GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, OCTOBER 16, 2023

LEAD EDITOR: SANJAY HAZARIKA

- **PBOC stays on hold but injects major liquidity** (link)
- **Oil markets reflect higher geopolitical risk** (link)
- **Swiss franc appreciates to record level against euro on safe haven flows** (link)
- **Favorable risk-return tradeoff in US Treasury market keeps demand high** (link)
- **High yield bond market in US remains stable despite surge in interest rates** (link)
- **Rising US Treasury yields are pushing emerging market yields higher** (link)

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Caution prevails in global markets

Markets are trading sideways as the crisis in the Middle East remains the primary focus. Investors are hoping that the war will remain contained and not spread to other countries, keeping a lid on oil prices. Stocks in Europe were slightly higher along with US equity index futures, while Treasuries and bunds unwound some of Friday's safe-haven gains. The Swiss franc reached its strongest level ever versus the Euro before pulling back slightly. The People's Bank of China stayed on hold but injected the largest amount of liquidity since 2020 as local markets continued to be under pressure. Meanwhile, analysts warned that the upcoming earnings season will be weaker than originally expected.

Key Global Financial Indicators

Last updated: 10/16/23 7:58 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		4328	-0.5	0	-3	21	13
Eurostoxx 50		4145	0.2	1	-3	23	9
Nikkei 225		31659	-2.0	2	-6	18	21
MSCI EM		38	-0.4	0	-3	11	0
Yields and Spreads				bps			
US 10y Yield		4.70	8.5	-10	37	68	82
Germany 10y Yield		2.79	5.0	2	11	44	22
EMBIG Sovereign Spread		450	8	-1	27	-123	-1
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		46.6	0.3	1	-2	-4	-7
Dollar index, (+) = $ appreciation		106.4	-0.2	0	1	-6	3
Brent Crude Oil ($/barrel)		90.6	-0.3	3	-4	-1	5
VIX Index (%, change in pp)		18.7	-0.6	1	5	-13	-3

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

Market participants are keeping a wary eye on developments in the Middle East. The impact of the conflict on financial markets has been limited so far, but risks remain. Bloomberg estimates that a wider war involving Iran could push oil prices up to $150/barrel. Meanwhile, earnings season is in full swing this week, with reports due from Goldman, Bank of America, and Morgan Stanley, among others. Friday's earnings reports from JP Morgan, Citi and Wells Fargo came in well above expectations. The data calendar for the US is relatively light, with retail sales the most important item. In the euro area, the ZEW business sentiment survey for Germany will be scrutinized for clues about the health of the faltering German economy. CPI and PPI reports for the euro area will be the other major focus. It will be a big week for China, which is due to report on GDP, industrial production, and retail sales. Japan is due to report on inflation, while the UK will release inflation and employment data. Central bank meetings are scheduled in South Korea and Indonesia. Fed Chair Powell is scheduled to give a speech in New York on Thursday.

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United States

Demand in the Treasury market remains very strong despite the recent surge in interest rates that has inflicted heavy losses on many bondholders. There is a widespread belief that the Fed's rate hikes are over and that interest rates have peaked for the cycle. In such a situation, the risk-reward framework for owning Treasuries is very attractive, because further mark-to-market losses are less likely while even a modest decline in interest rates will deliver large positive returns. The impact is largest for the longest maturity bonds, as they have the most sensitivity to interest rates. A 50 bps decline in interest rates will deliver a 13% annual return for owners of the 30-year Treasury bond, with the potential for even higher returns if rates fall further from there. Owners of the 10-year Treasury note will suffer just a 1% loss if rates rise by 50 bps, versus a positive return of more than 8% if interest rates fall by 50 bps.

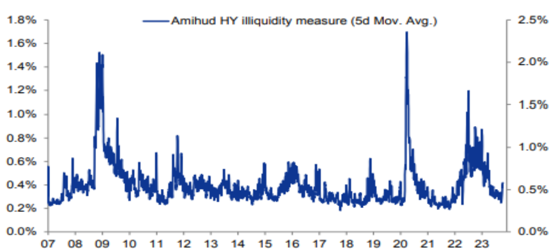
Bond Market's Risk/Reward
Estimated 12-month total returns based on different yield movements

	300bp rise	150bp rise	50bp rise	50bp fall	150bp fall	300bp
2-year Treasury	2.3	3.7	4.6	5.53	6.5	7.9
5-year Treasury	-5.5	-0.6	2.9	6.45	10.2	16.1
10-year Treasury	-14.9	-5.8	1.0	8.34	16.4	29.8
20-year Treasury	-24.7	-11.6	-1.1	11.37	26.0	53.2
30-year Treasury	-30.4	-15.7	-2.9	13.19	33.5	74.7

