GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, OCTOBER 17, 2023

LEAD EDITOR: SANJAY HAZARIKA

- **Derivatives markets price higher US interest rates for longer** (link)
- **Treasury yields rise as US retail sales beat expectations** (link)
- **Yen could retest 150 versus dollar** (link)
- **Equity markets yet to react to war in the Middle East** (link)
- **German ZEW business survey stronger than expected** (link)
- **Markets dial down UK rate hike expectations as wage growth slows** (link)

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Markets hope for containment

Markets are hoping that the war in the Middle East will be contained as US President Biden is reported to be considering a visit to Israel as early as tomorrow. Equity markets were lower across the board, with European stocks in negative territory and US equity index futures also in the red. Treasury and bund yields were up again this morning, and close to the highs for the year that were reached earlier this month. Earnings season continued as Bank of America and Goldman Sachs reported results that were better than expected. Other companies whose reports are imminent include United Airlines and Tesla. Meanwhile, a number of Federal Reserve officials are scheduled to make remarks ahead of the blackout period that precedes the next FOMC meeting on November 1. Markets assign a probability of less than 10% to a rate hike at that meeting, although the odds of a hike at the December 13 meeting stand at almost 40%.

Key Global Financial Indicators

Last updated: 10/17/23 7:59 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		4374	1.1	1	-2	19	14
Eurostoxx 50		4135	-0.4	-2	-4	20	9
Nikkei 225		32040	1.2	1	-4	18	23
MSCI EM		38	0.7	1	-3	9	1
Yields and Spreads			bps				
US 10y Yield		4.76	5.2	11	43	75	88
Germany 10y Yield		2.84	5.3	6	16	57	27
EMBIG Sovereign Spread		445	-5	-7	30	-124	-7
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		46.5	0.0	0	-2	-4	-7
Dollar index, (+) = $ appreciation		106.1	-0.1	0	1	-5	3
Brent Crude Oil ($/barrel)		90.0	0.4	3	-4	-2	5
VIX Index (%, change in pp)		17.7	0.5	1	4	-14	-4

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

Mature Markets back to top

United States

Retail sales came in much stronger than expected. Treasury yields jumped after the release of the data, and the dollar appreciated versus the euro and the yen. US equity index futures were lower.

US RETAIL SALES

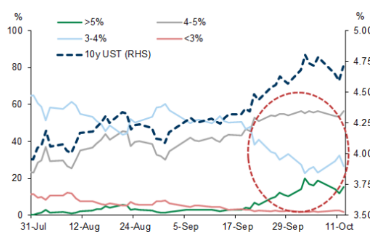
SOURCE: BLOOMBERG

Data Release	Consensus Forecast	Actual Date
Retail sales mom	0.3%	0.7%
Retail sales ex-autos	0.2%	0.6%
Retail sales ex-auto and gas	0.1%	0.6%

Derivatives markets are predicting that interest rates will be higher for longer. Pricing in the market for derivatives on interest rate swaps, known as swaptions, suggests that investors think the 10-year Treasury yield is likely to remain in the 4−5% range rather than fall back below the 4% level. The 10-year Treasury last closed below 4% on July 31. However, contacts noted that bullish sentiment is beginning to return to the Treasury market as current yield levels prove attractive to investors. Flows from investment funds have been especially strong. After the summer selloff, the risk-reward for Treasury investors has improved significantly, because even moderately lower rates can deliver large gains, while moderately higher rates will result in smaller losses.

Exhibit 1 : The recent selloff appears to have been driven by shifts in tail probabilities, with investors focusing on upside risks to yields

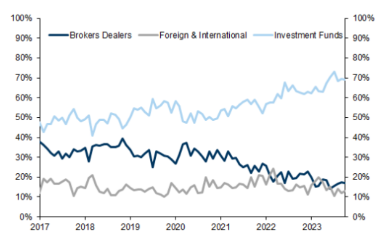
Swaption-implied probability of 3m-ahead 10y yield outcomes



