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## Markets become cautious after two days of rallies

The euphoria of the last two days has dissipated as the benchmark 10-year US Treasury yield breaks decisively over 4%, a key psychological barrier for markets. Most European equities are down and US equity index futures are lower as the mood has turned more cautious. Market participants are grappling with competing narratives, as stronger than expected corporate earnings boost sentiment while worries about inflation and recession temper expectations. The latest inflation print in the UK highlighted the risks to the outlook as surging food prices pushed inflation back into double digit territory to a new 40-year high, weakening the pound. Meanwhile, Goldman became the latest US bank to beat earnings forecasts and its stock price gained 2% after yesterday's earnings release. United Airlines, Nestle and Netflix also did much better than expected. On the economic front, US industrial production data was well ahead of forecasts yesterday and the numbers for prior months were revised upwards, a sign of strength that further muddies the waters for global markets.

Key Global Financial Indicators

Last updated: 10/19/22 8:10 AM	Level		Change from Market Close					Since 23-Feb-22
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	
<b>Equities</b>								
							%	
S&P 500		3720	1.1	4	-5	-18	-22	-12
Eurostoxx 50		3476	0.3	4	-1	-17	-19	-13
Nikkei 225		27257	0.4	3	-2	-7	-5	3
MSCI EM		35	0.0	2	-7	-33	-28	-26
<b>Yields and Spreads</b>								
							bps	
US 10y Yield		4.10	9.2	20	61	246	259	211
Germany 10y Yield		2.37	8.7	6	57	248	255	214
EMBIG Sovereign Spread		566	-2	8	61	207	199	153
<b>FX / Commodities / Volatility</b>								
							%	
EM FX vs. USD, (+) = appreciation		48.3	-0.5	0	-3	-13	-8	-9
Dollar index, (+) = \$ appreciation		112.8	0.6	0	3	20	18	17
Brent Crude Oil (\$/barrel)		90.9	0.9	-2	-1	7	17	-6
VIX Index (% change in pp)		31.3	0.8	-2	6	16	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

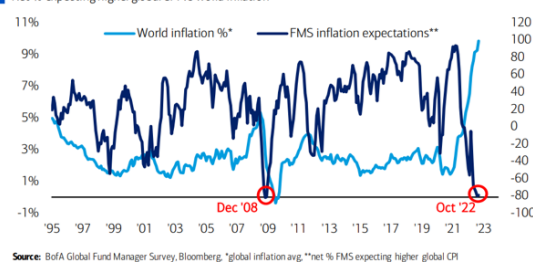
**Investors are extremely bearish on CPI and the global economy, according to the latest Fund Manager Survey (FMS) from Bank of America.** The proportion of investors forecasting a weaker economy in the next 12 months is close to a record, while inflation expectations remain very high. Allocations to cash are at their highest level (6.2%) since April 2001 as investors run for cover amidst the global selloff. In terms of their allocations to equities, investors are underweight by three standard deviations relative to their history. On the brighter side, 79% expect CPI to fall in the next 12 months. Furthermore, the Bank's analysts think the survey shows signs of capitulation, implying that the worst may be over and that markets may have scope to improve next year. Nevertheless, headwinds remain significant. Just 28% expect short term rates to be lower in the next 12 months, and a strong majority want companies to focus on strengthening their balance sheets rather than expanding their businesses.

**Chart 2: Close to a record share of FMS investors expect a weaker economy in next 12m...**  
FMS net % expecting stronger economy



Source: BofA Global Fund Manager Survey, Bloomberg.

**Chart 3: ...as global inflation and inflation expectations remain stubbornly high...**  
Net % expecting higher global CPI vs world inflation



Source: BofA Global Fund Manager Survey, Bloomberg. \*global inflation avg. \*\*net % FMS expecting higher global CPI

**US housing data for September presented a mixed picture.** Most expected a weak report, but building permits turned out to be stronger than expected. Treasury yields moved higher shortly after the data came out and US equity index futures weekend.