Source: F/m Investments, Bloomberg Bloomberg

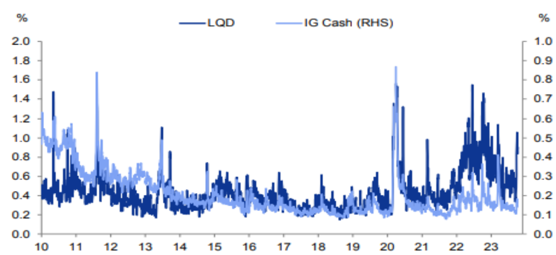
Conditions in the US high yield (HY) bond market have remained stable despite the recent surge in interest rates. Liquidity has been robust and intra-day volatility is well contained. The spread on the Bloomberg HY bond index had moved higher in recent weeks but has subsequently come down. The difference between the net asset value (NAV) of HY exchange traded funds (ETFs) and their prices had widened sharply as the Treasury market sold off, but has since returned to normal, with the difference becoming very small as it tends to be when markets are functioning normally. Due to strong investor interest, credit spreads in riskier segments of the HY market such as leveraged loans have become much tighter. Contacts report that confidence in the HY market remains high because most investors expect a soft landing for the US economy, with lower default rates than originally forecasted.

Exhibit 3: The HY Amihud liquidity measure rose only slightly in the recent sell-off
5-day moving average of the median HY Amihud illiquidity measure



Source: FINRA TRACE, Goldman Sachs Global Investment Research

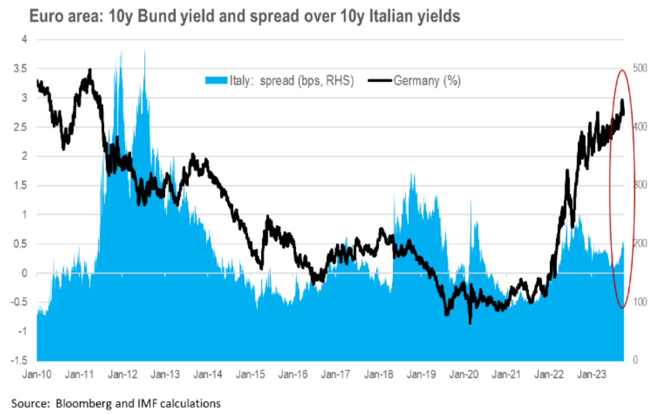
Exhibit 4: Intra-day vol in the HY cash market also remained well-behaved in the recent sell-off
Intraday volatility as measured by the percentage difference between the high and low bid price in each trading day



Source: FINRA TRACE, Goldman Sachs Global Investment Research

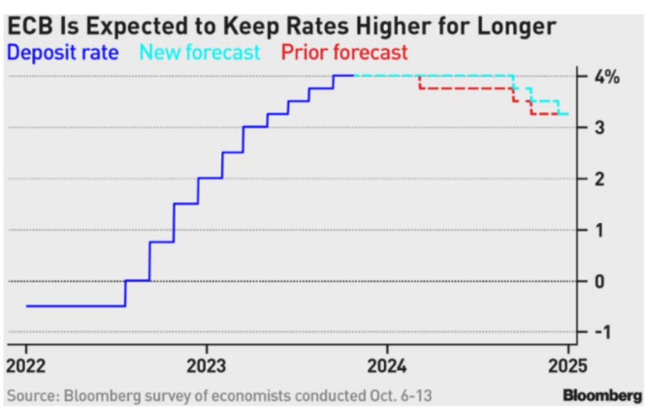
Euro Area

European equities were mixed with the Stoxx 600 equity index little changed. The euro was stronger against the dollar (+0.2% at around 1.05) with data showing that net long positions have continued to decrease for the eighth consecutive week as long positions have decreased. **Sovereign yields were edging higher this morning (10y bund +5bps to 2.79%) after closing 5bps lower on Friday.** ECB President Lagarde cautioned that core inflation remains strong, and that wage growth is historically high. ECB Governing Council (GC) member De Cos argued that the recent increases in euro-area long-term interest rates are not related to domestic factors such as market expectations for euro area inflation but were driven instead by US market dynamics.

