Global Markets Monitor

FRIDAY, NOVEMBER 18, 2022

- **Fed Fund forwards at the lower end of a sufficiently hawkish stance** (link)
- **Past hiking cycles have seen initially solid corporate earnings** (link)
- **Euro area banks prepay €296 bn of TLTRO funding, less than expected** (link)
- **German IG Metall union agrees with below-inflation wage deal** (link)
- **Japanese inflation reaches highest level in 40 years** (link)
- **President-elect Lula's re-affirming his spending plans sparks further sell-off in Brazil** (link)

Mature Markets | Emerging Markets | Market Tables

Risk sentiment rebounds as investors look past hawkish rhetoric

A day after hawkish comments by St. Louis Fed president Bullard, markets are rebounding even as yields continue to move higher. After two days of losses, equity markets in advanced economies are rising as investors look past the recent rhetoric. President Bullard said yesterday that a Fed policy rate between 5–7% is sufficiently restrictive, later qualifying that his desired minimum level is 5–5.25%. Following the speech, the market implied peak Fed funds rate moved slightly over 5%, a modest increase from pricing before the comments. The treasury curve continued to flatten (the UST 2-yr rate is now 70 bp above that of the 10-yr). This morning, European equities are 1% higher and US equity futures are indicating a similar move. Emerging market currencies are mostly stronger versus the dollar amid the risk rebound, along with modest dollar weakness. The Brazilian real (1.2%) is leading gains as officials in president-elect Lula's team have attempted to assure investors that the incoming administration will have fiscal responsibility.

Key Global Financial Indicators

Last updated:	Level		Change from Market Close					Since
11/18/22 8:08 AM	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
Equities					%		%	
S&P 500		3947	-0.3	0	6	-16	-17	-7
Eurostoxx 50		3922	1.1	1	13	-11	-9	-1
Nikkei 225		27900	-0.1	-1	4	-6	-3	5
MSCI EM		38	0.2	3	9	-25	-22	-19
Yields and Spreads					bps			
US 10y Yield		3.80	3.0	-2	-21	221	229	180
Germany 10y Yield		2.05	3.4	-11	-23	233	223	183
EMBIG Sovereign Spread		489	5	-22	-78	135	122	77
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		49.7	0.3	0	2	-7	-5	-6
Dollar index, (+) = $ appreciation		106.6	0.0	0	-5	12	11	11
Brent Crude Oil ($/barrel)		88.3	-1.7	-8	-2	9	13	-9
VIX Index (%, change in pp)		23.6	-0.3	1	-7	6	6	-7

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

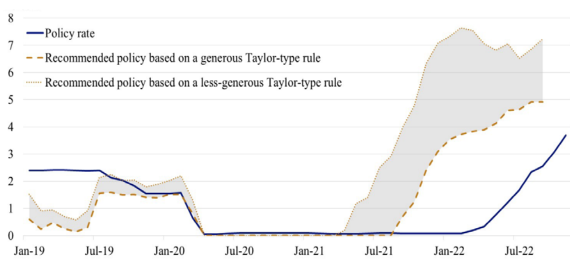
Mature Markets

back to top

United States

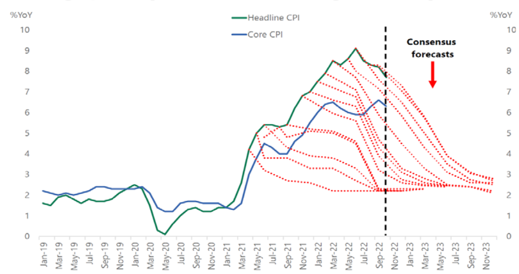
Current market policy rate expectations are at the lower end of a sufficiently restrictive stance. Commentary by St. Louis Fed President Bullard yesterday pushed back against market pricing that the weaker than expected October inflation release could imply a lower terminal Fed Funds rate. In his speech, President Bullard referred to Taylor-type monetary policy rules, which recommend an optimal level for the Fed Funds rate based on various input parameters. These include how far inflation deviates from its target, how far below potential the US economy is operating, and on the assumed level of the real natural rate of interest. Varying these input parameters between more and less generous assumptions, a Fed Funds rate between 5–7% would be deemed sufficiently restrictive for a monetary policy stance consistent with the Fed's dual mandate goals (right chart below). The lower end of this range depends on the assumption that inflation will fall quickly, as surveys expect (see left chart below), rather than leveling off more slowly or staying at elevated levels.

