and bond prices are positively correlated when inflation is high, so bonds are much less effective as equity hedges, leaving investors with nowhere to hide. The Fed's view that inflation was temporary kept the equity-bond correlation low in 2021 despite rising inflation, but this year the Fed has turned aggressively hawkish as inflation kept rising, turning the correlation positive.

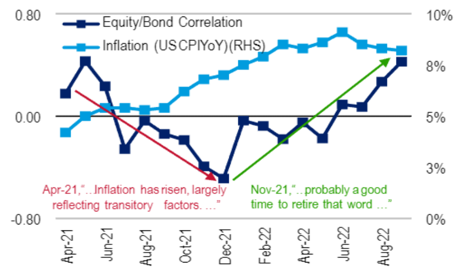
Exhibit 6: Equity/bond correlation versus inflation (US CPI YoY)
Equity/bond correlation tends to be positive in times of elevated inflation



Source: BofA Global Research. Monthly data from 1962-Mar through 2022-Sep. Correlation measured using an average of EWMA with lambda = 0.94 and 0.97. See Appendix for details on equity and bond component.

BofA GLOBAL RESEARCH

Exhibit 7: Recent trend in equity/bond correlation and US CPI YoY
The Fed's "transitory" narrative helped keep equity/bond correlation low despite elevated inflation



Source: BofA Global Research. Monthly data from 2021-Apr through 2022-Sep. Correlation measured using an average of EWMA with lambda = 0.94 and 0.97. See Appendix for details on equity and bond component.

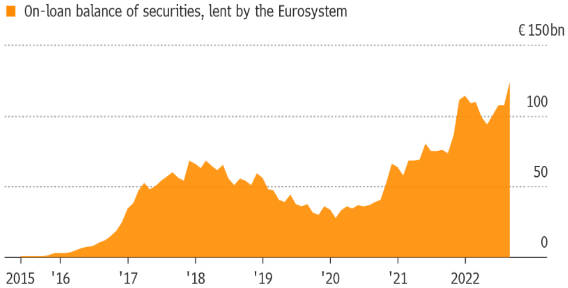
BofA GLOBAL RESEARCH

Euro Area

The euro depreciated (-0.7%) ahead of the US October inflation data print, while sovereign yields were little changed. ECB Governing Council member Centeno yesterday spoke in favour of further monetary policy action, noting that the cost of no ation would exceed the cost of higher rates. On the data front, Italian industrial production data for September disappointed (-1.8%m/m vs expected -1.5% from 2.3%).

German swap spreads narrowed by roughly 2 bps after the ECB increased the limit for the Eurosystem's securities lending against cash collateral to €250 bn from €150 bn, as of today. This means that euro area central banks can now lend out more cash against collateral. ECB Board member Schnabel said the change was 'a precautionary measure to ease collateral scarcity and support market functioning around the year-end'. This follows concern from the International Capital Market Association (ICMA) last month over repo and money market conditions in the euro area, noting the normalization of interest rates and related market volatility could increase the potential for market dislocations. The German 2y swap spread, the difference between the 2y bund yield and the equivalent swap rate, used as an indicator of collateral scarcity—is now roughly 35 bps lower than in September.

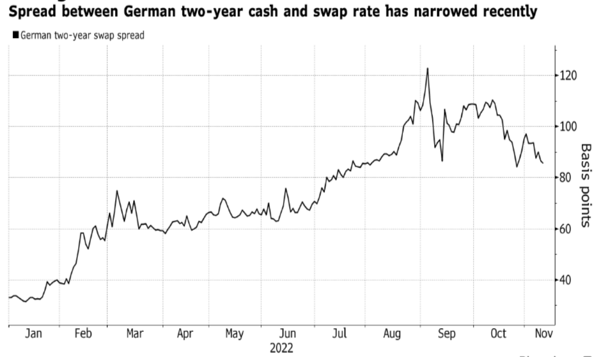
Collateral Demand
Eurosystem central banks lend out more securities to market



