GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

FRIDAY, SEPTEMBER 9, 2022

- **US financial conditions reverse August easing amid hawkish central bank pivot** (link)
- **Money markets price in 75 bps ECB policy rate hike at October meeting** (link)
- **Euro area bank stocks outperform as excess reserves will get renumerated** (link)
- **Japanese government unveils near-term relief measures to combat inflation** (link)
- **Chinese inflation moderates more than expected in August** (link)
- **Peru's central bank delivers smaller-than-expected 25 bps policy rate increase** (link)

Mature Markets | Emerging Markets | Market Tables

Markets try to gauge monetary policy outlook

The move higher in core sovereign bond yields has paused and stocks are rebounding this morning as investors mull the outlook for continued policy tightening. Equity markets are showing resilience and posting gains across most regions this morning despite continued hawkishness from major central banks. Yesterday, Fed Chair Powell reiterated the central bank's messaging over the last month, saying that officials need to act strongly as they have been doing to restore price stability. Before easing slightly this morning, US Treasuries initially resumed their recent sell off with 2-year yields once again approaching multi-year highs of 3.5% and swap markets now pricing in a more than 80% chance of a 75 bps hike at the upcoming September FOMC meeting. While also steadying this morning, European bond yields jumped back to local highs yesterday with front-end yields skewed to the upside as most analysts viewed yesterday's ECB rate hike and press conference as exhibiting a hawkish tilt, while in the UK, fiscal support to contain rising energy costs initially pushed UK gilt yields higher across the curve. The improved risk sentiment is driving broad US dollar weakness across G10 and EM pairs, while European natural gas prices are lower as investors await details from the EU energy ministers' meeting today.

Key Global Financial Indicators

Last updated: 9/9/22 8:03 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		4006	0.7	1	-3	-11	-16	-5
Eurostoxx 50		3570	1.7	1	-4	-15	-17	-10
Nikkei 225		28215	0.5	2	-1	-7	-2	7
MSCI EM		38	-0.5	-3	-4	-27	-21	-19
Yields and Spreads					bps			
US 10y Yield		3.27	-5.1	8	49	197	176	127
Germany 10y Yield		1.71	-1.0	18	79	207	188	148
EMBIG Sovereign Spread		498	-12	-11	-4	159	131	85
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		50.3	0.3	1	-1	-11	-4	-5
Dollar index, (+) = $ appreciation		108.9	-0.7	-1	2	18	14	13
Brent Crude Oil ($/barrel)		90.7	1.7	-3	-6	27	17	-6
VIX Index (%, change in pp)		23.0	-0.6	-3	1	4	6	-8

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

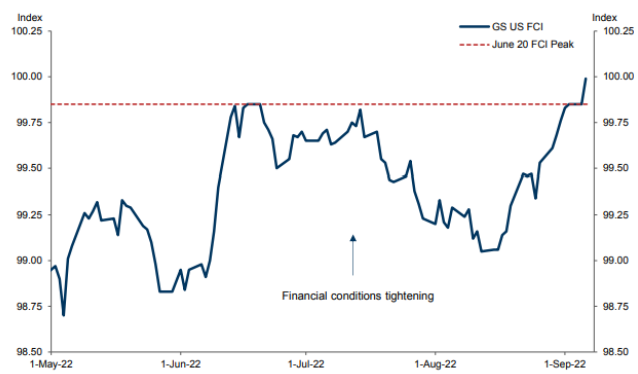
Mature Markets

back to top

United States

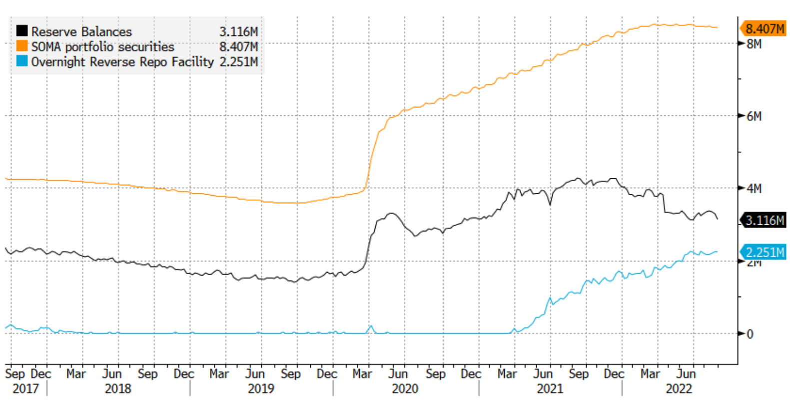
US financial conditions have tightened to new highs, driven by the hawkish monetary policy shift in August. According to Goldman Sachs analysts, this is the fourth major tightening driven by such a shift this year. Hopes of a Federal Reserve pivot due to growth concerns that flourished in July were again dispelled in August, and the policy outlook now remains more balanced. Markets price in roughly a 75–50–25 bps policy rate path for the next three FOMC meetings, which is expected to keep growth on a solidly below-potential path in the second half of 2022.

