



- Markets front load Fed rate hike expectations but remain dovish for 2023 ([link](#))
- European energy prices continue to ease ([link](#))
- Most US equity sectors in red as bear market rally stalls ([link](#))
- Asian foreign currency reserves decline ([link](#))
- Latin American markets grapple with stubbornly high core inflation ([link](#))

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Global markets rally as sentiment improves

Friday's rally extended into the new week, with most equity indexes around the world higher for the day. Markets have enjoyed two days of respite from the relentlessly stronger dollar, a key factor weighing on sentiment over the past few weeks. The euro was up sharply this morning on comments from Bundesbank President Nagel supporting further rate hikes, and the yen has recovered slightly from its worst level since 1998. Markets were also encouraged by a pause in the recent surge in Treasury and bund yields, and news of progress by Ukraine in the war against Russia. Markets were also up in Japan on news that restrictions on tourism would be eased. However, contacts sound a note of caution ahead of tomorrow's crucial US CPI data, which could have a major impact on markets if it comes in significantly higher or lower than market forecasts. This report along with PPI on Wednesday and the Michigan sentiment index on Friday will be the last major data points ahead of the next FOMC meeting beginning on September 20 and the statement and press conference on September 21. Markets expect a 75 bps rate hike at this particularly important meeting where the latest dot plot and staff economic projections will also be released.

Key Global Financial Indicators

Last updated: 9/12/22 8:04 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		4067	1.5	3	-5	-9	-15
Eurostoxx 50		3623	1.5	4	-4	-13	-16
Nikkei 225		28542	1.2	3	0	-6	-1
MSCI EM		39	1.5	0	-5	-26	-20
Yields and Spreads			bps				
US 10y Yield		3.28	-3.4	9	44	193	177
Germany 10y Yield		1.66	-4.3	9	67	199	183
EMBIG Sovereign Spread		490	-8	-20	-8	148	123
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		50.4	0.5	0	-2	-11	-4
Dollar index, (+) = \$ appreciation		108.1	-0.8	-1	2	17	13
Brent Crude Oil (\$/barrel)		93.6	0.8	-2	-5	28	20
VIX Index (% change in pp)		23.4	0.6	-2	4	2	6

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

Following aggressive 75 bps rate hikes from the ECB and the Bank of Canada, attention now turns to the Fed which is due to announce its latest policy move at the FOMC meeting on September 21. A key input into the Fed's calculations will be tomorrow's all-important CPI report, followed by PPI on Wednesday. Retail sales are due on Thursday. Germany is also scheduled to publish CPI data tomorrow, along with the widely followed ZEW business confidence survey. Euro area industrial production data are due on Wednesday. China will release industrial production data on Wednesday and retail sales data on Thursday. India will also report CPI and industrial production tomorrow. The Bank of England postponed this Thursday's meeting by a week due to the period of national mourning following the death of Queen Elizabeth. The BOE is expected to hike by 50 bps in the face of a strong market for labor and rising inflation expectations. The Central Bank of Russia will hold its next policy meeting on Friday when it is expected to stay on hold at 8%. The 77th United Nations General Assembly begins tomorrow.

US CPI Forecasts for August

Source: Bloomberg

Indicator	Consensus Forecast
CPI month-on-month	-0.1%
Core CPI mom	+0.3%
CPI year-on-year	8.1%
Core CPI yoy	6.1%

