GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

THURSDAY, OCTOBER 5, 2023

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Global Bond Sell-Off Shows Signs of Slowing

Treasury markets stabilized after 30-year yields touched 5%. Several key drivers played a role in shaping the market sentiment. In the ISM services, the new orders component slowed while oil prices corrected following a lackluster EIA report that indicated waning demand for gasoline, prompting break-even inflation to ease to levels last seen mid-July. Euro area data releases continue to point to economic weakening, while 10-year Bund yields stabilized below yesterday’s 3% peak as French and Spanish bond auctions saw solid demand. Asia saw mixed inflation data with upbeat inflation data in Korea and Philippines and downbeat inflation data in Thailand. The Bank of Japan resumed ETF purchases for the first time since March. The Asian trading session saw better bond buying, although a Japanese 30-year bond auction was received poorly. Supportive news came also from Hong Kong SAR and China. In Hong Kong SAR, the government will pause selling commercial land given current market conditions with high vacancy rates. In China, Sunac (one of the major property developers) won court approval for its offshore debt restructuring plan, the first among troubled property developers, receiving broad support from the creditors.

Key Global Financial Indicators

Last updated: 10/5/23 8:40 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		4264	0.8	0	-5	13	11
Eurostoxx 50		4116	0.4	-1	-4	19	8
Nikkei 225		31075	1.8	-3	-7	14	19
MSCI EM		37	-0.3	-2	-5	1	-2
Yields and Spreads				bps			
US 10y Yield		4.76	3.2	19	50	101	89
Germany 10y Yield		2.94	2.3	1	33	91	37
EMBIG Sovereign Spread		453	12	30	36	-90	1
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		46.3	-0.4	-1	-2	-6	-7
Dollar index, (+) = $ appreciation		106.7	-0.1	0	2	-4	3
Brent Crude Oil ($/barrel)		85.5	-0.4	-10	-5	-8	0
VIX Index (%, change in pp)		18.5	-0.1	1	5	-10	-3

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

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United States

This morning, initial jobless claims came in slight below expectations. The US treasury curve steepened in the early hours of trading: rates sold-off in the long end of the curve by around 4bps at the 10 and 30-year tenors. Initial jobless claims continue to be at historically low levels. This is the last data print related to the labor market before the release of non-farm payrolls tomorrow. The trade balance print was better than expected.

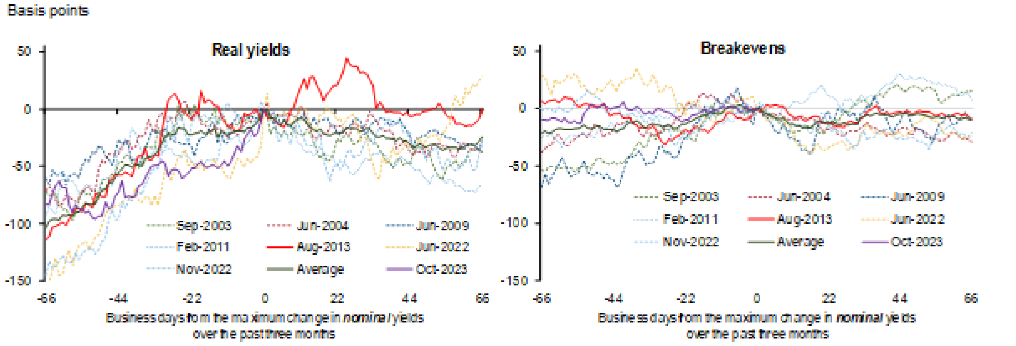
Variable	Consensus	Actual	Prior	Revised
Initial jobless claims	+210k	+207k	+204k	+205k
Continuing Claims	+1671k	+1664k	+1670k	+1665k
Trade balance	-$59.8bn	-$58.3bn	-$65.0bn	-$64.7bn

