GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

FRIDAY, OCTOBER 14, 2022

- **UK markets rally on hopes of fiscal U-turn** (link)
- **Yen at weakest since 1990** (link)
- **Poor liquidity in government bonds challenges markets** (link)
- **Rising equity-bond correlations increase risk of higher volatility** (link)
- **Dollar funding costs are up sharply** (link)

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Markets are up as earnings season begins

Stocks in Europe posted healthy gains in the wake of yesterday's strong US rally, although US equity futures were mixed to slightly lower this morning. Earnings season has begun with JP Morgan reporting results that were well ahead of analyst forecasts, boosting investor sentiment. Wells Fargo also had good earnings, but its results were dragged down by a $2 bn regulatory charge. The UK remains in focus as the BOE is expected to end its support program for the gilt market today, and press reports indicate that PM Truss will announce a reversal of the controversial spending program that has roiled markets in recent weeks. The Chancellor of the Exchequer has been dismissed. UK markets are rallying on hopes of the fiscal U-turn. Meanwhile, the yen has fallen to its weakest level against the dollar since 1990, blowing past the 145 level that triggered intervention by the Ministry of Finance earlier this month and approaching the 148 mark.

Key Global Financial Indicators

Last updated: 10/14/22 7:55 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		3670	2.6	-2	-7	-17	-23	-13
Eurostoxx 50		3410	1.4	1	-4	-18	-21	-14
Nikkei 225		27091	3.3	-1	-2	-7	-6	2
MSCI EM		35	0.3	-5	-10	-32	-29	-27
Yields and Spreads				bps				
US 10y Yield		3.89	-5.2	1	49	238	238	190
Germany 10y Yield		2.21	-7.9	1	49	240	239	198
EMBIG Sovereign Spread		573	6	31	86	210	206	161
FX / Commodities / Volatility				%				
EM FX vs. USD, (+) = appreciation		48.4	0.1	-1	-3	-12	-8	-9
Dollar index, (+) = $ appreciation		113.1	0.7	0	3	20	18	18
Brent Crude Oil ($/barrel)		93.1	-1.6	-5	-1	11	20	-4
VIX Index (%, change in pp)		31.7	-0.3	0	6	15	14	1

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

Mature Markets

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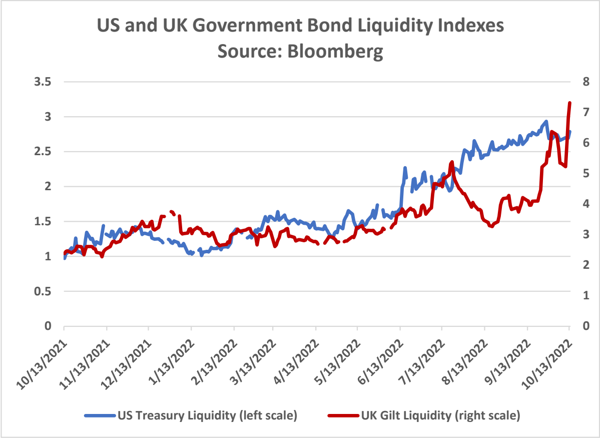
Global Government Bond Liquidity

Poor liquidity in key government bond markets has become a significant challenge. The Bloomberg Treasury and gilt liquidity indexes (which indicate lower liquidity as a higher index level) have surged. US Treasury Secretary Yellen recently flagged the risk of a breakdown in Treasury trading. With quantitative tightening (QT) by the Fed ongoing, banks are more reluctant to make markets due to the constraints on their balance sheets placed by the supplementary liquidity ratio (SLR) as well as the prospect of mark-to-market losses. Many are worried about a repeat of the turmoil that occurred in 2019, when a surge in repo rates forced the Fed to end its QT and inject large amounts of liquidity into the system. Meanwhile, liquidity in the gilt market has also dried up as interest rates soared after the release of the so-called mini-budget which greatly expands government spending. The BOE has intervened to prop up the market but uncertainty remains very high as the central bank is scheduled to end its gilt support program today.



United States

US retail sales data for September were mixed but generally better than expected. The market response was muted.