Source: ECB
Note: data includes both lending against securities collateral and cash collateral

Bloomberg

Easing Concerns
Spread between German two-year cash and swap rate has narrowed recently

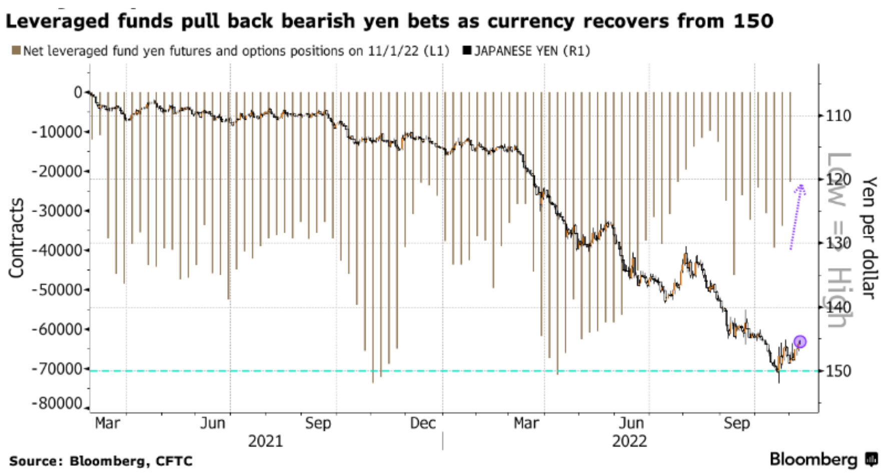


Source: Bloomberg

Bloomberg

Japan

Equities slipped -0.7%, dragged down by consumer discretionary and technology stocks. Machine tool orders fell -5.4% y/y in October (previous: +4.3%), the first decline in two years on weaker domestic demand **Bank of Japan (BOJ) Governor Kuroda said he has no desire for another term**, after it ends in April 2023. Kuroda noted that rapid, one-sided yen weakness has taken a pause after the government's FX interventions. He also pledged to continue with monetary easing to achieve inflation with wage gains, following his meeting with PM Kishida today. **Japanese yen and 10-year yields were little changed.** Foreign investors finally turned net buyers of Japanese bonds in week ended November, following six straight weeks of net selloffs. Separately, leveraged funds have eased on their bearish derivative yen bets amid the yen's recent recovery against the dollar, Bloomberg notes.



Emerging Markets

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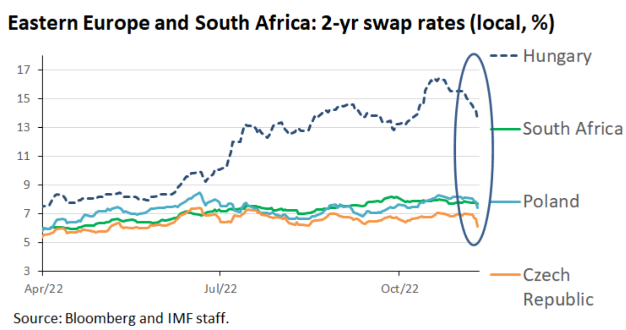
Local rates in EMEA fell sharply after Czech consumer prices unexpectedly fell 1.4% mom in October and the central bank of Poland left rates unchanged. Contacts also continue to speculate on progress on EU funding, which supports risk sentiment. In Serbia, the central bank hiked its policy rate 50 bps to 4.50%, as expected. **Asian equities fell -1.4% net**, on news of China's strengthened COVID measures**. South Korea's** government will have state-owned enterprises guarantee additional project financings of 10 tr won ($7.3 bn). That adds to 10 tn won of similar guarantees already unveiled in October as part of a broader 50 tn won aid package for the national real estate sector amid tight local credit market. **Latin America also declined.**