According to President Bullard, Fed Funds between 5-7% could be sufficiently restrictive…



Source: St. Louis Fed

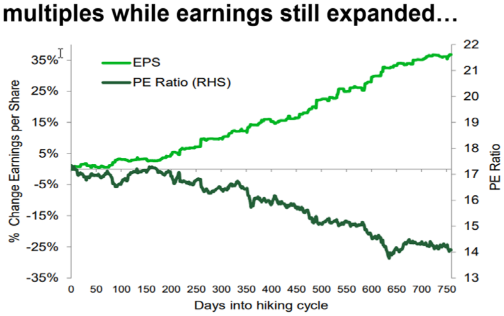
… with the lower range hinging on inflation falling quickly and not moving sideways.



Source: Apollo

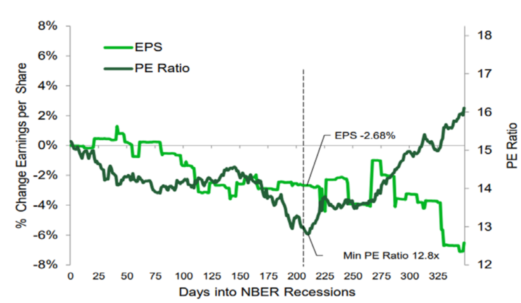
Past hiking cycles have seen initially solid corporate earnings that shrank in a recession. To the extent history serves as a meaningful indicator, TD analysts tried to identify the effect of hiking cycles and recessions on corporate earnings using data since the 1970s. On average, US equities continued to rise in a rate hike cycle. TD analysts explain this by corporate earnings benefitting from a strong US economy entering the hiking cycle with significant momentum. A positive stock market return was somewhat dampened by a falling price-to-earnings (P/E) ratio (see left chart below) on the back of a rising discount factor. On average 2.5 years after a first interest rate hike a recession ensued. Past recession cycles tell a story of two halves. In the early stages of a recession, earnings tended to decline, resulting in significantly negative stock returns. There was a turning point that came about 200 days into an average recession cycle when P/E multiples troughed (see right chart below). Positive equity returns in the second half of the recession were driven by re-expanding valuation multiples on the back of loosening financial conditions while earnings continued trending lower.

Past hiking cycles saw deflating equity multiples while earnings still expanded…



Source: TD Securities

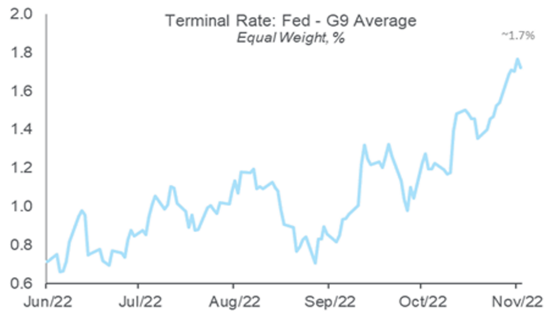
… while a first phase of a recession saw earnings contraction before multiples expanded again.