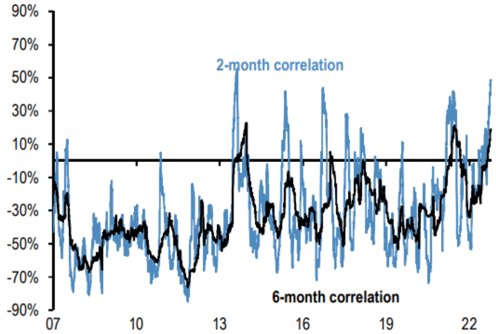
US Retail Sales Report, 8.30 am

Source: Bloomberg

Variable	Consensus Forecast	Actual Data Print
Retail sales month-on-month	+0.2%	+0%
Retail sales ex-auto mom	-0.1%	+0.1%
Retail sales ex-auto and gas	+0.2%	+0.3%

Rising equity-bond correlations are increasing the risk of even higher market volatility in the future. The extended market selloff has significantly raised the correlation between stocks and bonds. This has raised worries about highly leveraged risk parity funds which seek to exploit the normally negative correlation that has existed between stocks and bonds over the past 20 years, according to JP Morgan. The negative correlation reduces the volatility of portfolios that hold both bonds and equities, allowing the use of leverage to boost returns. However, when the correlation turns positive, the risk parity business model breaks down, forcing these funds to sell both equity and fixed income assets. The size and structural importance of risk parity funds means that the overall market is at risk of much higher volatility when these funds sell their assets. With uncertainty remaining high due to the threat of inflation, the future path of Fed policy and the slowdown in China, markets could be confronted with even more turbulent conditions heading into the end of the year.

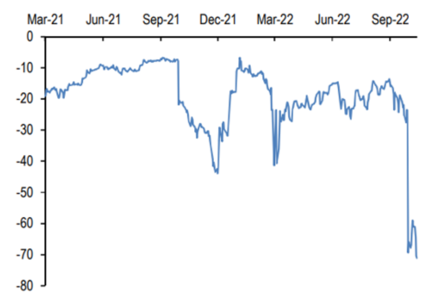
Figure 5: Bond-equity correlation
2- and 6-month rolling correlation between daily returns of MSCI World Local vs. GBI Global hedged into USD indices



Source: Bloomberg Finance L.P., J.P. Morgan

The spike in US interest rates, the ongoing Fed rate hikes, and the relentless rise of the dollar has led to much higher dollar funding costs for non-US based investors. The cross-currency basis swap markets for the euro and the yen where investors borrow dollars to finance their investments has seen costs move steadily higher. The market selloff has caused many investors to sell risk assets and park the proceeds in dollar cash, making dollar funding scarce. Poor liquidity has caused a surge in costs in the three month sector, although the six month sector has seen a more gradual increase although still significant increase. Funding costs are especially high for the turn of the year when funding needs tend to be at their highest. On a more positive note, longer maturity funding costs have risen more slowly.

Figure 7: 3m EUR/USD cross-currency basis
In Bps. Based on €STR and SOFR rates.



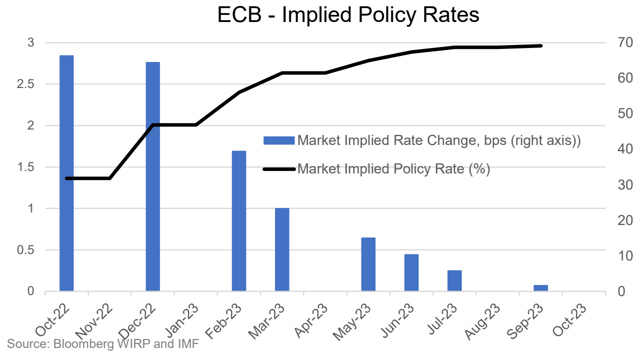
Source: J.P. Morgan

Figure 8: 6m EUR/USD cross-currency basis
In Bps. Based on €STR and SOFR rates.