Source: Bloomberg

Yesterday, markets took a breather from the steep sell-off the in the Treasury markets over the last couple of weeks. A big drop in the ISM new orders component to 51.8 (from 57.5) overshadowed the overall ISM services headline that printed in line with expectations at 53.5 (expected 53.6 from 54.5) provided support to bond markets. Treasuries mostly rallied in the 2-year maturity point by -10bps to 5.03%, which was driven by break-even inflation that declined -8bps, approaching a 1.88% level that was last seen mid-July. Oil prices extended their decline from the previous week, as Brent crude dipped by 5.3% on the day, breaching the critical $90 per barrel threshold. This decline was, in part, precipitated by a lackluster weekly report from the Energy Information Administration (EIA), pointing at weakening demand for gasoline. The currencies of oil exporters like the Canadian dollar (-0.3%), Norwegian krone (-0.3%) and the Colombian peso (-1.2%) underperformed on the day against the US dollar. The greenback was still down against other advanced (-0.2%) and emerging market currencies (-0.2%). The S&P 500 was able to pare some of its losses today (+0.8%) but remains down for the week (-0.6%) whereas mid-caps as measured by the Russell 200 struggled to rally (+0.1%), remaining close to the year-to-date trough.

Thus far, the rise in real yields appears aligned with recent bond market corrections. In Monday's GMM, we emphasized that an uptick in term premia drove the recent spike in yields as changes in short-rate expectations have remained marginal. A comparable scenario unfolded during the three-month period surrounding the 2013 Taper Tantrum, where the pace of term premium increases mirrored the current situation in magnitude. To gain further insight, we revisit this historical event study by dissecting nominal yields into real yields and break-even inflation. Back in 2013, real yields surged by a substantial +60 bps over just eight trading days. In two separate episodes during the first half of 2022, coinciding with the Federal Reserve's initial tightening moves, real yields soared by as much as +150 bps within three months, whereas real yields have been increasing +62 bps within the last three months.

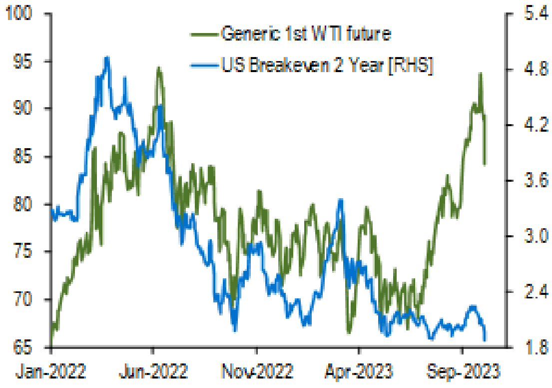
Change in real yields and breakevens of 10-year US Treasuries
Basis points



Source: Bloomberg IMF Staff Calculations.
Note: Latest series assumes a peak in nominal yields as of Oct 3rd. For historical episodes we look at periods during which nominal yields increased 100bps in a 3-month period since 2000.

Commodities

Drop in oil prices have also driven front-end breakevens lower
US dollar per barrel, percent



Source: Bloomberg, IMF Staff Analysis

Oil dropped -5.3% as the implied demand for gasoline reached the lowest seasonal level in 25 years. Oil prices wiped out its gains from September, breaching through the $90/bbl level during yesterday's trading session. The inverted oil forwards curve shifted downward on the day as exemplified by the 3-year forward, which dropped near $71/bbl (-4.4%). The release of the EIA Crude Inventory Report on Wednesday morning, which showed the four-week average of implied gasoline demand, slumped to the lowest seasonal level in 25 years. The increase in oil prices from $70/bbl partly followed OPEC's decision to restrain supply back in summer. The sharp decline was reflected in break-evens especially in the front-end (-10bps).

Japan

Prime Minister Kishida vowed to make wage increases sustainable in his remarks at the convention of Japan's confederation of labor unions. With higher inflation, real wage growth has been negative in early 2022. Japanese yen appreciated to 148.9 yen per dollar (+0.1%) as the strengthening of US dollar paused. Japanese stocks advanced (NIKKEI: +1.8%), while the Bank of Japan resumed its ETF purchases for the first time since March, acquiring 70.1 billion yen.

Long-end JGB yields rose during the day after a weak 30-year debt auction. The 30-year JGB yield was little changed at 1.81% from yesterday but rose as high as 1.83% (+2.1 bps) during the day after the debt auction drew limited demand. The difference between the average and cut-off prices lengthened to the most since 2019. Analysts noted that investors were holding out for higher yields amid uncertainty around the prospective monetary policy normalization by the Bank of Japan. Primary dealers were also reluctant to order sizeable amounts in the auction. Meanwhile, the 10-year JGB yield edged up to 0.805%.

