GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

WEDNESDAY, OCTOBER 18, 2023
LEAD EDITOR: SANJAY HAZARIKA

- **Treasury yields in US hit highest level since 2007** (link)
- **BOJ intervenes as JGB yields hit decade highs** (link)
- **Stocks in China fall despite stronger than expected GDP data** (link)
- **US yield curve steepening led by real yields** (link)
- **Treasury market selloff in US remains orderly** (link)

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Markets retreat in uncertain environment

Markets are in a pessimistic mood this morning, with euro area stocks down across the board and US equity futures in negative territory. The war in the Middle East and the potential default of Chinese property developer Country Garden have weighed on sentiment, despite stronger than expected Chinese GDP data. Oil prices are up sharply as Bloomberg reports that Iran has called for an oil embargo against Israel. Treasury and bund yields are holding steady after reaching new post-2007 highs yesterday, with market conditions remaining stable despite the surge in yields. The dollar is stronger against the euro and the yen, following US rates higher. A key focus for markets is Fed Chair Powell's speech tomorrow in New York, one of the last Fed speeches before the blackout period begins ahead of the next FOMC meeting on November 1. UK inflation was higher than expected, possibly opening the door to another rate hike from the Bank of England.

Key Global Financial Indicators

Last updated: 10/18/23 7:56 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		4373	0.0	0	-2	18	14
Eurostoxx 50		4125	-0.7	-2	-3	19	9
Nikkei 225		32042	0.0	0	-4	18	23
MSCI EM		38	-0.3	0	-3	8	0
Yields and Spreads			bps				
US 10y Yield		4.82	-1.7	26	51	81	94
Germany 10y Yield		2.88	-0.4	16	17	59	31
EMBIG Sovereign Spread		442	-3	-8	27	-126	-10
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		46.6	0.0	0	-2	-4	-7
Dollar index, (+) = $ appreciation		106.3	0.0	0	1	-5	3
Brent Crude Oil ($/barrel)		91.8	2.1	7	-3	2	7
VIX Index (%, change in pp)		18.3	0.4	2	4	-12	-3

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

Mature Markets

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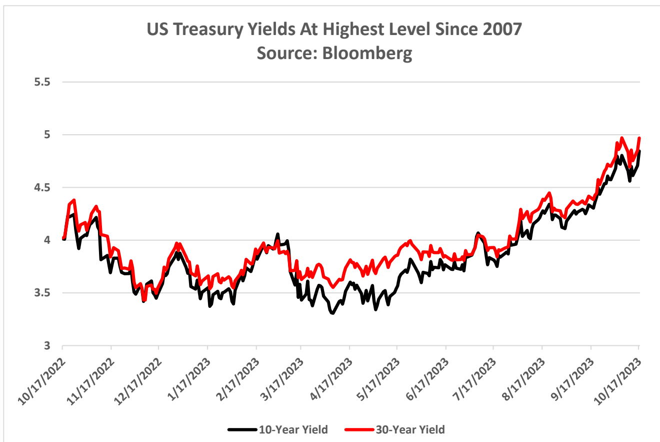
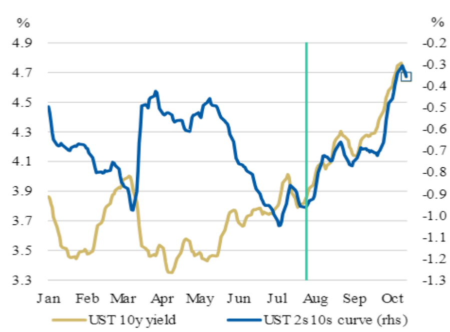
Yields hit the highest level since 2007 yesterday, with the benchmark 10-year yield up over 90 bps since it last closed below 4% on July 31, while the long bond yield is up nearly 100 bps over the same period. The two-year yield reached its highest level since 2006. The selloff yesterday was triggered by much higher than expected retail sales data, raising fears that a stronger US economy could induce the Fed to remain hawkish and delay the beginning of rate cuts in 2024. The move was accentuated by better-than-expected industrial production data. The widely followed Citi Surprise Index for the US remains quite strong, in contrast to the indexes for China, the euro area and the UK, highlighting that the US economy is doing much better than most other countries. The probability of a rate hike at the December 13 FOMC meeting increased to nearly 50%, while the market is pricing fewer than 2.5 rate cuts in 2024 from four rate cuts a few months ago. The real 10-year rate from the Treasury Interest Rate Protected Security (TIPS) remains below the 2.50% level seen last week.



