GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, SEPTEMBER 19, 2022

- **Global markets face new era of challenges as central banks hike aggressively** (link)
- **Markets expect more ECB tightening amidst high inflation** (link)
- **Italian sovereign spreads remain contained** (link)
- **Investor allocations to bonds at lowest in 15 years** (link)
- **Diversification benefits of Treasuries eroded by higher rates** (link)

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Markets in retreat amidst high uncertainty

Global markets were lower as investors head into a potentially momentous week, with key meetings at the Fed, Bank of England, and Bank of Japan, among many others. Stocks are down almost everywhere across the globe. Interest rates marched higher, with the benchmark US 10-year Treasury yields finally hitting 3.50%, its highest level since 2011. The market is now trading at the 2022 high for the 10-year Treasury, which it briefly touched back on June 14. A decisive break higher could inject substantial volatility into risk assets and trigger a major selloff. Euro area interest rates also moved higher, with the 10-year bund yield at its highest level since 2013. The dollar appreciated continued its relentless appreciation today, with the Chinese currency weakening yet again despite the efforts of the authorities to fix it a stronger level. The pound is at its lowest level versus the dollar since 1985, while the yen is near its weakest level since 1998.

Key Global Financial Indicators

Last updated: 9/19/22 7:55 AM	Level		Change from Market Close					Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
Equities					%		%	
S&P 500		3873	-0.7	-5	-8	-13	-19	-8
Eurostoxx 50		3471	-0.8	-5	-7	-16	-19	-13
Nikkei 225		27568	-1.1	-2	-5	-10	-4	4
MSCI EM		38	-0.9	-3	-5	-26	-23	-20
Yields and Spreads					bps			
US 10y Yield		3.49	4.5	14	52	213	198	150
Germany 10y Yield		1.80	4.6	15	57	208	198	157
EMBIG Sovereign Spread		505	12	14	19	163	138	92
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		49.5	-0.2	-2	-1	-12	-6	-7
Dollar index, (+) = $ appreciation		110.0	0.2	2	2	18	15	14
Brent Crude Oil ($/barrel)		89.1	-2.5	-5	-8	18	14	-8
VIX Index (%, change in pp)		27.8	1.5	4	7	7	11	-3

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

The week ahead will be dominated by Wednesday's FOMC meeting, with a rate hike of 75 bps fully priced in by markets and a small probability of a 100 bps hike also being priced. Attention will focus on the latest dot plot of FOMC members' forecasts for future interest rates, as well as the Fed's Staff Economic Projections for GDP, inflation, and other metrics for the economy. Fed Chair Powell's press conference is likely to attract even more scrutiny than usual. The Bank of England will meet on Thursday, with markets forecasting almost three full rate hikes amidst major uncertainty about inflation and the health of the UK economy. Gilt yields have shot up to their highest level in 11 years. The Bank of Japan also meets on Thursday, and its meeting will also attract more interest than usual as the yen trades close to its weakest level since 1998 and with the authorities warning that FX intervention may be imminent. Some analysts are expecting a hawkish shift from a central bank that is one of the last holdouts of dovish policy among the big central banks (the Swiss National Bank is the other). The euro area will publish PMI data on Friday. The major political events of the week are the Italian election and the continuation of the UN General Assembly.

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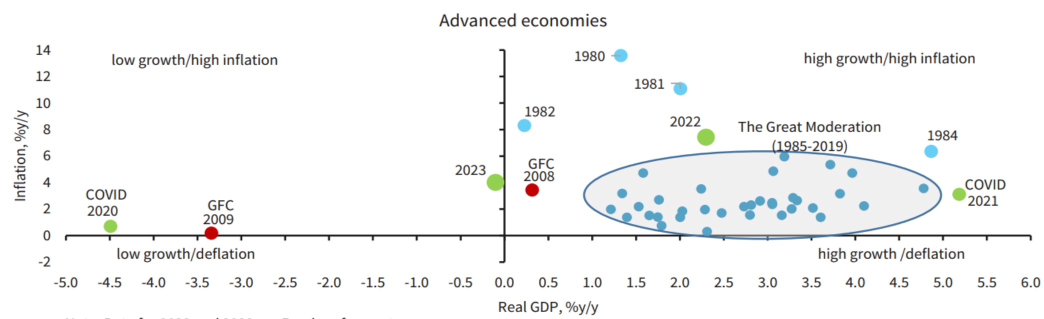
Global markets

