GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, OCTOBER 3, 2022

- **Coordinated global efforts to weaken the Dollar appear unlikely** (link)
- **Monetary policy anticipated to become restrictive in the near-term** (link)
- **2022 has been a particularly bad year for joint US bond and equity returns** (link)
- **UK announces reversal of UK tax cut** (link)
- **European PMI confirm accelerating deterioration in activity** (link)
- **EM hard currency bond fund outflows accelerate** (link)

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Markets mixed with UK fiscal surprise

Markets had an eventful start to the first trading day of the final quarter of the year after a surprise reversal UK fiscal policy. UK Chancellor Kwarteng surprised markets this morning with an announcement to drop plans to abolish the 45% income tax rate, announced in the *mini budget* 10 days ago. While the immediate reaction was muted, sovereign yields decreased in later trade with the most notable moves seen in the gilt market, for example the 2y gilts yields were down 40bps by mid-morning. While the pound appreciated in later trade, the euro weakened after a downward revision in final September PMI data confirmed that that activity continues to deteriorate at an accelerating pace. On the commodity front, oil prices increased (+4%) amid speculation that OPEC is considering an output cut in excess of 1mn barrels per day at its meeting later this week. Markets continue to grapple with the economic outlook against a backdrop of monetary policy tightening, and while the dollar strength has started to pose a substantial headwind for economies abroad, analyst point out that the odds of coordinated FX intervention to weaken the dollar appear unlikely.

Key Global Financial Indicators

Last updated: 10/3/22 1:00 PM	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		3586	-1.5	-3	-9	-18	-25	-15
Eurostoxx 50		3304	-0.4	-1	-7	-18	-23	-17
Nikkei 225		26216	1.1	-1	-5	-8	-9	-1
MSCI EM		35	-0.4	-3	-10	-31	-29	-27
Yields and Spreads					bps			
US 10y Yield		3.70	-13.0	-23	51	224	219	171
Germany 10y Yield		2.01	-10.2	-11	48	223	218	178
EMBIG Sovereign Spread		560	-9	43	60	204	193	147
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		48.6	0.4	0	-3	-13	-8	-9
Dollar index, (+) = $ appreciation		112.4	0.3	-1	3	20	17	17
Brent Crude Oil ($/barrel)		88.5	3.9	5	-5	12	14	-9
VIX Index (%, change in pp)		31.9	0.3	0	6	11	15	1

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

In terms of data releases, markets are focused on US labor market data with Jobless Claims on Thursday and Nonfarm Payrolls on Friday. For PMIs, the US sees the release of the ISM-manufacturing later today and ISM-services indicators on Wednesday. In terms of inflation, South Korea and Thailand will report the latest data on Tuesday, Colombia on Wednesday, Taiwan on Thursday and both Mexico and Chile on Friday. Throughout the week, several macro reports for August will inform the state of Germany's economy. In terms of central bank meetings, the Reserve Bank of Australia convenes today, the Reserve Bank of New Zealand on Wednesday and the Central Bank of Peru on Thursday. Elsewhere on the central bank front ECB September meeting minutes are due on Thursday. Finally, markets are also focused on the UK Conservative Party conference this week.

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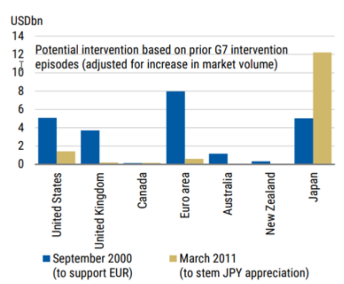
Global Markets

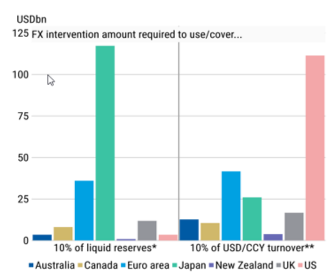
Coordinated global efforts of a coordinated FX intervention to weaken the dollar appear unlikely. With dollar strength beginning to pose a substantial headwind for economies abroad, market participants have been pondering on the merits of a globally coordinated intervention, such as those seen during the 1980s with the Plaza and the Louvre Accords. These could entail two steps, first weakening, and then stabilizing the US dollar. However, even though a weaker dollar would be deflationary abroad, it would be inflationary in the US, which would squarely oppose the Fed's current number one objective of fighting inflation. Nevertheless, from an operational perspective, volume-adjusted historical coordinated FX intervention volumes are instructive in that they approximate the necessary amounts with which G7 countries would need to intervene for meaningfully impacting the FX market. Extrapolation from prior FX interventions, in September 2000 and March 2011, indicates necessary volumes between USD 15–25bn (left chart). However, no other G7 country than Japan could cover 10% of the daily spot USD/CCY trading volume with 10% of its reserves (right chart below). Accordingly, Morgan Stanley analysts argue that **an extended FX intervention campaign to sustainably devalue the US dollar appears neither politically nor operationally viable at this juncture.**