Source: J.P. Morgan

Euro Area

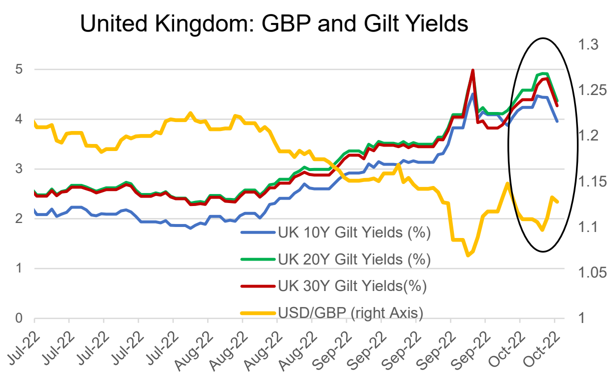
European markets are rebounding strongly this morning. ECB officials continued to express views about the appropriate pace of monetary tightening and prospects for quantitative tightening (QT). Yesterday, Bundesbank governor and ECB governing council member Nagel said that the ECB should enact a “robust” interest rate increase this month to ensure that inflation expectations do not become unmoored. Belgian governor Wunsch said in a CNBC interview that interest rates will have to go over 2% by year end, and he would not be surprised if they had to go over 3% at some point. Lithuanian governor Simkus also said yesterday that he favored a 75 bps hike this month, and 50 or 75 bps in December. This is in line with market pricing for ECB rate hikes. On QT, Nagel indicated that there is agreement within the 25-member Governing Council that QT should be tackled early in 2023. This morning, ECB president Lagarde mentioned that inflation and slower growth may hurt financial stability, and that there are early signs of rising credit risks.



Source: Bloomberg WIRP and IMF

United Kingdom

Local markets are rallying on the last day of the BOE's temporary bond buying program, fueled by expectations that the government is about to announce a U-turn on its fiscal strategy. PM Liz Truss is expected to hold a press conference on the UK economy later today. The sharp rally in UK gilt markets is continuing. All gilts tenors are rallying 25–27 bps, and the 10y yields are back under 4% at 3.93% for the first time since October 4 and yields on 30y gilts are back to 4.3%. Rumors of changes in fiscal policy started in the media yesterday afternoon and accelerated overnight on reports that chancellor Kwarteng had left Washington DC early to discuss fiscal policy in London. It was announced in the late morning that Liz Truss would hold a press conference on the economy at 2 PM London time (9 PM Eastern Standard Time). Market participants are expecting that the government will cancel its plans to keep the corporation tax unchanged at 19%, and go back to the previous government's plan to raise it to 25% in April, when the new fiscal year starts)



Source: Bloomberg and IMF

Japan

Japanese yen depreciated (-0.3%), touching 147.6 yen per dollar, the weakest level since August 1990. Japanese authorities continued with their verbal warnings against currency speculation as they tried to dissuade traders from testing the intervention strategy. Options pricing suggested that traders are positioned for short-term strength of the yen but longer-term weakness. The 10-year JGB yield was little changed; the Bank of Japan bought 118 bn yen (0.8%) of bonds under the fixed-rate bond purchase operation today. Longer-tend JGB yields dropped (30-year: -1.2 bps). Equities gained (NIKKEI: +3.3%) following the global stock market rally.

Emerging Markets

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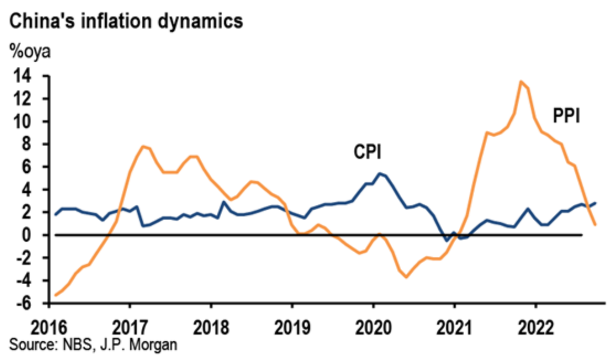
EMEA markets were up in line with broader markets. Asian markets also rallied with the US market, and local yields were higher. The EU is to increase its assistance to Ukraine, with €2 bn to be released within days and a further €3 bn to be sent by the end of the year. The Monetary Authority of Singapore tightened policy. **Stocks in Latin America were little changed, although hard currency bond yields were higher.** Brazil has seen large inflows into domestic bond funds this year.