Source: Goldman Sachs Global Investment Research

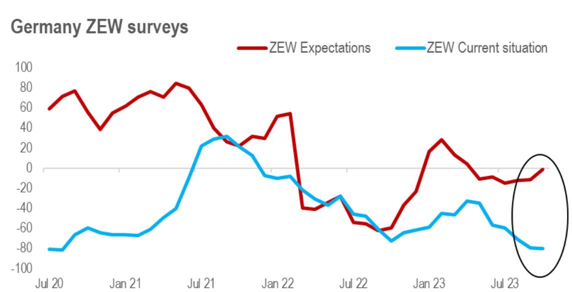
Exhibit 2 : The percent allotted to investment funds across maturities has grown from around 50% in 2017 to about 70% today

Treasury auction allotment shares, % of ex-Fed Total



Source: Treasury, Goldman Sachs Global Investment Research

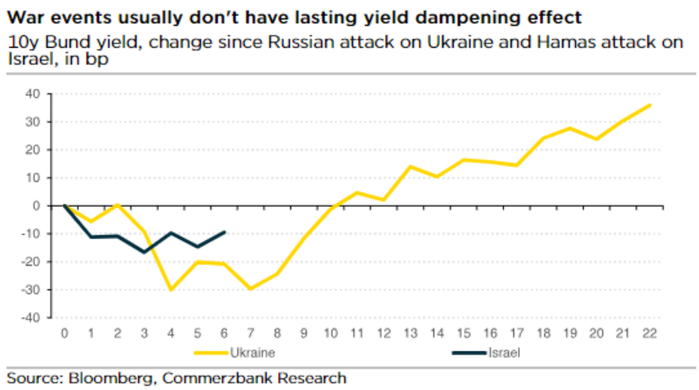
Euro Area



Source: Bloomberg and IMF calculations

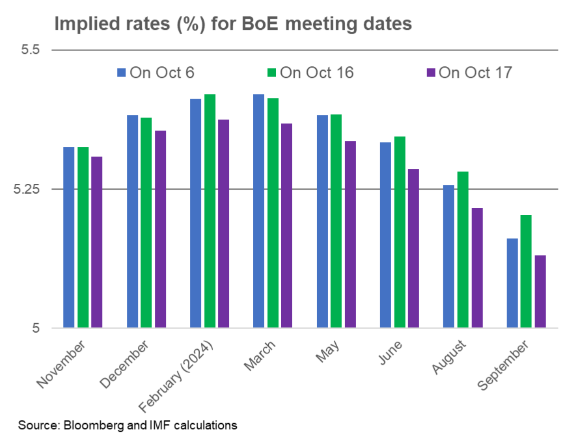
The euro retraced some opening losses after the expectations component of the German ZEW survey surprised on the upside but was marginally weaker against the dollar in later trade (-0.1% trading at around 1.05). The ZEW measure of expectations was not as bad as expected, coming in at -1.1 in October (versus expected -9 from 11.4 in September). **JPMorgan analysts caution that the euro could see further weakening**, arguing that the exchange rate is not yet reflecting the numerous uncertainties faced by the euro, including tighter financial conditions, possible geographical risks, and stagnant economic growth. **European equities were mixed with the Stoxx 600 equity index marginally lower.**

Sovereign yields were edging higher (10y bund +3bps to 2.82%) while contacts highlight more hawkish tones in ECB commentary. Yesterday, ECB Chief Economic Lane said that the ECB has to be "open to doing more", and also argued that the ECB is "quite some distance" from starting rate cuts. ECB President Lagarde reportedly told euro area finance ministers that the ECB is keeping an eye on oil price developments for any inflationary impact from the Israel-Hamas conflict, according to Bloomberg. Some contacts note that the key theme for European Government Bond (EGB) markets today is likely to be issuance activity, with German, Dutch, and Finnish bond auctions and new benchmark issuance by Germany and the Netherlands.



United Kingdom

The pound weakened against the dollar (-0.5% to 1.22) and the euro (-0.4% to 0.87) as the markets scaled back BoE tightening expectations after data showed elevated but easing wage pressures in August. UK wage growth excluding bonuses eased in line with expectations in the three months to August (7.8% from a revised 7.9% in July), while average weekly earnings were slightly weaker than expected (8.1% versus expected 8.3% from 8.5%). Today's data release has reinforced analysts' expectations for the BOE to keep interest rates unchanged at the upcoming meeting in November. Focus now shifts to the September inflation data print, set to be released tomorrow, but contacts argue that it would require a significant upside surprise to see a November BOE hike. Meanwhile, BOE chief economist Huw Pill yesterday said that the central bank still has some work to do to return inflation to target. Pill also estimated that roughly 50% of the monetary policy tightening that had been done in this cycle has filtered through to the economy, while MPC member Dhingra estimate that only 25% of the tightening had fed through**.** Markets are now pricing in roughly 12bps of tightening by March 2024, compared to roughly 17bps priced in yesterday.



