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- R**—a novel natural rate that incorporates financial stability considerations ([link](#))
- ECB September meeting minutes show some caution on tightening ([link](#))
- European gas prices ease but remain volatile as storage increases ([link](#))
- Peru's central bank raises its key interest rate by 25 bps to 7%, as expected ([link](#))
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Markets end the week treading water

Markets traded cautiously ahead of the US payrolls report. European bourses were mixed and US equity index futures lacked direction this morning. Advanced economy sovereign bond yields rose, with 10-year Treasury yields heading for a 10th consecutive week of increases, the longest streak since 1984. Treasury yields jumped immediately after the release of a slightly stronger than expected US payrolls report and an unexpected drop in the unemployment rate. The dollar was little changed and the VIX index hovered above the 30 ppt mark, well above historical averages. Elsewhere, 30-year UK gilts continued their ascent on reports that pension funds are still offloading illiquid assets. The Bank of England yesterday purchased £154 mn of bonds through its bond-buying operation after not buying any bonds in the two preceding days. In emerging markets, central banks continued tightening with Peru (+25 bps), Uruguay (+50 bps), Ghana (+250 bps), and Uganda (+100 bps) hiking rates amid persistent inflationary pressures.

Key Global Financial Indicators

Last updated: 10/7/22 8:04 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities							
S&P 500		3745	-1.0	3	-6	-15	-21
Eurostoxx 50		3427	-0.2	3	-2	-16	-20
Nikkei 225		27116	-0.7	5	-4	-3	-6
MSCI EM		36	-0.6	4	-6	-28	-25
Yields and Spreads							
US 10y Yield		3.84	2.1	2	58	227	233
Germany 10y Yield		2.16	7.9	6	59	235	234
EMBIG Sovereign Spread		543	-5	-26	38	177	176
FX / Commodities / Volatility							
EM FX vs. USD, (+) = appreciation		48.7	-0.1	1	-3	-12	-7
Dollar index, (+) = \$ appreciation		112.1	-0.1	0	2	19	17
Brent Crude Oil (\$/barrel)		95.4	1.1	9	8	16	23
VIX Index (% change in pp)		30.4	-0.1	-1	6	11	13

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

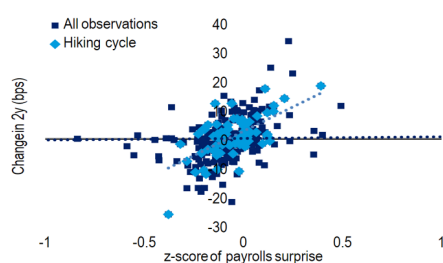
The US jobs report saw a stronger than expected September nonfarm payroll report. Employment numbers at 263k (vs. 255k exp) leading to an unemployment rate of 3.5% (vs. 3.7% exp.) while average hourly earnings growth coming in as expected at 0.3% m/m and 5.0% y/y. In reaction to the data release, investors continued to price out the pivot scenario for the Fed, with both US Equity futures selling off by -0.8% for the S&P 500 while Treasury yields jumped (10-years +5 bps). In foreign exchange markets, the dollar appreciated following the release.

US September Non-Farm Payrolls Report		
	Consensus Forecast	Actual Number
Non-farm payrolls	255k	263k
Unemployment rate	3.7%	3.5%
Average hourly earnings m/m	0.3%	0.3%
Average hourly earnings y/y	5.0%	5.0%
Labor force participation rate	62.4%	62.3%

Source: Bureau of Labor Statistics

The Fed has typically maintained the terminal rate for longer when payrolls hit an inflection point. The central bank's actions abroad, softer manufacturing PMIs and tighter funding conditions gave some investors hope for a shift in the Fed's policy stance towards a more moderate stance earlier this week. Bank of America analysts, however, dismiss these hopes as wishful thinking and believe the Fed's work is far from over. They urge caution for two reasons. First, shorter-term interest rates in past rate-hike cycles have been highly correlated with nonfarm payrolls surprises, suggesting a Fed reaction function that was targeting a labor market rebalancing (left chart). Furthermore, they also recall recent Fed speak explicitly stating the intention to keep tightening until the labor market shows sustained signs of a slowdown. To achieve this, the inflection point in payrolls (i.e. the switch from positive m/m change to negative m/m change) appears particularly important as it brings the unemployment rate to an upward trajectory. Conditioning past hiking cycles up to this inflection point illustrates that the Fed typically maintained the terminal rate for an extended period (right chart). This is at odds with market pricing for fed fund cuts after May next year, when a terminal rate of 4.60% is currently priced.