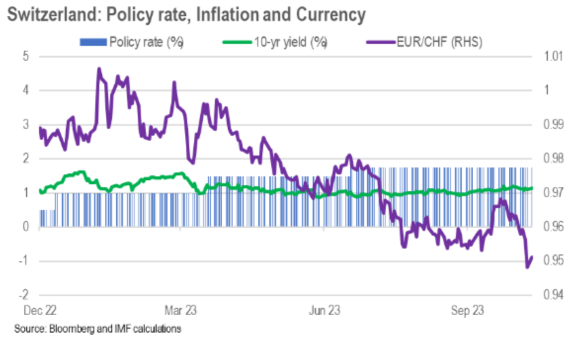


Italian spreads remain above 200bps while ECB commentary suggests a lack of concern. ECB GC member Visco said that the levels of spreads are not worrying and would not require ECB intervention, while GC member Simkus suggested that higher borrowing costs in Italy should not impact ECB discussions around the timing of rolling off PEPP reinvestments. Meanwhile, GC member Kažimír doesn't expect PEPP changes "before the summer", and "it could be a year before we'll consider cuts" **Analysts caution that spreads could widen further when Italy unveils its budget today—which likely to confirm the budget deficit higher than 3% until 2025.** Moreover, contacts do not expect negative rating action from S&P's rating review on Friday, but analysts are keeping an eye on the current assessment and rating sensitivities. 10y Italian spreads were trading at around 202bps this morning, marginally lower from Friday.

Economist now see the ECB keeping rates unchanged until September 2024. A recent Bloomberg survey showed that economists no longer expect that the ECB would start cutting rates in March, but instead now see rates remaining on hold until September 2024. However, markets are pricing in roughly 22bps of cuts by June 2024.

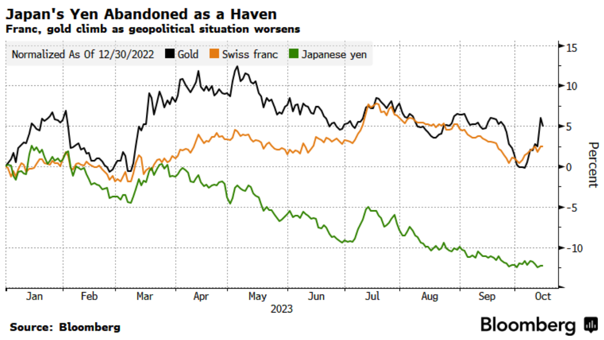


The Swiss Franc appreciated to a record level against the euro, with the EUR/CHF falling to 0.948 on Friday, as geopolitical tensions in the Middle East sparked a bid for safe-haven currencies. Rabobank analysts also highlight that net short positions of the Swiss Franc have decreased. ING analysts argue that the Swiss National Bank has the euro cross rate very controlled and would allow only measured strengthening of the Swiss Franc. The Swiss Franc was marginally weaker this morning (-0.3% at 0.95 against the euro) but remains roughly 4% stronger than at the start of the year.



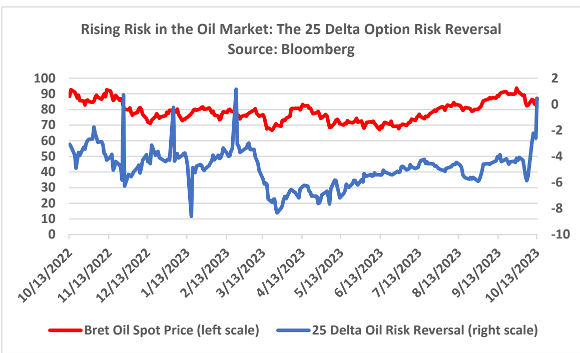
Japan

Japanese equities declined on growing concerns about the conflict in the Middle East (NIKKEI: -2.0%), underperforming regional peers. Some analysts pointed out that Japanese yen has lost its safe-haven luster in recent days. The yen has stayed close to the 150 yen per dollar level, while gold has risen, and the Swiss franc has appreciated. Negative interest rates along with the uncertainty about when and how the Bank of Japan will start normalizing monetary policy makes Japanese yen look less desirable in comparison to gold and other safe-have currencies.



Commodities

The oil market is starting to price in the impact of higher geopolitical risk. The spot market has seen a relatively small impact, with the US WTI benchmark oil price rising modestly from $82 on October 6, the day before the Hamas attack, to $87 last Friday. However, the options market for oil is starting to reflect higher geopolitical risk. The prices of call options on WTI have risen above the prices of put options for the first time since February. This is known as a positive skew, with the risk reversal (difference between the volatilities of call and put options) moving above zero. The same situation prevails in the market for Brent crude.