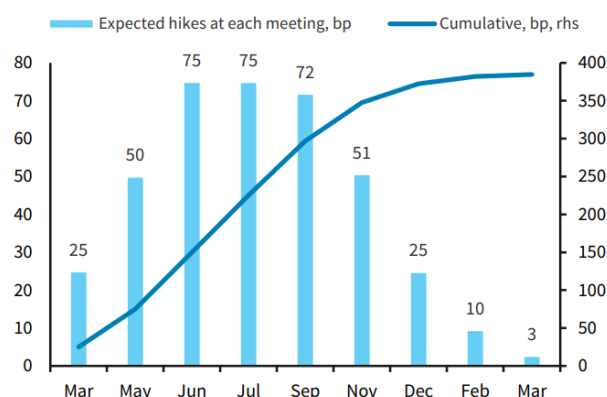
Mature Markets

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United States

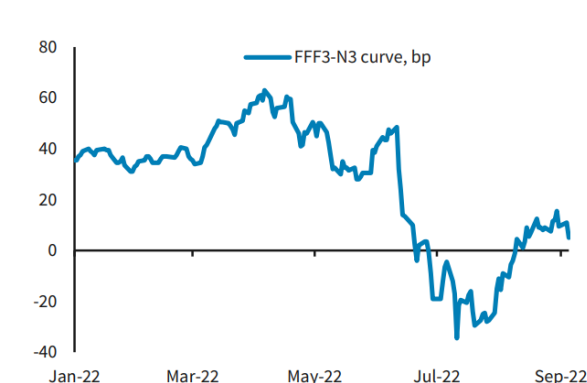
Markets are front-loading Fed rate hike expectations, pricing in an 80% chance of a 75 bps hike at the September FOMC meeting, while being much more dovish for 2023. The Fed Funds and eurodollar futures markets predict only fractional increases in 2023 and call for the policy rate to fall in the second half of 2023. The terminal Fed Funds is expected to be around 4%. However, the Bloomberg consensus forecast for CPI in 2023 is 3.7%, meaning that a terminal Fed policy rate close to 4% will result in a real policy rate that is only slightly positive. If, as many expect, CPI is closer to 4% in the first half of next year, the Fed may decide to deliver more rate hikes than the markets are currently expecting, which could result in a shock to risk assets. Much depends on the Fed's communications policy in the months ahead, with officials facing a difficult task in guiding market expectations in an era when central banks appear to have abandoned forward guidance.

FIGURE 6. A 75bp hike at the Sep meeting is all but priced in



Source: Barclays Research

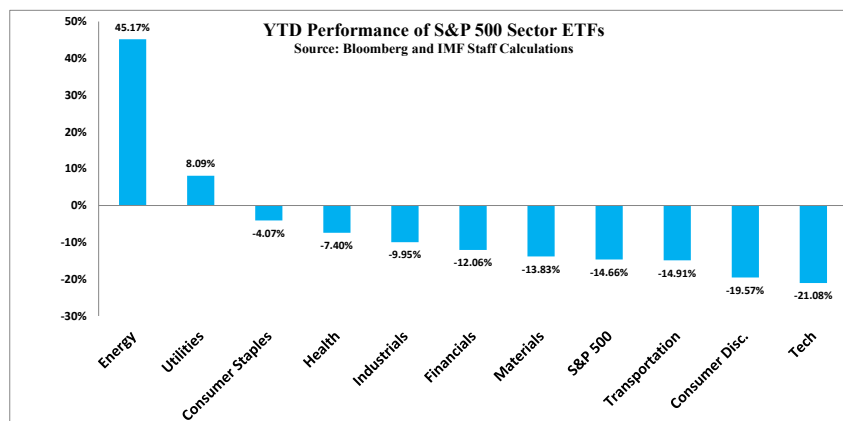
FIGURE 7. Markets are pricing in only 5bp of hikes in 1H23



Source: Bloomberg, Barclays Research

Most US equity sectors have fallen into negative territory as the bear market rally came to an end.

Stocks began to fall sharply after the S&P 500 set a new record on January 3 of 4796.5. The index fell by 20% to 3666.8 by June 16, fulfilling the definition of a bear market. However, hopes of a dovish pivot in Fed policy sparked a strong rally in the summer, which peaked on August 16. At that point, hawkish Fed rhetoric brought the rally to an end, and Fed Chair Powell's strongly hawkish speech at Jackson Hole sent markets back into decline, suggesting that the summer's moves were nothing more than a bear market rally. Of all the sectors in the S&P 500, the energy sector has posted outsized gains due to the commodity rally, and utilities have also done well for the same reason, but all other sectors are in the red. The technology sector, which has led surging markets in recent years, has taken the biggest hit, probably because sharply higher interest rates have challenged their valuations and investors are taking profits after years of gains.