Change in 2y Treasury yields on payrolls surprise



Source: Bank of America

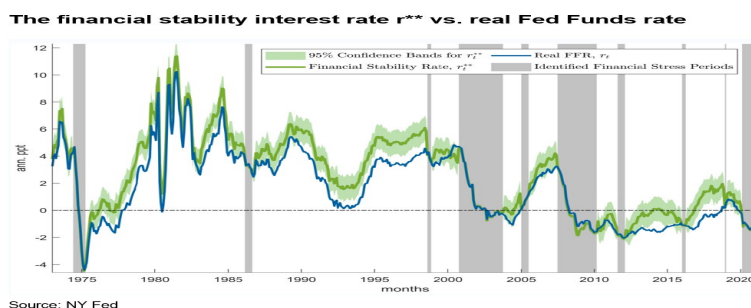
Timing around when payrolls turn negative vs terminal rate

Terminal rate	Months around terminal when payrolls turn negative
Mar '80	+1
May '81	+3
Jan '82	-5
Aug '84	no turn, just moderation
Feb '89	+17
Feb '95	+11
May '00	+1
Jun '06	+13
Dec '18	+2, not negative but decline to 24k

Source: Bank of America

R is a novel natural rate of interest that takes into account financial stability considerations.** Defined as the neutral rate for financial stability, R** emerges as a new concept in the Fed's analytical toolkit. According to NY Fed analysis, R** can move below the natural rate of interest after prolonged periods in a low yield environment, reflecting the excessive leverage in the economy that has built up because of investors' hunt for yield. It suggests that when central banks exit a low yield environment, they might surpass the neutral rate of financial stability before adopting a restrictive monetary policy stance (i.e., policy rates above the natural rate, which would bring supply and demand in the economy into equilibrium).

so as to bring down inflation). Indeed, the New York Fed's analysis shows that in a number of instances, when the real Fed Funds rates increased towards the neutral financial stability rate, financial instability ensued, e.g., in the credit market ruptures leading up to the Global Financial Crisis, the repo market dislocation in the fall of 2019 or the dash for cash in the Treasury market in 2020. Accordingly, the R^{**} framework can be instructive in that it formalizes an approach for how central banks can reflect on financial stability considerations in the conduct of monetary policy implementation.



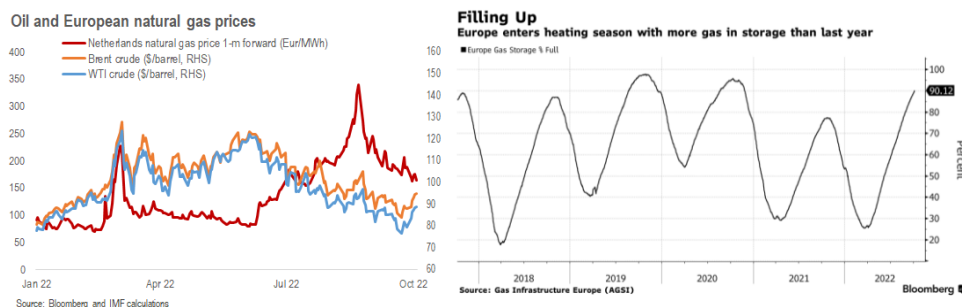
Euro area

European equities were little changed ahead of the US payroll data. The euro was little changed against the dollar (+0.2%) while sovereign yields increased (10-year bund +7bps). Southern spreads were little changed with 10-year Italian spreads remaining at roughly 244bps.

The ECB has reportedly encouraged individual banks to exercise constraint in variable pay and dividends, cautioning that the energy crisis could see higher defaults. Bloomberg reports that, according to anonymous sources, the ECB now expects a sharper 2023 economic downturn. Data this morning showed that, **Germany's August industrial production and retail sales data pointed to a further weakening of the economy.**

While the ECB hiked rates by 75 bps in September, the minutes of that meeting released yesterday showed that a 50 bps hike had been favored by some board members, because of recession fears. The 75 bps hike was nevertheless unanimous, as recession fears were overshadowed by the high level of inflation and worries that inflation expectations could become unanchored. While emphasizing that policy will continue to be data-dependent, the minutes also showed support for the indication that rates will be increased further. The minutes also indicated that policy rates were seen to still be 'significantly below the neutral rate', even with the September hike. **Market pricing was little changed and a 75 bps October hike remains close to fully priced in, in line with analyst expectations.** Some analysts, however, highlight the risk that the ECB could take more cautious steps further out if the economy weakens more than expected.