Source: TD Securities

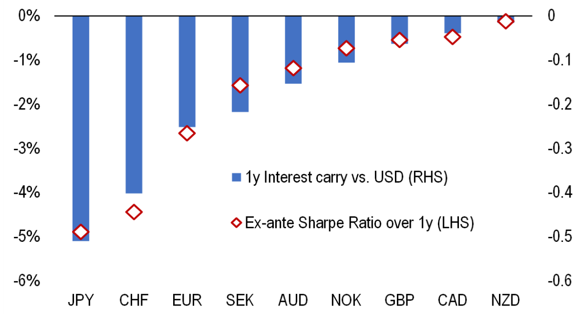
Shorting the dollar is costly even as positioning appears crowded. During 2022, a sequence of major shocks to the global economy has led to dollar strength. Technical elements have been supportive, too, including geopolitical uncertainty and trend following. A number of market analysts note a potential peak in Fed tightening in 2023 as a catalyst for a reversion of the dollar strength. Notwithstanding this, the US also has relatively higher terminal interest rate expectations than other G9 countries (left chart below) as a result of its tighter labor market that requires more policy restraint to contain services inflation. Accordingly, from an investor perspective, shorting the dollar becomes a costly value proposition as the interest carry between all 1y G9 government bonds and Treasuries is negative (see right chart below). While there is a vast dispersion of carry across currencies, ranging from -5.1% for being long JPY to -0.1% for being long NZD, the average 1-year carry of shorting the Dollar amounts to -2%. With implied volatilities ranging from 8.3% for CAD to 14.4% for NOK, a similar conclusion can be drawn when looking at ex-ante Sharpe Ratios.

Fed terminal rate pricing outpaced G9 central banks…



Source: Citi

…implying that shorting the Dollar brings negative carry.



Note: Ex-ante Sharpe Ratio as carry vs. USD divided by FX-option implied volatility.

Source: IMF Staff calculations

Euro area

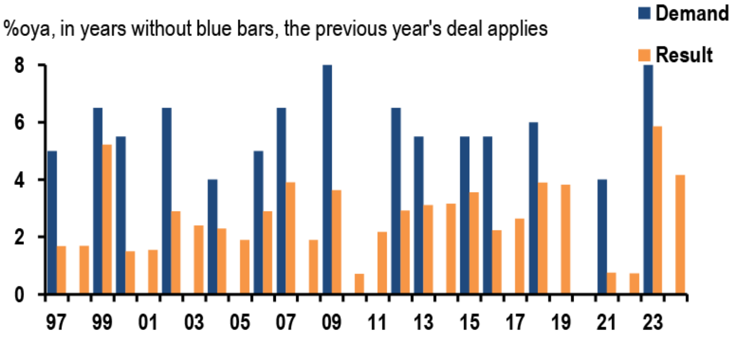
European equities (+1%) gained as Germany's IG Metall union reached an agreement on a wage increase of 8.5% spread over two years. Analysts believe that the below-inflation deal reduces the risk of large second-round effects. The association of German gas storage operators said that Germany could get through this and next winter. **ECB President Lagarde said interest rates may need to be lifted to levels that restrict economic expansion to drive down inflation.**

2-yr German bund yields fell 5 bp and the euro gave up earlier gains on the news that euro area banks will prepay €296 bn of TLTRO funding, compared to around €600 bn expected. Analysts had also expected a rather wide range of prepayments from €200 bn to €1.5 tn. Contacts are not surprised that banks are taking a cautious approach in holding on to liquidity given broader macroeconomic uncertainty. Today's repayment represents just under 15% of outstanding TLTRO loans. Banks will have the option to further prepay in each of the next four months, and then on a quarterly basis.

Germany's IG Metall union reached a pay deal including a total wage rise of 8.5% stretched over two years and a one-off tax-free payment of €3k. Wages will be increased by 5.2% in June 2023 and by 3.3% in May 2024. The one-off payment of €3k is what the German government had offered to exempt from tax and social security contributions. The deal was reached after five rounds of talks and a series of warning strikes. The deal applies within Baden-Wuerttemberg but provides the model for other regions. Analysts believe that the deal reduces the risk of large second-round effects.