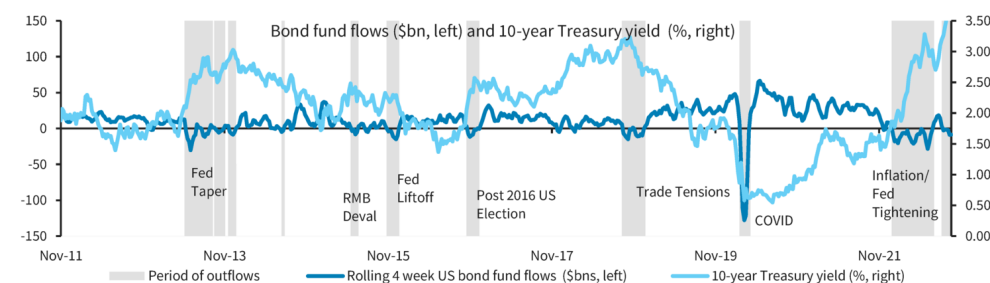
### US Housing Data 8.30 am

Source: Bloomberg

Indicator	Consensus Forecast	Actual Data Print
Housing Starts	1462K	1439K
Building Permits	1530K	1564
Housing Starts Month-on-Month	-7.1%	-8.1%
Building Permits mom	-0.8%	+1.4%

**Bond outflows in the US market are moderating as investors take the view that interest rates may not rise much further.** The benchmark 10-year US Treasury crossed the psychologically important 4% level on Monday and is currently trading at 4.10%, but the forward curve remains surprisingly benign. For the 10-year, the market forecasts levels of 4.09% in six months and 4.08% in 12 months. For the two-year, which is currently trading at 4.51%, the market sees its yield holding steady in six months and falling to 4.48% in 12 months. Analysts at Barclays find that outflows for overall long term bonds have ended, while the government bond sector is actually seeing inflows. However, outflows remain high for mortgage-backed securities and long term corporate bonds, as well the leveraged loan sector.

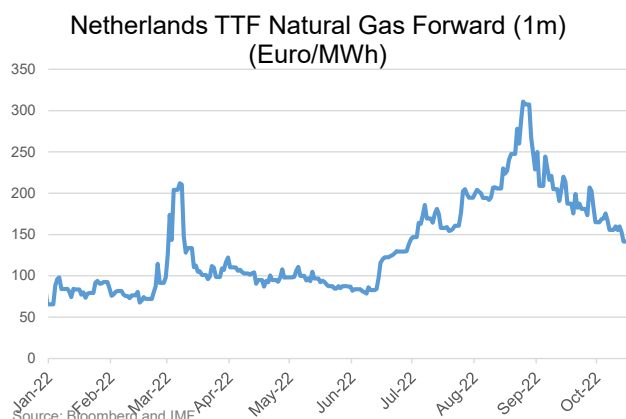
Figure 3. Periods of sustained outflows from US bond funds



Source: EPFR, Bloomberg, Barclays Research

## Euro Area

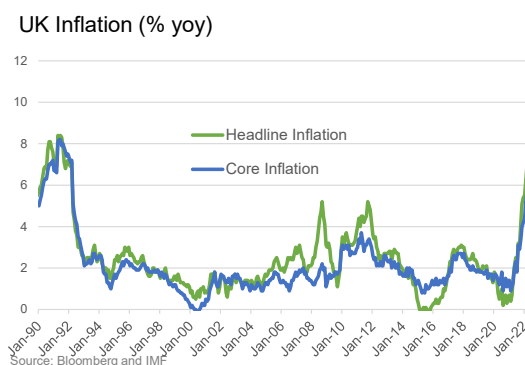
**As expected, the EU Commission announced yesterday a new emergency package to tackle the energy crisis.** The EU commission proposed measures to 1) use the EU's joint purchasing power as leverage in negotiations with global gas suppliers; 2) avoid extreme price spikes in energy derivatives by changing trading rules; 3) launch a new liquefied natural gas (LNG) index to better reflect the region's energy reality, as the current pricing benchmark no longer reflects the shift from pipeline gas to LNG. Ursula von der Leyen, the president of the EU Commission, also said that the EU is still looking at options for capping prices for gas used in electricity production, as is done in Spain and Portugal for example. The Commission's plan is expected to be discussed by EU leaders at a summit on October 20–21 in Brussels, and a meeting of energy ministers in mid-November is expected to sign off on the proposals.