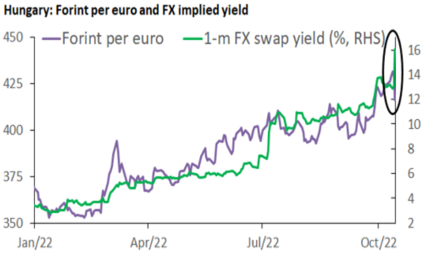
China

September inflation data came in slightly below expectations. CPI inflation accelerated to 2.8% y/y in September from 2.5% in August (consensus: +2.9%). Data showed easing core CPI and energy prices along with an uptick in food prices, reflecting subdued demand in services activity. Meanwhile, PPI inflation moderated to 0.9% from 2.3% (consensus: +1.0%) on the back of falling prices of commodities and producer goods**. Chinese equities gained** (CSI 300: +2.4%), following the global stock market rally. RMB depreciated (-0.3%) as the People's Bank of China (PBC) continued setting the daily RMB fixing stronger than expected (today: 495 pips). Market contacts indicated that the RMB fixing in recent days may not follow the formula but appeared to put a floor to RMB at around 7.25 yuan per dollar. Under the current framework, RMB would be allowed to move up to 2% from the daily fixing on a given day. **The PBOC continued withdrawing liquidity;** today's liquidity withdrawal amounted to 56 bn yuan ($7.8 bn). The key interbank rate (DR007) edged down to 1.48% (-9.0 bps). CGB yields declined (1-year: -1.0 bp; 10-year: -2.7 bps).

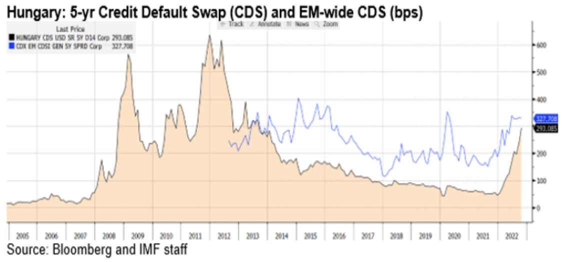


Hungary

The forint appreciated (+2.9%) and bond yields rose sharply after the central bank (NBH) said that it will leave its base rate at 13% unchanged but will offer a 18% interest on a new one day deposit facility. The NBH also raised the overnight collateralized lending rate to 25% and suspended its one-week collateralized loan. **The fixing on the overnight Budapest interbank rate (Bubor) rose to 17.92 % (from 12.73% yesterday) and 5-yr bond yields are around 150 bps higher at 14.11%.** Contacts believe that this sizeable rate hike will drive local deposit rates much higher and is likely to decrease the appetite of local banks to lend. **Contacts also point out that demand for protection against a credit event has increased sharply in the past week (with the 5-yr CDS up 29 bps to 293 bps yesterday) as discussions on EU funds continue and inflation was higher than expected at 20% yoy in September.**



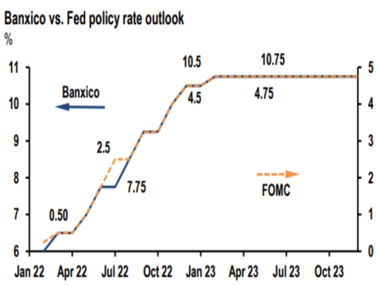
Source: Bloomberg and IMF staff



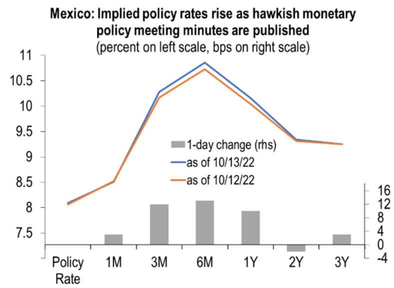
Source: Bloomberg and IMF staff

Mexico

Implied policy rates rose in the context of hawkish monetary policy minutes and an upward surprise in US inflation. The tone of the minutes of Banxico's last monetary policy meeting were assessed by J.P. Morgan as quite hawkish. The bank's analysts project now a terminal policy rate of 10.75% in the current hiking cycle, to be reached in the first quarter of 2023. Markets fully price in such terminal rate but disagree on its expected persistence, seeing the policy rate starting to decline already in Q2 2023, arriving at 10.3% in October 2023. Any potential positive impetus of the minutes on the Mexican peso and local stock markets was muted subsequent to a higher-than-expected US inflation print.