Exhibit 1: Financial conditions have tightened past recent peaks



Source: Goldman Sachs Global Investment Research

Markets see a potential reserve scarcity scenario in 2023. According to Federal Reserve officials, the current QT process will necessitate a more complicated adjustment process in private sector balance sheets compared to the last QT. Even prior to the start of QT, reserve balances had been declining and have now fallen by more than $900 bn YTD. With reserve drainage expected to intensify in September, as the higher caps kick in, the large amounts of cash stashed at the overnight reverse repo (RRP) facility of the Federal Reserve are key to preventing upward pressures on interest rates. The Federal Reserve expects money to flow out of the facility, as a wider range of alternative short-term investments becomes available and as investor’s uncertainty over the path of rates decreases. However, some market analysts see challenges in draining the RRP and see a scenario of elevated RRP balances and reserve scarcity as likely in 2023. The Standing Repo Facility and the foreign repo facility are available to deal with any liquidity shortfalls and buy the Federal Reserve some time to contemplate how to proceed with QT.

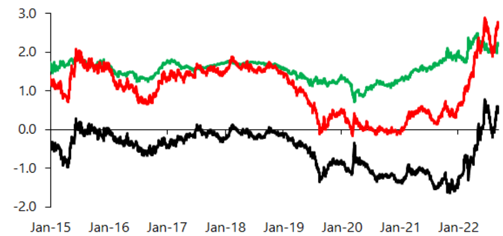


Euro area

Equities (+1.6%) are higher as investors await details on the EU energy ministers' meeting. More details are expected on electricity savings, the ex-post levy on infra-marginal power production (non-gas fueled), and liquidity support to energy providers.

The euro (+0.9%) is stronger in line with general U.S. dollar weakness. Euro area rates are 1–2 bps lower after closing higher post-ECB yesterday. **Measures for euro area real yields edged lower after closing higher yesterday.**

Euro area: 5yr/5yr inflation and 5yr/5yr interest rate swaps (%)



Source: Bloomberg and IMF staff

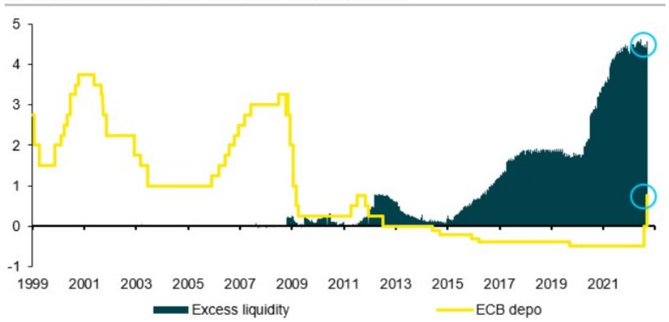
The ECB arguably abandoned its forward guidance at its July meeting, but ECB president Lagarde offered a sense of direction. She said that the Governing Council "expects to raise interest rates further… over the next several meetings." President Lagarde elaborated that "several" probably means "more than two" (including yesterday's meeting) and probably less than five.

A hike of 75 bps is now priced for the meeting on October 27, not in the least because press reports indicate that ECB officials are planning another jumbo hike. In contrast, Banque de France governor Villeroy de Galhau said this morning that the ECB did not create a "jumbo habit" (of 75 bps hikes). The governor also indicated that bringing rates to neutral would be a rate "below or close to" 2%. **The ECB Governing Council also intends to discuss quantitative tightening at a non-policy meeting on October 5.**

Bank stocks (+3%) outperformed for a second day in a row as excess reserves of banks will now get remunerated. Yesterday, the ECB suspended the two-tier system used for remunerating excess reserves of banks, returning to a simple framework whereby all excess liquidity will get remunerated at the depo rate of 0.75% currently. Banks should also benefit from higher interest margins on deposits.