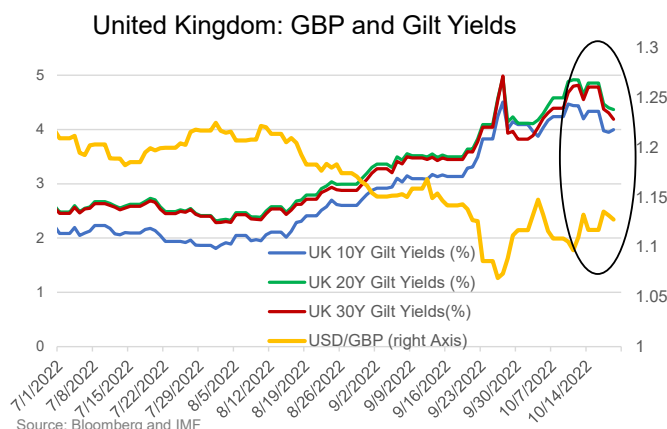
Source: Bloomberg and IMF

## United Kingdom

**The British pound depreciated (0.4% to 1.13 £/\$) and 10-year yields went up 5 bps (to 4%) as September inflation increased to 10.1% yoy in September, up from 9.9% in August.** While the reading was close to expectations, inflation is now at its highest in 40 years. Core inflation increased to 6.5% yoy, up from 6.3% in August. Markets are currently pricing 94 bps in hikes at the next MPC meeting on November 3. Analysts expect inflation to peak in October, with Goldman Sachs analysts expecting a peak at 11.1% yoy, and JP Morgan analysts expecting 10.4% yoy.



**Yields on 20 and 30-year gilts are down (the 30-year yield is down 15 bps, to 4.15%) as the BOE will initially limit bond sales to short- and medium-term maturities when it starts quantitative tightening (QT) on November 1<sup>st</sup>. The announcement came after the market close yesterday.**



## Emerging Markets

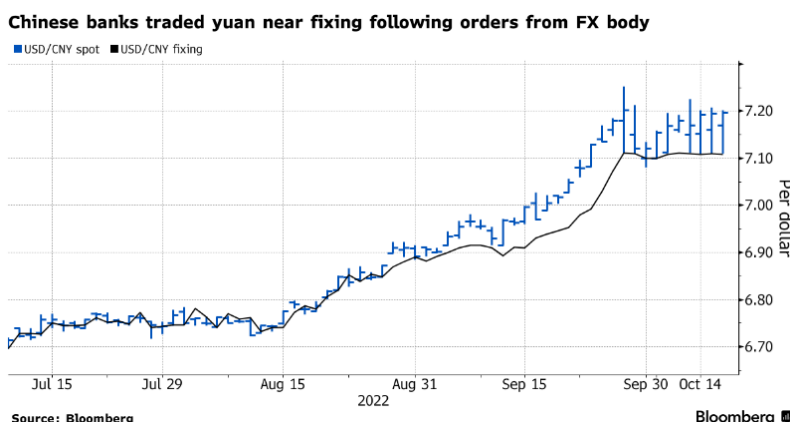
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**EMEA equities were mostly trading lower and currencies weakened against the dollar this morning.** Equities in Russia (-3.3%) and Czech Republic (-2.4%) underperformed. Equities in Turkey (+1%) outperformed, while the lira was little changed against the dollar and local currency bond yields fell (10y -6bps) ahead of the central bank rate decision tomorrow. Saudi Arabia sold international bonds for the first time since 2021. **Asian equities fell -1.1% on net.** Hong Kong SAR dived -2.4%, dragged by consumer and technology stocks. Mainland China equities slumped -1.2%. **Asian currencies mostly depreciated. Hong Kong SAR** Chief Executive Lee announced measures aimed at attracting foreign talent, including stamp duty refunds for foreigners after a seven-year stay and relaxed visa rules for high earners and graduates from top universities. **Thailand** FM Arkhom revealed that the government is planning a targeted stimulus which may include more energy subsidies. In **Latin America**, equities closed higher for a second day, led by Brazil. Local currencies were little changed, except in Colombia where the peso lost another 1.7% to a new record low.