Past coordinated FX interventions adjusted by FX turnover volume growth



Source: Central bank/government websites, IMF, Macrobond, Morgan Stanley Research; Note: Published spot intervention volumes are used when available. Otherwise, interventions are proxied through IMF data or monthly changes in FX reserves. Volumes are adjusted for the increase in total FX spot trading volume since each episode

Comparison of current stocks of liquid FX reserves (securities and deposits) to current FX turnover



Source: Macrobond, BIS, Morgan Stanley Research; Note: *Liquid reserves include securities and currency deposits. **Daily USD/CCY spot turnover. For the US, only USD/G7 turnover is considered.

United States

Forward real rates suggest that US monetary policy will become restrictive in the near-term. A yardstick for gauging the monetary policy stance is to compare forward real interest rates with the natural rate of interest R*. By way of background, R* is the optimal level of real interest rates that central banks should adopt over the longer term to allow the economy to reach potential growth, while minimizing inflationary pressures. Under an assumption that the US economic activity converges to potential growth within 5 years, the forward rate of 5y TIPS five years from now (5y5y) can be seen as a market-implied gauge for R*, while near-term forwards of 1y TIPS one year from now (1y1y) can be seen as the market pricing of further Fed hikes in this tightening cycle. As of last Friday, the 1y1y TIPS forward stood at 2.39%

while the 5y5y TIPS forward stood at 1.35%, which reflects a monthly increase of more than 150 bps for the former and 60 bps for the latter (left chart). Accordingly, Deutsche Bank analysts note that **near-term forward real rates are finally pricing a restrictive Fed monetary policy stance**. Given the natural rate of interest is an unobserved variable, a similar conclusion can be drawn when comparing the current level of the 1y1y forward to a range of R* estimates based on macro- or interest rate models, for which Allianz analysts establish a plausible range of 0.5-1.50% (right chart).

Near-forward real rates and market-implied R*

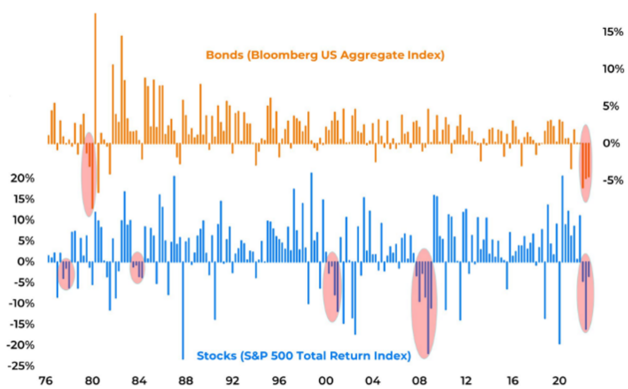
Source: Deutsche Bank

Estimates of R* based on macro- or interest rate-models

Source: Allianz

This year has been the worst year on record for joint US bond and equity returns since 1976. While both the Bloomberg US Aggregate and the S&P 500 Index have seen episodes of three or more quarters of losses since 1976, 2022 is unprecedented in this regard. Both the Bloomberg US Aggregate and the S&P 500 posted three consecutive quarters of losses, both down -12.6% and -5.9%, respectively, in q3. The collapse of diversification benefits has been a particular headwind for conventional multi-asset investors, who have split their asset allocation into bonds and equities to reduce the variability of returns.