Emerging Markets

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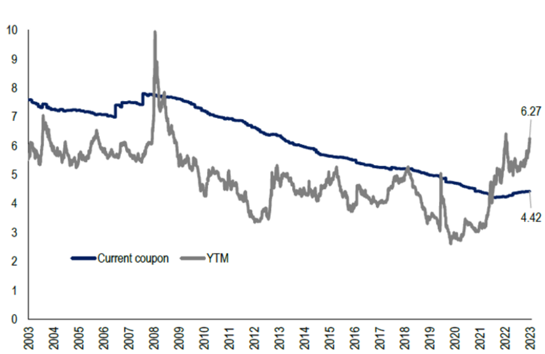
EMEA equities were mixed while currencies were mostly strengthening. Zambia's Ministry of Finance and National Planning (MOFNP) announced over the weekend that a memorandum of understanding had been agreed with Zambia's official creditor committee (OCC) on the comprehensive debt treatment agreed to in June. **Asian markets retreated today on growing concerns about the conflict in the Middle East.** In India, wholesale prices fell 0.26% y/y in September, in contrast to an expected 0.4% increase. **Markets in Latin America closed lower on Friday, with Brazil and Mexico registering the largest losses.** Regional currencies also depreciated.

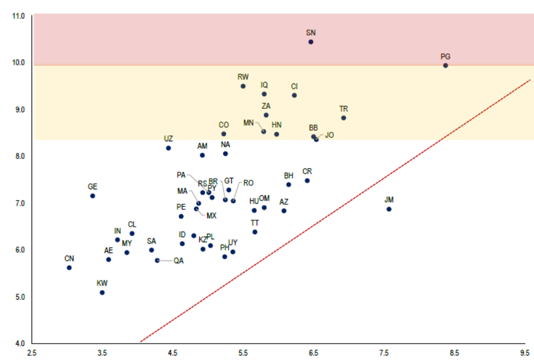
EM Sovereign Credit

Rising US treasury rates are driving the sovereign yields in EMs higher, even though the spreads have remained sticky. According to a market report, the average yields on investment grade EM sovereign paper has risen to 6.27% vis-à-vis the average coupon of 4.42% currently. For "B" rated sovereign debt, this differential between yield and coupon is estimated to have exceeded 230bps. While this implies that EM sovereigns are facing higher rates on new issuances, the report estimates that only a small share of the $13.1 bn of at-risk bonds (yields over 8%) are scheduled to be rolled over in the near term.

Higher UST rates has driven yields in the non-defaulted part of the EMIBGD close to multi-decade...
%, IG - segment



Many countries would have to issue at much higher rates than their current average coupons..
Y-axis: YTW; X-axis: Average Coupon Rate - red line denotes the points where the average coupon equals the YTW

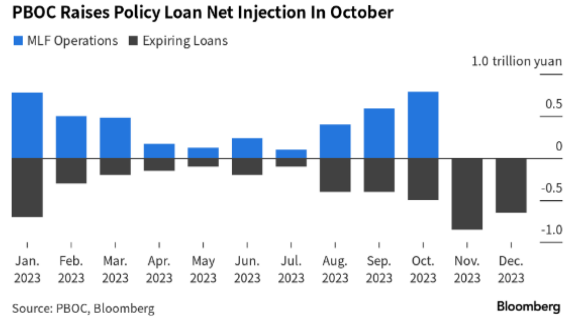


Sources: J.P. Morgan

China

The People's Bank of China (PBC) kept the 1-year medium-term lending facility (MLF) rate at 2.50% as expected. However, the PBC provided one-year MLF funding in an amount of 789 bn yuan ($107 bn), more than expected. This is the largest liquidity injection since 2020. Given some liquidity withdrawal via open market operations, the PBC injected (net) liquidity in an amount of 655 bn yuan ($89 bn) today. Analysts noted that the liquidity injection aimed to maintain stable systemwide liquidity conditions amid rising local government bond issuance and stronger funding demand during the tax payment season. The key interbank repo rate (DR007) dropped to 1.81% (-7.5 bps), close to the policy rate of 1.80%. CGB yields were mixed (1-year: -1.0 bp; 10-year: +0.6 bp). **Chinese equities declined** (CSI 300: -1.0%; Hong Kong SAR-listed: -1.1%), with IT stocks leading the decline in onshore markets following the news that the US administration plans to tighten measures to restrict China's access to advanced semiconductors and chipmaking machinery. RMB depreciated to 7.31 yuan per dollar (-0.1%) as the PBC continued setting the daily RMB fixing stronger than expected.