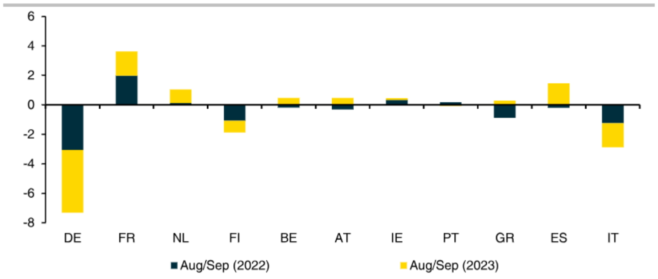
Euro Area

European equities were trading marginally higher, and the euro fractionally appreciated. Euro area data releases continue to point to economic weakening. German export data for August not only fell significantly below expectations but also underwent substantial downward revisions for the preceding month, printing at -1.2% y/y (expected -0.6% from revised -1.9%). Similarly, French industrial production fell to -0.5%y/y (expected -0.5% from revised +2.5%) and manufacturing production fell to -1.1% (from revised +2.6%). Moreover, in Germany export data released this morning disappointed. The Stoxx 600 Europe index was trading higher (+0.3%) with most sectors trading in the green. The euro was marginally stronger against the dollar, trading at around 1.05/$.

Sovereign yields were slightly higher this morning after closing lower yesterday. Bunds found support this morning, after 10-year yields yesterday surpassed 3% for the first time since 2011, trading today in a tight range around 2.93%. Market contacts perceive that the recent selloff in European sovereign debt markets was mostly driven by higher long-end UST yields and caution that the 3% level could be tested again. Whereas Italian bonds outperformed bunds yesterday with the 10y spread to Bunds narrowing to around 194bps, it snapped back to 198bps this morning. As regards the BTP Valore—orders on 3rd day amounted to €3.6bn, with cumulative orders now at €12.9bn (compared to €14.9bn after three days at first issue in June). On the issuance side, French and Spanish bond auctions saw solid demand.

The latest bi-monthly ECB report on Pandemic Emergency Purchase Programme (PEPP) reinvestments reveal recurring seasonal shifts. The report indicates a shift towards France and Spain, away from Germany and Italy. Commerzbank analysts highlight the seasonal nature of these shifts as the patterns mirrors the reinvestment flows seen one year ago in August/September 2022. There remains some uncertainty as to whether the ECB used its flexibility last week when Italian spreads reached 200bps, while analysts highlight that those trades would not have settled in time to be included in yesterday's data.

It seems to be seasonal
Flexible PEPP-reinvestments, in €bn



Source: ECB, Commerzbank Research

United Kingdom

Leading indicators point at slowing economic momentum. Construction PMI data came in softer than expected, easing to 45.0 in September (expected 50.0 from 50.8). BoE deputy governor Broadbent noted this morning that there are clear signs that higher interest rates are weighing on the UK economy. Markets continue to price in about +18bps of BoE tightening by February, little changed from yesterday. The pound was little changed against the dollar this morning (trading at around 1.21/$), while 10y gilt yields were marginally higher (+1bps to 4.59%).

The Bank of England's Decision Maker Panel survey triggers mixed readings. One-year ahead inflation expectations saw a slight increase to 4.9% y/y in September from 4.8%, while three-year ahead CPI expectations remained stable at 3.2%. Year-ahead own-price inflation is anticipated to ease to 4.8% in the three months ending in September, down from the 5.0% recorded in August. Expected year-ahead wage growth stands unchanged at 5.1%. ING analysts note that the survey consistently reports higher realized price and wage growth compared to firms' expectations. Despite this, they expect the Bank of England to maintain current interest rates at the November policy meeting. Conversely, other market analysts believe the survey data could potentially support the case for another interest rate hike by the Bank of England.