New challenges emerge as ECB takes rates above zero while excess liquidity remains at record highs

ECB depo announcement rate, in %, and excess liquidity, in € trn

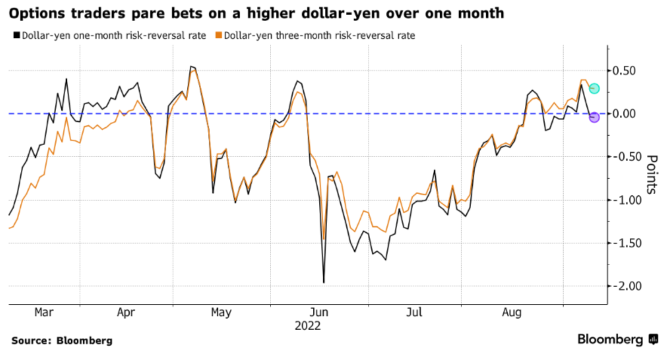


Source: Bloomberg, Commerzbank Research

The ECB also decided to temporarily remove the 0% interest rate ceiling for remunerating government deposits in the Eurosystem. The higher rate should prevent an abrupt outflow of such deposits into the market, at a time when some segments of the euro area repo markets are showing signs of collateral scarcity.

Japan

Japan's government unveiled near-term relief measures to combat inflation. Low-income households will receive ¥50 k ($347), while regional governments will receive ¥600 bn ($4.2 bn) for their own inflation measures, according to Bloomberg. Gasoline subsidies and price caps for wheat, animal feed will remain. Separately, **Bank of Japan (BOJ) Governor Kuroda slammed sudden FX moves as undesirable.** Following a meeting with PM Kishida, Kuroda characterized a 2–3 yen move against the US dollar in a day as *very sudden*. Relatedly, the Finance Ministry reiterated that no options will be ruled out if excessive one-sided FX moves persist. Options traders reduced bets on a weaker yen following the news, Bloomberg reports. **Japanese yen strengthened +1.4%**, **equities firmed +0.4%, 10-year yields were little changed.**



Emerging Markets

back to top

Latin American stocks and currencies were little changed yesterday. Equities performed mixed, with gains in Peru (+0.9%), Mexico (+0.5%), and Argentina (+0.4%), and losses in Colombia (-0.6%) and Chile (-0.4%), while currencies appreciated in Brazil (+0.7%) and Chile (+0.5%). A marked improvement in Colombian consumer confidence from -10.4 to -2.4 (on a scale from -100 to 100) failed to provide support for local stock markets. **Asian equities rallied +1.5% on net.** Hong Kong SAR surged +2.7%, mainland China equities rallied (CSI 300: +1.4%). Asian currencies mostly appreciated, and 10-year yields were little changed. **Bank Indonesia** revealed that it intervenes in the FX market only occasionally to smooth volatility and build market confidence, Bloomberg reports. **EMEA equities were mostly trading higher, and currencies strengthened against the dollar this morning.** Equities in Turkey (+2.6%) and South Africa (+2.5) saw the largest gains, while the South African rand outperformed against the dollar (+1.6%). Currencies in Central Eastern Europe (CEE) were mixed against the euro ahead of the EU energy ministers meeting later today, with the Hungarian forint (+0.4%) outperforming while the Polish zloty was little changed. Analysts highlight that Poland's central bank press conference yesterday indicated that the tightening cycle is not over yet, although the tone was seen as slightly more dovish than July's press conference.

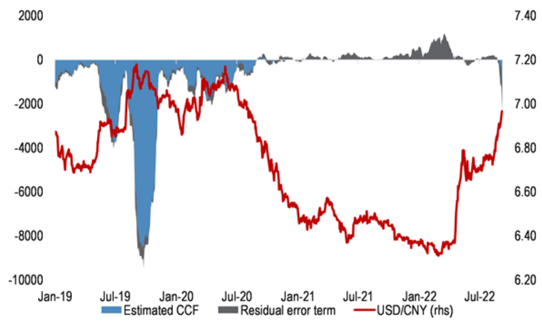
China

Chinese inflation moderated more than expected in August. Consumer inflation cooled to 2.5% y/y (consensus: 2.8%, previous: 2.7%), amid sporadic domestic lockdowns to contain COVID. Producer inflation dived to 2.3% y/y (consensus: 3.2%, previous: 4.2%). Some analysts noted that slower inflation may provide room for additional monetary policy stimulus, while others saw low odds of further lending facility rate cuts following recent central bank moves to support the yuan. Separately, **President Xi urged**

the government to increase support for medium-sized and small companies. He also called for strengthening intellectual rights protection to encourage corporate innovation, local media reported. Meanwhile, China expanded its incentives for start-ups and university graduate hires. Among measures, platform companies will receive funding support via special loans. Also, loans targeting the jobless looking to start businesses will be extended a year if they cannot be paid in time. Separately, **Equities rallied (CSI 300: +1.4%)**, despite news of fresh domestic travel restrictions ahead of mid-Autumn holidays. Property developer shares rallied as much as 3.4%, following news that at least 24 cities have allowed parents to help pay their children's mortgages by tapping their own housing provident funds**. Chinese yuan appreciated +0.5%, 10-year yields were little changed**.