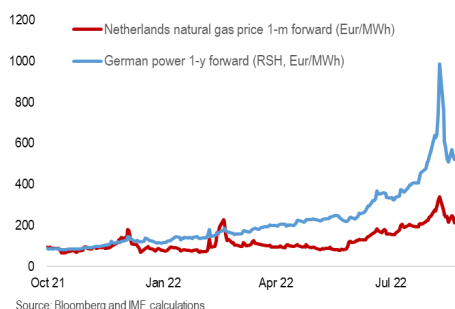
Euro Area

European equities were trading higher this morning with the Stoxx 600 Europe index up +1%. Sovereign yields increased in early trade but reversed moves later with the German 10y bund yield marginally lower (-3bps at 1.66%). The euro appreciated (+0.9%) amid broader US dollar weakening. While ECB hawkishness, developments in Ukraine, and lower gas prices likely play a supportive role for the euro, some analysts attribute recent euro strength to an unwillingness of markets to take on new US dollar exposure ahead of the US CPI print due tomorrow.

ECB speakers hinted at the need for further tightening following the hawkish ECB meeting last week. ECB sources see an increasing likelihood that the key policy rate will reach 2% or higher, according to a Reuters article. Sources reportedly said that such tightening would be likely if the ECB's first 2025 inflation projection, due in December, remains above 2%. Separately Bundesbank President Nagel over the weekend also spoke in support of further ECB hiking if the inflation outlook does not change. He added that inflation could reach over 10% by December. ECB executive board member Elderson also made hawkish remarks, emphasizing the importance of inflation expectations not becoming unanchored. **Markets are now pricing in roughly 67 bps of tightening for the October ECB meeting (compared to +75 bps at the end of last week) with a total of roughly 118 bps of tightening priced in by the end of the year.**

European natural gas prices continued to fall this morning with Dutch 1-m ahead prices (-5%) now at €195/MwH as markets await further details on plans to bring energy markets back into balance. EU ministers met on Friday to review the European Commission's proposed measures—including gas price caps, emergency liquidity for utilities, further demand reduction plans and taxes on fossil-fuel companies—but specific details are yet to be agreed upon. Analysts caution that a price cap on Russian gas will likely result in a complete shutdown of Russian gas sales to Europe, which could lead to renewed pressure on natural gas prices and add further risk to gas supply security. **The European Commission is expected to announce further details later this week.**

European natural gas and power prices



United Kingdom

Most analysts see the freezing of energy bills translating into a less severe economic downturn, while higher medium-term inflation and further monetary policy tightening is expected. The government last week announced a fiscal package that caps household energy bills and also supports businesses. Analysts expect that the package will reduce the extent of an economic downturn this winter as purchasing power improves, but still see lackluster economic performance with somewhat lower short-term inflation and higher inflation in the medium-term. **This morning the pound appreciated (0.7%) despite July's monthly GDP data coming in below expectations (+0.2% mom vs expected +0.3% from -0.6%).** August CPI data are due on Wednesday.

Our new growth forecasts

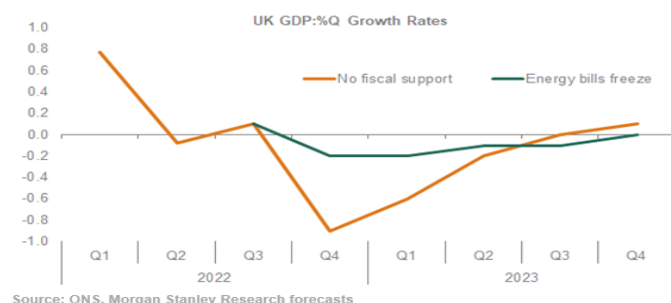
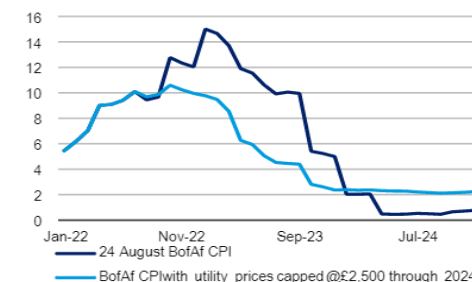