Global markets are facing a new era of major challenges. Analysts at Barclays forecast that the Great Moderation of 1985–2019 with its market-friendly environment is coming to an end, and that a new era of difficult policy choices is at hand. With inflation at four decade highs, global central banks have been forced into a highly aggressive rate hike cycle despite weakening growth prospects, especially for advanced economies (AEs). With China stuck in the doldrums, next year's recovery is likely to be relatively weak. The analysts predict a period of "Painful tradeoffs" for AE central banks. Their task is made more complicated by the large fiscal support packages being planned for the euro area and the UK to tackle the impending winter energy crisis, as well as large spending initiatives in the US and Japan. These spending packages could push inflation even higher and force central banks to tighten even more than currently expected, which could be very negative for markets.

FIGURE 5. **The era of The Great Moderation has ended and central banks are focused on preventing a return to the high inflation of the early 1980s; this means an end to Goldilocks and a period of painful policy trade-offs**



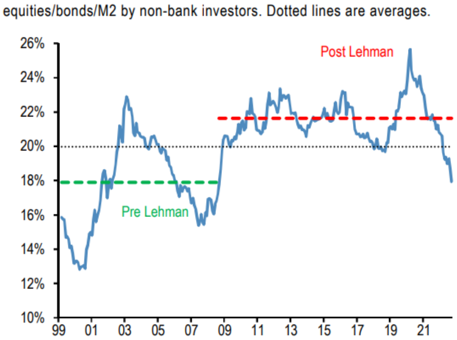
Note: Data for 2022 and 2023 are Barclays forecasts

Source: IMf WEO, Haver Analytics, Barclays Research

United States

Investor allocations to bonds are at their lowest level in 15 years. JP Morgan analysts estimate that allocations haven fallen to pre-Lehman levels. The latest US inflation data is likely to accelerate this trend, while markets are starting to price a much more aggressive rate hike cycle for the Fed. Eurodollar and Fed Funds futures markets are now predicting a terminal rate above 4.4% by March 2023, up from roughly 3.75% in past weeks. A key milestone for markets is the 3.50% yield on the 10-year, the 2022 intra-day high last seen on June 14. A decisive break beyond that level could herald a much bigger selloff in bond markets. 10-year yields have surged by over 170 bps from the 2022 low back in March, while the two-year yield has shot up by more than 310 bps. The two-year/10-year yield spread is close to its largest inversion of the century.

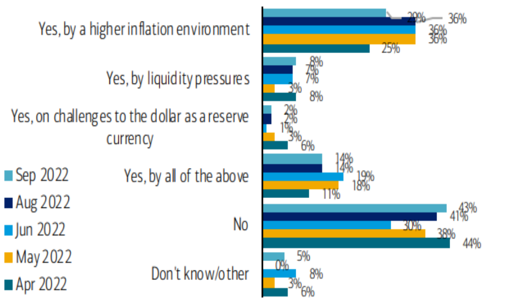
Figure 4: Implied bond allocation by non-bank investors globally
Global bonds held by non-bank investors as % total holdings of equities/bonds/M2 by non-bank investors. Dotted lines are averages.



Source: J.P. Morgan

Treasuries are becoming less popular as a hedge against equity market volatility, further undermining investor demand. The latest Bank of America survey of fund managers found that stubbornly high inflation has eroded investors' confidence in Treasuries for hedging purposes. This view has been borne out by recent price action in the stock market, which shows that the diversification benefit of Treasuries as a hedge for stocks remain very low. A significant move higher in rates could further reduce the demand for Treasuries as a hedging instrument, putting even more upward pressure on yields. Going into this week's FOMC meeting and the months ahead, investors face a highly uncertain and risky period, with interest rate volatility likely to remain elevated.

Exhibit 6: Is UST role as a hedge for portfolios being eroded:
Inflation is still considered to undermine USTs as a hedge



Source: BofA Global Research FX and Rates Sentiment Survey

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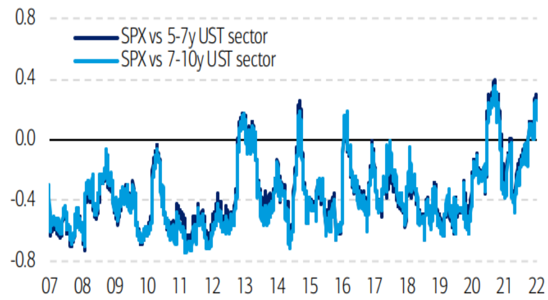
Exhibit 7: Limited diversification benefits of USTs recently
Positive correlations between S&P and USTs total returns (3m correlations)



