GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

FRIDAY, SEPTEMBER 30, 2022

- **Poor liquidity conditions exacerbate volatility in the US Treasury market** (link)
- **British pound reverses losses since mini-budget** (link)
- **Euro area headline inflation rises to 10% y/y, core at 4.8% y/y** (link)
- **Germany announces cap on gas and electricity prices** (link)
- **Japan's Prime Minister Kishida wants a new stimulus package** (link)
- **Chinese authorities ramp up efforts to stabilize the property sector downturn** (link)
- **Poland's September inflation surprises on the upside** (link)
- **The Czech national bank confirms FX intervention** (link)
- **Colombia surprises with a smaller-than-expected 100 bps hike** (link)
- **Mexico hikes to 9.25% in line with expectations** (link)

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Volatile markets gain while inflation surprises on the upside

Equity markets in Europe opened in the green and US equity futures were positive on the final day of a tumultuous month in financial markets, as investors continue to grapple with the monetary policy outlook against a backdrop of deteriorating economic growth. Yesterday's synchronized sell-off for equities and bonds saw the S&P 500 closing at a 21-month low. However, this morning sovereign yields were lower again, with the largest declines seen in the UK gilt market. The British pound has recovered most of its losses since the mini-budget announcement last week, but volatility remains high and this morning the pound weakened after early morning gains. On the data front, euro area inflation surprised on the upside, following an upside surprise to German inflation yesterday. In Japan, PM Kishida instructed government bureaus to come up with a stimulus package, with an aim to mitigate the impact of inflation. In emerging markets, inflation also surprised on the upside in Poland, while central banks in India, the Czech Republic, Kenya, Colombia, and Mexico announced monetary policy decisions in the past 24 hours.

Key Global Financial Indicators

Last updated: 9/30/22 12:28 PM	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		3640	-2.1	-3	-8	-15	-24	-14
Eurostoxx 50		3289	0.3	-2	-6	-19	-23	-17
Nikkei 225		25937	-1.8	-4	-6	-10	-10	-2
MSCI EM		35	-2.2	-5	-11	-31	-28	-26
Yields and Spreads					bps			
US 10y Yield		3.69	-9.2	1	59	221	218	170
Germany 10y Yield		2.09	-9.6	6	57	228	226	186
EMBIG Sovereign Spread		569	5	67	76	216	202	156
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		48.6	-0.3	-1	-3	-12	-8	-9
Dollar index, (+) = $ appreciation		112.5	0.2	-1	4	19	18	17
Brent Crude Oil ($/barrel)		89.1	0.7	3	-8	13	15	-8
VIX Index (%, change in pp)		31.5	-0.3	2	6	8	14	1

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

Mature Markets

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United States

Yesterday the S&P 500 declined (-2%) to the lowest level of this year as fragile risk sentiment, and high volatility weighed on markets. All eleven major sectors closed in the red, with Mega tech shares driving the losses as Apple fell by 5%. US Treasuries gradually pared earlier losses over the NY session, with 10-year yields rising 5 bps to 3.78%.

This morning, the PCE deflator, the Fed's favored price gauge, eased by less than expected to 6.2% in August (vs expected 6.0%) from a revised 6.4% in July, and increased more than expected on a monthly basis (0.3%mom vs expected 0.1%). Excluding food and energy, the core PCE deflator edged up to 4.9% from a revised 4.7% (vs expected 4.7%). Personal spending increased to 0.4%, ahead of the expected 0.2%. Market impact was muted immediately after the release.

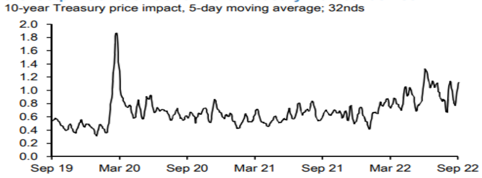
Poor liquidity conditions likely exacerbated recent volatility in US Treasury yields. US Treasury yields rose sharply this month, with the 10-year yield up nearly 60 bps as markets anticipate tighter monetary policy. Recent turmoil in the UK gilt market spilled over to global markets and pushed yields and volatility even higher, with moves likely exacerbated by poor liquidity conditions. Liquidity indices show that US Treasury market liquidity conditions are impaired against a backdrop of monetary policy uncertainty. JPMorgan analysts point out that market depth—sum of the three bids and offers by queue position, which measures how much can be traded at any given price level—remains depressed with current levels similar to those seen in April 2020. In addition, the yield difference between the fitted curve and actual yields has widened, and price impact (average move in mid-price against a $100 mn flow, which measures how much each trade moves the market) remains high levels (right chart).