Japan

Japanese equities gained on optimism that the conflict in the Middle East will be contained (NIKKEI: +1.2%). Masato Kanda (Japan's chief currency official) said that rate hikes and interventions are ways to respond to excessive currency movements. His remarks, especially the part related to rate hikes, were perceived as a theoretical discussion rather than a hint for the Bank of Japan's policy changes. Long-end JGB yields rose (10-year: +2.1 bp; 30-year: +3.7 bps) after a weak 20-year debt auction, which drew a lower-than-expected cut-off price. **Japan's largest labor union reportedly will call for wage increases by at least 5%,** the largest amount since late 1990s.

Australia and New Zealand

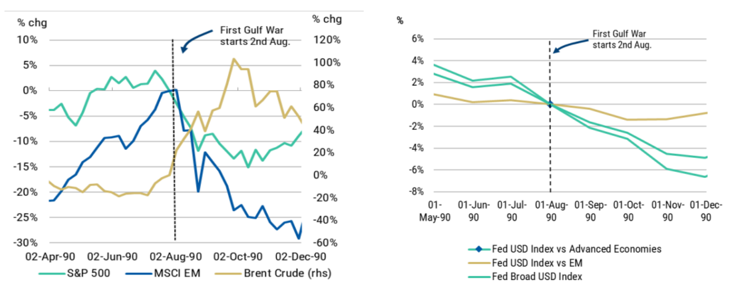
Australian government bond yields rose in response to the release of the Reserve Bank of Australia (RBA)'s minutes. The minutes revealed that the RBA will not tolerate a slower-than-forecast return to the inflation target. This prompted market participants to raise the likelihood of a rate hike at the RBA policy meeting in November. Government bond yields rose across the curve (1-year: +11.2 bps; 10-year: +8.9 bps; 30-year: +9.1 bps), while the one-year overnight index swap (OIS) rate increased by 8.7 bps to 4.33%, compared with the current policy rate at 4.10%. %). **In New Zealand, CPI moderated to 5.6% y/y in 2023Q3, lower than expected** (consensus: +5.9%). The New Zealand dollar depreciated (-0.7%), while long-end government bond yields increased, in line with regional trends (10-year: +2.6 bps; 30-year: +3.1 bps). With easing inflationary pressures, market participants saw a lower probability of a rate hike in November. The one-year OIS rate dropped to 5.71% (-7.5 bps).

Commodities

The main channel for the conflict in the Middle East to impact global financial markets is through the price of oil. Bloomberg forecasts that a wider war involving Iran could push Brent crude prices up to $150/barrel due to the impact on global supply. The first Gulf war of 1990−91 saw a major rise in oil prices and a big hit to equity markets. The Brent crude spot price is up just $6 since October 6, the day before the Hamas attack, and some analysts are worried that markets are underestimating the probability of a negative shock if the war escalates. World equity markets are actually higher than where they were on October 6. Other analysts are more optimistic, taking the view that it is not in anyone's interest to escalate the war beyond its present confines.

Morgan Stanley

Oil Risks Key for Broader Markets



Source: Bloomberg, Morgan Stanley Research; Note: Charts show the cumulative change in asset prices before and after August 2, 1990.

Foreign Exchange

As the yen trades near 150 versus the dollar, markets seem confident that the Japanese likely are not likely to intervene to support the currency. Contacts predict that the currency could depreciate beyond the 150 level to 155 or even 160. Yen moves against the dollar on a monthly basis have become much smaller this year than they were last year. In the foreign exchange options market, the volatility of one-month dollar call/yen put options has fallen to 8%, the lowest since March 2022. This has reassured markets after Finance Minister Suzuki noted earlier this month that any decision to intervene will be based on the volatility of the currency rather than its absolute level. In October 2022, the Bank of Japan spent ¥6.3 tn yen, a record amount then equivalent to $42.4 bn, to support the currency.