US Stocks and Bonds, Quarterly returns



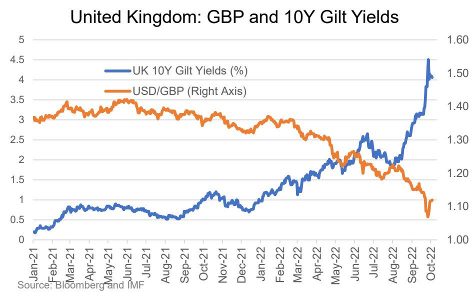
Source: IMF Staff Calculations, Bloomberg

United Kingdom

The British pound and gilt yields were trading broadly unchanged to Friday's levels, reversing an early rally following the UK chancellor's announcement (on twitter) that he was reversing plans to abolish the 45% tax rate announced in its *mini budget* 10 days ago. The chancellor said that the measure had become a *distraction*, overshadowing the rest of the government's economic plan. The pound jumped as much as 1% and 10y Gilt yields dropped 12 bps on the announcement but later reversed most of those gains. By the late morning, the pound was trading flat to Friday's closing levels (1.12 $/ £) and 10y gilt yields were almost unchanged from Friday at 4.07%. **Some contacts are concerned that just removing the tax cut will do little to ease concerns about fiscal sustainability in the UK**, and point that the measure has done little to restore market confidence in the government. **The market is now focused on the chancellor's upcoming speech entitled *Delivering a Growing Economy*, at the**

Conservative's party annual conference at about 4pm (London time) this afternoon. The UK equity market was down 0.7%.

Traders have pared bets for BOE rate hikes in November to 122bps from 140bps on Friday. After market close on Friday, S&P put the UK's rating on negative outlook (from stable), on a deterioration of the fiscal outlook, estimating that the U.K.'s general government deficit will widen by an average 2.6% of GDP annually through 2025, while net general government debt will continue on an upward trajectory, in contrast to their previous expectation of it declining as a percentage of GDP from 2023. S&P affirmed the rating at AA.



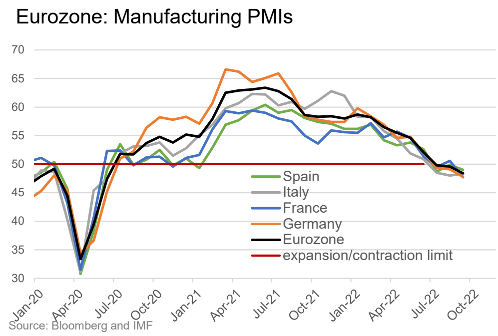
Euro area

European equity markets were down across the board, with the Stoxx Europe 600 losing 1.5%. The euro was 0.4% weaker against the dollar (to 0.98/$). 10-year bund yields were 10bps lower at 1.99% while Italian spreads were little changed at 241 bps.

On Friday, EU energy ministers agreed on regulation to introduce common measures to reduce electricity demand and to collect and redistribute the energy sector's surplus revenues to final customers, in line with previous proposals. EU energy ministers agreed to cap revenues from most non-fossil electricity producers to €180 per megawatt hour by taxing any excess profits from non-marginal energy producers. The Council also agreed to a voluntary overall reduction target of 10% of gross electricity consumption and a mandatory reduction target of 5% of the electricity consumption in peak hours. Member states also agreed to set a mandatory temporary solidarity contribution of 33% on the taxable profits of businesses active in the crude petroleum, natural gas, coal, and refinery sectors. Member states will use proceeds from the solidarity contribution to provide financial support to households and companies and to mitigate the effects of high retail electricity prices. **The measures agreed upon are time limited, and will apply from 1 December 2022 to 31 December 2023.**

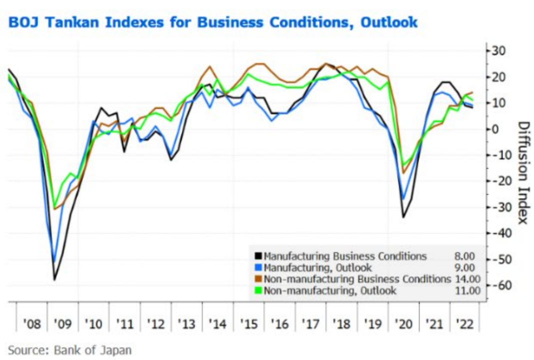
European natural gas prices remain volatile as the markets balance Gazprom's announcement on Saturday that it was suspending gas deliveries to Italy and EU energy ministers reaching a political agreement on Friday on a proposal for a Council Regulation to address high energy prices—even though no agreement was reached on a wholesale gas price cap. Gazprom, Italy's ENI and the Austrian government have announced that they are working to resolve the issue. **European natural gas eased with 1-m ahead prices (-7%) now at roughly 177 €/MwH.**