Having increased sharply of late, the strengthening bias in the daily CNY fixings still screens relatively marginal compared to 2019

Pips, 20-day rolling sum of the strengthening bias (the difference between actual fixings and JPM model estimates incorporating only the o/n basket currency performance

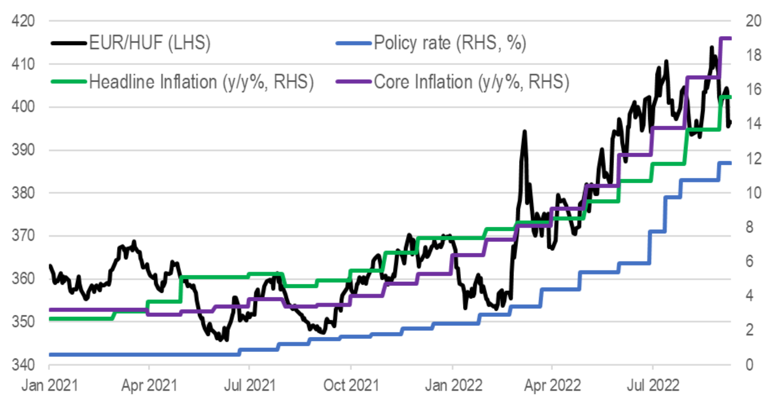


Source: J.P. Morgan

Hungary

Analysts expect further monetary policy tightening as inflationary pressures persists. While data released yesterday showed a smaller-than-expected acceleration in headline inflation (15.6% y/y vs expected 15.9% from 13.7%), core inflation surprised on the upside (19% y/y vs expected 18.6% from 16.7%). ING analysts expect headline inflation to peak at around 22% by end 2022, and forecast average 2023 inflation at 15%. The National Bank of Hungary (NBH) increased its policy rate by 100 bps to 11.75% at its most recent meeting in August and also announced an increase in the required reserve ratio, regular NBH discount bill auctions and a new deposit instrument to sterilize banking system liquidity in longer maturities. Given the newly announced liquidity-draining measures, **ING analysts see smaller interest rate hikes going forward as a possibility, but still expect a terminal rate of 14% by year-end.**

Hungary: Currency, Policy rate and Inflation



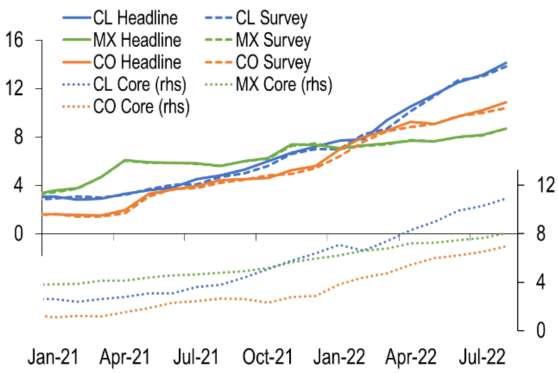
Peru

Peru's central bank hiked its policy rate by 25 bps to 6.75%. The hike surprised on the downside, as market consensus expected a 50 bps hike. The central bank based the decision on softening inflationary dynamics, which it observed via declines in actual and expected inflation in August. The bank still acknowledged international price pressures, supply bottlenecks, and a weakening global economic cycle, but pointed to signs of improvement in the domestic economy. Meanwhile the Peruvian government announced spending plans to promote public and private investments and to provide additional relief for vulnerable households. The plans' costs are gauged at $0.8 bn and are, according to the finance minister, already included in the budget for the current fiscal year.