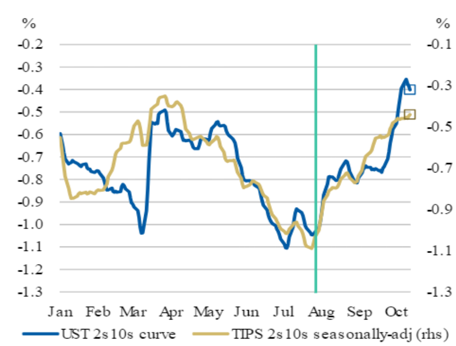
The US two-year/10-year yield spread has increased by nearly 60 bps since the Treasury selloff began on August 1, led by real yields. While the 10-year Treasury yield has risen by more than nearly 90 bps, the 10-year breakeven Treasury Inflation Protected Security (TIPS) breakeven yield, an important market measure of inflation expectations, is little changed over the same period. Morgan Stanley analysts contend that the move was triggered by the realization that the Fed would be more hawkish than originally expected, and that interest rates were likely to stay higher for longer. If the market was worried about other challenges such as worries about fiscal sustainability or heavy new supply, then nominal yields would have risen more than real yields, resulting in higher TIPS breakeven yields. The 10-year real yield reached 2.50% on October 6, the highest since 2007, before falling back.

Exhibit 3: UST 10y yield and UST 2s10s yield curve (5-day moving averages)



Source: Morgan Stanley Research, Federal Reserve, Bloomberg

Exhibit 4: UST 2s10s yield curve and TIPS 2s10s yield curve* (5-day moving averages)

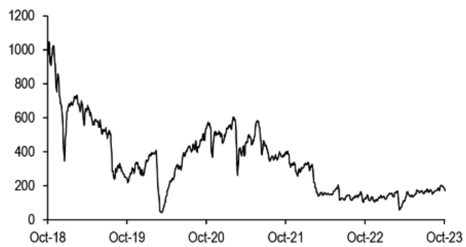


Source: Morgan Stanley Research, Federal Reserve, Bloomberg
* We seasonally-adjust TIPS yields

The selloff in the US Treasuries has been severe, but market conditions remain orderly. JP Morgan reports that market depth has remained robust, in contrast to the period in October when turbulence in the UK led to a much more disorderly selloff in Treasuries. Treasury market volatility is up slightly but remains well below the levels seen in March and October 2022. Implied volatility for derivatives on interest rate swaps, known as swaptions, remains high but realized volatility is more muted than usual, and the difference between the two is larger than usual. Demand for Treasuries has remained robust, especially from mutual funds. The risk-reward tradeoff at these higher yield levels has become quite favorable for investors, as even modest declines in yields can deliver large gains, while modest rises in yields will result in smaller losses.

Figure 17: Despite the recent sell-off, market depth has remained on its gradual upward trend that began earlier this year...

Duration-weighted Treasury market depth*; 5-day moving average; $mn 10-year Treasury equivalents (5-day moving average)



Source : BrokerTec, J.P. Morgan

Figure 18: ...And even over the last month, depth has held in well across most sectors

Current level, 1-month change, and 5-year statistics for 5-day moving average of Treasury market depth*; by sector of the curve, $mn unless otherwise indicated

Maturity	Level	1m chg	5y z-score	5-year avg	5-year min	5-year max	%
2y	81	1	-0.8	317	16	1959	33%
5y	67	1	-1.0	164	19	427	32%
10y	84	-19	-0.9	147	16	323	22%
30y	17	5	0.0	17	4	44	64%
Total	**170**	**-14**	**-0.9**	**342**	**43**	**1047**	**29%**