Source: J.P. Morgan forecasts. Updated Sep 29 (Banxico) and Oct 7 (FOMC)



Source: Bloomberg.

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Global Financial Indicators

10/14/22 7:58 AM	Level		Change					Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
Equities					%		%	%
United States		3670	2.6	-2	-7	-17	-23	-13
Europe		3410	1.4	1	-4	-18	-21	-14
Japan		27091	3.3	-1	-2	-7	-6	2
China		3842	2.4	1	-2	-22	-22	-17
Asia Ex Japan		58	0.2	-5	-11	-33	-30	-27
Emerging Markets		35	0.3	-5	-10	-32	-29	-27
Interest Rates					basis points			
US 10y Yield		3.89	-5.2	1	49	238	238	190
Germany 10y Yield		2.21	-7.9	1	49	240	239	198
Japan 10y Yield		0.25	0.1	0	-1	17	18	5
UK 10y Yield		4.00	-20.0	-24	87	296	303	252
Credit Spreads					basis points			
US Investment Grade		192	-1.4	13	29	104	80	49
US High Yield		529	-5.1	31	62	199	192	123
Europe IG		130	-1.6	-1	23	79	82	58
Europe HY		616	-7.2	-17	91	358	374	264
Exchange Rates					%			
USD/Majors		113.15	0.7	0	3	20	18	18
EUR/USD		0.97	-0.7	0	-3	-16	-15	-14
USD/JPY		147.9	0.5	2	3	30	28	29
EM/USD		48.4	0.1	-1	-3	-12	-8	-9
Commodities					%			
Brent Crude Oil ($/barrel)		93	-1.6	-5	0	22	27	7
Industrials Metals (index)		147	-0.7	0	-4	-17	-15	-22
Agriculture (index)		69	-0.5	0	-1	21	13	-2
Implied Volatility					%			
VIX Index (%, change in pp)		31.7	-0.3	0.3	5.5	14.8	14.5	0.7
US 10y Swaption Volatility		159.6	-0.4	3.5	32.0	89.8	80.5	65.3
Global FX Volatility		12.7	0.0	0.4	1.4	5.8	5.3	5.2
EA Sovereign Spreads					10-Year spread vs. Germany (bps)			
Greece		263	1.8	-2	9	154	111	23
Italy		243	3.5	-8	14	140	108	71
Portugal		108	0.8	-2	5	57	44	16
Spain		117	1.0	-5	2	54	43	14