Liquidity Indices (RMSE of fitted UST curve)

Source : JPM

Exhibit 2: ...and price impact has moved higher as well, indicating the footprint of each trade in the Treasury market has risen

10-year Treasury price impact, 5-day moving average; 32nds

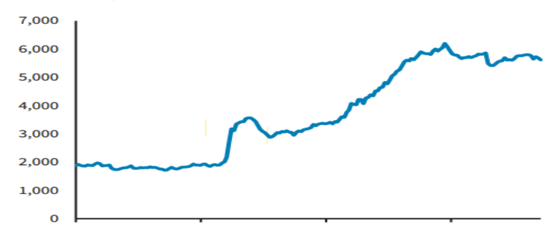


* Price impact defined as the average move in order book mid-price against a $100mn flow in traded notional. See Drivers of price impact and the role of hidden liquidity, J. Younger et al., 1/13/17 for more details.

Source: J.P. Morgan, BrokerTec

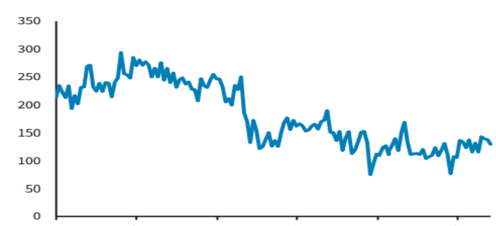
Market analysts think that Treasury selling seen recently and piling-up of securities on dealer balance sheets are more likely to reduce secondary market liquidity than to push up funding rates, although uncertainty remains. Recent global rate volatility induced speculation that sharp Treasury yield increases and high volatility may cause market dysfunction and create funding market dislocations, similar to what was seen in March 2020. However, Barclays analysts point out several differences in the market environment between now and March 2020. **First, there is ample liquidity in the financial system** now (left chart): the reserve balance is 1.8 times larger than in March 2020, and nearly $2.4 tn cash is parked at the Fed RRP. **Second, dealers' balance sheet pressure looks less severe** than it was in early 2020 (right chart): as of mid-September, primary dealers' Treasury inventories were less than $130 bn.

FIGURE 1. **Liquid resources ($bn)**



Note: Sum of bank reserves and RRP balances (domestic and foreign)
Source: Federal Reserve, Barclays Research

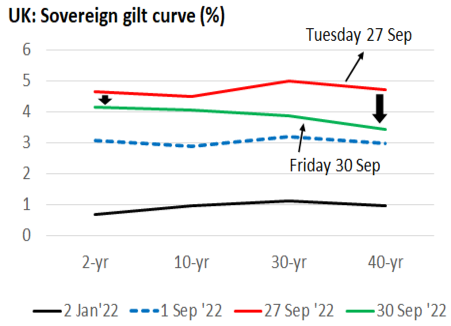
FIGURE 4. **Dealer Treasury inventories ($bn)**



Source: Federal Reserve, Barclays Research

United Kingdom

The British pound is set to close the month around 4.7% weaker but has reversed most losses since the announcement of the mini-budget as opinion polls shifted sharply in favor of Labor. The latest poll by YouGov showed that the Labor party is leading Labor by around 33 points. PM Truss and Chancellor Kwarteng are also meeting with the head of the Office for Budget Responsibility, the UK's independent fiscal watchdog**. Short-dated 2-yr gilt yields moved 28 bps lower, compared to a 12 bps in the 10-yr and 30-yr segment. Bank stocks (+1.4%) and shares of pension funds and insurers outperformed today.**

