GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, OCTOBER 18, 2022

- **US recession seen as certain within 12 months** (link)
- **European natural gas prices fall sharply** (link)
- **China delays release of key economic data amidst 20th Party Congress** (link)
- **Interest rate volatility pushes US credit spreads wider** (link)
- **Rising volumes of option trading driving US equity markets** (link)
- **Emerging market high yield corporate defaults hit GFC level** (link)

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Markets display cautious optimism

The global rally continued again after weeks of losses and high volatility. European stocks extended their gains for a fourth day and US equity futures pointed to another positive session. There is an air of cautious optimism in global markets this morning. Credit spreads are tighter and oil prices are flat to slightly lower as the Biden administration prepares to sell another 10 to 15 million barrels of oil from the Strategic Petroleum Reserve. Gas prices in Europe are down due to warmer weather and a new package of EU measures to tackle the energy crisis, easing concerns. However, the level of uncertainty remains very high and few are willing to make big bets in the current environment. The pound is weaker after the Bank of England denied press reports that it would postpone quantitative tightening. Corporate bonds in the UK are experiencing a major meltdown in an environment of policy uncertainty and high inflation, but UK stocks are doing much better than most global peers with modest losses in local currency terms. The yen is in the midst of its worst drawdown ever as it nears the 150 level versus the dollar. Market participants are disappointed that the authorities in China remain committed to the zero Covid policy and its repeated lockdowns, which have done so much damage to the economy.

Key Global Financial Indicators

Last updated: 10/18/22 7:41 AM	Level: Last 12m	Level: Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD	Since 23-Feb-22
Equities					%		%	
S&P 500		3678	2.6	2	-5	-18	-23	-13
Eurostoxx 50		3480	1.1	4	-1	-16	-19	-12
Nikkei 225		27156	1.4	3	-1	-7	-6	3
MSCI EM		35	2.7	0	-7	-32	-28	-26
Yields and Spreads					bps			
US 10y Yield		4.00	-0.6	6	56	240	249	201
Germany 10y Yield		2.31	4.5	2	56	246	249	209
EMBIG Sovereign Spread		568	-2	21	63	212	201	155
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		48.5	-0.3	0	-2	-12	-8	-9
Dollar index, (+) = $ appreciation		112.2	0.2	-1	2	19	17	17
Brent Crude Oil ($/barrel)		91.5	-0.1	-3	0	8	18	-6
VIX Index (%, change in pp)		30.9	-0.4	-3	5	15	14	0

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

Mature Markets

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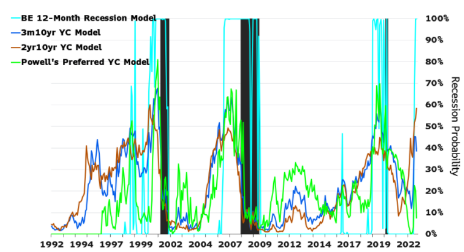
United States

A recession in 12 months is almost certain, according to analysis by Bloomberg. The Fed in hawkish mode, inflation data coming in strong and economic statistics getting weaker all increase the probability of a recession, which is estimated at close to 100% from 65% a month earlier. The Conference Board's model assigns a probability of 98%, while its survey of CEOs finds that 96% of respondents also expect a recession. The Bloomberg model also assigns a probability of a recession in 11 months at 75%, while the 10 month ahead probability is up to 25%. Negative GDP growth and millions of job losses have become a grim reality.