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

Emerging Market Financial Indicators

Last updated: 10/14/2022 8:02 AM	Exchange Rates: Level, Last 12m	Level, Latest	Change (in %), 1 Day	Change (in %), 7 Days	Change (in %), 30 Days	Change (in %), 12 M	YTD	Since 23-Feb-22	Local Currency Bond Yields (GBI EM): Level, Last 12m	Level, Latest	Change (in basis points), 1 Day	Change (in basis points), 7 Days	Change (in basis points), 30 Days	Change (in basis points), 12 M	YTD	Since 23-Feb-22
		vs. USD	(+) = EM appreciation							% p.a.						
China		7.20	-0.4	-1.1	-3	-11	-12	-12		2.8	-1.8	-7	4	-26	-6	-6
Indonesia		15427	-0.4	-1.1	-3	-8	-8	-7		7.4	2.6	13	25	121	100	88
India		82	0.0	0.0	-4	-9	-10	-9		7.7	-0.2	-7	8	114.5	135	
Philippines		59	0.1	0.0	-3	-14	-13	-13		5.8	6.3	6	16	156	134	84
Thailand		38	-0.6	-1.7	-4	-13	-13	-16		3.2	-3.0	10	43	136	134	97
Malaysia		4.70	-0.3	-1.2	-4	-12	-11	-11		4.4	-0.4	5	35	90	85	77
Argentina		151	-0.2	-1.4	-6	-34	-32	-29		87.7	-216.2	-96	801	3914	3713	3974
Brazil		5.28	-0.3	-1.5	-2	4	5	-5		11.8	0.4	16	-8	80	112	28
Chile		945	-0.7	-0.7	-3	-13	-10	-16		6.6	0.0	-14	7	83	122	73
Colombia		4580	0.6	0.7	-4	-18	-11	-15		10.8	0.0	49	101	426	436	290
Mexico		20.07	-0.4	-0.1	-1	2	2	1		9.3	-1.0	8	59	182	178	146
Peru		4.0	0.0	-0.1	-2	0	0	-6		8.8	2.8	8	62	305	287	277
Uruguay		41	-0.2	-0.6	-1	6	8	3		11.6	9.3	21	12	357	285	342
Hungary		431	1.8	1.1	-6	-28	-25	-26		10.3	-28.0	27	68	666	577	547
Poland		4.97	-1.1	0.4	-5	-21	-19	-18		7.1	-5.3	19	117	454	358	321
Romania		5.1	-0.5	-0.3	-3	-16	-14	-14		9.1	7.9	63	102	472	430	397
Russia		63.3	0.5	-1.8	-5	13	19	29		9.5	0.0	49	127	166	75	-166
South Africa		18.2	0.2	-0.7	-4	-19	-13	-17		9.5	-6.0	-1	29	169	203	187
Turkey		18.59	-0.2	-0.1	-2	-51	-28	-26		13.5	-5.0	139	202	-636	-1087	-897
US (DXY; 5y UST)		113	0.8	0.4	3	20	18	18		4.14	-6.5	-1	53	309	287	223

	Equity Markets: Level, Last 12m	Level, Latest	Change (in %), 1 Day	Change (in %), 7 Days	Change (in %), 30 Days	Change (in %), 12 M	YTD	Since 23-Feb-22	Bond Spreads on USD Debt (EMBIG): Level, Last 12m	Level, Latest	Change (in basis points), 7 Days	Change (in basis points), 30 Days	Change (in basis points), 12 M	YTD	Since 23-Feb-22
										basis points					
China		3842	2.4	1	-2	-22	-22	-17		204	7	4	-6	1	-4
Indonesia		6815	-1.0	-3	-5	3	4	-2		211	10	41	18	46	26
India		57920	1.2	0	-2	-6	-1	1		199	8	40	50	67	45
Philippines		5905	0.2	0	-10	-18	-17	-20		163	7	41	34	62	26
Thailand		1561	0.0	-1	-6	-5	-6	-8		0	0	0	0	0	0
Malaysia		1382	0.7	-3	-6	-14	-12	-13		120	9	23	-14	3	-13
Argentina		140764	3.2	-3	-4	76	69	54		2810	32	484	1201	1130	1073
Brazil		114300	-0.5	-2	3	1	9	2		316	21	27	11	5	-15
Chile		4961	0.5	-4	-12	24	15	13		200	15	26	38	60	26
Colombia		1178	0.1	-3	-3	-17	-17	-22		482	40	90	193	134	90
Mexico		45767	0.2	-1	-2	-12	-14	-11		459	16	41	105	127	89
Peru		19966	0.5	-2	4	1	-5	-15		238	22	45	69	88	48
Hungary		39549	2.0	0	-4	-28	-22	-17		328	17	108	207	204	175
Poland		46421	1.8	-1	-8	-38	-33	-26		53	-3	27	27	21	37
Romania		10678	1.3	-2	-10	-16	-18	-19		389	46	105	185	196	157
Russia		1937	-0.9	0	-20	-55	-49	-37		3411	-577	938	3228	3234	2897
South Africa		64794	0.6	-1	-5	-3	-12	-14		514	49	97	152	159	125
Turkey		3622	1.9	2	5	157	95	80		630	19	44	130	52	67
Ukraine		519	0.0	0	0	-1	-1	0		4188	352	725	3677	3429	2715
EM total		35	0.1	-5	-10	-32	-29	-27		481	29	63	103	95	23

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

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