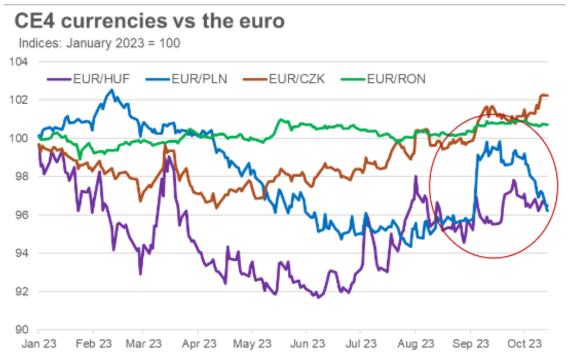
PBOC Raises Policy Loan Net Injection In October



Source: PBOC, Bloomberg

Poland

The Polish zloty (+0.8% to 4.50/€) was trading stronger the euro and equities rallied after exit polls of the parliamentary election pointed in favor of the opposition majority. The 2023 general elections were held in Poland yesterday, with analysts noting that the elections likely had a record high turnout. Exit polls released so far suggests that the opposition bloc comprising the Civic Coalition, the Third Way, and the Left could win an outright majority in the Sejm. While uncertainty still remains on the actual final outcome of the elections, market have responded positively, and contacts note that a pro-EU turn and judicial reform reversal could unlock access to EU funds. This morning the Polish zloty appreciated and has now fully retraced losses made in the aftermath of the larger-than-expected September policy rate cut. The Polish equity market rallied (+3.4%).



Source: Bloomberg and IMF calculations

This monitor is prepared under the guidance of Jason Wu (Assistant Director), Charles Cohen (Advisor), Nassira Abbas (Deputy Division Chief), and Caio Ferreira (Deputy Division Chief). Fabio Cortes (Senior Economist), Sanjay Hazarika (Senior Financial Sector Expert), Esti Kemp (Financial Sector Expert-London Representative), Johannes S Kramer (New York Representative), and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Benjamin Mosk (Senior Financial Sector Expert), Yingyuan Chen (Financial Sector Expert), Andrew Ferrante (Research Assistant), Deepali Gautam (Research Officer), Phakawa Jeasakul (IMF Resident Representative in Hong Kong SAR), Harrison Kraus (Research Assistant), Yiran Li (Research Assistant), Xiang-Li Lim (Financial Sector Expert),Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), Mustafa Oguz Caylan (Research Officer), Silvia Ramirez (Senior Financial Sector Expert), Patrick Schneider (Financial Sector Expert), Ying Xu (Economist), Dmitry Yakovlev (Senior Research Officer), and Akihiko Yokoyama (Senior Financial Sector Expert). Javier Chang (Senior Administrative Coordinator), Lauren Kao (Administrative Coordinator), and Srujana Sammeta (Administrative Coordinator) are responsible for the word processing and production of this monitor.

Global Financial Indicators

10/16/23 7:59 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4328	-0.5	0	-3	21	13
Europe		4145	0.2	1	-3	23	9
Japan		31659	-2.0	2	-6	18	21
China		3627	-1.0	-2	-2	-6	-6
Asia Ex Japan		64	-0.4	0	-3	12	-1
Emerging Markets		38	-0.4	0	-3	11	0
Interest Rates					basis points		
US 10y Yield		4.70	8.5	-11	36	68	82
Germany 10y Yield		2.79	4.9	1	11	44	22
Japan 10y Yield		0.76	0.0	-4	5	51	34
UK 10y Yield		4.46	7.5	-2	10	13	79
Credit Spreads					basis points		
US Investment Grade		155	1.4	0	7	-38	-4
US High Yield		457	6.4	5	46	-72	-23
Exchange Rates					%		
USD/Majors		106.43	-0.2	0	1	-6	3
EUR/USD		1.05	0.3	0	-1	7	-2
USD/JPY		149.5	-0.1	1	1	0	14
EM/USD		46.6	0.3	1	-2	-4	-7
Commodities					%		
Brent Crude Oil ($/barrel)		90.6	-0.3	3	-3	13	11
Industrials Metals (index)		137	0.5	-2	-4	-7	-17
Agriculture (index)		65	0.1	1	-3	-5	-6
Implied Volatility					%		
VIX Index (%, change in pp)		18.7	-0.6	1.0	4.9	-13.3	-3.0
Global FX Volatility		8.3	0.1	-0.2	0.2	-4.4	-2.4
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		155	-1.8	1	12	-106	-51
Italy		202	-1.7	-4	24	-42	-12
Portugal		74	-2.7	-6	0	-35	-28
Spain		114	-0.2	-1	7	-3	5