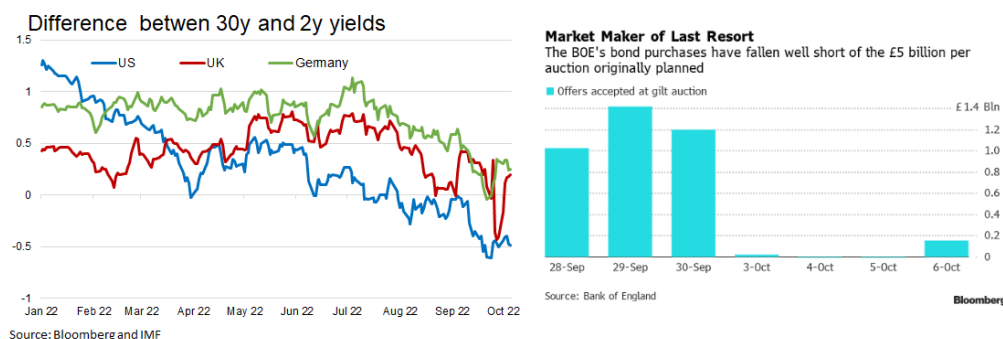
European gas prices remain volatile and fell 7% this morning against a backdrop of higher inventories and gas imports while policy responses to the energy crisis remains in focus. Gas storage levels for Europe are now at 90%, higher than this time in 2021 but lower than levels seen in 2019 and 2020, according to Bloomberg. EU leaders are set to meet at an informal summit today to discuss a response to the energy crisis. BofA analysts note that discussions may address energy price caps. Separately, Swedish investigators yesterday said that the **leaks in Nord Stream 1 and Nord Stream 2, two natural gas pipelines from Russia, were caused by detonations that are likely a result of sabotage.** Evidence will now be analyzed with the aim of determining if anyone could be prosecuted, according to a spokesperson for the Swedish Security Service.



Morgan Stanley analysts have revised euro area growth expectations downward and now see 2023 growth at -0.5% (from -0.2% previously), with GDP declining for three consecutive quarters starting in Q3 2022. The downward revision comes as business surveys indicate that the recession has likely already materialized, and inflation reached 10% in September. **Analysts highlight risks a result of highly volatile energy markets, and caution that energy supply issues could disrupt production chains significantly and lead to a more severe recession.**

United Kingdom

The FTSE 100 traded marginally higher, while the pound appreciated against the dollar (+0.2%) and gilt yields increased (10-year gilt +5 bps to 4.2%). Contacts continue to expect the pound to weaken, and expect volatility in the currency to persist. **30-year gilt yields continued to increase (+5 bps to 4.34%) amid reports that pension funds are still offloading illiquid assets.** The Bank of England (BoE) yesterday purchased £154 mn of bonds through its bond-buying operation after not buying any bonds in the two preceding days. UK pension funds are reportedly continuing to sell off illiquid assets to raise cash ahead of October 14, the date at which the auctions are set to end, according to Bloomberg. **In a letter to the chairman of the Treasury Committee, BoE deputy governor Jon Cunliffe shed light on the market turmoil related to the pension industry and the set-up of the temporary bond buying program.** The letter highlighted that the BoE intervention is *temporary and targeted* and was *not intended to create central bank money on a lasting basis, nor cap or control long-term interest rates.* **BoE policymaker Haskell echoed comments from BoE Chief economist Pill, highlighting that there was undoubtedly a UK-specific factor in the movement of government bond yields in the aftermath of the UK's mini-budget announcement:** while US and German sovereign bond yields also increased, gilt yields saw much larger moves.



Japan

Household spending was weaker than expected in August, falling 1.7% m/m as the rising cost of living weighed on consumers' budget. On the y/y basis, household spending increased 5.1% (consensus: +6.7%). While increasing 1.7% y/y in nominal terms, labor cash earnings decreased 1.7% in real terms. Analysts noted that consumer sentiment is worsening as people get into a saving mode amid falling real income. **The Financial Services Agency ordered Sumitomo Mitsui Financial Group (SMFG) to improve**

operations at its brokerage unit, which was found to engage in stock market manipulation; SMFG's share price dropped (-1.2%). The **Japanese yen was little changed, hovering around 145 yen per dollar**. Traders were cautious about potential FX interventions as Japanese authorities last intervened when Japanese yen reached 145.9 yen per dollar. Long-end JGB yields edged up (30-year: +1.6 bps), while the 10-year JGB yield stayed unchanged at 0.247%. Japanese equities declined (NIKKEI: -0.7%), similar to regional trends.