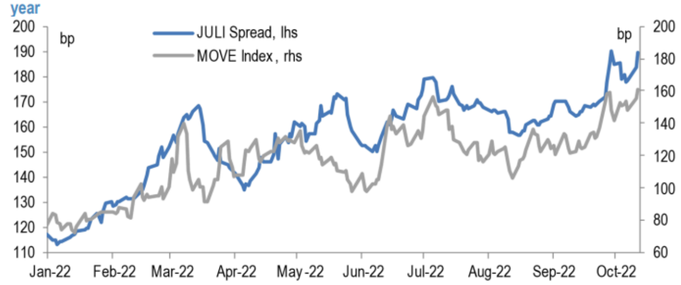
Recession Risks Within Next 12 Months



Source: Bloomberg Economics

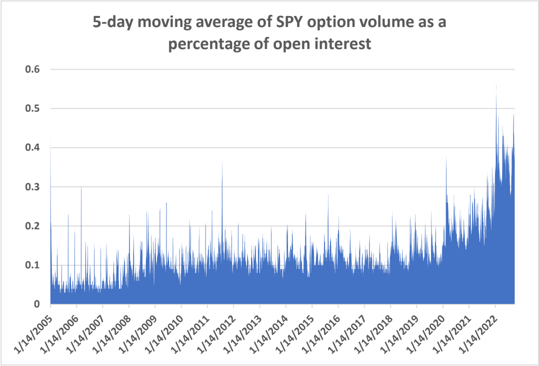
High interest rate volatility has resulted in wider US investment grade (IG) credit spreads. JP Morgan's JULI index of IG credit hit 190 bps, the highest level of the year. The volatility has been exacerbated by massive sales of corporate bonds and other assets by UK pension funds which were caught out by the very large increase in gilt yields that triggered margin calls and the need to raise cash. There are worries that gilt yields could reverse recent decreases and renew their move higher, which could in turn push credit spreads even wider. UK pension funds are major participants in the US IG corporate bond market. Trading in credit default swap (CDS) index products has surged as investors seek protection in an environment of high uncertainty. Volumes have already exceeded the levels seen in 2020 and 2021. CDS trading on individual companies is also up sharply despite low cash trading volumes.

Figure 4: Treasury market volatility remains elevated and has been a good spread predictor this year



Source: J.P. Morgan

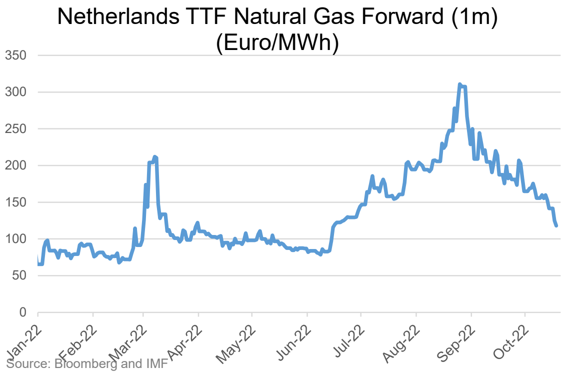
Option trading has taken on a much larger role in US equity markets, according to analysis by Bloomberg. The volume of options on the S&P 500's SPY exchange traded fund (ETF) has soared as a percentage of open interest for the ETF itself. Much of the rise in option volume has been driven by retail trading, with day traders leading the way. Exchanges now provide a wide array of short-dated option expiries for both institutional and retail investors to bet on. The analysts think much of the transaction volume is intra-day, with traders closing out their positions before the end of each session. This could account for the surge in transactions seen going into the end of the session as day traders rush to close out their positions.



Euro Area

European markets are fairly quiet this morning after the tumult of the last few days. Equity markets are up, while bond markets show some signs of stabilization although yields continue to increase.

European gas prices are down 30% since the start of October, due to warmer weather and directed policy measures. Warmer-than-usual weather and high levels of storage (above 90%) have somewhat eased somewhat concerns about winter supply shortages in Europe. Yesterday, German Chancellor Olaf Scholz ordered an extension for the country's three remaining nuclear plants until mid-April 2023 to help ease the crisis. In addition, Bloomberg reports today that the European Union is set to unveil a new emergency package to tackle the energy problem. Measures include changing trading rules to avoid extreme moves in energy derivatives, establishing a new gas price index to better reflect prices, and using the EU's joint purchasing power to negotiate with global suppliers. Finally, the package would also offer tools for member states to use state aid to mitigate the impact of high energy crisis on companies and households, with countries offered the possibility to use as much as €40 bn from the EU's cohesion funds. The commission's plan is expected to be discussed by EU leaders at a summit on Oct. 20–21 in Brussels.