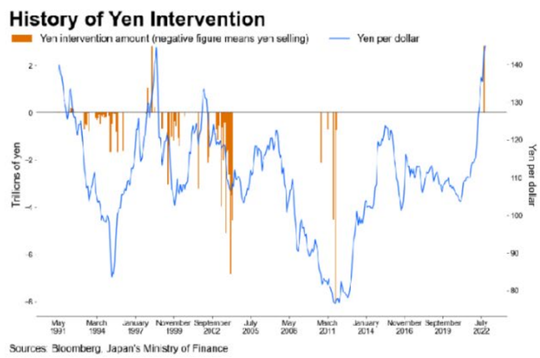
On the data front, the final euro area September PMI data confirmed that that activity continues to deteriorate at an accelerating pace. The Eurozone-wide Manufacturing PMI came in at 48.4, marginally down from the 48.5 flash estimate released 10 days ago. It is down from 49.6 in August and at its lowest level since mid-2020. **All readings of the big 4 eurozone economies were confirmed below the 50 mark, which indicates economic contraction**. The German and Spanish manufacturing PMIs was lower than the flash estimates (47.8 vs 48.3 and 49 vs 49.4 respectively). Data for France was in line with the flash estimate (47.7 vs 47.8), while Italy's data was revised upwards (48.3 vs. 47.5).



Japan

The finance minister reiterated that bold action would be taken in response to excessive currency moves, with the yen weakening (-0.3%) to above 145 against the dollar. Amid speculation that the Japanese authorities could intervene for the second time this year, analysts point out that considering Japan's limited capacity, intervention at current levels is unlikely. The Japan government reportedly spent ¥2.8 tn ($19.6 bn) on its September yen intervention, according to Bloomberg, after the currency weakened to a 24-year low of 145.9 earlier this month. On the data front, **Tankan survey results showed a continued deterioration in the confidence levels of large manufactures**, with the index falling to +8 in Q3 (vs expected +10, from +9) as optimism of oil, coal and non-ferrous metal manufactures declined. In contrast, large service sector and construction companies saw an improvement in sentiment. Separately, a BoJ report showed businesses' inflation expectations increasing to a new record high amid high commodity prices and a rapid weakening of the yen, according to Bloomberg. Japanese equities gained +1%.





Emerging Markets [back to top]

EMEA equities were mixed while currencies were trading mostly lower against the dollar. Central Eastern European currencies mostly gained against the euro, with the Polish zloty +0.5% stronger, and the Czech koruna up +0.2%, while the Hungarian forint weakened (-0.3%). On the data front, Poland's September manufacturing PMI surprised on the upside (43.0 vs expected 40.2 from 40.9) while readings disappointed for Hungary (49.6 vs expected 55.0 from 57.8) and the Czech Republic (44.7 vs expected 45.6 from 46.8). **Asian equities were mixed, slipping -0.5% on net.** The Philippines outperformed (+0.7%) while Sri Lanka (-2.8%) and Thailand (-1.5%) saw the largest declines. On the data front Indonesia's headline inflation accelerated to 5.95% in September from 4.69%, broadly in line with expectations. September PMI manufacturing increased to 53.7 from 51.7. China is closed for a week-long holiday. **Latin American stocks were mixed while currencies were mostly down on Friday.** Equities increased in Brazil (+2.2%) ahead of the Presidential election that took place on Sunday, with equities also up in Chile (+1.6%), and Argentina (+0.8%). Equities fell in Mexico (-1.1%) and Colombia (-0.7%). The Colombian Peso had the biggest move Friday, depreciating by -1.7%) against the dollar after the central bank hiked its benchmark rate by less than expected (100 bps vs 150 bps).

EM Fund Flows

EM hard currency bond fund outflows were the largest since March 2020. EM bond flows were -$4.2bn (compared to -$2.6bn last week), while EM equity flows were -$2.3bn (compared to -$2.5bn last week). This was the third consecutive week of outflows for EM bond funds with local currency bond fund outflows (-$1.1bn) being the largest in 10 weeks. Local currency bond fund outflows were mostly from EM ex China (-$904mn) and hard currency bond fund outflows were mainly from general EM bond funds (-$2.9bn). Regarding EM equity funds, outflows were only non-ETF driven (-$2.7bn), while ETFs (+$378mn) posted the largest inflow in nine weeks. Equity fund outflows occurred in all regions, with Asia ex-Japan (-$495mn), EMEA (-$58mn), and Latam (-$8mn).