China

Equities declined (CSI 300: -0.8%), following news of tightened COVID measures as cases surged in several major Chinese cities. **China's banks are confident of expanding corporate loans in Q4**, local media reported. The expansion is expected to be driven by manufacturing and equipment replacement loans, but individual housing and retail loan growth may lag. Separately, **China's smaller firms are struggling with high costs and pandemic disruptions**, China's Association of Small and Medium Enterprises said, according to Bloomberg. Conditions remained in contractionary territory in October, the association said, with 9.5% of surveyed firms not producing anything and only 26.7% of surveyed firms operating at full capacity. Relatedly, **Zhengzhou city's banks have started to let individuals and smaller firms delay loan repayments**, Bloomberg reports. The grace period can be extended if borrowers are still unable to repay due to the pandemic. **10-year yields were broadly unchanged. The yuan was little changed against the dollar** but fell to a 13-month low against currencies of its main trading partners, Bloomberg estimated.

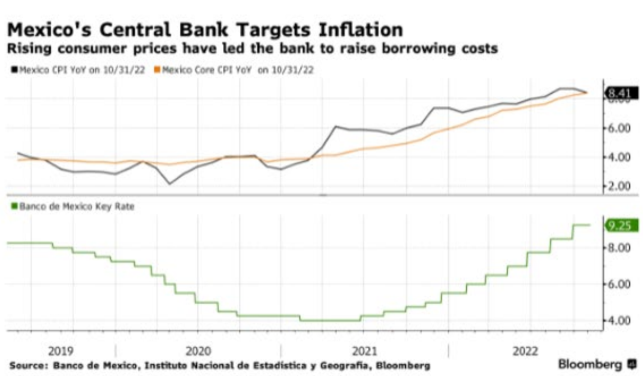
Czech Republic

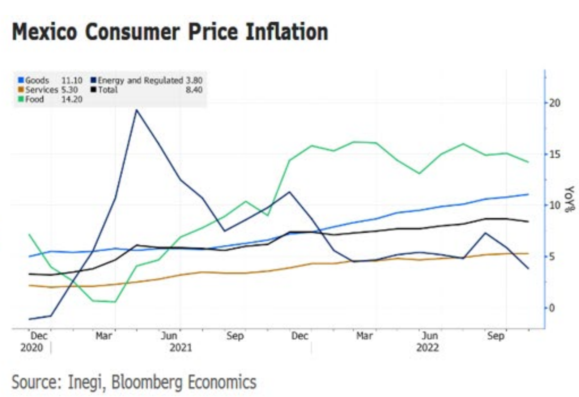
Czech swap yields dropped a spectacular 50–60 bps in morning trading after CPI inflation fell to -1.4% mom in October, compared to a gain of 0.9% mom expected. On a yearly horizon, CPI inflation fell to +15.1% yoy, compared to 17.9% yoy expected and 18% in September. **Contacts point out that the government is expanding support for higher energy prices but were nevertheless surprised by the inflation data.** The central bank had been expecting inflation to peak around 20% yoy this year and decline toward the 2% target by the middle of 2024.



Mexico

Mexico's October CPI slows more than expected ahead of Banxico's planned rate hike. Prices increased 8.41% y/y in October (Bloomberg median estimate 8.45%), compared 8.7% y/y in September, and 0.57% m/m. Core inflation continued to increase in October reaching 8.42% y/y. Yields fell across the curve with 2-year and 10-year falling 8.3 bps and 12.1 bps respectively. The 2/10 spread reached -56.2 bps compared to -52.4 bps yesterday and 5-year CDS increased to 154.5 bps following the announcement. Economists expect Banxico to increase their key rate by 75 bps to 10%, staying in lockstep with the Fed, in order to bring inflation back within 100 bps of the 3% target.