## China

**China is seen easing credit further in Q4 to support growth**, Shanghai Securities reports. Analysts expect increased lending to infrastructure and equipment upgrade projects. **Equities slumped -1.2%.** Property developer shares rallied following Longfor and Country Garden's announcements on Tuesday of additional state-backed bond sales, Bloomberg reports. **The yuan depreciated (-0.3%).** Five-day average onshore yuan trading volumes have slumped to about \$30 bn, the lowest since June amid the ongoing 20<sup>th</sup>

Party Congress. Separately, the onshore yuan has recently strengthened more than +1% at the open as banks reportedly followed instructions to trade the currency near the PBOC's fixing rate. **10-year yields were little changed.**



## Colombia

**Local currency bonds gained on plans to reduce 2023 public debt sales.** Public Credit Director Acosta said the 2023 financial plan will reduce the offering of TES peso bonds relative to the 2022 plan (\$7.9bn). This follows Monday's announcement that further TES auctions will be halted for this year, after having issued about 90% of the planned total. The yield on the 2031 TES dropped 40 bps this week to 14.1% after reaching a record high of 14.4% last Friday. The government is also evaluating how the peso's recent drop affects the FX-denominated public debt, with an aim to limit these exposures to about 30% of the total. **The peso weakened another 1.6% to a fresh record low**, after data showed outsized growth in August, fueling concerns of inflationary pressure and large external imbalances. Since the June 19 election, the peso has weakened over 18%, among the worst performing EM currencies.

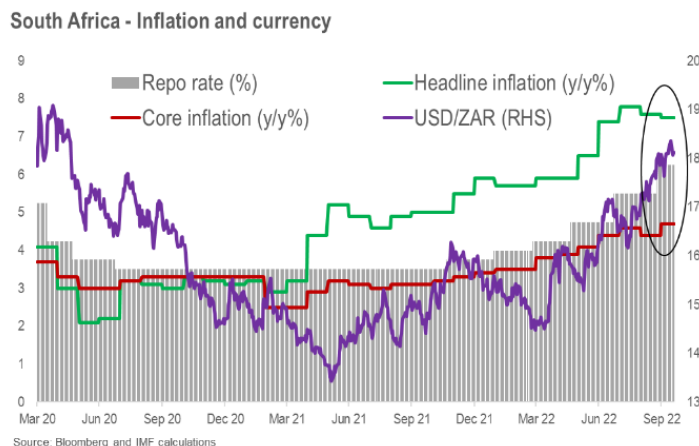
### Colombia: sovereign yields and exchange rate



## South Africa

**Local bond yields were little changed after September headline inflation continued to ease while core inflation accelerated** (+4.7%yoy, in line with consensus expectations, from 4.4%). This is the second consecutive month that headline inflation eased (+7.5%yoy vs expectations to remain unchanged at 7.6%), after it reached a 13-year high of 7.8% yoy in July. The monetary policy committee (MPC) hiked the key rate by 75 bps to 6.25% at their September meeting and revised inflation forecasts downward (headline CPI seen to peak at 7.4% in Q3 and average 2023 inflation expected at 5.3%).