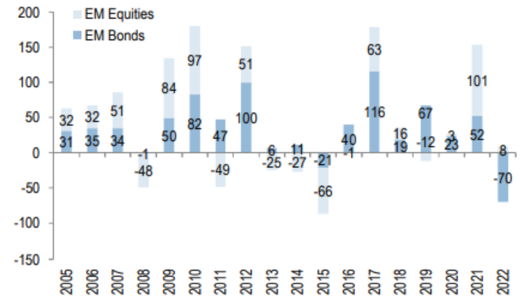
Exhibit 1: Weekly Cross-Asset Flows

USD billion

	Asset	8w flows (8w ago → current)	This wk	YTD
Fund Flows	**EM Bonds and Equities**		-6.5	-62.0
	EM Bonds		-4.2	-70.0
	Hard Ccy		-3.1	-36.3
	Local Ccy^		-1.1	-33.7
	o.w. EM ex-China		-0.9	-15.8
	o.w. China		-0.2	-16.6
	EM Equities		-2.3	7.9
	US HG		0.1	-51.9
	US HY		-1.3	-49.6
	Global Equities		6.8	86.8
	EM Bond and Equity ETFs		-1.8	32.8
	EM Bond ETFs		-2.1	-10.1
	EM Equity ETFs		0.4	42.9
	Non-resident EM flows*		-6.2	-70.3

Exhibit 2: Annual EM bond and equity fund flows

USD billion



*High frequency non-resident EM portfolio flow data where available. ^Local ccy split is retail only. Source – All charts and data in this report: J.P. Morgan, EPFR Global, Bloomberg Finance L.P

Turkiye

The Turkish lira was little changed after the September headline inflation acceleration was broadly in line with expectations (83.5%y/y from 80.2%). The central bank cut its interest rate by 100bps to 12% in September and President Erdogan has expressed hopes for further cuts going forward. Analysts highlight that the interest rate cuts are likely to add further pressure to inflation. **Goldman Sachs analysts highlight that the currencies of emerging markets with lower real yields or weaker external balances**, **driven by both shifts in the terms of trade and the relative domestic demand strength, have seen the largest declines in 2022**. Turkish equities rallied (+2.9%) this morning while the five-year CDS increased by 6 bps to 788 bps and the lira weakened marginally against the dollar (-0.2%). The lira has weakened by roughly 28% this year.

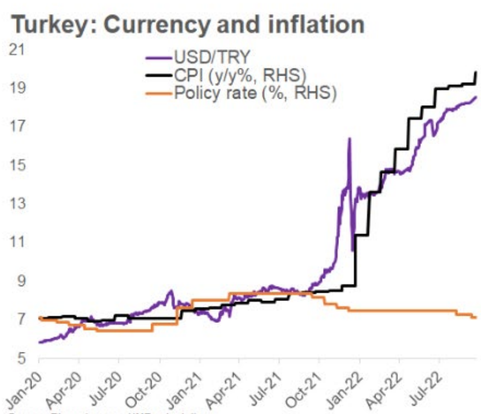
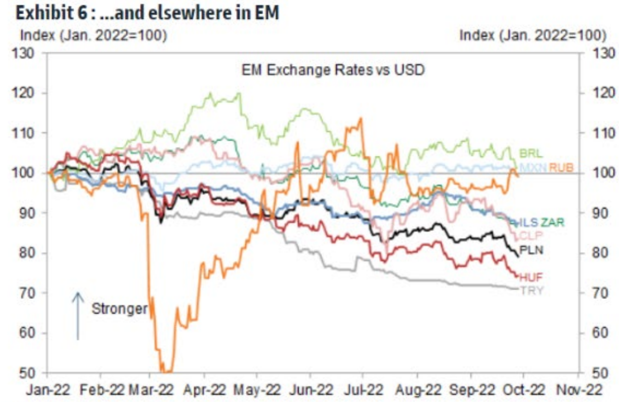