Source: BofA Global research

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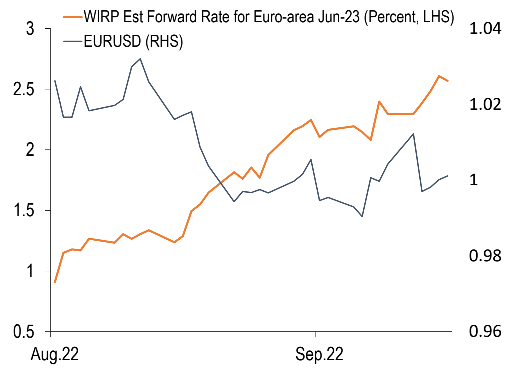
Euro Area

Equities were lower and interest rates were higher as euro area markets joined the global selloff. Markets in the UK are closed for the Queen's funeral and Japan is closed for a national holiday.

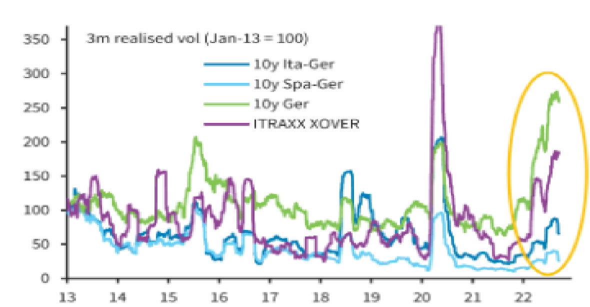
Markets are pricing over 70 bps of ECB tightening for the upcoming October 27 meeting and have significantly increased their rate expectations for next year. For example, the estimated forward rate for June 2023 has increased sharply to over 2.5%, from 1.24% on August 15 (see Chart). These moves have reflected hawkish rhetoric from ECB officials over the past week, including ECB Vice President de Guindos, and ECB Governing Council members Makhlouf and Kazāks. ECB officials are concerned about the risk of second-round inflationary effects, with survey-based measures, including the ECB's consumer expectations survey, indicating that long-run inflation expectations have been on an upward trend. Meanwhile, the euro has remained weak to the dollar, hovering around parity in recent weeks (see Chart).



Source: Bloomberg

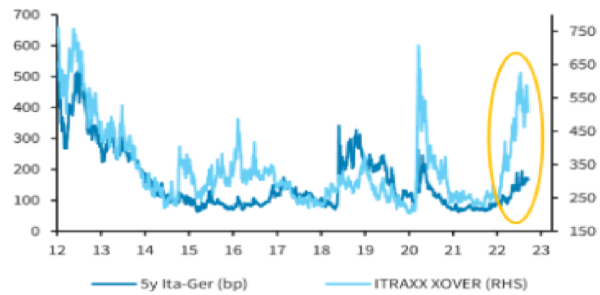
Ahead of national general elections on September 25, and despite a backdrop of weaker economic growth and tighter monetary policy, Italian sovereign spreads have been trading in a fairly narrow range in recent weeks. The volatility of Italian spreads has been muted despite elevated volatility in broader European rates and credit markets (see Charts). Analysts commented that this may reflect the fact that the ECB's anti-fragmentation toolkit likely holds meaningful credibility with market participants. In addition, spreads may be supported by continued PEPP reinvestments. According to Barclays analysis, since early July the ECB increased its Italian sovereign bond holdings by about €10 bn in net terms, while German holdings were reduced by €14 bn.

Figure 1. Peripheral spread volatility is well contained currently, despite notably elevated rate market and risky asset vol…



Source: Bloomberg, Barclays Research

Figure 2. …with Italian spreads meaningfully tight relative to broad EUR credit indices



Source: Bloomberg, Barclays Research

Emerging Markets back to top

EMEA markets were mixed, with Poland higher but Turkey falling back. Currencies were little changed. **Asian equities slipped -0.7% on net.** India outperformed +0.7, Vietnam fell -2.3%, and the Philippines lost -1.7%. South Korea's government has reportedly asked banks to report their FX positions hourly, up from thrice daily, amid increased FX monitoring, Bloomberg reports. **LATAM markets saw modest movements on Friday.** While equities in Brazil and Colombia were down marginally, the regional currencies held their ground against the USD. On the political front, new polls continue to show former president Lula in the lead. The country is headed for the first round of presidential elections on October 2. In Chile, bonds continued to slide (down 0.6% in the last two sessions) following Moody's announcement on Thursday to downgrade the country's rating from A1 to A2 due to rising debt burden.