Monthly Yen Moves Against the Dollar Have Become Much Less Volatile in 2023

Source: Bloomberg
Note: October 2023 data shows month-to-date performance as of Oct. 16
Bloomberg

Emerging Markets

EMEA equities were mostly higher while currencies were mixed. Equities in Egypt (+2.5%) outperformed. CEE currencies were mostly stronger against the euro, **with the Polish Zloty (+0.4% to 4.43/€) continuing to outperform after interim election results confirmed exit polls**, pointing to a change in government. Polish equities were up (+1.7%). Contacts note that final official results are expected later today. **Bloomberg reports that Ghana's Eurobonds are underperforming after the government outlined proposals for restructuring terms for bondholders involving a nominal haircut of up to 40%. Asian equities gained on optimism that diplomatic efforts may help contain the conflict in the Middle East.** Asian share prices rose 0.9% overall, led by Philippine (+1.3%), Korean (+1.0%) and Hong Kong (+0.8%) equities. Asian currencies were mixed, trading in a tight range. One exception was Thai baht, which depreciated (-0.3%) on foreign fund outflows from local bond and stock markets. **LATAM markets also closed higher on Monday, led by Chile (+1.3%) and Mexico (+0.9%).** In currency markets, the Mexican peso outperformed its regional peers, appreciating 1.1%, while the Brazilian real was up 0.7%.

Emerging Market Fund Flows

EM funds flows remained negative for the eleventh consecutive week. For the week ending on October 12, EM fund outflows intensified to -$5 bn from -$3.6 bn in the week before. This was driven by rise in equity fund outflows, which increased to -$3.3 bn (from -$861mn), as bond fund outflows at -$1.2 bn, while sizable, declined from -$1.9 bn in the week before. Both hard and local currency bonds witnessed net withdrawal of -$1.2 bn and -$0.5 bn, respectively. Within equity funds, EM Asia saw dramatic increase in outflows of -$1.9 bn vis-à-vis inflow of $0.55 bn in the week before, while LATAM saw small inflows. With this, the YTD total EM funds flows now stand at -$3.1 bn.

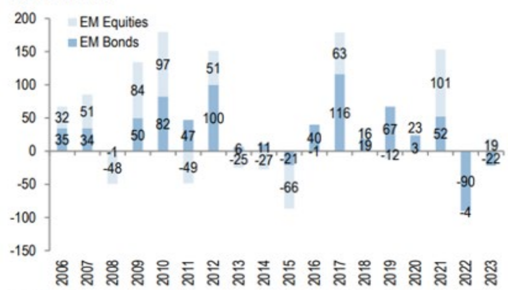
Figure 1: Weekly cross-asset flows

USD billion

	Asset	8w flows (8w ago → current)	This wk	YTD
Fund Flows	**EM Bonds and Equities**		-5.0	-3.1
	EM Bonds		-1.7	-21.8
	Hard Ccy		-1.2	-17.3
	Local Ccy^		-0.5	-4.5
	o.w. EM ex-China		-0.4	-0.5
	o.w. China		-0.2	-5.2
	EM Equities		-3.3	18.8
	US HG		1.6	237.8
	US HY		-1.4	-7.7
	Global Equities		-3.5	-52.9
	EM Bond and Equity ETFs		-2.6	30.2
	EM Bond ETFs		-0.8	-3.0
	EM Equity ETFs		-1.8	33.2
	Non-resident EM flows*		0.2	17.7

Figure 2: EM bond and equity fund flows

USD billion



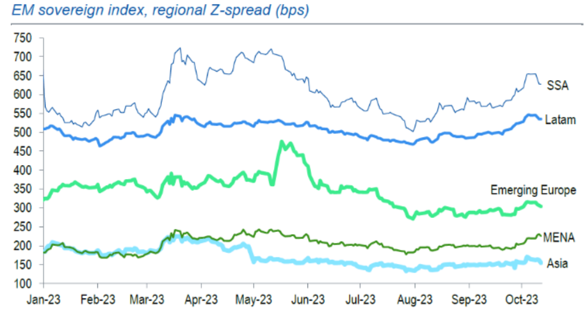
*High frequency non-resident EM portfolio flow data where available. ^Local ccy split is retail only. Source for all charts and data in this report: J.P. Morgan, EPFR Global, Bloomberg Finance L.P.