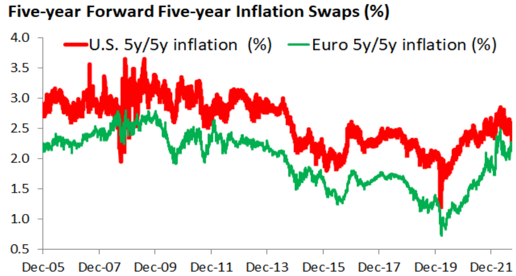


Source: Bloomberg and IMF staff

Euro area

Equities (+1%) gained but the euro (-0.4%) is weaker. German 10-yr bund yields are 10 bps lower, in line with US 10-yr yields. **Italian 10-yr yields are 15 bps lower at 4.50% as the Italian government reportedly revised its budget deficit lower in updated forecasts, from 5.6% GDP to 5.1% in 2022 and from 3.9% to 3.4% in 2023, while for 2024 it was slightly revised up (from 3.3% to 3.5%).** HSBC points out that the numbers imply that Finance Ministry expects to achieve a primary fiscal surplus (of around 0.5% of GDP) in 2023.

Euro area inflation rose to 10% y/y (9.7% y/y expected), for the first time since the introduction of the euro. German headline CPI surprised to the upside yesterday (10% versus 9.5% exp). Core inflation was 4.8% y/y (4.7% expected). In contrast, French headline inflation was 6.2% y/y (6.6% y/y expected). Italian headline inflation was 9.5% y/y, as expected. **Euro area 5-yr/5-yr and US 5-yr/5-yr inflation swaps both trade at 2.14% after U.S. inflation swaps fell 35 bps this week.**



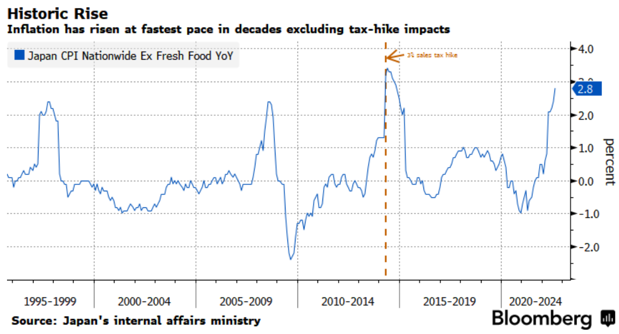
Source: Bloomberg, and IMF staff

Spot natural gas prices are 4% weaker as EU energy ministers meet in Brussels to discuss measures to tackle the sharp rise in natural gas prices. A group of 15 countries including France, Italy, Spain, and Poland has been urging the European Commission to propose a price cap on all wholesale gas transactions to help rein in surging prices but countries including Germany and the Netherlands have reportedly opposed an EU-wide cap.

Yesterday, the German government introduced a cap on gas and electricity prices and removed a planned gas surcharge, planning up to €200 bn of financing for the caps. The government plans to finance the cap via off-budget borrowing with a fund of €200bn (about 5% of GDP) as the government intends the federal deficit next year to return to the constitutional debt brake (which caps federal borrowing, adjusted for the economic cycle, at 0.35% of GDP).

Japan

Prime Minister Kishida instructed government bureaus to come up with a stimulus package, with an aim to mitigate the impact of inflation. Potential measures will help tackle price rises, encourage pay increases, and speed up Kishida's drive to transform capitalism. Existing price-relief measures, including gas subsidies and cash handouts for low-income households, were extended earlier this month. Analysts noted that the emphasis on inflation in the stimulus package shows the pain of rising costs. On the data front, **August activity data came out stronger than expected.** Industrial production expanded 2.7% m/m (consensus: +0.2%); retail sales grew 1.4% m/m (consensus: +0.2%); and housing starts increased 4.6% y/y (consensus: -4.0%). The unemployment rate dropped to 2.5% as expected. Nevertheless, consumer confidence weakened to 30.8 in September from 32.5 in August, pointing to a dimmer economic outlook going forward. **Japanese equities retreated (NIKKEI: -1.8%), following the decline in global equities yesterday**. The Japanese yen was little changed. Long-end JGB yields declined (10-year: -0.9 bp; 30-year: -1.1 bps), supported by the Bank of Japan (BOJ)'s larger than expected planned bond purchases. The BOJ bought 550 bn yen ($3.46 bn) of bonds compared with the 500 bn yen ($3.81 bn) planned.