Exhibit 1: BofA CPI inflation forecast

We expect CPI inflation to peak at 10.6% in October 2022, 450bp lower and three months earlier than previously



BofA GLOBAL RESEARCH

The majority of analysts expect a 50 bps hike at the BoE's September meeting while some see potential for a 75 bps hike. The BoE's September meeting was postponed by a week to September 22 due to a period of national mourning following the death of Queen Elizabeth II. While the consensus is for a 50 bps hike, JPMorgan analysts expect a 75 bps hike arguing that a 50 bps move would be difficult to justify after the large fiscal package announcement that came against a backdrop of decreased market confidence over the UK's fiscal position. Analysts are also divided on the terminal rate—with Morgan Stanley seeing the terminal rate at 3.5% reached by March 2023, while Goldman Sachs expects the terminal rate at 4% in March 2023, and Bank of America predicts 4% in August 2023. **Markets are pricing in roughly 66 bps of tightening for the September meeting with roughly 188 bps of tightening priced in by the end of 2022.**

Emerging Markets

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EMEA markets are joining the global rally. Turkey stands out with a major 3.2% rally. **Asian equities firmed +0.8% on net.** China, Hong Kong SAR, and South Korean markets were closed for holidays today. **Other Asian currencies and 10-year yields were little changed.** Indonesia FM Indrawati said that fuel

price hikes are adequate for the 2022 budget, hinting at no further hikes, according to Bloomberg. Indrawati also said monetary policy should not be used excessively, and that tightening moves should not come at the expense of the economic recovery. In **Latin America**, risky assets rallied last Friday, with equities up by 1.6% to 2.2% across the region, and local currencies strengthened against the dollar.

EM Fund Flows

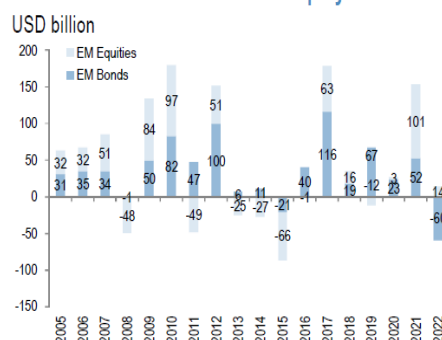
Outflows from hard currency bond funds outpaced local currency funds for the third week, while equity outflows increased substantially to the largest level since Dec 2021. Investors withdrew \$886 mn from EM hard currency bond funds, following the \$1 bn outflow last week. Local currency bond funds saw a \$497 mn outflow, mainly from EM ex-China funds (-\$472 mn), similar to last week. Since March, local currency bond funds haven't had a single week of net inflows. EM equity fund outflows increased substantially to \$3.8 bn, the largest weekly outflow since December 2021, from the \$596 mn outflow last week. Outflows were observed across the regions, led by Asia ex-Japan (\$1.7 bn).

Exhibit 1: Weekly Cross-Asset Flows

USD billion				
Asset	8w flows (8w ago → current)	This wk	YTD	
EM Bonds and Equities		-5.2	-45.1	
EM Bonds		-1.4	-59.6	
Hard Ccy		-0.9	-29.1	
Local Ccy ^A		-0.5	-30.5	
o.w. EM ex-China		-0.5	-13.3	
o.w. China		0.0	-15.8	
EM Equities		-3.8	14.4	
US HG		1.0	-61.8	
US HY		-1.7	-42.9	
Global Equities		-11.3	95.4	
EM Bond and Equity ETFs		-1.9	36.7	
EM Bond ETFs		-0.3	-6.8	
EM Equity ETFs		-1.6	43.5	
Non-resident EM flows*		-4.3	-63.2	