Exhibit 6 : ...and elsewhere in EM



Source: Goldman Sachs Global Investment Research

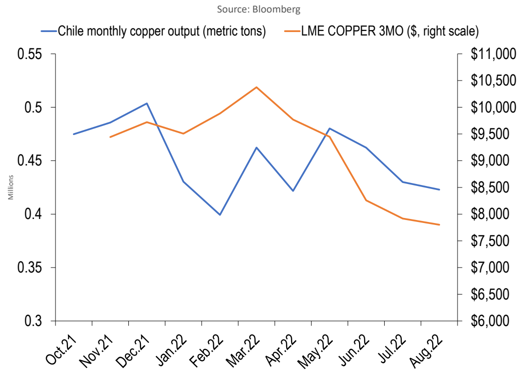
Latam

Colombia

Colombian peso (-1.7%) depreciated on Friday and two-year swap rates dropped 32 bps after the central bank hiked its benchmark rate by less than expected (100 bps vs 150 bps). According to Bloomberg, the peso's performance on Friday was the third worst out of 140 currencies. Analysts suggest that the dovish move by the central bank will negatively affect inflation expectations. Colombia's inflation increased to 10.8%y/y in August, the fastest pace in 23 years, with food prices increasing by 26%. President Petro will start to gradually remove gasoline subsidies next month, as well as incorporate a large increase in minimum wage in January, potentially risking a further rise in prices.

Chile

Chile's copper production declined for third consecutive month. Chile produced 422,888 metric tons of copper in the month of August. According to Chile's statistic agency, production decreased (-9.4% y/y and -1.7% m/m). The quality of ore has been worsening, which requires mines to move more rock in order to produce the same amount of copper. Copper 3-m futures are down (-22.4%) YTD, and (-41.5%) from its peak in March amid rising recession fears. Over the same time periods, the Chilean Peso has depreciated -12% and 19.7% respectively.



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Global Financial Indicators

10/3/22 1:02 PM	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		3586	-1.5	-2	-9	-18	-25	-15
Europe		3307	-0.3	-1	-7	-18	-23	-17
Japan		26216	1.1	-1	-5	-8	-9	-1
China		3805	-0.6	-1	-5	-22	-23	-18
Asia Ex Japan		59	-0.6	-4	-11	-31	-29	-26
Emerging Markets		35	-0.4	-3	-10	-31	-29	-27
Interest Rates					basis points			
US 10y Yield		3.69	-13.6	-23	50	223	218	170
Germany 10y Yield		2.00	-10.7	-11	48	223	218	177
Japan 10y Yield		0.25	0.2	-1	1	18	18	5
UK 10y Yield		3.91	-17.9	-33	100	291	294	244
Credit Spreads					basis points			
US Investment Grade		188	-3.2	17	26	103	76	45
US High Yield		552	13.5	37	43	230	214	146
Europe IG		135	0.7	1	16	84	88	64
Europe HY		643	1.4	-12	56	383	401	291
Exchange Rates					%			
USD/Majors		112.41	0.3	-1	3	20	17	17
EUR/USD		0.98	-0.4	2	-2	-16	-14	-14
USD/JPY		144.9	0.1	0	3	31	26	26
EM/USD		48.6	0.4	0	-3	-13	-8	-9
Commodities					%			
Brent Crude Oil ($/barrel)		89	3.9	7	-4	22	21	2
Industrials Metals (index)		143	-0.1	1	-2	-11	-17	-24
Agriculture (index)		68	0.3	1	0	18	12	-3
Implied Volatility					%			
VIX Index (%, change in pp)		31.9	0.3	-0.4	6.4	10.7	14.7	0.9
US 10y Swaption Volatility		156.0	5.9	-3.0	31.3	81.7	77.0	61.7
Global FX Volatility		12.9	0.0	0.1	1.9	6.1	5.4	5.4
EA Sovereign Spreads					10-Year spread vs. Germany (bps)			
Greece		287	11.3	26	19	179	135	47
Italy		242	0.4	-3	10	138	107	70
Portugal		108	1.7	2	0	54	44	17
Spain		119	1.3	1	0	55	45	16