Emerging Markets

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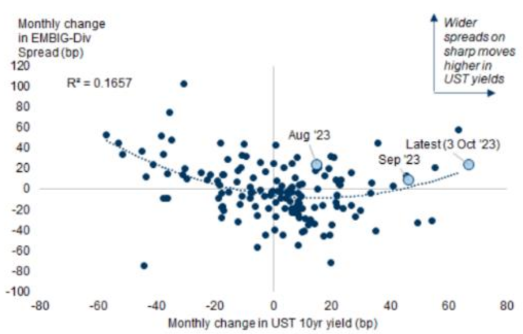
Asian markets gained on improving market sentiment as the global bond selloff eased. Asian equities gained, up 0.9% overall, led by Taiwanese (+1.1%) and Indian (+0.7%) equities. Asian currencies also appreciated, led by Korean won (+0.9%), as the strengthening of US dollar paused.

Equities across Latin America ended Wednesday flat while currency markets showed divergence. Mexican equities climbed modestly later in the day and ended positive (+0.8%), and although Brazilian equities rose during mid-day, they finished the day near Tuesday’s close. Except for the Colombian Peso, which depreciated by -1.2% due to its vulnerability as an oil-dependent currency, precipitated by the recent slump in oil prices, currency markets remained calm.

EMEA equities were mostly trading lower while currencies posted mixed results. Equities in Türkiye underperformed (-1.3%). CEE currencies were trading in a tight range against the euro, with the Polish zloty outperforming (+0.3% to 4.59/€) outperforming. The Romanian leu was marginally stronger against the euro (+0.1% to 4.97/€) ahead of the monetary policy decision later today, where consensus expect the central bank to cut its policy rate unchanged at 7%.

The recent Treasury sell-off prompted EM Sovereign bond spreads to widen. Initially, during August and September, EM sovereign spreads displayed resilience despite broader pressure on equities and other risk assets. However, these spreads have recently expanded in response to the sharp increase in UST yields and US rates volatility. This trend aligns with historical patterns, as EM sovereign spreads tend to widen notably following substantial upticks in UST yields. Analysis from Goldman Sachs further suggests that US rate volatility is also closely tied to global market liquidity, which, in turn, influences EM sovereign spreads. While EM sovereign spreads are still relatively narrow, market contacts anticipate limited room for tightening, leaving interest rate carry as the primary driver of returns.

Exhibit 1 : EM sovereign credit has widened out alongside higher UST yields ...



Source: Bloomberg, Goldman Sachs Global Investment Research

Exhibit 2 : ... and the more recent move higher in US rate volatility

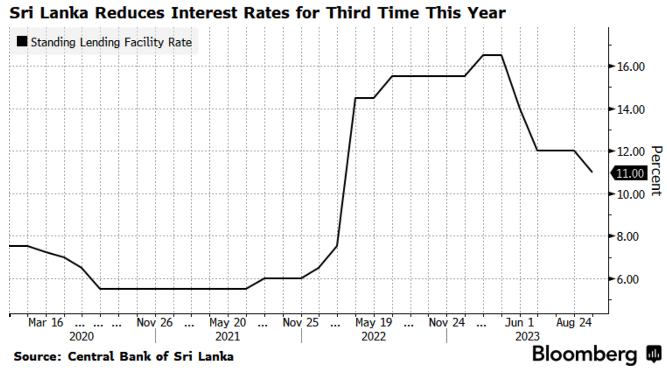
Source: Bloomberg, Goldman Sachs Global Investment Research

Brazil

The deceleration in sugar cane production has led to a resurgence in sugar futures. Substantial rainfall in key sugar cane cultivation areas throughout October is expected to present a significant risk to financial markets, according to experts at commodity risk management consulting firm StoneX. They anticipate that rainfall in October will continue, which could slow down sugar cane crushing rates, resulting in a reduced global sugar supply. This challenge is exacerbated by the continued influence of warming weather patterns, attributed to El Niño, which have already disrupted rainfall patterns in Brazil this year. Despite the hurdles posed by a robust US dollar, the world benchmark contract for raw sugar trading has managed to reverse its recent losses.