Emerging Markets

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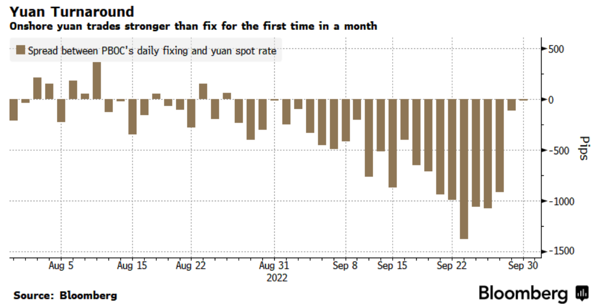
Asian equities were mixed today, falling 0.1% on net. Indian equities gained (+1.8%), while share prices dropped in Philippines (-3.3%), Taiwan Province of China (-0.8%), Korea (-0.7%), and China (CSI 300 -0.6%). **Most Asian currencies appreciated**, led by Thai baht (+1.0%), Indian rupee (+0.6%), and Philippine peso (+0.6%). **Long-end government bond yields were mixed**, with 10-year yields falling in Taiwan Province of China (-16.8 bps) and Indonesia (-4.1 bps) while rising in China (+3.4 bps). In Korea, industrial production declined 1.8% m/m in August, larger than expected (consensus: -0.8%). **FTSE Russell placed Korea on a watch list for potential inclusion in its World Government Bond Index.** Korean won appreciated (+0.5%); long-end government bond yields declined (30-year: -11.3 bps). In Hong Kong SAR, retail sale declined 0.1% y/y in August, weaker than expected (consensus: +2.7%). **After a relentless sell-off this week, EMEA markets are mixed this morning.** Equity markets are up in Hungary (+2.5%), the Czech Republic (+0.9%), Poland (+0.8%) and South Africa (+0.7%), and broadly flat in Turkey. Currencies are slightly down vs. their reference currencies. Local currency yields are stabilizing in Central and Eastern Europe, after a sharp increase since last Friday (+82 bps in Poland to 7.24%, +64 bps in Hungary to 9.9%, +43 bps in the Czech Republic to 5.33%). Yesterday, the Czech national bank left the policy rate unchanged at 7%, as expected, **while the Kenyan central bank surprised markets with a larger than expected 75 bps hike to 8.25%** (8% expected). **In Latam, equity markets declined, currencies depreciated, and credit default swaps widened across most countries** on renewed investor concerns of further monetary policy tightening, a global recession, and turmoil in Europe.

China

RMB appreciated onshore (+0.3%) but depreciated offshore (-0.2%). Chinese banks were reportedly told to trade RMB at levels closer to the daily RMB fixing at the market open. This morning, RMB was trading stronger than the fixing the first time in a month. The People's Bank of China (PBC) also set the daily RMB fixing at 7.0998 yuan per dollar, stronger than expected by 558 pips. Chinese equities declined onshore (CSI 300: -0.6%; Hong Kong SAR-listed: flat). The PBC injected liquidity in an amount of 184 bn RMB ($25.9 bn) to ease tightening liquidity conditions at the quarter-end. The key interbank rate (DR007) edged down slightly to 2.09% (-4 bps), staying close to the policy rate (at 2.0%). Long-end CGB yields rose (10-year: +3.3 bps; 30-year: +4.6 bps). **Official composite PMI deteriorated to 50.9 in September from 51.7 in August, driven by the weakening non-manufacturing component** which dropped to 50.6 from 52.6 (consensus: 52.4). Official and Caixin manufacturing PMIs gave different pictures. Official manufacturing PMI improved to 50.1 from 49.4, better than expected (consensus: 49.7), while Caixin manufacturing PMI (with a greater coverage of export-oriented small enterprises) weakened to 48.1 form 49.5, weaker than expected (consensus: 49.5).