EM fund flows

Outflows from EMs continued last week, slowed down. This deceleration in outflows was driven by equity funds flows, with $1.7 bn of outflows compared to $3.8 bn the week before. Bond fund outflows were marginally higher at $1.5 bn (vis-à-vis $1.4 bn in the week before). Both hard currency and local currency bond funds saw marginally higher outflows of $934 mn. and $587 mn, respectively. With this, the YTD bond and equity fund flows stand at -$62.4 bn and $12.8bn, respectively, while the total fund flows are at -$49.7 bn.

Exhibit 1: Weekly Cross-Asset Flows

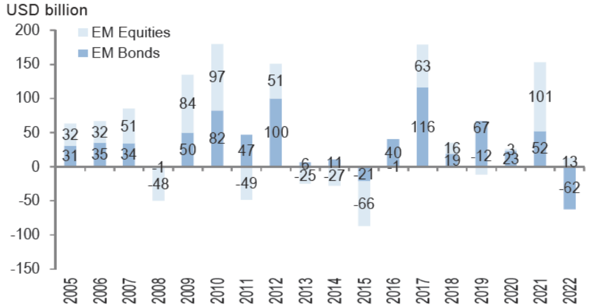
USD billion

Asset	8w flows (8w ago → current)	This wk	YTD
EM Bonds and Equities		-3.2	-49.7
EM Bonds		-1.5	-62.4
Hard Ccy		-0.9	-31.5
Local Ccy^		-0.6	-30.9
o.w. EM ex-China		-0.4	-13.7
o.w. China		-0.2	-16.0
EM Equities		-1.7	12.8
US HG		-0.2	-62.0
US HY		0.2	-42.7
Global Equities		8.7	104.1
EM Bond and Equity ETFs		-0.2	36.5
EM Bond ETFs		0.0	-6.8
EM Equity ETFs		-0.2	43.3
Non-resident EM flows*		1.7	-62.5

Fund Flows

Exhibit 2: Annual EM bond and equity fund flows

USD billion

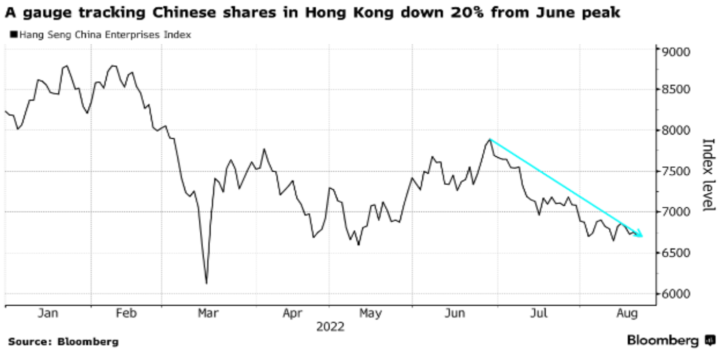


*High frequency non-resident EM portfolio flow data where available. ^Local ccy split is retail only. Source – All charts and data in this report: J.P. Morgan, EPFR Global, Bloomberg Finance L.P

China

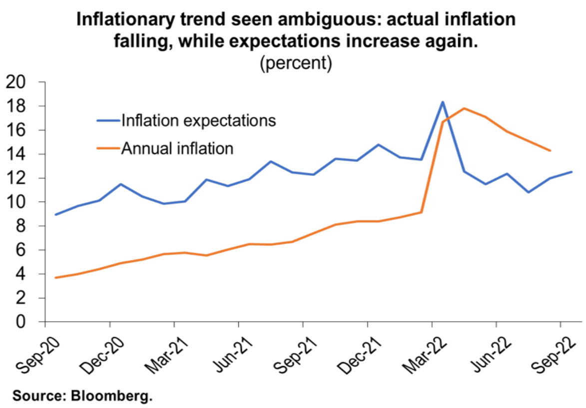
Equities slipped (Shanghai: -0.4%, Shenzhen: -0.8%). Hong Kong-traded Chinese shares fell -1.7% and headed closer to a bear market. **President Xi affirmed China's unchanged economic fundamentals.** In his Shanghai Cooperation Organization (SCO) remarks on Friday, Xi also called on SCO members to strengthen a local currency cross-border payment and settlement system and promote the establishment of an SCO development bank. Separately, **China's FX regulator warned firms against speculative yuan**