Wage negotiations in the German metal/engineering sector

%oya, in years without blue bars, the previous year's deal applies



Source: IG Metall, J.P. Morgan

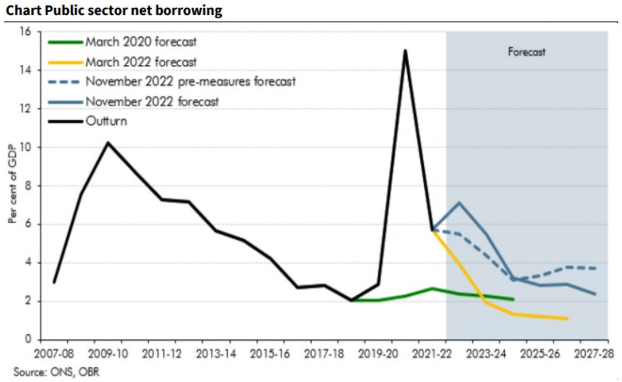
Italian 10-yr spreads fell 13 bp to 193 bp this week as Italy saw strong retail and institutional demand of €12 bn for a new 6-yr inflation-linked BTP. Retail demand was €7.28 bn and institutional demand €4.71 bn at a yield of 1.6%.

United Kingdom

The pound (+0.4%) firmed after the Chancellor announced a fiscal tightening of around 2% of GDP yesterday, less austere than some contacts had feared. Analysts point out that the budget signals a heavily back-loaded tightening after a probable 2024 election. A total of £30 bn will come from reduced spending plans and £25 bn from tax increases by 2027–28. Tax measures included a broadening of the windfall tax on energy profits and the freezing of various tax thresholds on income, capital gains and employer national insurance contributions.

10-yr gilt yields are 7 bp higher as the new budget showed a significant increase in gilt supply throughout the period with the biggest occurring next financial year. Money markets are currently pricing bank rate around 3.5% at end year, a couple of bp lower on the day.

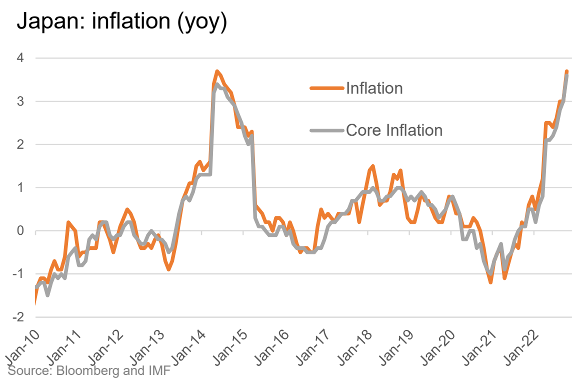
Chart Public sector net borrowing



Source: OBR

Japan

The Japanese yen was gaining 0.3% and yields on Japanese 10y bonds were little changed, as Japanese inflation reached its highest level in 40 years, at 3.7% y/y in October, up from 3% in September. Core inflation came in at 3.6% y/y and has now exceeded the Bank of Japan's 2% price target for seven straight months. Following the release, Governor Kuroda reiterated his view that the central bank's ultra-low interest rates remain appropriate, though he acknowledged that the latest gains were significant, and that inflation could accelerate further.