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

Emerging Market Financial Indicators

Last updated: 10/16/2023 8:00 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)						
	Level		Change (in %)					Level		Change (in basis points)				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.					
China		7.31	-0.1	-0.3	0	-2	-6		2.8	1.5	3	1	-5	-31
Indonesia		15721	-0.2	-0.2	-2	-1	-1		6.8	-1.2	-25	8	-61	-17
India		83	0.0	0.0	0	-1	-1		7.7	2.9	-21	-13	5.7	22
Philippines		57	0.0	0.3	0	4	-2		5.8	3.7	4	-3	-3	-22
Thailand		36	0.0	1.9	-2	5	-5		3.4	3.0	-8	20	15	73
Malaysia		4.74	-0.2	-0.1	-1	0	-7		4.0	0.2	-3	15	-42	0
Argentina		350	0.0	0.0	0	-57	-49		105.1	0.0	-286	-1633	1736	1684
Brazil		5.08	-0.5	1.4	-3	4	4		12.0	8.2	16	59	26	-57
Chile		938	0.2	-1.8	-5	4	-9		5.6	2.5	-16	26	-75	27
Colombia		4241	0.5	1.9	-7	8	14		9.3	-7.5	-43	71	-152	-53
Mexico		17.93	0.9	1.6	-4	12	9		9.4	-4.1	-5	41	13	70
Peru		3.9	-0.5	-0.8	-4	3	-1		7.7	1.7	9	82	-111	-31
Uruguay		40	-0.1	-1.5	-4	3	0		9.8	-10.2	-2	45	-178	-89
Hungary		367	0.6	0.2	-2	14	2		7.2	1.0	-33	37	-343	-238
Poland		4.25	1.6	1.7	2	15	3		4.9	-7.5	-19	22	-239	-127
Romania		4.7	0.3	-0.3	-1	6	-2		6.9	0.7	-12	25	-226	-82
Russia		97.2	0.5	2.7	-1	-36	-24							
South Africa		18.8	1.1	2.8	1	-4	-9		9.9	6.8	-4	38	48	76
Turkey		27.88	-0.3	-0.6	-3	-33	-33		27.5	19.0	46	22	1404	1763
US (DXY; 5y UST)		106	-0.2	0.3	1	-6	3		4.69	5.0	-7	23	42	68

	Equity Markets							Bond Spreads on USD Debt (EMBIG)					
	Level		Change (in %)					Level		Change (in basis points)			
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	7 Days	30 Days	12 M	YTD
								basis points					
China		3627	-1.0	-2	-2	-6	-6		174	1	-10	-30	-3
Indonesia		6896	-0.4	0	-1	1	1		134	5	-2	-77	-6
India		66167	-0.2	1	-2	13	9		142	-5	2	-57	0
Philippines		6199	-1.1	-1	1	5	-6		109	3	-3	-54	12
Thailand		1427	-1.6	-1	-7	-9	-14		0	0	0	0	0
Malaysia		1439	-0.4	2	-1	4	-4		97	-1	-1	-23	-3
Argentina		760674	6.2	24	37	440	276		2516	-163	340	-294	311
Brazil		115754	-1.1	2	-3	3	5		222	-5	-9	-94	-52
Chile		5778	-0.4	2	-4	16	10		146	10	18	-54	14
Colombia		1116	0.4	1	2	-4	-13		352	-8	7	-130	-20
Mexico		49380	-0.7	-1	-4	9	2		372	-4	12	-87	-9
Peru		22148	-0.1	0	-4	12	4		162	3	1	-76	-18
Hungary		56203	0.5	2	-3	42	28		199	-9	1	-129	-23
Poland		69566	3.7	7	3	49	21		126	-8	-4	73	53
Romania		14199	-0.5	2	0	33	22		216	-8	-3	-173	-40
South Africa		73027	0.1	2	-2	14	0		392	-11	11	-122	25
Turkey		7989	-1.5	-2	0	120	45		401	1	-1	-229	-39
Ukraine		507	0.0	0	0	-2	-2		3650	-65	344	-538	-429
EM total		38	0.0	0	-3	11	0		410	-4	27	-71	35

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

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