However, Goldman Sachs analysts' near-term inflation forecasts are above those of the SARB. Taking into consideration the weakening of the rand, **the analysts expect another 75bps hike at the November MPC meeting with the terminal rate seen at 7.75% Q1 2023**. Markets are fully pricing in a 75bps hike in November. **The rand was trading weaker against the dollar (-0.4%) this morning, roughly 12% weaker than at the start of the year.**



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## Global Financial Indicators

10/19/22 8:13 AM	Level		Change				YTD	Since 23-Feb-22
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		
<b>Equities</b>			%				%	%
United States		3716	1.1	4	-5	-18	-22	-12
Europe		3479	0.4	4	-1	-17	-19	-12
Japan		27257	0.4	3	-2	-7	-5	3
China		3777	-1.6	0	-4	-23	-24	-18
Asia Ex Japan		58	-0.4	1	-9	-34	-30	-27
Emerging Markets		35	0.0	2	-7	-33	-28	-26
<b>Interest Rates</b>			basis points					
US 10y Yield		4.10	8.9	20	61	246	259	211
Germany 10y Yield		2.37	8.1	5	56	247	254	214
Japan 10y Yield		0.26	0.1	0	0	17	19	6
UK 10y Yield		4.02	6.6	-42	88	285	305	254
<b>Credit Spreads</b>			basis points					
US Investment Grade		191	-0.3	-3	28	101	79	48
US High Yield		499	-2.9	-36	9	182	161	92
Europe IG		126	1.7	-7	15	76	78	55
Europe HY		600	3.0	-37	47	345	357	248
<b>Exchange Rates</b>			%					
USD/Majors		112.81	0.6	0	3	20	18	17
EUR/USD		0.98	-0.9	1	-3	-16	-14	-14
USD/JPY		149.7	0.3	2	5	31	30	30
EM/USD		48.3	-0.5	0	-3	-13	-8	-9
<b>Commodities</b>			%					
Brent Crude Oil (\$/barrel)		91	0.7	-2	0	19	24	4
Industrials Metals (index)		142	-0.6	-3	-7	-21	-18	-24
Agriculture (index)		67	-0.4	-2	-2	17	11	-4
<b>Implied Volatility</b>			%					
VIX Index (% change in pp)		31.2	0.7	-2.4	5.5	15.5	14.0	0.2
US 10y Swaption Volatility		150.1	-4.6	-10.5	14.4	74.9	71.0	55.8
Global FX Volatility		12.4	0.0	-0.4	0.9	5.4	5.0	4.9
<b>EA Sovereign Spreads</b>			10-Year spread vs. Germany (bps)					
Greece		272	-0.4	4	15	160	120	31
Italy		240	-1.2	-3	11	134	105	68
Portugal		107	-0.7	-3	2	55	42	15
Spain		115	0.3	-3	0	52	41	12

Colors denote **tightening**/**easing** financial conditions for observations greater than  $\pm 1.5$  standard deviations. Data source: Bloomberg.