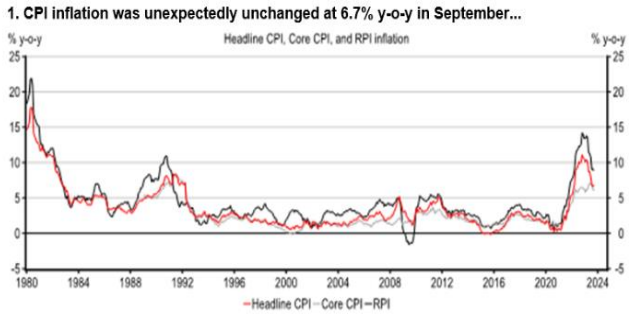
Source : BrokerTec, J.P. Morgan
*Market depth is the sum of the three bids and offers by queue position, averaged between 8:30 and 10:30am daily Total is the sum of 2-, 5-, 10-, and 30-year depth in 10-year equivalents

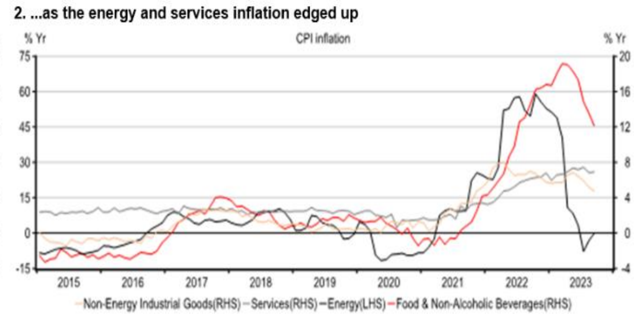
Euro Area

European equities were weaker with the Stoxx 600 equity index 0.6% lower. The energy sector was up (+0.7%) as oil prices increased amid concerns of conflict escalation in the Middle East, and also better-than-expected economic growth data from China. Brent crude oil increased by 2.2% to $92/barrel. **The euro was weaker against the dollar at 1.0562.** On the data front the final euro area inflation print for September confirmed earlier estimates (+4.3%y/y). **Sovereign yields were little changed with the 10y bund trading at around 2.88%,** after closing sharply higher yesterday (10yr bund yields +10bps) in the aftermath of stronger-than-expected US data. **10y Italian spreads are 4bps higher this morning at 205bps.**

United Kingdom

Analysts continue to expect that the BoE would remain on hold in their November meeting after September inflation print surprised marginally on the upside. Data released this morning showed headline inflation remaining unchanged at 6.7% y/y in September, while consensus had expected a marginal decrease to 6.6%, and core inflation easing by less than expected to 6.1%y/y (versus expected 6.0% from 6.2%). Contacts highlight that higher motor-fuel prices were mostly offset by lower food-price inflation. Services inflation, however, was marginally higher (6.9%y/y versus expectations to remain unchanged at 6.8%), but slightly below the BoE's forecasts. Markets are pricing in roughly 16bps of tightening by February (compared to 14bps yesterday), with 6bps of tightening priced in for the November policy meeting. Most analysts continue to expect that the BoE will remain on hold at the November meeting, with JPMorgan noting risks that tightening could be resumed in early 2024. **The pound was marginally stronger against the dollar (trading at around 1.22) and the euro (+0.2% to 0.87) while 10y gilt yields were roughly 5bps higher at 4.56**%.





Source: HSBC and ONS

Japan

The Bank of Japan (BOJ) intervened in the bond market again as JGB yields reached new decade highs. The BOJ announced an unscheduled bond purchase operation after the 10-year JGB yield touched 0.815%. The purchase will include 300 bn yen ($2 bn) of 5-to-10-year JGBs and 100 bn yen ($0.67 bn) of 10-to-30-year JGBs. Market participants viewed that the purchase amount is too small to have any material impact. The 10-year JGB yield still increased to 0.804% (+2.8 bps) today, while longer-end yields also rose (30-year: +2.1 bps). Separately, the BOJ reportedly will discuss raising its inflation projection for FY2023 and FY2024 at its November policy meeting. The inflation forecast could increase from 2.5% to 3.0% for FY2023. The Japanese yen was little changed at 149.8 yen per dollar and Japanese equities held steady.