Emerging Market Credit

Analysts have become more cautious on EM credit against a backdrop of a higher-for-longer rates environment and the ongoing Israel-Hamas conflict. Standard Chartered analysts argue that the credit fundamentals of EM sovereigns are likely to be further weakened in the medium term by the 'higher-for-longer rates environment. Moreover, taking the Israel-Hamas conflict has made analysts more cautious on EM credit. MENA credit has underperformed since the start of the conflict, and analysts caution that geopolitical risk could see further spread widening. In the meantime, JPMorgan analysts have also cautioned that geopolitical events add uncertainty to emerging market FX.

Figure 1: MENA credit underperforms after start of Israel-Hamas conflict

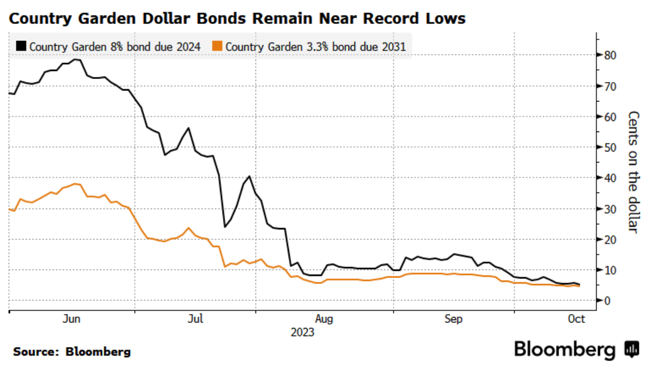
EM sovereign index, regional Z-spread (bps)



Source: Bloomberg, Standard Chartered Research

China

Chinese equities gained on improving global sentiment driven by optimism about the Middle East situation (CSI 300: + 0.4%; Hong Kong SAR-listed: +0.7%). RMB depreciated slightly to 7.31 yuan per dollar. Meanwhile, the People's Bank of China (PBOC) continued setting the daily RMB fixing stronger than expected; today's deviation from expectations amounted to 1,232 pips. **Vice Premier He Lifeng said that China will look to improve cooperation through the Belt and Road Initiative with an emphasis on sustainable debt.** China also wants to make the initiative greener and healthier. Meanwhile, Russian President Putin arrived in Beijing to attend the Belt and Road Forum. **The PBOC reportedly asked state-owned banks to roll over existing local government financing vehicle (LGFV) debt** with longer-term loans at lower interest rates. However, lending rates should not be lower than CGB yields. **Markets closely watched whether Country Garden will default.** The company would suffer its first-ever USD bond default if it misses an interest payment deadline today (the 30-day grace period will lapse today). Country Garden's USD bonds have been traded below 10 cents on the dollar in recent months. In addition, markets are monitoring the situation at China Evergrande, which may face a court-ordered liquidation at a hearing in Hong Kong SAR on October 30.



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Global Financial Indicators

	Level		Change				
10/17/23 8:02 AM	**Last 12m**	**Latest**	**1 Day**	**7 Days**	**30 Days**	**12 M**	**YTD**
Equities					%		%
United States		4374	1.1	1	-2	19	14
Europe		4135	-0.4	-2	-4	20	9
Japan		32040	1.2	1	-4	18	23
China		3639	0.4	0	-2	-5	-6
Asia Ex Japan		64	0.5	1	-2	10	-1
Emerging Markets		38	0.7	1	-3	9	1
Interest Rates					basis points		
US 10y Yield		4.76	5.2	11	43	75	88
Germany 10y Yield		2.84	5.3	6	16	57	27
Japan 10y Yield		0.78	2.0	0	7	53	36
UK 10y Yield		4.50	1.7	7	14	52	83
Credit Spreads					basis points		
US Investment Grade		155	0.4	1	9	-39	-4
US High Yield		453	-3.7	-1	47	-71	-27
Exchange Rates					%		
USD/Majors		106.12	-0.1	0	1	-5	3
EUR/USD		1.06	0.2	0	-1	7	-1
USD/JPY		149.5	0.0	1	1	0	14
EM/USD		46.5	0.0	0	-2	-4	-7
Commodities					%		
Brent Crude Oil ($/barrel)		90.0	0.4	3	-3	12	10
Industrials Metals (index)		135	-1.0	-2	-5	-6	-18
Agriculture (index)		65	0.0	2	-3	-4	-6
Implied Volatility					%		
VIX Index (%, change in pp)		17.7	0.5	0.7	4.0	-13.6	-3.9
Global FX Volatility		8.1	0.0	-0.2	0.0	-4.3	-2.6
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		151	-2.7	0	9	-116	-54
Italy		201	3.1	6	23	-38	-13
Portugal		72	-1.1	-2	-3	-35	-30
Spain		112	0.4	2	5	-4	3