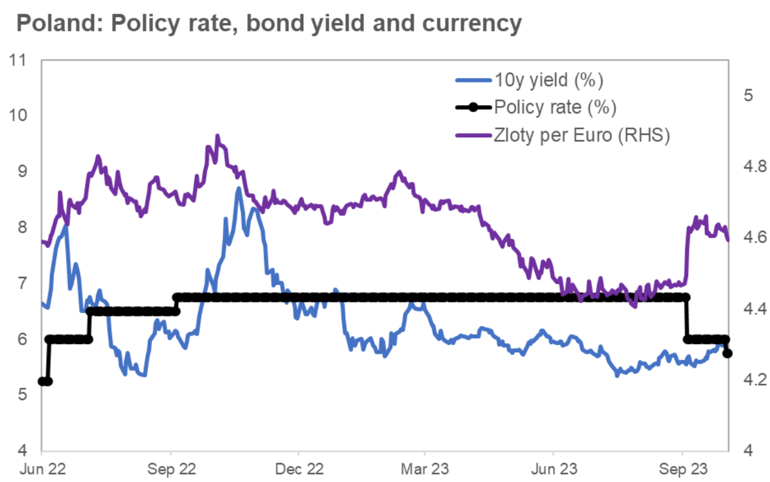
Sri Lanka

The Central Bank of Sri Lanka (CBSL) cut the policy rate by 100 bps to 11% as expected. The CBSL noted that the rate cut decision, which was consistent with the aim of stabilizing inflation at the 5% level in the medium term, will help accelerate the downward adjustment in market interest rates and thus support economic growth. This was the third time that the CBSL lowered the policy rate this year. Analysts still flagged concerns about a slow buildup of foreign reserves. As of end-September, foreign reserves stood at around $3.5 bn, including the swap facility from the People's Bank of China. Sri Lankan rupee depreciated (-0.1%); equities declined (-0.2%); government bond yields increased (10-year: +11 bps).



Poland

The Polish zloty appreciated after central bank of Poland (NBP) cut interest rates by 25bps to 5.75%. The decision came in line with expectations as the consensus expected a 25bps rate cut following the 75bps cut by the NBP in September. However, some economists had expected a 50bps cut after the preliminary September inflation data released last week surprised on the downside. The Polish zloty appreciated (+0.5% to 4.59/€) after the decision and continued to strengthen this morning. Market contacts are now focused on governor Glapinski's press conference, set to take place later today. In the meantime, JP Morgan analysts continue to expect 25bps rate cuts at each of the upcoming policy meetings to take the base rate to 4%, while Goldman Sachs analysts expect the NBP to turn more hawkish after the Parliamentary elections that are set to take place on October 15, and thus do not see any further easing this year. However, Goldman Sachs analysts expect significant further rate cuts in 2024.



Source: Bloomberg and IMF calculations

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Global Financial Indicators

10/5/23 8:41 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4259	0.8	-1	-5	13	11
Europe		4116	0.4	-1	-4	19	9
Japan		31075	1.8	-3	-7	14	19
China		3690	-0.3	0	-3	-4	-5
Asia Ex Japan		62	-0.2	-2	-6	2	-3
Emerging Markets		37	-0.3	-2	-5	1	-2
Interest Rates					basis points		
US 10y Yield		4.76	3.2	19	50	101	89
Germany 10y Yield		2.94	2.2	1	33	91	37
Japan 10y Yield		0.81	0.3	5	15	56	39
UK 10y Yield		4.60	2.5	12	8	57	93
Credit Spreads					basis points		
US Investment Grade		154	-0.7	4	7	-27	-5
US High Yield		459	0.4	27	47	-47	-21
Exchange Rates					%		
USD/Majors		106.73	-0.1	0	2	-4	3
EUR/USD		1.05	0.0	-1	-2	6	-2
USD/JPY		149.1	0.0	0	1	3	14
EM/USD		46.3	-0.4	-1	-2	-6	-7
Commodities					%		
Brent Crude Oil ($/barrel)		85.5	-0.4	-8	-4	5	5
Industrials Metals (index)		138	-0.7	-4	-4	-9	-17
Agriculture (index)		63	-0.3	-3	-6	-7	-8
Implied Volatility					%		
VIX Index (%, change in pp)		18.5	-0.1	1.2	4.5	-10.1	-3.2
Global FX Volatility		8.6	0.0	0.2	0.3	-3.6	-2.1
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		144	-3.1	-11	13	-123	-61
Italy		199	4.1	5	26	-46	-16
Portugal		73	0.4	-2	-1	-35	-28
Spain		111	1.3	2	6	-10	2