Emerging Markets

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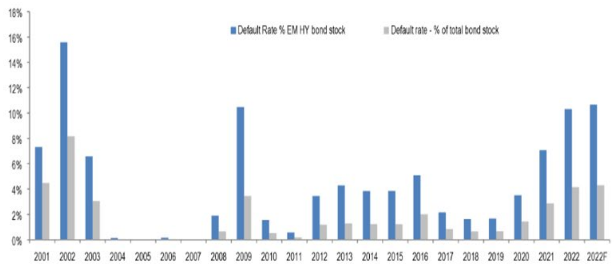
EMEA equities were mostly higher while currencies were trading mostly weaker against the dollar this morning. The South African rand was little changed against the dollar following yesterday's gain (+1.6%) after a three-year wage agreement was reached between the county's state-owned ports and rail operator, bringing an end to a strike that weighed on mineral exports. **Asian equities firmed +1.5% on net and currencies mostly strengthened**. In **New Zealand,** headline inflation cooled far less than expected in Q3 (7.2% y/y, consensus: 6.5%, previous: 7.3%), while the central bank's core inflation gauge reached a new record of 5.4% y/y, fueling rate hike expectations. **Reserve Bank of Australia** (RBA) deputy Governor Bullock cited household spending, global economy concerns as reasons behind the bank's relatively mild +25 bps October hike. In **Latin America,** risky assets closed higher amid the global rally.

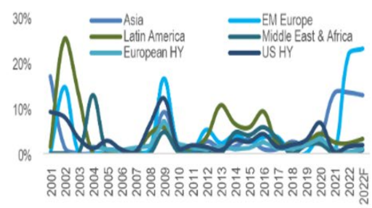
Regional stocks were up by over 1.5% on average, with modest gains in local currencies in most countries. Chile was the notable exception, with the peso extending losses by another 1%. Contacts noted that intense volatility without a clear local driver has been keeping investors on the sidelines, further reducing local market liquidity.

EM Corporate High Yield Debt

The default rate of EM high yield corporate debt reached 10.3%, on track to exceed the Global Financial Crisis level. Default activities remain dominated by China property developers and Russian firms, with default rate running at 13.4% in Asia and 21.7% in EM Europe. **Excluding these troubled areas, default rate in other EM regions is less than 2%,** which is much closer to AE market level.



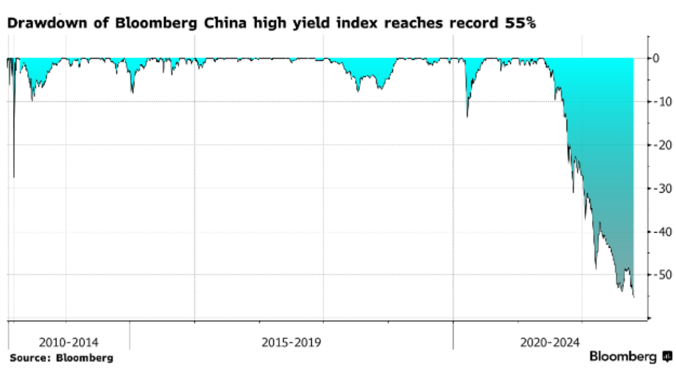
Source: J.P. Morgan, Bloomberg Finance L.P., Rating agencies.



Source: J.P. Morgan; Note: default rates are par weighted and exclude 100%-quasi-sovereigns.

China

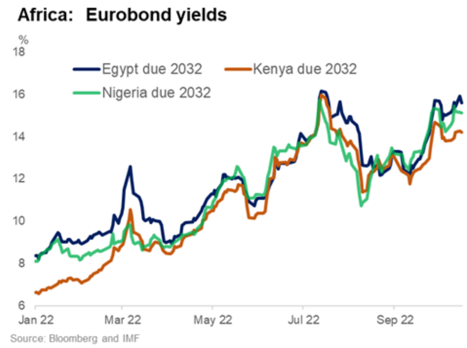
China delayed key economic data releases in the midst of the 20th Party Congress. Releases including GDP data for Q3, industrial production, retail sales, and urban unemployment for September will all be affected. No reasons for the delay nor new publication dates were provided. However, **China Premier Li stated that China's economy is recovering and improving**, Xinhua news reported. Li also called for better policy implementation to sustain China's recovery, and largely echoed President Xi's earlier Party Congress pledges. Separately, **more cities have reportedly cut home mortgage rates below 4%**, for first-time homebuyers, Bloomberg reports. Yuan borrowing costs against the dollar dived to a 14-year low in the swaps market, amidst continued expectations of loose liquidity conditions in China, according to Bloomberg. China high yield notes slumped to reach a record drawdown of 55% amid persisting property sector woes, according to Bloomberg.