Emerging Markets

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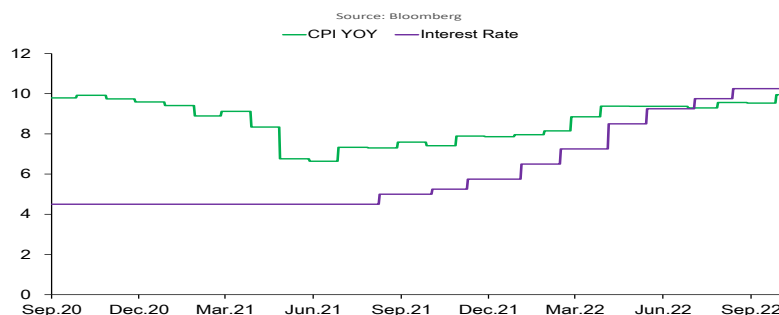
Asian markets retreated amid global risk-off sentiment. Investors turned cautious on hawkish remarks from Fed officials. Asian equities declined, -1.7% on net, led by Taiwan POC (-1.4%) and Hong Kong SAR (-1.2%) equities. Tech stocks generally underperformed as concerns about a global computer and memory chip downturn deepened; Samsung Electronics reported its first profit decline since 2019. Asian currencies depreciated, led by Korean won (-0.7%), Indian rupee (-0.6%), and Indonesian rupiah (-0.5%). The Korean won came under pressure as Korea's current account balance turned into a deficit, while higher oil prices put pressure on the Indian rupee. Long-end government bond yields increased, with 10-year yields rising in the Philippines (+12 bps) and India (+5 bps). **In EMEA, markets were quiet** ahead of the US jobs data release. Currencies were mixed. **The Polish zloty (+0.6%) outperformed after governor Glapinski spoke of a pause in the hiking cycle and not a formal end of hikes.** Yesterday, the Hungarian central bank sold HUF2 bn of its new one-week discount bill at the inaugural auction of the instrument, but market contacts pointed out that the central bank's 1-w deposit facility offers more attractive conditions. **Russia will report CPI data for September later**, with contacts generally expecting the central bank to keep its policy rate unchanged at 7.5% in late October. **Latin American stocks were mixed, and currencies depreciated against the dollar yesterday.** Equities increased in Mexico (+1.1%), Brazil (+0.3%), and Colombia (+0.2%), and fell in Argentina (-1.4%) and Chile (-0.2%).

Peru

Peru's central bank raised its key interest rate by 25 bps to 7%, as expected. This is Peru's 15th consecutive month of rate hikes, now reaching the highest level since 2001. Scotiabank believes Peru is close to halting its rate hikes, predicting this to be one of the last. The bank noted that it will be closely monitoring inflation expectations and economic activity, given analysts are split over whether this was the final one. Last week, central bank chief Julio Velarde revealed policy makers won't need to raise rates much more.

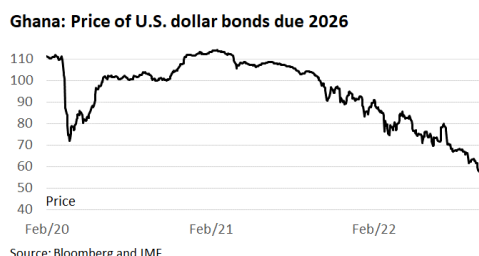
Uruguay

Uruguay's central bank raised interest rates by 50 bps to 10.75%. CPI rose to 9.95% y/y in September, driven by rising food and healthcare prices. The central bank signaled that it plans to raise the benchmark rate at the next two policy meetings, with a 50 bps hike expected at the next policy meeting. The central bank is aiming to raise rates enough for inflation expectations to reach their target range of 3–6%.