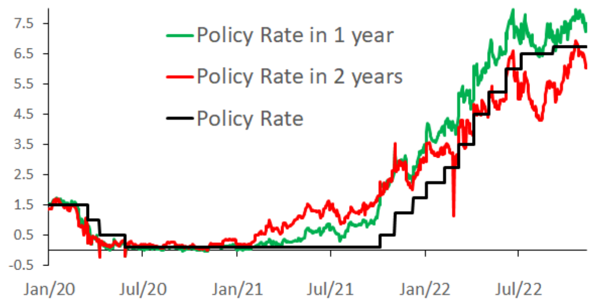




Poland

Local yields are sharply lower after the central bank left its policy rate unchanged at 6.75%, a surprise move. The central bank warned that inflation will remain high in the short-term, and its return to target will be gradual. Central bank projections show a 50% probability that annual inflation will be in the range of 14.4–14.5% in 2022 (against 13.2–15.4% in the July 2022 projection), 11.1–15.3% in 2023 (compared to 9.8–15.1%), and 4.1–7.6% in 2024 (compared to 2.2–6.0%). Governor Glapinski will hold a press conference later today.

Poland: Current and implied policy rates (%)



Source: Bloomberg and IMF staff

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Global Financial Indicators

11/10/22 8:13 AM	Level		Change					Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
Equities					%		%	%
United States		3751	-2.1	1	4	-19	-21	-11
Europe		3730	0.0	4	11	-14	-13	-6
Japan		27446	-1.0	-1	4	-6	-5	4
China		3686	-0.8	1	-1	-25	-25	-20
Asia Ex Japan		59	-1.9	5	1	-31	-29	-26
Emerging Markets		36	-1.7	4	2	-30	-27	-24
Interest Rates					basis points			
US 10y Yield		4.08	-1.1	-7	20	253	257	209
Germany 10y Yield		2.16	-1.0	-8	-18	241	234	193
Japan 10y Yield		0.25	0.0	0	0	19	18	6
UK 10y Yield		3.44	-1.5	-8	-103	252	247	196
Credit Spreads					basis points			
US Investment Grade		180	-0.7	2	-2	65	69	38
US High Yield		505	2.0	26	0	161	168	99
Europe IG		108	0.1	-5	-26	60	60	37
Europe HY		528	4.5	-23	-118	281	285	176
Exchange Rates					%			
USD/Majors		110.84	0.3	-2	-2	17	16	15
EUR/USD		1.00	-0.6	2	3	-13	-12	-12
USD/JPY		146.2	-0.2	-1	0	28	27	27
EM/USD		49.4	-0.2	1	2	-10	-6	-7
Commodities					%			
Brent Crude Oil ($/barrel)		92	-0.3	-2	-2	24	27	8
Industrials Metals (index)		153	-0.7	5	4	-6	-11	-18
Agriculture (index)		68	-0.3	-1	-3	15	12	-3
Implied Volatility					%			
VIX Index (%, change in pp)		26.4	0.3	1.1	-6.0	7.7	9.2	-4.6
US 10y Swaption Volatility		132.6	0.0	-17.7	-23.6	50.7	53.5	40.0
Global FX Volatility		11.4	0.0	-0.5	-1.2	4.4	4.0	3.9
EA Sovereign Spreads					10-Year spread vs. Germany (bps)			
Greece		249	2.4	6	-6	109	97	9
Italy		212	0.5	-5	-18	94	77	41
Portugal		98	0.7	-1	-6	36	33	6
Spain		105	1.0	-2	-9	35	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: 11/10/2022 8:16 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		7.25	-0.1	0.7	-1	-12	-12	-13		2.9	1.0	6	4	-13	2	1
Indonesia		15694	-0.2	0.0	-2	-9	-9	-9		7.3	-2.8	-11	3	131	94	83
India		82	-0.5	1.3	1	-9	-9	-9		7.6	-2.1	-3	-11	109.1	131	
Philippines		58	-0.3	1.1	1	-14	-12	-12		6.1	2.5	28	38	165	165	115
Thailand		37	0.0	3.0	3	-11	-10	-13		3.0	-3.5	-19	-24	119	114	77
Malaysia		4.70	-0.1	1.0	-1	-12	-11	-11		4.5	0.8	15	11	98	90	82
Argentina		160	-0.2	-1.5	-7	-38	-36	-33		96.4	25.3	213	776	4657	4585	4846
Brazil		5.32	-2.2	-3.7	-2	3	5	-6		13.0	92.8	131	140	142	233	149
Chile		902	0.5	4.7	4	-12	-6	-12		5.7	-7.0	-67	-107	61	28	-21
Colombia		4886	0.2	3.7	-6	-21	-17	-20		11.0	0.0	-62	67	458	454	308
Mexico		19.55	0.2	0.5	2	6	5	4		9.1	-0.5	-26	-20	159	154	122
Peru		3.9	0.2	1.1	1	3	2	-4		7.7	-0.6	-52	-94	185	181	171
Uruguay		40	-0.1	0.2	2	9	11	5		11.2	0.1	-21	-26	257	243	300
Hungary		403	-0.3	3.3	9	-21	-19	-21		9.4	-89.0	-186	-79	553	484	454
Poland		4.73	-0.5	1.8	6	-15	-15	-14		6.6	-24.5	-80	-36	370	309	272
Romania		4.9	-0.6	2.2	4	-12	-11	-11		8.8	-2.5	-23	24	417	394	361
Russia		60.9	0.6	2.3	5	17	23	34		10.7	0.0	-1	155	225	197	-44
South Africa		17.8	0.1	3.6	2	-13	-10	-15		9.3	-6.0	-19	-20	173	190	174
Turkey		18.60	0.0	0.1	0	-47	-28	-26		12.5	11.0	111	20	-687	-1179	-989
US (DXY; 5y UST)		111	0.3	-1.8	-2	17	16	15		4.23	-0.9	-14	9	302	297	233