Latin American Inflation Trends

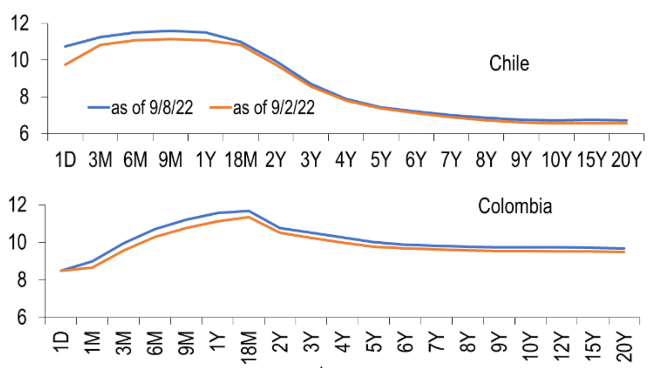
Inflation has persisted and has accelerated in some Andean economies. This week's inflation prints for the region pointed so far to widespread persistence in price pressures: headline inflation rose in August by 55 bps to 8.7% y/y in Mexico, by 100 bps to 14.1% y/y in Chile, and by 63 bps to 10.8 % y/y in Colombia, while plateauing around 9.5% y/y in Uruguay. Core inflation rates increased across the board. Actual inflation exceeded market expectations substantively, except in Mexico, hinting at possible further monetary tightening in the region. Chilean and Colombian local interest swap curves shifted up during the week, in particular around the 9-month horizon (+46 bps in Chile and +44 bps in Colombia). Both curves indicate now terminal policy rates of well beyond 11% in their respective central banks' current hiking cycles.

Inflationary trends persist in the region, and...
(inflation rates, percent on both scales)



Source: Bloomberg.

...local interest swap rates rose, particularly for shorter tenors.
(percent)



Source: Bloomberg.

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Global Financial Indicators

Last updated: 9/9/22 8:04 AM	Level		Change					Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
Equities					%		%	%
United States		4019	0.7	1	-3	-11	-16	-5
Europe		3570	1.7	1	-4	-15	-17	-10
Japan		28215	0.5	2	-1	-7	-2	7
China		4094	1.4	2	-2	-18	-17	-11
Asia Ex Japan		65	-0.5	-3	-4	-27	-21	-18
Emerging Markets		38	-0.5	-3	-4	-27	-21	-19
Interest Rates					basis points			
US 10y Yield		3.27	-5.1	8	49	197	176	127
Germany 10y Yield		1.71	-1.0	18	79	207	188	148
Japan 10y Yield		0.25	0.1	1	8	21	18	6
UK 10y Yield		3.07	-7.4	16	110	234	210	159
Credit Spreads					basis points			
US Investment Grade		166	-2.1	1	-1	76	54	23
US High Yield		486	-16.3	-33	16	168	148	79
Europe IG		106	-5.7	-7	3	62	59	35
Europe HY		520	-28.9	-36	1	294	278	168
Exchange Rates					%			
USD/Majors		108.90	-0.7	-1	2	18	14	13
EUR/USD		1.00	0.4	1	-2	-15	-12	-11
USD/JPY		142.7	-1.0	2	6	30	24	24
EM/USD		50.3	0.3	1	-1	-11	-4	-5
Commodities					%			
Brent Crude Oil ($/barrel)		91	1.7	-3	-4	36	23	0
Industrials Metals (index)		152	2.1	3	-3	-8	-12	-19
Agriculture (index)		68	0.8	1	3	23	12	-3
Implied Volatility					%			
VIX Index (%, change in pp)		23.0	-0.6	-2.5	1.3	4.2	5.8	-8.0
US 10y Swaption Volatility		126.2	-1.9	1.5	5.9	60.9	47.2	31.9
Global FX Volatility		11.3	0.0	0.3	0.9	4.7	3.9	3.8
EA Sovereign Spreads					10-Year spread vs. Germany (bps)			
Greece		255	3.6	-13	26	140	103	15
Italy		228	2.3	-4	14	125	93	57
Portugal		104	2.5	-4	2	48	40	12
Spain		115	2.2	-4	4	48	40	11