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

Exhibit 2: Annual EM bond and equity fund flows



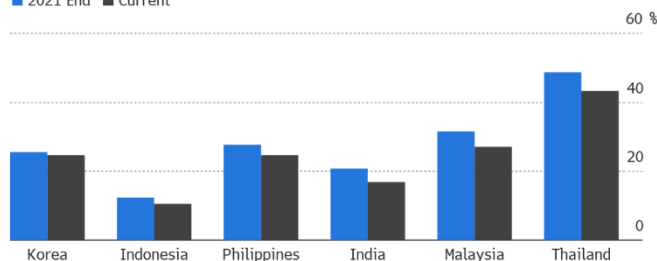
Asian Foreign Currency Reserves

Foreign currency reserves at several Asian countries are sharply lower as the dollar rally continues apace. Their “reserve cover,” the number of months of imports they can purchase with their foreign currency reserves, has fallen to its worst level since 2008 for seven major Asian economies, excluding China. On average, this has fallen to seven months. Worries are growing that these countries will have more limited ammunition to fight future dollar appreciation if it occurs, putting more strain on their domestic economies. This is especially true for countries with high proportions of foreign trade.

Reserve Cover

FX reserves as a percentage of GDP has declined

■ 2021 End ■ Current



Source: Bloomberg

Bloomberg

Latin America Inflation

Core inflation pressures remain intense amid mixed progress on headline inflation. The August CPI for the 5 main inflation targeting countries in the region surprised to the upside, led by Colombia and Chile, underscoring intense pressures from core and services inflation. However, headline inflation is showing tentative signs of easing, led by Brazil and Peru, while analysts expect the peak is near for Chile, Mexico, and Colombia.

Latin America Headline Inflation

(PPP weighted average of 5 main inflation targeting countries)

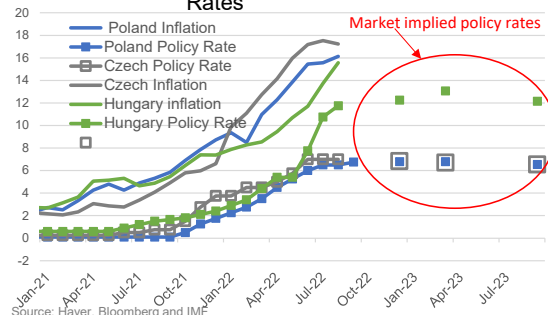


Source: Goldmand Sachs

Czech Republic

Czech inflation unexpectedly slowed in August, leading the market to revise its rates expectations down. Czech inflation unexpectedly dropped in August to 17.2% yoy (17.7% expected) from 17.5% in July. Momentum also slowed to 0.4% mom, down from 1.3% in July, fueling expectations that the central bank will keep the policy rate unchanged at 7% for the rest of the year. Compared to last Friday, the market now expects the policy rate to be lower by 17 bps in 3 months (to 6.83%), and by 30 bps in 6 months (to 6.7%). More generally, while inflation is still very high in central and eastern Europe, momentum is starting to slow in some countries.

CEE: Inflation and Market Implied Policy Rates



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), Mohamed Diaby (Economist, EP), 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), 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), Akihiko Yokoyama (Senior Financial Sector Expert), and Xingmi Zheng (Research Assistant). 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