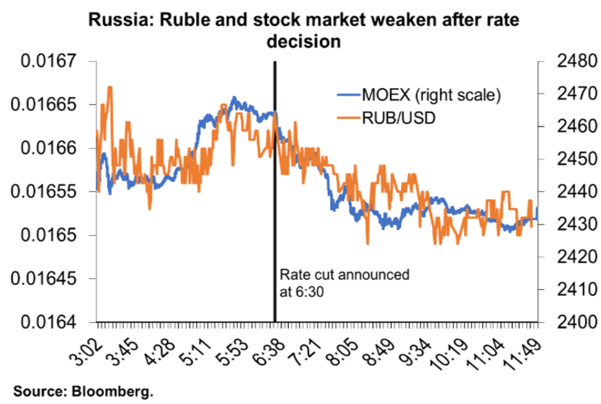
trading. The State Administration of Foreign Exchange also said on Friday that firms should adhere to a *risk neutral* FX risk management concept to better cope with external shocks. **Renminbi depreciated (onshore: -0.4%, offshore: -0.3%)**, despite China's central bank having fixed the yuan at a new record strong bias against the US dollar (6.9396). **10-year yields were little changed.**



Russia

Russian equities and the ruble retreated on Friday after the central bank's rate cut of 50 bps to 7.5%. Inflation, which peaked in April at 17.8% y/y and fell since then to currently 14.3% y/y, is projected to continue to fall until early 2023 but is subsequently expected to start increasing again (inflation expectations are already on the rise), to end 2023 in the central bank's forecast range of 5–7% y/y. Drivers for renewed inflationary pressures in 2023 are seen in supply bottlenecks due to Russia's decoupling from the global economy, a potential revival in consumer lending, and a possibly continued expansionary fiscal stance.





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Global Financial Indicators

9/19/22 7:57 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD	Since 23-Feb-22
Equities					%		%	%
United States		3873	-0.7	-5	-8	-13	-19	-8
Europe		3469	-0.9	-5	-7	-16	-19	-13
Japan		27568	-1.1	-2	-5	-10	-4	4
China		3928	-0.1	-4	-5	-19	-20	-15
Asia Ex Japan		64	-0.9	-3	-5	-26	-23	-19
Emerging Markets		38	-0.9	-3	-5	-26	-23	-20
Interest Rates					basis points			
US 10y Yield		3.49	4.5	14	52	213	198	150
Germany 10y Yield		1.80	4.7	15	57	208	198	158
Japan 10y Yield		0.26	0.0	1	6	20	19	6
UK 10y Yield		3.14	-2.8	4	101	232	217	166
Credit Spreads					basis points			
US Investment Grade		164	2.7	0	6	74	52	21
US High Yield		494	13.3	24	39	181	156	87
Europe IG		113	0.7	8	10	61	65	41
Europe HY		555	3.2	41	35	302	313	204
Exchange Rates					%			
USD/Majors		109.93	0.2	1	2	18	15	14
EUR/USD		1.00	-0.3	-1	-1	-15	-12	-12
USD/JPY		143.6	0.5	1	5	31	25	25
EM/USD		49.5	-0.2	-2	-1	-12	-6	-7
Commodities					%			
Brent Crude Oil ($/barrel)		89	-2.4	-5	-7	30	21	2
Industrials Metals (index)		153	-0.3	-2	-3	-7	-12	-19
Agriculture (index)		68	-0.8	-3	3	22	12	-3
Implied Volatility					%			
VIX Index (%, change in pp)		27.9	1.6	4.0	7.3	7.1	10.6	-3.2
US 10y Swaption Volatility		132.2	4.7	2.7	7.9	61.6	53.1	39.5
Global FX Volatility		11.5	0.1	0.6	0.3	4.8	4.0	4.0
EA Sovereign Spreads					10-Year spread vs. Germany (bps)			
Greece		266	13.8	12	19	154	114	26
Italy		228	0.6	-3	1	128	93	57
Portugal		104	0.0	0	-1	50	40	12
Spain		115	-0.4	0	-1	52	41	12