Egypt

Expectations for Egyptian pound weakening increased amidst anticipation that an IMF staff-level agreement will be reached soon, according to press reports. The central bank devalued the currency by roughly 15% in March and analysts expect the pace of currency weakening to gather steam, taking the view that further depreciation might be necessary before the IMF executive board approval of a new loan. While the Egyptian pound weakened to a record low 19.7 in offshore trading yesterday, the 3-

month non-deliverable forward contract moved to 22.9—indicating expectations for a 14% weakening in the currency. Bank of America analysts highlight that the COP27 conference that takes place in Egypt next month will likely impact the currency depreciation timeline and argue that the size of the headline program ($3bn–$5bn over 4 years) is likely priced in by the market already. Egypt's 2032 Eurobonds yields are roughly 15bps lower so far this week.



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Global Financial Indicators

10/18/22 7:49 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		3678	2.6	2	-5	-18	-23	-13
Europe		3485	1.3	4	0	-16	-19	-12
Japan		27156	1.4	3	-1	-7	-6	3
China		3838	-0.2	3	-2	-22	-22	-17
Asia Ex Japan		58	2.4	0	-9	-33	-29	-26
Emerging Markets		35	2.7	0	-7	-32	-28	-26
Interest Rates					basis points			
US 10y Yield		4.00	-1.4	5	55	240	249	201
Germany 10y Yield		2.31	3.7	1	55	245	248	208
Japan 10y Yield		0.26	0.1	0	0	16	19	6
UK 10y Yield		4.03	5.2	-41	89	289	306	255
Credit Spreads					basis points			
US Investment Grade		192	-1.5	10	28	102	80	49
US High Yield		514	-10.1	8	20	191	176	107
Europe IG		123	-4.1	-12	12	72	75	52
Europe HY		588	-20.7	-57	35	329	345	237
Exchange Rates					%			
USD/Majors		112.20	0.1	-1	2	19	17	17
EUR/USD		0.98	-0.1	1	-2	-15	-14	-13
USD/JPY		149.1	0.0	2	4	30	30	30
EM/USD		48.5	-0.2	0	-2	-12	-8	-9
Commodities					%			
Brent Crude Oil ($/barrel)		92	0.1	-3	2	21	25	6
Industrials Metals (index)		143	-0.4	-2	-6	-22	-17	-24
Agriculture (index)		67	-0.5	-2	-2	18	11	-4
Implied Volatility					%			
VIX Index (%, change in pp)		30.9	-0.5	-2.8	4.6	14.6	13.7	-0.1
US 10y Swaption Volatility		156.6	-1.0	-4.7	21.0	77.2	77.5	64.0
Global FX Volatility		12.5	0.0	-0.2	1.1	5.5	5.0	5.0
EA Sovereign Spreads					10-Year spread vs. Germany (bps)			
Greece		272	5.0	8	20	160	120	32
Italy		242	3.4	4	15	137	107	71
Portugal		108	0.9	1	4	55	44	16
Spain		117	1.1	0	1	53	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: 10/18/2022 7:52 AM	Exchange Rates: Level		Change (in %)					Since	Local Currency Bond Yields (GBI EM): 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		7.20	0.0	-0.4	-3	-11	-12	-12		2.8	0.0	-3	4	-34	-5	-6
Indonesia		15464	0.2	-0.7	-3	-9	-8	-7		7.4	0.2	8	23	135	106	95
India		82	0.0	0.0	-3	-9	-10	-9		7.6	2.2	-7	3	107.7	133	
Philippines		59	0.3	0.1	-2	-14	-13	-13		5.8	-1.3	5	15	153	133	83
Thailand		38	0.1	0.1	-3	-12	-13	-15		3.2	1.5	1	24	133	138	101
Malaysia		4.72	0.0	-0.9	-3	-12	-12	-11		4.5	0.4	5	33	88	88	80
Argentina		153	-0.5	-2.2	-5	-35	-33	-30		86.6	-0.1	-205	515	3747	3604	3865
Brazil		5.28	0.8	-1.7	-2	4	5	-5		11.7	-10.0	13	-7	54	106	22
Chile		973	-0.1	-4.6	-5	-16	-12	-19		6.4	0.0	-47	-24	40	94	45
Colombia		4727	-0.7	-2.5	-7	-20	-14	-17		11.3	0.0	74	153	477	484	338
Mexico		19.99	0.0	0.5	0	2	3	1		9.3	-6.5	6	46	170	180	148
Peru		4.0	0.3	-0.4	-3	-1	1	-6		8.7	-7.2	6	51	276	280	270
Uruguay		41	0.1	-0.1	-1	6	8	3		11.6	-8.2	20	23	359	290	347
Hungary		420	-0.4	5.3	-5	-26	-23	-24		10.8	15.0	39	135	696	629	599
Poland		4.89	-0.2	2.2	-4	-19	-17	-17		7.4	15.5	29	143	469	389	352
Romania		5.0	-0.1	1.3	-2	-15	-13	-13		9.0	0.6	44	104	452	422	389
Russia		62.0	0.1	4.5	-1	15	21	32		10.0	183.0	79	179	206	126	-115
South Africa		18.1	-0.2	0.5	-2	-19	-12	-16		9.5	5.0	-5	29	170	206	190
Turkey		18.59	0.0	-0.1	-2	-50	-28	-26		10.9	-218.0	-173	-54	-909	-1338	-1148
US (DXY; 5y UST)		112	0.1	-0.9	2	19	17	17		4.21	-1.6	4	58	304	295	231