Emerging Markets

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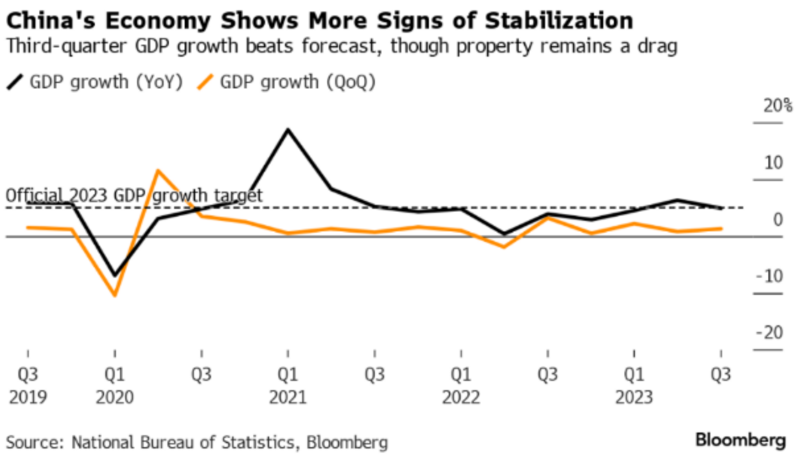
EMEA equities were mixed while currencies were mostly slightly weaker amid concern that conflict in the Middle East could escalate. Equities in Egypt (+1.1%) continue to outperform. CEE currencies were mostly marginally weaker against the euro, with the Polish zloty (-0.6% to 4.45/€) underperforming. **Asian equities were lower and long-end government bond yields increased, with 10-year yields rising in Indonesia (+10.9 bps) and Korea (+6.4 bps), following the rise in US treasury yields.** Equity markets in Latin America were mixed while regional currencies appreciated against the dollar. In Argentina, ahead of the first round of general elections on Oct 22nd, domestic financial markets showed resilience, with equities surging by 8.3%**.**

China

Chinese equities declined despite stronger-than-expected 2023 Q3 GDP data. China's economy grew 4.9% y/y in 2023 Q3, beating expectations (consensus: +4.5%). Sequentially, economic growth accelerated from 0.5% q/q in 2023 Q2 to 1.3% in 2023Q3 (consensus; +0.9%). **September activity provided more**

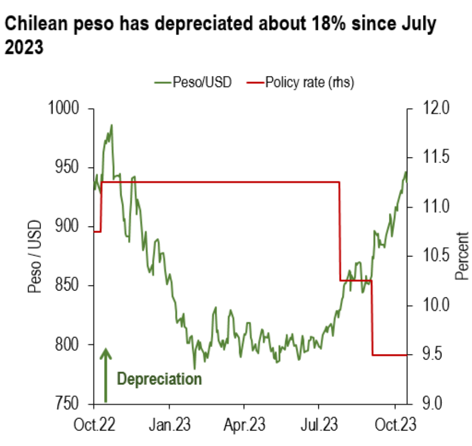
evidence that the growth slowdown may have stabilized. Industrial production increased by 4.5% y/y (consensus: +4.4%), while retail sales grew 5.5% y/y (consensus: +4.9%). The unemployment rate also fell to 5.0% (consensus: 5.2%). Regarding fixed investment, there was a pickup in manufacturing and infrastructure investment. However, the contraction of property investment deepened to 9.1% year-to-date y/y (consensus: -8.9%).

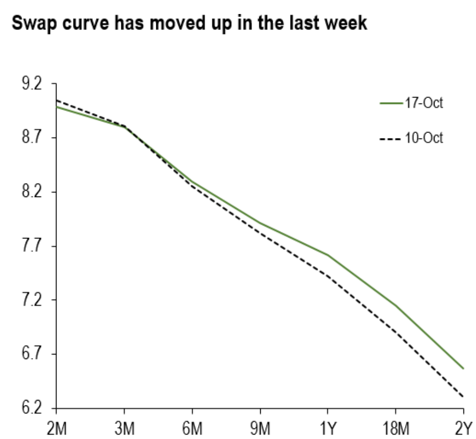
Country Garden is set for its first-ever offshore USD bond default. The company said that it will not be able to meet all of its offshore payment obligations on time due to a deep correction in China's home market and its subdued sales, in response to an inquiry on its missing interest payment ($15.4 mn). The 30-day grace period will expire today. The default would trigger a cross-default on about $10 bn of USD bonds. Share prices of real estate firms fell (onshore: -1.3%; Hong Kong SAR-listed: -0.7%).