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

Emerging Market Financial Indicators

Last updated: 9/19/2022 8:02 AM	Exchange Rates								Local Currency Bond Yields (GBI EM)							
	Level		Change (in %)					Since	Level		Change (in basis points)					Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
		vs. USD	(+) = EM appreciation							% p.a.						
China		7.01	-0.4	-1.3	-3	-8	-9	-10		2.8	-1.4	3	5	-24	-9	-10
Indonesia		14978	-0.2	-0.9	-1	-5	-5	-4		7.2	-0.9	7	10	107	82	71
India		80	0.0	-0.3	0	-8	-7	-7		7.6	-6.3	14	17	114.6	130	
Philippines		57	0.0	-1.0	-3	-13	-11	-11		5.7	0.0	3	33	185	118	68
Thailand		37	-0.5	-2.0	-3	-10	-10	-13		3.0	0.5	23	47	130	114	77
Malaysia		4.55	-0.3	-1.1	-2	-8	-8	-8		4.2	3.1	13	21	85	58	50
Argentina		144	-0.2	-1.5	-6	-31	-28	-25		81.5	99.2	300	1045	3365	3089	3350
Brazil		5.29	-0.7	-3.7	-2	1	5	-5		12.0	9.5	45	-6	88	133	49
Chile		922	0.1	-1.4	-4	-15	-8	-14		6.6	2.0	-13	7	170	117	68
Colombia		4435	-0.4	-1.8	-4	-14	-8	-12		9.7	-4.5	9	94	348	333	186
Mexico		20.15	-0.6	-1.6	0	0	2	0		8.8	0.0	19	72	173	131	99
Peru		3.9	0.1	0.1	-1	6	3	-4		8.2	0.2	11	32	181	229	219
Uruguay		41	-0.5	-0.6	-2	4	9	4		11.4	-2.0	6	52	347	267	324
Hungary		402	0.5	-2.3	0	-25	-19	-21		9.5	0.0	1	47	627	494	464
Poland		4.71	0.0	-1.7	0	-17	-14	-14		6.0	0.0	24	28	401	246	209
Romania		4.9	-0.5	-1.7	-2	-15	-12	-11		8.0	-7.7	-5	57	449	318	285
Russia		60.2	0.3	0.6	-1	22	25	36		8.2	-24.6	3	-1	55	-53	-294
South Africa		17.8	-0.8	-3.6	-4	-17	-10	-15		9.2	7.0	26	33	185	177	161
Turkey		18.29	-0.2	-0.4	-1	-53	-27	-24		11.6	10.0	20	-535	-557	-1274	-1084
US (DXY; 5y UST)		110	0.2	1.5	2	18	15	14		3.69	6.2	24	60	283	243	179

	Equity Markets								Bond Spreads on USD Debt (EMBIG)						
	Level		Change (in %)					Since	Level		Change (in basis points)				Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22	Last 12m	Latest	7 Days	30 Days	12 M	YTD	23-Feb-22
									basis points						
China		3928	-0.1	-4	-5	-19	-20	-15		199	-4	-19	-10	-4	-9
Indonesia		7195	0.4	-1	0	18	9	4		183	7	7	9	18	-2
India		59141	0.5	-2	-1	1	2	3		163	3	18	19	31	9
Philippines		6437	-1.7	-4	-6	-6	-10	-13		138	8	11	30	37	1
Thailand		1632	0.1	-2	0	2	-2	-4		0	0	0	0	0	0
Malaysia		1452	-1.1	-3	-4	-5	-7	-8		99	2	-14	-30	-18	-34
Argentina		145742	0.7	1	11	86	75	60		2393	67	-13	912	713	656
Brazil		109280	-0.6	-3	-2	-2	4	-2		298	9	-17	6	-13	-33
Chile		5523	-1.5	0	3	24	28	26		178	9	13	31	38	4
Colombia		1210	-0.3	-2	-8	-8	-14	-20		415	14	26	134	67	23
Mexico		46770	0.1	1	-4	-10	-12	-9		424	14	21	85	92	54
Peru		19364	0.0	-1	-2	8	-8	-17		210	23	30	41	60	20
Hungary		40028	-0.1	-4	-7	-24	-21	-16		267	45	56	132	143	114
Poland		49687	0.7	-3	-9	-30	-28	-21		23	-3	32	0	-9	7
Romania		11575	-1.5	-3	-8	-6	-11	-12		295	-3	36	104	102	63
Russia		2438	0.1	0	11	-40	-36	-21		3411	-577	938	3228	3234	2897
South Africa		65722	-1.3	-6	-6	5	-11	-12		445	34	9	94	90	56
Turkey		3322	-1.6	-9	10	134	79	65		627	22	-7	151	49	64
Ukraine		519	0.0	0	0	-1	-1	0		3402	-426	-3128	2938	2643	1929
EM total		38	-0.4	-3	-5	-26	-23	-20		433	15	13	80	47	-25

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

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