	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		3686	-0.8	1	-1	-25	-25	-20		216	10	20	16	13	8
Indonesia		6967	-1.5	-1	0	4	6	1		192	-5	-8	18	27	7
India		60614	-0.7	0	6	1	4	6		187	-22	-3	47	55	33
Philippines		6168	-1.2	0	5	-16	-13	-16		156	4	-5	46	55	19
Thailand		1619	-0.2	0	4	-1	-2	-5		0	0	0	0	0	0
Malaysia		1450	0.2	2	5	-5	-8	-9		122	4	11	8	5	-11
Argentina		143092	-3.3	-4	-1	50	71	57		2549	-31	-262	830	869	812
Brazil		113580	-2.2	-3	-2	7	8	1		294	16	-7	-30	-17	-37
Chile		5322	-1.0	3	5	19	24	22		164	-10	-25	30	24	-10
Colombia		1250	-0.3	0	4	-9	-11	-17		442	-23	-19	141	94	50
Mexico		50546	-0.7	-1	11	-2	-5	-2		404	-7	-43	67	72	34
Peru		21813	-0.7	5	9	7	3	-7		191	-10	-32	36	41	1
Hungary		42876	-2.5	3	10	-20	-15	-10		258	-12	-54	139	134	105
Poland		52805	-0.9	4	15	-27	-24	-16		80	25	19	31	48	64
Romania		11311	0.5	4	4	-11	-13	-14		319	-14	-32	136	127	87
Russia		2187	0.9	1	14	-48	-42	-29		3411	-577	938	3228	3234	2897
South Africa		68921	-1.0	4	6	1	-6	-8		400	-15	-64	60	45	11
Turkey		4429	1.6	8	24	173	138	120		508	-25	-112	37	-70	-55
Ukraine		519	0.0	0	0	-1	-1	0		4247	-255	378	3733	3488	2774
EM total		36	-0.9	4	2	-30	-27	-24		433	-12	-26	60	46	-25

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

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