Chile

The Central bank is reported to be concerned about currency depreciation in its upcoming monetary policy meeting. The Chilean peso has depreciated 18% since July 2023, making it one of the worst performing regional currencies. During this time, the central bank had cut its policy rate by 175 bps despite the US monetary policy remaining tight, primarily reacting to easing inflationary pressures. While the divergence in policy paths of Chile and US has been weighing on the currency, fresh concerns over oil prices due to the recent conflict in the Middle East, have been acting as an additional drag lately. Over the last one week the currency depreciated by 0.8% and the Camara curve has shifted up, with rates for tenors 12 months or more increasing by 20–25 bps.



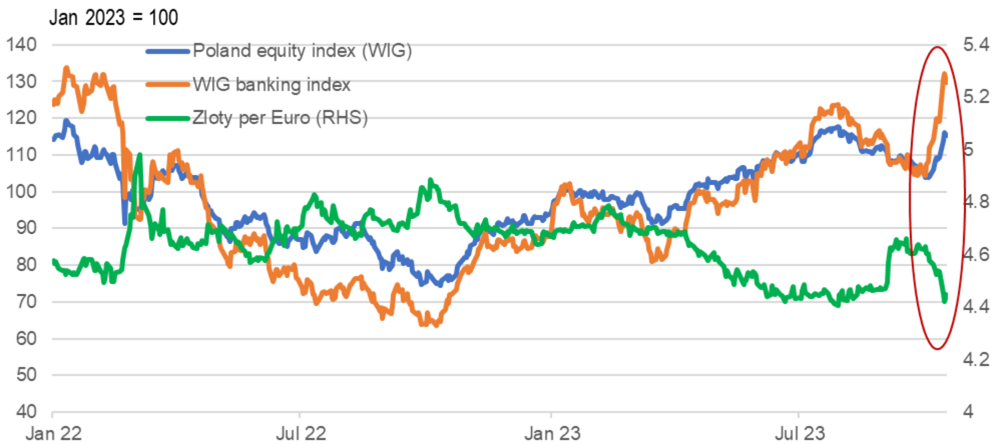


Source: Bloomberg

Poland

Polish financial assets extended gains yesterday after the final results of the country's parliamentary elections confirmed a path for opposition parties towards a workable majority. The Civic Coalition, Third Way and the Left Party together obtained 248/460 seats in Poland's lower house. Analysts expect that the conservative/populist Law and Justice (PiS) party would be called upon first to try to form a government, as the PiS party remains the single-largest party in parliament (with 194 seats), but it is seen as unlikely to be able to gather a majority. Goldman Sachs analysts highlight that **the election outcome has significant implications for Poland and the EU, including for example Poland-EU relations and monetary policy.** Analysts now see a quick resolution to matters that have delayed EU fund disbursement, and as regards the central bank, it is expected to become more hawkish in the short-term, but still cut rates substantially in 2024. While it is expected that the formation of a new government would take time, contacts note that the Polish zloty could see further support amid hopes of a more market-friendly environment, higher capital inflows, and lower risk premiums.

Poland: Equities and Currency



Source: Bloomberg and IMF staff calculations

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Global Financial Indicators

10/18/23 7:57 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		4373	0.0	0	-2	18	14
Europe		4126	-0.6	-2	-3	19	9
Japan		32042	0.0	0	-4	18	23
China		3611	-0.8	-2	-3	-4	-7
Asia Ex Japan		64	-0.4	-1	-2	10	-1
Emerging Markets		38	-0.3	0	-3	8	0
Interest Rates					basis points		
US 10y Yield		4.82	-1.7	26	51	81	94
Germany 10y Yield		2.88	-0.4	16	17	59	31
Japan 10y Yield		0.81	2.8	4	9	55	39
UK 10y Yield		4.56	5.1	24	17	61	89
Credit Spreads					basis points		
US Investment Grade		155	0.2	2	9	-37	-4
US High Yield		450	-3.2	3	44	-64	-30
Exchange Rates					%		
USD/Majors		106.25	0.0	0	1	-5	3
EUR/USD		1.06	-0.1	-1	-1	7	-1
USD/JPY		149.6	-0.1	0	1	0	14
EM/USD		46.6	0.0	0	-2	-4	-7
Commodities					%		
Brent Crude Oil ($/barrel)		91.8	2.1	7	-2	15	12
Industrials Metals (index)		137	0.9	0	-4	-4	-17
Agriculture (index)		65	0.6	4	-1	-3	-5
Implied Volatility					%		
VIX Index (%, change in pp)		18.3	0.4	2.2	4.3	-12.2	-3.4
Global FX Volatility		8.0	0.0	-0.1	-0.1	-4.4	-2.7
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		148	-0.1	-3	3	-124	-58
Italy		204	3.7	9	24	-36	-10
Portugal		72	-0.6	-1	-2	-35	-29
Spain		113	0.7	3	6	-2	4