8/23/22 4:32 PM	Level		Change					Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
Equities			%				%	%
United States		4129	-0.4	-4	4	-8	-13	-2
Europe		3653	-0.2	-4	2	-13	-15	-8
Japan		28453	-1.2	-1	2	3	-1	8
China		4161	-0.5	0	-2	-15	-16	-10
Asia Ex Japan		67	0.3	-3	-1	-21	-19	-15
Emerging Markets		40	-0.2	-3	1	-21	-19	-16
Interest Rates			basis points					
US 10y Yield		3.06	-5.0	26	31	181	155	107
Germany 10y Yield		1.32	1.3	35	29	180	150	109
Japan 10y Yield		0.22	-0.1	5	1	20	15	2
UK 10y Yield		2.58	6.2	45	64	204	161	110
Credit Spreads			basis points					
US Investment Grade		160	-2.7	1	-12	65	48	17
US High Yield		486	4.3	32	-43	144	148	79
Europe IG		111	0.5	16	6	65	63	39
Europe HY		550	-1.8	75	19	317	308	198
Exchange Rates			%					
USD/Majors		108.54	-0.5	2	2	17	13	13
EUR/USD		1.00	0.3	-2	-2	-15	-12	-12
USD/JPY		136.8	-0.5	2	0	25	19	19
EM/USD		50.1	0.3	-1	0	-10	-5	-6
Commodities			%					
Brent Crude Oil (\$/barrel)		100	3.8	8	2	55	35	14
Industrials Metals (index)		158	0.0	-1	6	0	-9	-16
Agriculture (index)		69	2.0	4	11	21	13	-2
Implied Volatility			%					
VIX Index (% change in pp)		24.1	0.3	4.4	1.1	7.0	6.9	-6.9
US 10y Swaption Volatility		132.2	-0.8	18.8	9.4	56.4	53.2	37.9
Global FX Volatility		11.3	-0.1	0.9	0.2	4.5	3.9	3.9
EA Sovereign Spreads			10-Year spread vs. Germany (bps)					
Greece		262	11.6	25	39	155	110	22
Italy		233	0.6	17	5	127	98	62
Portugal		109	0.5	7	-8	48	44	17
Spain		119	0.6	6	-4	48	45	16

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

Emerging Market Financial Indicators

Last updated: 9/12/2022 8:11 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)								
	Level		Change (in %)					YTD	Level		Change (in basis points)					YTD
	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		6.93	0.4	-0.4	-3	-7	-8		2.7	2.5	2	-8	-27	-12		
Indonesia		14842	-0.1	0.4	-1	-4	-4		7.1	-2.7	-1	16	100	76		
India		80	0.1	0.4	0	-7	-7		7.5	5.0	-5	10	102.0	116		
Philippines		57	-0.1	0.2	-2	-12	-10		5.6	-5.0	28	30	183	115		
Thailand		36	0.2	0.8	-3	-9	-9		2.8	5.5	-2	49	115	91		
Malaysia		4.50	-0.1	-0.2	-1	-8	-7		4.1	1.5	4	9	80	46		
Argentina		141	-0.2	-1.6	-5	-31	-27		78.5	34.3	56	956	3073	2789		
Brazil		5.12	0.6	0.7	-1	2	9		10.7	-86.5	-108	-130	-32	-1		
Chile		910	-3.1	-3.6	-1	-13	-6		6.6	-2.5	5	11	165	122		
Colombia		4354	1.0	3.0	0	-12	-7		9.7	-10.0	11	59	344	324		
Mexico		19.80	0.5	0.9	0	0	4		8.6	-6.0	-7	37	163	112		
Peru		3.9	0.0	-0.1	1	6	3		8.3	0.1	11	44	183	236		
Uruguay		41	0.1	0.2	-2	5	9		11.3	0.0	23	36	341	261		
Hungary		390	1.5	4.5	-2	-24	-17		9.4	-45.0	-18	138	646	493		
Poland		4.63	1.1	2.9	-2	-17	-13		5.7	-19.8	-45	60	375	220		
Romania		4.8	0.8	0.4	-2	-13	-10		8.1	3.1	26	23	443	323		
Russia		60.2	1.4	2.1	2	21	25		8.2	-3.0	-3	-15	89	-55		
South Africa		17.1	1.5	0.6	-5	-17	-7		8.9	-7.5	-6	46	165	149		
Turkey		18.24	-0.1	-0.1	-2	-54	-27		11.3	-8.0	-155	-543	-596	-1303		
US (DXY; 5y UST)		108	-0.8	-1.3	2	17	13		3.39	-4.2	10	44	258	213		

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