Ghana

The Bank of Ghana (BoG) hiked its policy rate by 250 bps to 24.5% yesterday, compared to a hike of 150 bps expected, citing elevated inflation and balance of payment risks. The BoG's core inflation measure, which excludes energy and utility, rose to 32.6 % y/y in August, from 30.2% y/y in July 2022. Net international reserves, which excludes encumbered assets and petroleum funds, are estimated at \$2.7 bn in September 2022. **Analysts at Goldman Sachs consider yesterday's hike a "frontloading" of hikes for the remainder of the year but see the risk for more hikes tilted towards the upside.** The central bank hiked 300 bps in an emergency meeting in August, but US dollar bonds have remained under pressure as contacts warn about debt sustainability.



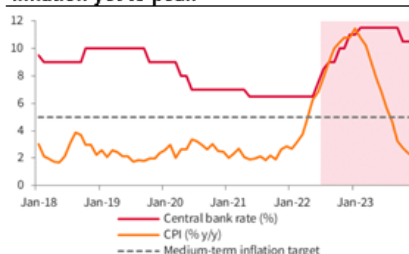
Uganda

The Bank of Uganda (BoU) hiked its key rate 100 bps to 10.0% yesterday, as expected. The BoU warns that a combination of global factors, a recent drought, and a weaker exchange rate have driven inflation to the highest level since 2012. Annual headline inflation rose to 10% in September 2022, from 9% in August 2022. **Analysts at Absa expect another hike of 100 bps in December and a hike of 50 bps in February 2023.**

Figure 1: Core inflation drifts further away from target










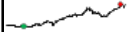


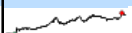


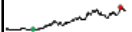



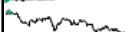







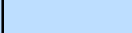


Figure 2: Further policy rate hikes likely with inflation yet to peak



This monitor is prepared under the guidance of Ranjit Singh (Assistant Director), Nassira Abbas (Deputy Division Chief), Charles Cohen (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 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), 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), 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.

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Global Financial Indicators

10/7/22 8:04 AM	Level		Change				YTD	Since 23-Feb-22
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		
Equities			%				%	%
United States		3745	-1.0	3	-6	-15	-21	-11
Europe		3427	-0.2	3	-2	-16	-20	-14
Japan		27116	-0.7	5	-4	-3	-6	3
China		3805	-0.6	-1	-5	-22	-23	-18
Asia Ex Japan		61	-0.7	3	-7	-29	-26	-23
Emerging Markets		36	-0.6	4	-6	-28	-25	-23
Interest Rates			basis points					
US 10y Yield		3.84	2.1	2	58	227	233	185
Germany 10y Yield		2.16	7.9	6	59	235	234	194
Japan 10y Yield		0.25	-0.2	1	0	18	18	6
UK 10y Yield		4.20	3.4	11	117	313	323	272
Credit Spreads			basis points					
US Investment Grade		179	-1.7	-11	11	89	68	37
US High Yield		498	-8.0	-51	-3	168	161	92
Europe IG		127	-0.6	-8	13	76	79	55
Europe HY		612	-1.0	-29	54	353	370	260
Exchange Rates			%					
USD/Majors		112.11	-0.1	0	2	19	17	17
EUR/USD		0.98	0.1	0	-2	-15	-14	-13
USD/JPY		144.9	-0.1	0	1	30	26	26
EM/USD		48.7	-0.1	1	-3	-12	-7	-8
Commodities			%					
Brent Crude Oil (\$/barrel)		95	1.1	12	9	29	30	9
Industrials Metals (index)		150	-0.5	5	2	-8	-13	-20
Agriculture (index)		68	0.5	0	1	18	12	-3
Implied Volatility			%					
VIX Index (% change in pp)		30.4	-0.1	-1.2	5.8	10.9	13.2	-0.6
US 10y Swaption Volatility		158.0	1.3	7.9	22.2	83.3	79.0	63.7
Global FX Volatility		12.1	0.0	-0.8	0.5	5.4	4.7	4.6
EA Sovereign Spreads			10-Year spread vs. Germany (bps)					
Greece		261	-7.7	-14	3	154	109	21
Italy		244	0.9	3	15	140	109	73
Portugal		108	-0.6	1	3	53	44	16
Spain		119	-1.3	0	3	54	44	15

Colors denote **tightening**/**easing** financial conditions for observations greater than ± 1.5 standard deviations.

Data source: Bloomberg.