Emerging Markets

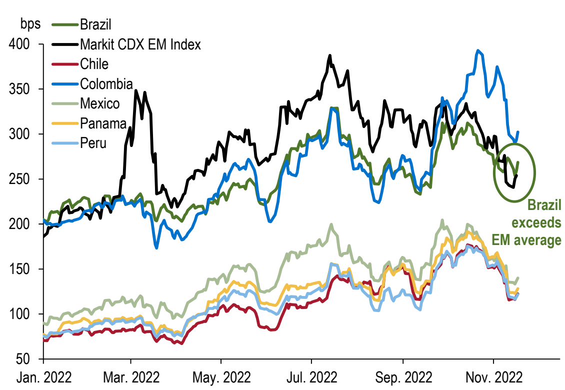
back to top

Asian equities were muted today. Most currencies were registering small gains. The South Korean won was broadly stable after three days of losses, even though the launch of a ballistic missile by North Korea weighed on sentiment. The Philippine peso was gaining 0.2% as Bloomberg reported that the Philippine central bank said it is open to adjusting FX rules to curb speculation against the currency. 10y bonds were broadly unchanged. Over the last week, yields on 10y Philippine bonds have climbed above those of Indonesia for the first time in 9 years, as the Philippine Central Bank is seen as more hawkish, despite both banks hiking rates yesterday (Philippines +75 bp to 5%, and Indonesia +50 bp to 5.25%). Malaysia is holding general elections this weekend, and the outcome seems wide open as polls give no coalition a clear advantage. **Markets in EMEA were mixed in a relatively quiet session.** The Hungarian forint (+0.7%) and South African rand (+0.6%) outperformed. Regional swap yields are generally higher with the notable exception of Hungary, where swap yields fell 20 bp. **Hawkish Fed speak weighed on LatAm currencies and most of the major equity indices within the region yesterday.** The Chilean peso was the worst performer (-1.1%) as most commodities, including copper, closed the day lower. Across equity markets, only the Colombian COLCAP gained for the day (+1.3%).

Brazil

Brazilian markets were caught wrong footed at the open after comments from President-elect Lula on financial markets and about his spending policies kicked-off a wide sell-off. The Bovespa Index and the real were down by as much as 2.7% and 2.6% respectively during session lows. The yield curve cheapened by roughly 40 bp during morning trading. The market started to trim its losses after Aloizio Mercadante, Lula's transition team's group coordinator, said that "there have been discussions to cutting expenses" according to reports by Bloomberg. Despite some assets bouncing back from sessions lows in the afternoon, Brazil's 5-year CDS continues to trade above the EM average.

Brazil joins Colombia as both 5-year CDS' now trade above the Markit CDX EM Index.



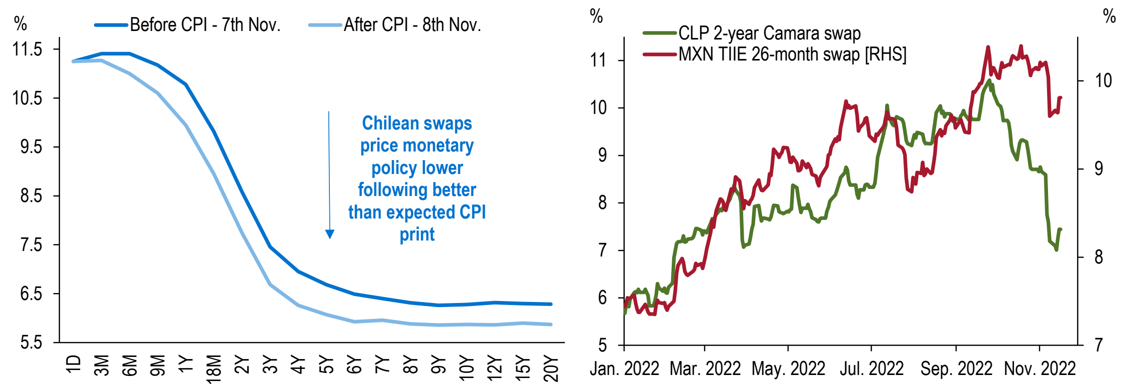
China

Equities declined slightly, with the CSI 300 losing 0.4% and the Hang Seng down 0.3%. The Chinese yuan outperformed other Asian currencies (+0.6% to 7.11/$) amid Bloomberg reports that state-owned banks were selling dollars to suport the yuan this morning. The yuan was further supported by comments from PBOC adviser Liu Shijin saying that if China can "completely get rid of the impact of the pandemic in 2023 H1," actual growth could be higher than 5%.

Chile and Mexico

Front-end rates in Chile and Mexico re-price higher (+20bp and +17bp, respectively) after hawkish comments from Fed officials. Despite, Mexico having one of the highest real rates across Emerging Markets and Chile's latest CPI print coming under expectations last week, rates markets priced the front-end higher following comments by St. Louis Fed President Bullard. Chile's better than expected inflation print had caused the whole swaps curve to shift lower by more than 50bp (LHS chart below). Earlier in the week, Banxico's Deputy Governor had commented that the bank's reaction to the Fed is "not mechanical.