## Emerging Market Financial Indicators

Last updated: 10/19/2022 8:14 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)								
	Level		Change (in %)				YTD	Since 23-Feb-22	Level		Change (in basis points)				YTD	Since 23-Feb-22
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M			Last 12m	Latest	1 Day	7 Days	30 Days	12 M		
	vs. USD		(+)= EM appreciation						% p.a.							
China		7.23	-0.4	-0.7	-3	-12	-12	-13		2.8	0.5	-1	5	-31	-4	-5
Indonesia		15498	-0.2	-0.9	-3	-9	-8	-7		7.5	3.0	11	27	139	109	98
India		83	-0.8	-0.9	-4	-9	-10	-10		7.7	2.9	-8	6	110.6	136	
Philippines		59	-0.3	0.0	-3	-14	-14	-13		5.8	0.0	5	15	145	133	83
Thailand		38	-0.6	-1.1	-4	-13	-13	-16		3.3	5.5	10	30	142	144	106
Malaysia		4.72	-0.1	-0.8	-4	-12	-12	-11		4.5	0.0	2	29	86	86	78
Argentina		153	-0.2	-1.4	-6	-35	-33	-30		86.8	20.4	-135	536	3772	3625	3886
Brazil		5.29	-0.9	0.2	-2	6	5	-5		11.6	-7.9	-16	-19	-3	94	10
Chile		983	-1.3	-4.0	-6	-17	-13	-20		6.6	7.5	-15	-1	68	116	67
Colombia		4765	-0.8	-3.3	-8	-21	-15	-18		11.2	0.0	53	145	467	476	329
Mexico		20.13	-0.5	-0.7	-1	1	2	1		9.3	0.5	0	45	169	179	147
Peru		4.0	0.0	-0.1	-3	-1	1	-6		8.7	0.1	-9	46	273	275	265
Uruguay		41	-0.2	-0.5	-1	6	8	2		11.5	-9.1	16	14	350	280	338
Hungary		423	-0.9	5.1	-6	-26	-23	-24		11.1	20.0	45	160	730	654	624
Poland		4.90	-0.8	2.0	-4	-20	-18	-17		7.6	21.0	22	156	482	402	365
Romania		5.0	-0.7	1.0	-2	-16	-14	-13		9.1	1.8	17	105	454	423	391
Russia		61.4	0.9	4.7	0	15	22	33		9.3	-69.0	-8	110	134	57	-184
South Africa		18.2	-0.7	0.3	-3	-20	-13	-17		9.5	5.5	-3	35	181	212	196
Turkey		18.59	0.0	-0.2	-2	-50	-28	-26		10.5	3.0	-224	-107	-942	-1378	-1188
US (DXY; 5y UST)		113	0.6	-0.5	3	20	18	17		4.31	9.2	20	63	315	305	241

	Equity Markets									Bond Spreads on USD Debt (EMBIG)						
	Level		Change (in %)				Since			Level		Change (in basis points)			YTD	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		
								basis points								
China		3777	-1.6	0	-4	-23	-24	-18		208	8	9	1	5	0	
Indonesia		6860	0.4	-1	-5	3	4	-1		220	6	37	40	55	35	
India		59107	0.2	3	-1	-4	1	3		210	14	47	66	78	56	
Philippines		6148	0.3	5	-5	-16	-14	-17		178	8	40	61	77	41	
Thailand		1589	-0.1	1	-3	-3	-4	-6		0	0	0	0	0	0	
Malaysia		1415	1.1	3	-3	-12	-10	-11		125	13	26	-5	8	-8	
Argentina		137542	-1.0	0	-8	63	65	51		2812	-16	419	1183	1132	1075	
Brazil		115743	1.9	0	4	5	10	3		302	-4	4	1	-9	-29	
Chile		5123	0.4	4	-7	28	19	17		194	1	16	31	54	20	
Colombia		1189	1.8	1	-1	-16	-16	-21		486	6	71	195	138	94	
Mexico		46309	0.2	1	-1	-12	-13	-10		439	-12	15	89	107	69	
Peru		20203	0.6	2	4	-2	-4	-14		232	3	22	63	82	42	
Hungary		40039	-2.1	3	-1	-26	-21	-16		313	-7	46	197	189	160	
Poland		46752	-1.3	1	-7	-37	-33	-26		57	-7	34	30	25	41	
Romania		10836	-1.1	2	-5	-14	-17	-18		383	21	88	183	191	151	
Russia		1986	-2.3	2	-18	-54	-48	-36		3411	-577	938	3228	3234	2897	
South Africa		65624	-1.1	2	-1	-2	-11	-12		489	14	44	133	134	100	
Turkey		3904	1.6	11	22	173	110	94		599	-25	-28	86	21	36	
Ukraine		519	0.0	0	0	-1	-1	0		4129	222	727	3630	3370	2656	
EM total		35	-0.6	2	-7	-33	-28	-26		471	3	38	96	85	13	

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

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