Chinese authorities ramped up efforts to stabilize the property sector downturn. Reportedly, state-owned banks were told to extend loans at least 600 bn RMB ($84.4 bn) to the property sector by the year-end. Furthermore, authorities will offer income tax breaks for some home purchases. Some cities will also be allowed to relax the floor of first-home mortgage rate (currently, the floor is 20 bps below the 5-year lending prime rate); eligible cities are those where new home prices had declined during June-August this year. **Onshore equities of real estate firms gained (+2.5%).**

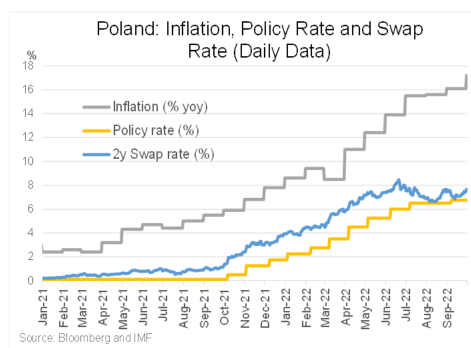


India

The Reserve Bank of India (RBI) raised the repurchase rate by 50 bps to 5.9%, as expected. The cash reserve ratio was kept unchanged at 4.5%, as expected. The RBI kept its inflation forecast for the fiscal year ending March 2023 at 6.7% while revising down its growth forecast to 7.0% (from 7.2%). Governor Das noted that the inflation trajectory remains clouded with geopolitical uncertainty, but the correction in crude oil may ease cost pressures. He also mentioned that the RBI's FX interventions are to curb exchange rate volatility. **FTSE Russell retained India on the watch list for possible inclusion in its emerging markets bond index.** Analysts noted that this retaining decision reflected the hesitancy to expedite index inclusion of India bonds due to operational issues. Analysts did not expect a major price impact from the FTSE's decision as positioning towards a potential inclusion announcement appeared light. **The Indian rupee appreciated (+0.6%); long-end government bond yields increased (10-year: +0.9 bp; 30-year: +2.4 bps); Indian equities gained (+2.0%).**

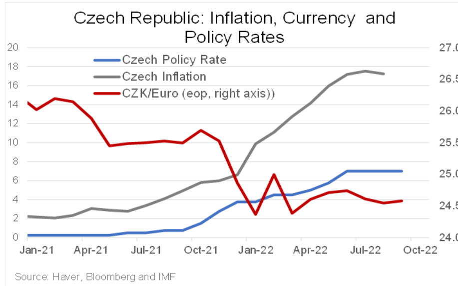
Poland

The polish zloty is underperforming slightly (-0.2% to 4.87/euro) after inflation increased further in September to 17.2% y/y (from 16.1% in August) and surprised markets sharply on the upside (16.4% expected). After two months of deceleration, inflation momentum increased, with m/m inflation at 1.6% (up from 0.8% in August, and 0.5% in July). The Polish 2y swap rate increased 24 bps after the inflation release, to 7.69%, reflecting expectations of additional rate hikes. The next MPC meeting is next Wednesday, and markets are expecting a 25 bps hike to 7%.



Czech Republic

The Czech koruna is losing 0.2% to the euro (to 25.6/euro), reversing some of yesterday's appreciation after the MPC meeting. The Czech Central bank kept the policy rate unchanged at 7% as expected, but in the press conference, the governor confirmed that the central bank will continue using its reserves to prevent *excessive exchange rate moves*. He further stated that there is no limit on how much of its FX reserve balance it is willing to use. He also said that rates are likely to remain high for a prolonged period of time in order to ensure price stability and that higher rates could be needed if there is additional fiscal easing.