Front-end local rates in Chile and Mexico followed US rates higher following hawkish commentary



Source: Bloomberg

This monitor is prepared under the guidance of Charles Cohen (Acting 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), Tom Piontek (Senior Financial Sector Expert) and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Mustafa Oguz Caylan, Yingyuan Chen (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), Johannes S Kramer (New York Representative), Harrison Kraus (Research Assistant), Yiran Li (Research Assistant), Aurelie Martin (Senior Economist-London Representative), Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), 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) Olga Lefebvre (Staff Assistant), and Srujana Sammeta (Staff Assistant) are responsible for the word processing and production of this monitor.

Disclaimer: *This is an internal document produced by the Global Markets Analysis Division (GA) of the Monetary and Capital Markets Department. It reflects GA staff's interpretation and analysis of market views and developments. Market views presented may or may not reflect a consensus of market participants. GA staff do not independently verify the accuracy of all data and events presented in this document.*

Global Financial Indicators

	Level		Change					Since
11/18/22 8:08 AM	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
Equities					%		%	%
United States		3957	-0.3	-1	6	-16	-17	-6
Europe		3922	1.1	1	13	-11	-9	-1
Japan		27900	-0.1	-1	4	-6	-3	5
China		3802	-0.4	0	2	-22	-23	-18
Asia Ex Japan		64	0.5	5	11	-26	-22	-19
Emerging Markets		38	0.2	3	9	-25	-22	-19
Interest Rates					basis points			
US 10y Yield		3.80	3.0	-2	-21	221	229	180
Germany 10y Yield		2.05	3.4	-11	-23	233	223	183
Japan 10y Yield		0.25	0.3	1	-1	17	18	5
UK 10y Yield		3.27	6.4	-9	-68	234	230	179
Credit Spreads					basis points			
US Investment Grade		165	-0.7	-9	-25	55	53	22
US High Yield		477	-4.8	-16	-24	133	139	70
Europe IG		96	-2.4	-2	-29	46	48	24
Europe HY		475	-11.0	-6	-124	227	234	124
Exchange Rates					%			
USD/Majors		106.64	0.0	0	-5	12	11	11
EUR/USD		1.04	0.0	0	5	-9	-9	-8
USD/JPY		140.0	-0.1	1	-6	23	22	22
EM/USD		49.7	0.3	0	2	-7	-5	-6
Commodities					%			
Brent Crude Oil ($/barrel)		88	-1.7	-8	0	19	21	3
Industrials Metals (index)		158	0.4	-4	10	-3	-9	-16
Agriculture (index)		68	0.6	-1	0	11	11	-4
Implied Volatility					%			
VIX Index (%, change in pp)		23.6	-0.3	1.1	-6.9	6.0	6.4	-7.4
US 10y Swaption Volatility		134.9	0.3	18.1	-15.7	57.7	55.9	40.6
Global FX Volatility		11.5	0.0	0.1	-0.9	4.0	4.1	4.0
EA Sovereign Spreads					10-Year spread vs. Germany (bps)			
Greece		225	-1.3	-13	-47	78	73	-15
Italy		190	-2.1	-15	-51	70	55	18
Portugal		93	-1.3	-3	-14	31	29	1
Spain		99	-2.1	-5	-15	28	25	-4