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

Emerging Market Financial Indicators

Last updated: 9/9/2022 8:08 AM	Exchange Rates: Level, Last 12m	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Since 23-Feb-22	Local Currency Bond Yields (GBI EM): Level, Last 12m	Latest	Change (in basis points) 1 Day	7 Days	30 Days	12 M	YTD	Since 23-Feb-22
		vs. USD	(+) = EM appreciation							% p.a.						
China		6.93	0.5	-0.4	-3	-7	-8	-9		2.7	2.5	2	-8	-27	-12	-13
Indonesia		14830	0.5	0.5	0	-4	-4	-3		7.2	-0.9	2	6	100	79	67
India		80	0.2	0.3	0	-8	-7	-6		7.4	-1.9	-13	8	94	111	72
Philippines		57	0.5	-0.1	-2	-12	-10	-10		5.6	-5.0	28	30	183	115	65
Thailand		36	0.3	1.1	-3	-10	-8	-11		2.7	0.5	-9	35	109	86	48
Malaysia		4.50	0.1	-0.3	-1	-8	-7	-7		4.0	-1.9	3	9	82	45	37
Argentina		141	-0.2	-1.5	-5	-31	-27	-24		78.1	-106.1	22	937	3081	2755	3016
Brazil		5.19	0.4	-0.4	-1	0	7	-4		11.6	-4.4	-17	-52	34	94	10
Chile		881	0.5	1.7	3	-11	-3	-10		6.7	0.0	15	16	148	130	81
Colombia		4397	0.2	2.0	-2	-13	-7	-11		9.8	0.0	21	69	354	334	188
Mexico		19.92	0.2	0.1	2	0	3	2		8.7	0.0	-1	43	169	118	86
Peru		3.9	0.1	-0.4	1	5	3	-4		8.3	0.8	14	36	186	236	226
Uruguay		41	0.3	0.3	-2	5	10	4		11.3	3.3	3	36	341	261	318
Hungary		395	0.4	2.2	-2	-25	-18	-19		10.0	20.0	45	174	702	546	516
Poland		4.71	0.0	0.8	-2	-18	-14	-14		6.0	-5.5	-13	65	404	243	206
Romania		4.9	0.0	-0.8	-2	-14	-11	-10		8.0	-1.3	29	7	441	320	287
Russia		60.5	0.5	0.9	1	20	24	35		8.3	0.0	-5	5	90	-52	-293
South Africa		17.3	1.3	0.0	-4	-18	-8	-13		9.0	-3.0	6	32	182	159	143
Turkey		18.24	0.0	-0.3	-2	-54	-27	-24		11.4	0.0	-147	-544	-589	-1295	-1105
US (DXY; 5y UST)		109	-0.6	-0.5	2	18	14	13		3.38	-4.0	9	42	259	212	148

	Equity Markets: Level, Last 12m	Latest	Change (in %) 1 Day	7 Days	30 Days	12 M	YTD	Since 23-Feb-22	Bond Spreads on USD Debt (EMBIG): Level, Last 12m	Latest	Change (in basis points) 7 Days	30 Days	12 M	YTD	Since 23-Feb-22
									basis points						
China		4094	1.4	2	-2	-18	-17	-11		203	0	-16	-11	0	-5
Indonesia		7243	0.1	1	2	19	10	5		176	-4	-19	3	11	-9
India		59793	0.2	2	1	3	3	4		161	4	-21	15	29	7
Philippines		6606	0.2	-1	-1	-5	-7	-10		129	-4	-11	20	28	-8
Thailand		1655	0.9	2	2	1	0	-2							
Malaysia		1497	0.1	0	-1	-5	-5	-6		97	1	-29	-31	-20	-36
Argentina		141509	0.4	4	16	83	69	55		2343	-62	-39	854	663	606
Brazil		109916	0.1	0	1	-5	5	-2		295	-12	-22	2	-16	-36
Chile		5517	-0.4	-2	5	25	28	26		173	-17	2	30	33	-1
Colombia		1203	-0.6	-2	-9	-9	-15	-20		412	-13	12	136	64	20
Mexico		46283	0.5	2	-2	-10	-13	-10		414	-10	10	77	82	44
Peru		19177	0.9	4	-4	9	-9	-18		191	-4	6	21	41	1
Hungary		40925	0.1	-2	-4	-23	-19	-14		229	-43	23	96	105	76
Poland		50433	2.7	2	-8	-29	-27	-20		30	-1	61	4	-2	14
Romania		11884	-0.1	0	-6	-4	-9	-10		301	6	12	105	108	69
Russia		2403	0.5	-3	12	-40	-37	-22		3411	-577	938	3228	3234	2897
South Africa		68679	2.1	2	-2	7	-7	-8		432	-25	22	91	77	43
Turkey		3534	2.8	10	27	143	90	75		616	-50	-15	158	38	53
Ukraine		519	0.0	0	0	-1	-1	0		3880	29	-3295	3400	3121	2407
EM total		38	1.0	-3	-4	-27	-21	-19		426	-15	1	75	40	-32

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

back to top