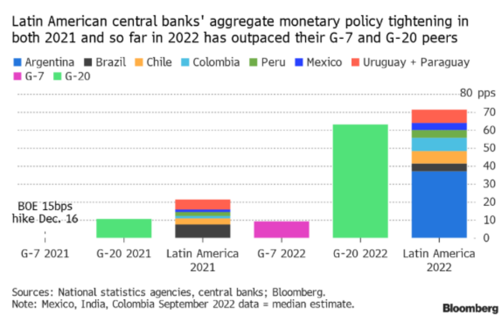


Colombia

The central bank slowed the pace of interest rate hikes by increasing its benchmark rate by 100 bps to 10%, below the expected 150 bps hike by analysts. The decision was supported by six board members while one member was in favor of a 50 bps increase. Some of the factors considered by the central bank was higher medium-term domestic inflation expectations and also monetary policy in developed economies becoming more contractionary than expected—a backdrop that saw the Colombian peso depreciate significantly. The central bank cut its 2023 economic growth forecast to 0.7% from 1.1%. Some analysts think that the decision might reflect that the central bank is approaching the end of its tightening cycle. In line with previous guidance, the central bank is not considering FX interventions as they are not considered appropriate under the current circumstances, according to ItauBBA Macroeconomic Analysis.

Mexico

The central bank increased its benchmark rate by 75 bps to 9.25%, in line with consensus expectations. Analysts note that policy makers continued their commitment to hike interest rates until inflationary pressures ease. Bloomberg Economics expects the central bank to increase its benchmark rate by 75 bps in November, 50 bps in December, and to hold the 10.5% benchmark rate until 3Q23, while Barclay's Research expects the benchmark rate to reach 10.75% by the end of the hiking cycle. Latin American central banks' monetary policy tightening has outpaced their G-7 and G-20 peers in 2021 and YTD 2022, according to Bloomberg.



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Global Financial Indicators

9/30/22 12:31 PM	Level		Change					Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
Equities			%				%	%
United States		3640	-2.1	-3	-8	-15	-24	-14
Europe		3291	0.4	-2	-6	-19	-23	-17
Japan		25937	-1.8	-4	-6	-10	-10	-2
China		3805	-0.6	-1	-5	-22	-23	-18
Asia Ex Japan		59	-2.4	-5	-12	-31	-29	-26
Emerging Markets		35	-2.2	-5	-11	-31	-28	-26
Interest Rates			basis points					
US 10y Yield		3.69	-9.4	1	59	220	218	170
Germany 10y Yield		2.08	-9.9	6	57	228	226	185
Japan 10y Yield		0.24	-1.1	1	2	17	17	5
UK 10y Yield		4.05	-9.2	22	135	303	308	257
Credit Spreads			basis points					
US Investment Grade		191	4.0	25	30	104	79	48
US High Yield		550	6.2	61	57	236	212	143
Europe IG		135	-3.0	5	16	85	88	64
Europe HY		645	-16.9	8	57	392	404	294
Exchange Rates			%					
USD/Majors		112.49	0.2	-1	3	19	18	17
EUR/USD		0.98	-0.5	1	-3	-16	-14	-14
USD/JPY		144.6	0.1	1	4	30	26	26
EM/USD		48.6	-0.3	-1	-3	-12	-8	-9
Commodities			%					
Brent Crude Oil ($/barrel)		89	0.7	3	-7	24	21	2
Industrials Metals (index)		147	0.8	0	-4	-8	-15	-22
Agriculture (index)		69	0.5	0	-1	20	13	-2
Implied Volatility			%					
VIX Index (%, change in pp)		31.5	-0.4	1.6	5.6	8.3	14.3	0.4
US 10y Swaption Volatility		150.9	0.0	11.2	24.4	77.3	71.9	56.6
Global FX Volatility		13.0	0.0	0.9	1.9	6.3	5.6	5.5
EA Sovereign Spreads			10-Year spread vs. Germany (bps)					
Greece		277	4.2	20	20	169	125	37
Italy		244	-3.4	12	9	138	109	72
Portugal		107	0.5	3	-2	52	43	15
Spain		118	-1.0	3	-1	52	44	15