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

Emerging Market Financial Indicators

Last updated: 11/18/2022 8:09 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		7.12	0.5	-0.3	1	-10	-11	-11		3.1	1.1	17	28	8	23	22
Indonesia		15684	-0.1	-1.2	-1	-9	-9	-9		7.1	1.9	-1	-39	103	67	56
India		82	0.0	-1.1	1	-9	-9	-9		7.4	6.0	-7	-22	92.9	111	
Philippines		57	0.2	0.0	3	-12	-11	-11		6.1	0.0	0	33	153	165	115
Thailand		36	0.3	0.7	7	-9	-7	-10		2.8	11.0	-1	-42	95	97	59
Malaysia		4.55	0.0	1.5	4	-8	-8	-8		4.3	-2.1	-20	-17	71	69	62
Argentina		163	0.0	-1.2	-6	-38	-37	-34		94.2	-53.4	-299	758	4389	4362	4623
Brazil		5.34	1.3	-0.2	-2	4	4	-6		13.0	-24.2	-19	131	126	233	149
Chile		921	0.0	-3.2	5	-10	-8	-14		5.6	-2.0	5	-92	-6	17	-33
Colombia		4980	0.4	-3.5	-4	-21	-18	-21		10.3	0.0	-14	-92	353	384	238
Mexico		19.45	-0.1	0.3	3	7	6	4		8.8	13.0	8	-54	129	126	94
Peru		3.8	0.1	1.0	4	5	4	-2		8.0	0.1	######	-67	212	208	198
Uruguay		40	0.1	0.5	4	11	12	7		11.1	0.0	0	-50	251	239	297
Hungary		393	1.0	-0.3	7	-19	-17	-19		8.6	-30.0	0	-230	446	404	374
Poland		4.53	0.2	0.0	7	-9	-11	-11		6.4	2.2	1	-93	329	288	251
Romania		4.8	-0.2	-0.7	5	-9	-9	-8		8.0	-6.4	-28	-107	314	314	281
Russia		60.2	0.4	0.9	3	22	25	36		11.5	20.9	74	144	256	270	29
South Africa		17.3	0.6	-0.2	5	-9	-8	-12		9.1	-4.5	-1	-36	168	171	155
Turkey		18.62	-0.3	-0.2	0	-41	-29	-26		11.6	-27.0	-50	106	-875	-1275	-1085
US (DXY; 5y UST)		107	0.0	0.3	-5	12	11	11		3.97	3.6	4	-25	275	271	207

	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		3802	-0.4	0	2	-22	-23	-18		206	-11	-1	8	3	-2
Indonesia		7082	0.5	0	1	5	8	2		180	-28	-40	18	15	-5
India		61663	-0.1	0	4	3	6	8		150	-38	-54	15	18	-4
Philippines		6437	0.5	2	8	-12	-10	-13		142	-14	-34	38	41	5
Thailand		1617	0.2	-1	2	-2	-2	-5		0	0	0	0	0	0
Malaysia		1449	0.0	0	3	-5	-8	-9		103	-24	-20	-7	-14	-30
Argentina		155259	0.7	7	13	73	86	70		2396	-96	-455	684	716	659
Brazil		109703	-0.5	0	-5	7	5	-2		293	-11	-14	-24	-18	-38
Chile		5180	-1.1	-3	1	21	20	18		155	-7	-41	22	15	-19
Colombia		1296	1.3	1	9	-3	-8	-14		407	-16	-80	102	59	15
Mexico		51361	-0.4	1	11	1	-4	0		386	-2	-61	54	54	16
Peru		21861	-1.3	-1	8	8	4	-7		184	0	-50	33	34	-6
Hungary		44137	0.2	1	8	-15	-13	-8		225	-31	-90	113	101	72
Poland		55084	0.5	1	16	-21	-21	-12		54	-28	-4	7	22	38
Romania		11739	0.2	2	7	-8	-10	-11		283	-22	-98	98	91	51
Russia		2200	-0.6	-1	8	-46	-42	-29		3411	-577	938	3228	3234	2897
South Africa		72674	0.7	0	10	3	-1	-3		395	8	-100	47	40	6
Turkey		4511	0.1	1	17	160	143	124		518	-6	-90	32	-60	-45
Ukraine		519	0.0	0	0	-1	-1	0		3688	-477	-471	3117	2929	2215
EM total		38	-0.4	3	9	-25	-22	-19		408	-17	-65	34	22	-50

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

back to top