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

Emerging Market Financial Indicators

Last updated: 10/5/2023 8:42 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		7.30	0.2	0.1	0	-1	-5		2.7	0.0	0	1	-14	-34
Indonesia		15615	0.1	-0.6	-2	-3	0		7.0	-6.6	17	60	-17	10
India		83	0.0	-0.1	0	-2	-1		7.8	-5.1	-1	16	25.1	34
Philippines		57	0.1	0.5	0	4	-2		5.7	-6.5	-9	-19	-1	-26
Thailand		37	0.4	-0.4	-4	1	-6		3.4	-6.8	6	45	35	81
Malaysia		4.73	0.0	-0.4	-1	-2	-7		4.1	-0.6	10	23	-25	3
Argentina		350	0.0	0.0	0	-58	-50		109.3	-402.7	-759	-926	2372	2110
Brazil		5.17	-0.3	-2.7	-4	0	2		12.1	10.1	19	68	56	-44
Chile		918	-0.3	-1.3	-5	2	-7		5.8	2.5	4	40	-97	46
Colombia		4264	-1.1	-4.0	-5	5	14		9.4	0.0	16	105	-53	-35
Mexico		18.11	-0.9	-3.2	-4	11	8		9.5	1.0	-6	52	33	75
Peru		3.8	0.2	0.0	-3	4	0		7.5	0.4	-1	60	-121	-48
Uruguay		39	-0.3	-2.0	-4	4	1		9.5	-10.4	8	33	-172	-113
Hungary		368	0.1	0.7	-2	16	1		7.6	9.0	23	64	-229	-199
Poland		4.38	0.1	0.2	-4	11	0		5.1	4.3	13	41	-170	-103
Romania		4.7	0.1	-0.5	-2	6	-2		6.9	11.3	16	30	-149	-81
Russia		100.0	0.0	-3.2	-2	-39	-26							
South Africa		19.6	-1.5	-3.3	-2	-9	-13		10.1	-7.6	5	57	68	93
Turkey		27.55	0.1	-0.6	-3	-33	-32		26.6	16.0	-95	396	1463	1679
US (DXY; 5y UST)		107	-0.1	0.5	2	-4	3		4.74	1.3	11	36	77	73

	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		3690	0.0	0	-3	-4	-5		171	-10	-14	-32	-6
Indonesia		6875	-0.2	-1	-2	-3	0		140	17	16	-71	0
India		65632	0.6	-1	0	13	8		145	8	4	-51	3
Philippines		6179	-1.9	-3	-1	4	-6		118	19	20	-46	21
Thailand		1453	0.1	-2	-6	-9	-13		0	0	0	0	0
Malaysia		1416	0.0	-2	-3	0	-5		97	1	-1	-13	-3
Argentina		593740	5.8	7	-1	305	194		2706	306	610	-11	501
Brazil		113607	0.2	-1	-3	-3	4		227	2	-2	-67	-47
Chile		5699	0.2	-2	-4	10	8		134	10	13	-45	2
Colombia		1097	-0.5	-2	4	-10	-15		358	25	35	-65	-14
Mexico		50733	0.7	-1	-4	11	5		379	7	20	-63	-2
Peru		22009	-0.8	-2	-4	9	3		163	9	19	-45	-17
Hungary		55761	-0.4	1	0	42	27		210	23	18	-91	-12
Poland		64299	0.0	0	-5	36	12		136	22	19	69	63
Romania		14100	-0.2	-1	7	29	21		222	25	18	-117	-34
South Africa		71097	0.8	-2	-5	8	-3		407	17	28	-61	40
Turkey		8278	-0.7	1	1	138	50		408	32	17	-200	-32
Ukraine		507	0.0	0	0	-2	-2		3631	306	224	-237	-448
EM total		37	-0.2	-2	-5	1	-2		417	29	43	-31	41

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

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