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

Emerging Market Financial Indicators

Last updated: 10/18/2023 7:59 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	0.0	-0.2	0	-2	-6		2.8	1.5	0	4	-3	-29
Indonesia		15730	-0.1	-0.2	-2	-2	-1		6.9	11.5	9	16	-56	-6
India		83	0.0	-0.1	0	-1	-1		7.8	7.1	4	-4	12.6	31
Philippines		57	0.1	0.1	0	4	-2		5.8	1.3	1	-1	0	-20
Thailand		36	0.1	0.4	-2	5	-5		3.4	5.0	10	28	21	81
Malaysia		4.75	-0.2	-0.6	-1	-1	-7		4.1	1.7	4	17	-38	3
Argentina		350	0.0	0.0	0	-56	-49		105.3	20.5	-322	-1030	1865	1705
Brazil		5.04	0.0	0.3	-4	5	5		12.0	11.8	26	63	34	-53
Chile		928	1.0	0.2	-4	5	-8		5.9	0.0	36	52	-64	54
Colombia		4198	1.0	0.8	-7	13	16		9.4	0.0	13	100	-175	-36
Mexico		18.03	-0.1	-1.1	-5	11	8		9.6	0.0	26	58	30	88
Peru		3.9	0.2	-0.8	-4	3	-1		7.7	-0.9	18	87	-93	-26
Uruguay		40	0.0	0.1	-4	3	0		9.8	2.8	-12	49	-180	-86
Hungary		364	-0.2	-0.1	-1	15	3		7.3	2.0	21	48	-352	-227
Poland		4.21	-0.7	1.3	3	15	4		5.0	-3.3	11	30	-238	-119
Romania		4.7	-0.2	-0.8	-1	6	-2		6.9	1.3	-4	31	-216	-81
Russia		97.2	0.8	1.2	-1	-36	-24							
South Africa		18.8	-0.2	-0.1	1	-4	-10		10.0	2.5	22	43	48	81
Turkey		28.01	-0.2	-1.1	-4	-34	-33		29.3	161.0	222	160	1876	1944
US (DXY; 5y UST)		106	0.0	0.4	1	-5	3		4.84	-2.5	27	39	62	84

	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		3611	-0.8	-2	-3	-4	-7		167	-9	-16	-40	-10
Indonesia		6928	-0.2	0	-1	1	1		122	-11	-7	-98	-18
India		65877	-0.8	-1	-3	11	8		136	-11	-3	-68	-6
Philippines		6268	-0.2	0	4	2	-5		99	-10	-7	-77	2
Thailand		1438	0.3	0	-6	-9	-14		0	0	0	0	0
Malaysia		1447	0.2	1	-1	2	-3		95	-3	-1	-28	-5
Argentina		823683	8.3	31	41	499	308		2382	-246	208	-469	177
Brazil		115908	-0.5	1	-2	0	6		219	-6	-8	-88	-55
Chile		5891	0.6	2	-2	15	12		142	4	18	-54	10
Colombia		1119	0.3	0	2	-6	-13		344	-15	12	-143	-28
Mexico		49666	-0.3	-1	-4	7	2		364	-7	6	-83	-17
Peru		22235	-0.3	0	-3	10	4		159	1	3	-75	-21
Hungary		56694	-0.6	1	-2	39	29		189	-16	-1	-126	-33
Poland		71003	-0.3	6	7	50	24		108	-26	-16	50	35
Romania		14185	0.5	0	0	29	22		209	-11	3	-173	-47
South Africa		72264	-0.8	-2	-2	9	-1		390	4	17	-105	23
Turkey		7943	-2.1	-5	3	107	44		391	2	-10	-217	-49
Ukraine		507	0.0	0	0	-2	-2		3667	119	463	-492	-412
EM total		38	-1.0	0	-3	8	0		400	-11	23	-73	25

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

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