	Equity Markets: Level		Change (in %)					Since	Bond Spreads on USD Debt (EMBIG): 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		3838	-0.2	3	-2	-22	-22	-17		207	11	8	-2	4	-1
Indonesia		6834	0.0	-2	-5	3	4	-1		220	20	37	42	55	35
India		58961	0.9	3	0	-4	1	3		204	14	41	59	72	50
Philippines		6129	2.7	5	-5	-16	-14	-17		176	15	38	60	75	39
Thailand		1590	1.2	1	-3	-2	-4	-6		0	0	0	0	0	0
Malaysia		1400	1.0	1	-4	-13	-11	-12		123	12	24	-8	6	-10
Argentina		138954	1.2	-4	-5	68	66	52		2851	40	458	1238	1171	1114
Brazil		113624	1.4	-2	4	-1	8	1		307	6	9	8	-4	-24
Chile		5103	2.6	2	-8	27	18	17		196	7	18	36	56	22
Colombia		1168	-0.8	-3	-3	-18	-17	-23		487	26	72	199	139	95
Mexico		46221	1.7	2	-1	-12	-13	-10		447	0	23	99	115	77
Peru		20077	1.7	1	4	-2	-5	-14		234	11	24	67	84	44
Hungary		40445	1.5	4	1	-26	-20	-15		315	3	48	198	191	162
Poland		47402	0.8	3	-4	-37	-32	-25		58	-3	35	35	26	42
Romania		10945	1.5	3	-7	-14	-16	-17		381	30	87	180	189	149
Russia		2022	0.5	4	-17	-52	-47	-34		3411	-577	938	3228	3234	2897
South Africa		66612	0.6	3	0	0	-10	-11		495	31	50	142	140	106
Turkey		3890	1.1	9	15	174	109	93		608	-12	-19	102	30	45
Ukraine		519	0.0	0	0	-1	-1	0		4159	290	757	3675	3400	2686
EM total		35	1.3	0	-7	-32	-28	-26		473	14	40	102	87	15

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

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