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

Emerging Market Financial Indicators

Last updated:	Exchange Rates							Local Currency Bond Yields (GBI EM)						
10/17/2023	Level		Change (in %)					Level		Change (in basis points)				
8:03 AM	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	0.0	-0.3	0	-2	-6		2.8	1.0	2	2	-4	-30
Indonesia		15716	0.0	0.1	-2	-1	-1		6.8	-0.4	-18	8	-67	-17
India		83	0.0	0.0	0	-1	-1		7.7	2.0	-12	-11	7.8	24
Philippines		57	0.1	0.2	0	4	-2		5.8	0.0	-1	-3	-3	-22
Thailand		36	-0.4	0.7	-2	5	-5		3.4	2.5	-3	23	17	76
Malaysia		4.74	0.0	-0.2	-1	0	-7		4.1	1.9	-1	17	-41	2
Argentina		350	0.0	0.0	0	-57	-49		105.1	0.0	-631	-1050	1844	1684
Brazil		5.05	-0.2	0.1	-4	5	5		11.9	13.8	19	53	19	-64
Chile		951	-0.5	-2.1	-7	2	-11		5.8	4.0	19	43	-58	44
Colombia		4241	0.5	1.9	-7	8	14		9.3	0.0	-28	84	-200	-53
Mexico		17.94	-0.3	0.0	-4	11	9		9.5	0.0	14	47	18	77
Peru		3.9	-0.1	-0.6	-4	3	-1		7.7	1.0	20	89	#VALUE!	-24
Uruguay		40	0.1	-0.5	-4	3	0		9.8	0.0	-2	46	-191	-89
Hungary		364	0.5	0.4	-1	15	3		7.3	6.0	2	45	-335	-230
Poland		4.19	0.6	2.2	4	16	4		5.0	7.5	2	34	-227	-115
Romania		4.7	0.1	-0.3	-1	7	-2		6.9	0.2	-13	30	-217	-82
Russia		97.3	0.2	3.0	-1	-36	-24							
South Africa		18.8	-0.3	1.0	1	-4	-10		9.9	-3.0	9	38	48	76
Turkey		27.92	-0.2	-0.7	-3	-33	-33		27.6	1.0	58	34	1446	1775
US (DXY; 5y UST)		106	-0.1	0.3	1	-5	3		4.75	3.4	14	29	52	75

	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		3639	0.4	0	-2	-5	-6		173	0	-10	-30	-4
Indonesia		6940	0.6	0	0	2	1		127	-2	-2	-83	-13
India		66428	0.4	1	-2	13	9		140	-7	1	-61	-2
Philippines		6281	1.3	0	3	2	-4		104	-2	-2	-67	7
Thailand		1433	0.4	0	-6	-10	-14		0	0	0	0	0
Malaysia		1444	0.4	1	-1	3	-3		96	-2	0	-24	-4
Argentina		760674	6.2	24	37	440	276		2436	-243	262	-413	231
Brazil		116534	0.7	2	-2	3	6		222	-5	-5	-90	-52
Chile		5853	1.3	1	-2	15	11		143	7	19	-56	11
Colombia		1116	0.4	0	2	-4	-13		347	-13	15	-141	-25
Mexico		49823	0.9	1	-3	8	3		368	-8	10	-88	-13
Peru		22313	0.7	0	-3	11	5		158	-1	2	-80	-22
Hungary		56452	0.2	1	-3	42	29		192	-16	2	-122	-30
Poland		70808	1.2	6	5	51	23		115	-19	-9	67	42
Romania		14186	0.0	1	0	32	22		208	-16	2	-172	-48
South Africa		72598	-0.7	-2	-3	10	-1		393	-10	20	-109	26
Turkey		7942	0.1	-6	0	106	44		397	-3	-4	-221	-43
Ukraine		507	0.0	0	0	-2	-2		3645	-70	441	-510	-434
EM total		38	-0.4	1	-3	9	1		404	-10	27	-74	29

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

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