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

Emerging Market Financial Indicators

Last updated: 10/3/2022 1:07 PM	Exchange Rates: Level, Last 12m	Level, Latest (vs. USD)	Change (in %) (+) = EM appreciation: 1 Day	7 Days	30 Days	12 M	YTD	Since 23-Feb-22	Local Currency Bond Yields (GBI EM): Level, Last 12m	Level, Latest (% p.a.)	Change (in basis points): 1 Day	7 Days	30 Days	12 M	YTD	Since 23-Feb-22
China		7.12	0.1	0.2	-3	-9	-11	-11		2.9	-0.5	8	14	-14	2	0
Indonesia		15303	-0.5	-1.1	-3	-7	-7	-6		7.3	-3.4	-4	20	110	96	84
India		82	-0.6	-0.3	-2	-9	-9	-9		7.7	5.5	-13	16	119.6	137	
Philippines		59	-0.6	-0.8	-3	-14	-14	-13		5.8	0.0	3	28	160	128	78
Thailand		38	-1.1	-0.7	-4	-11	-12	-15		3.2	2.5	-2	41	139	134	96
Malaysia		4.65	-0.2	-1.0	-3	-10	-10	-10		4.4	-1.9	-1	39	102	81	73
Argentina		147	-0.1	-1.3	-6	-33	-30	-27		84.8	-315.1	134	713	3516	3428	3688
Brazil		5.26	2.9	2.4	-2	4	6	-5		12.3	44.4	34	53	116	161	77
Chile		967	0.2	2.6	-9	-17	-12	-18		6.9	-0.8	-29	31	129	147	98
Colombia		4609	-1.7	-3.5	-4	-17	-11	-15		10.0	10.0	28	51	344	361	215
Mexico		20.07	0.4	1.5	0	2	2	1		9.2	-3.0	12	47	175	168	136
Peru		4.0	-0.2	-1.8	-3	4	0	-6		8.8	3.8	34	68	242	290	280
Uruguay		42	-0.1	-2.0	-2	3	7	1		11.5	0.0	0	47	358	274	332
Hungary		435	-0.8	-2.4	-6	-30	-25	-27		9.9	-5.0	12	23	628	534	504
Poland		4.95	0.2	0.1	-4	-20	-18	-18		6.7	-19.8	-2	49	434	315	278
Romania		5.1	-0.4	1.5	-4	-16	-14	-14		8.5	-8.6	20	77	470	365	332
Russia		59.1	1.8	-1.1	4	23	27	38		8.9	-0.9	-1	64	102	12	-229
South Africa		18.0	0.5	0.5	-5	-16	-11	-16		9.5	-11.0	-19	54	181	209	193
Turkey		18.57	-0.2	-0.6	-2	-52	-28	-26		12.0	-3.0	22	-88	-653	-1236	-1046
US (DXY; 5y UST)		112	0.2	-1.5	3	20	17	17		3.95	-13.6	-24	66	303	269	205

	Equity Markets: Level, Last 12m	Level, Latest	Change (in %): 1 Day	7 Days	30 Days	12 M	YTD	Since 23-Feb-22	Bond Spreads on USD Debt (EMBIG): Level, Last 12m	Level, Latest (basis points)	Change (in basis points): 7 Days	30 Days	12 M	YTD	Since 23-Feb-22
China		3805	0.0	-1	-5	-22	-23	-18		194	7	-11	-17	-9	-14
Indonesia		7010	-0.4	-2	-2	11	7	1		210	23	31	33	45	25
India		56789	-1.1	-1	-3	-4	-3	-1		184	25	29	38	52	30
Philippines		5783	0.7	-8	-14	-17	-19	-21		157	14	30	40	56	20
Thailand		1558	-2.0	-4	-4	-3	-6	-8		0	0	0	0	0	0
Malaysia		1398	0.2	-1	-6	-8	-11	-12		108	11	0	-24	-9	-25
Argentina		139115	0.8	-3	2	79	67	52		2815	277	397	1226	1135	1078
Brazil		110037	2.2	-2	-1	-3	5	-2		309	7	-3	5	-2	-22
Chile		5114	0.0	-1	-10	18	19	17		197	15	11	43	57	23
Colombia		1128	-0.7	1	-8	-18	-20	-25		461	27	38	159	113	69
Mexico		44627	-1.1	-2	-3	-13	-16	-13		476	24	55	122	144	106
Peru		19448	0.4	3	4	6	-8	-17		229	17	34	53	79	39
Hungary		37906	0.2	-2	-10	-29	-25	-21		318	42	69	206	194	165
Poland		45099	-1.9	-4	-9	-36	-35	-28		63	43	43	36	31	47
Romania		10776	1.3	1	-9	-15	-17	-18		377	49	88	181	185	145
Russia		2028	3.6	5	-18	-50	-46	-34		3411	-577	938	3228	3234	2897
South Africa		63691	-0.1	0	-5	0	-14	-15		492	40	51	132	137	103
Turkey		3289	3.4	1	2	135	77	63		614	-7	-36	116	36	51
Ukraine		519	0.0	0	0	-1	-1	0		3832	209	241	3318	3073	2359
EM total		35	-0.6	-3	-10	-31	-29	-27		467	20	39	94	81	9

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

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