Emerging Market Financial Indicators

Last updated: 10/7/2022 8:06 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		7.12	0.1	0.2	-3	-9	-11	-11		2.9	-0.5	8	14	-14	2	0
Indonesia		15251	-0.4	-0.2	-2	-7	-6	-6		7.2	4.8	-12	4	102	87	75
India		82	-0.5	-1.2	-3	-9	-10	-9		7.7	5.6	11	22	122.2	142	
Philippines		59	-0.4	-0.5	-3	-14	-13	-13		5.8	0.0	0	8	156	128	78
Thailand		37	0.1	1.3	-3	-10	-11	-14		3.1	6.0	-2	36	133	129	92
Malaysia		4.65	-0.3	-0.3	-3	-10	-10	-10		4.4	4.0	-3	29	81	80	72
Argentina		149	-0.2	-1.4	-6	-34	-31	-28		88.7	136.8	66	968	3936	3809	4070
Brazil		5.22	0.0	3.7	1	6	7	-4		10.8	-87.6	-109	-106	-41	7	-77
Chile		947	-0.3	2.3	-6	-14	-10	-17		6.9	0.5	-4	21	98	144	95
Colombia		4611	-0.8	-1.8	-3	-18	-12	-15		10.3	0.0	24	56	367	385	238
Mexico		20.07	0.3	0.4	0	3	2	1		9.2	7.5	0	40	166	171	139
Peru		4.0	-0.2	-0.1	-2	4	1	-6		8.7	0.1	-7	43	278	279	269
Uruguay		41	0.1	1.6	0	5	9	3		11.4	4.1	-10	7	348	265	322
Hungary		433	0.0	-0.3	-9	-28	-25	-26		10.0	5.0	5	9	642	544	514
Poland		4.96	0.6	-0.2	-5	-20	-19	-18		6.9	1.3	0	77	435	335	298
Romania		5.0	0.0	0.1	-4	-15	-14	-13		8.5	2.2	-7	61	451	367	334
Russia		62.0	-0.2	-3.1	-1	16	21	32		8.9	-23.9	0	35	98	13	-228
South Africa		18.0	0.0	0.5	-4	-17	-11	-16		9.4	4.0	-24	36	170	196	180
Turkey		18.59	-0.1	-0.3	-2	-52	-28	-26		12.0	1.0	2	58	-677	-1231	-1041
US (DXY; 5y UST)		112	-0.1	0.0	2	19	17	17		4.09	2.4	0	73	307	283	219

	Equity Markets								Bond Spreads on USD Debt (EMBIG)							
	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	7 Days	30 Days	12 M			
								basis points								
China		3805	0.0	-1	-5	-22	-23	-18		197	3	-7	-14	-6	-11	
Indonesia		7027	-0.7	0	-3	8	7	2		201	-24	20	9	36	16	
India		58191	-0.1	3	-3	-3	0	2		191	-4	27	40	59	37	
Philippines		5932	0.0	3	-10	-14	-17	-19		156	-17	20	20	55	19	
Thailand		1580	-0.6	-1	-5	-4	-5	-7		0	0	0	0	0	0	
Malaysia		1406	-1.0	1	-6	-10	-10	-11		111	-3	13	-22	-6	-22	
Argentina		144645	-1.4	5	3	87	73	58		2778	11	417	1207	1098	1041	
Brazil		117561	0.3	9	7	6	12	5		295	-27	-6	-14	-16	-36	
Chile		5184	-0.2	1	-6	26	20	18		185	-17	6	26	45	11	
Colombia		1218	0.2	8	1	-13	-14	-19		442	-29	16	143	94	50	
Mexico		46327	1.0	3	1	-9	-13	-10		443	-40	21	87	111	73	
Peru		20379	0.5	5	7	5	-3	-13		216	-15	20	35	66	26	
Hungary		39550	0.7	5	-4	-27	-22	-17		311	-19	66	189	187	158	
Poland		47076	-0.5	2	-4	-35	-32	-25		56	-18	24	31	24	40	
Romania		10972	0.3	3	-8	-14	-16	-17		343	-50	44	131	150	110	
Russia		1989	-1.6	2	-17	-53	-47	-36		3411	-577	938	3228	3234	2897	
South Africa		65709	-0.2	3	-2	1	-11	-12		465	-46	24	90	110	76	
Turkey		3571	0.5	12	5	156	92	77		611	-26	-24	108	33	48	
Ukraine		519	0.0	0	0	-1	-1	0		3836	5	10	3297	3077	2363	
EM total		36	-0.6	4	-6	-28	-25	-23		452	-34	16	70	66	-6	

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

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