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

Emerging Market Financial Indicators

Last updated: 9/30/2022 12:33 PM	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		7.12	0.1	0.2	-3	-9	-11	-11		2.9	-0.5	8	14	-14	2	0
Indonesia		15228	0.2	-1.2	-3	-6	-6	-6		7.4	-4.4	8	25	111	99	88
India		81	0.6	-0.4	-2	-9	-9	-8		7.6	-5.8	-11	13	113.3	131	
Philippines		59	0.6	-0.3	-4	-13	-13	-13		5.8	0.0	3	28	160	128	78
Thailand		38	1.0	-0.7	-3	-10	-11	-15		3.2	-15.0	5	46	137	131	94
Malaysia		4.64	0.0	-1.3	-3	-10	-10	-10		4.4	-8.3	4	37	98	76	69
Argentina		147	-0.2	-1.3	-6	-33	-30	-27		88.0	22.4	444	1061	3878	3743	4003
Brazil		5.40	-0.5	-5.2	-7	0	3	-7		12.0	-4.0	56	-12	91	133	50
Chile		962	0.3	0.9	-7	-16	-11	-18		7.0	0.0	1	50	160	159	110
Colombia		4530	-1.0	-3.6	-4	-15	-10	-14		9.9	0.0	18	41	334	351	205
Mexico		20.13	0.2	0.4	0	3	2	1		9.2	0.5	16	51	178	171	139
Peru		4.0	-0.6	-2.2	-4	4	1	-6		8.8	20.1	48	72	231	285	275
Uruguay		42	-0.7	-2.4	-2	3	7	1		11.5	0.0	0	44	360	274	332
Hungary		432	-0.6	-3.0	-8	-28	-25	-26		9.9	-8.0	50	60	657	542	512
Poland		4.96	-0.3	-1.4	-5	-20	-19	-18		6.9	-13.5	52	63	468	336	299
Romania		5.1	-0.5	0.6	-5	-16	-14	-14		8.6	11.4	39	64	489	374	341
Russia		58.9	-2.3	-1.8	4	23	28	39		8.9	54.6	-12	34	117	12	-229
South Africa		18.0	0.2	-0.1	-5	-16	-11	-16		9.6	-9.0	9	65	209	221	205
Turkey		18.55	-0.3	-0.7	-2	-52	-28	-25		11.9	-5.0	27	-148	-661	-1244	-1054
US (DXY; 5y UST)		112	0.2	-0.6	3	19	18	17		3.95	-6.8	-3	68	298	269	205

	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		3805	-0.6	-1	-5	-22	-23	-18		194	6	-13	-16	-9	-14
Indonesia		7041	0.1	-2	-2	13	7	2		225	49	42	49	60	40
India		57427	1.8	-1	-2	-2	-1	0		195	33	37	49	63	41
Philippines		5741	-3.3	-9	-14	-17	-19	-22		173	39	43	58	72	36
Thailand		1590	-0.2	-3	-2	-1	-4	-6		0	0	0	0	0	0
Malaysia		1395	-0.2	-2	-6	-9	-11	-12		114	16	3	-17	-3	-19
Argentina		138005	0.0	-8	1	78	65	51		2767	316	337	1195	1087	1030
Brazil		107664	-0.7	-6	-2	-3	3	-4		322	32	5	25	11	-9
Chile		5035	0.0	-3	-7	15	17	15		202	27	18	53	62	28
Colombia		1136	0.5	-2	-8	-17	-20	-25		471	53	52	171	123	79
Mexico		45103	-0.7	-3	0	-12	-15	-12		483	47	68	133	151	113
Peru		19371	0.3	-1	3	6	-8	-17		231	26	37	60	81	41
Hungary		37895	2.3	-2	-10	-28	-25	-21		330	77	104	203	206	177
Poland		46023	0.3	-4	-8	-35	-34	-27		74	58	112	48	42	58
Romania		10630	0.8	-2	-12	-16	-19	-19		393	84	112	201	200	160
Russia		1922	-1.6	-8	-20	-53	-49	-38		3411	-577	938	3228	3234	2897
South Africa		63658	0.6	0	-5	-1	-14	-15		511	81	96	154	156	122
Turkey		3139	-0.3	-4	-1	123	69	56		637	40	8	140	59	74
Ukraine		519	0.0	0	0	-1	-1	0		3831	239	423	3320	3072	2358
EM total		35	-0.6	-5	-11	-31	-28	-26		486	54	63	117	100	28

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

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