GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

WEDNESDAY, SEPTEMBER 25, 2024
LEAD EDITOR: SANJAY HAZARIKA

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Central banks take center stage

Stocks in Europe are mostly higher but US equity futures are slightly lower, pointing to a retreat from yesterday's record close for the S&P 500. Treasury and bund yields are higher and the dollar is holding steady against most of the other major currencies. Meanwhile, central banks have been active again. In China, the rate on the medium term lending facility was cut by 30 bps to 2%. The Swedish Riksbank cut its policy rate by 25 bps to 3.25% and the central bank of Hungary eased by 25 bps yesterday to 6.5%. The Czech National Bank is expected to lower its policy rate by 25 bps to 4.25% later today, while Nigeria defied expectations with a 50 bps rate hike yesterday to counter stubbornly high inflation.

Key Global Financial Indicators

Last updated: 9/25/24 7:42 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		5733	0.3	2	2	32	20.19
Eurostoxx 50		4929	-0.2	2	0	18	9
Nikkei 225		37870	-0.2	5	-1	17	13
MSCI EM		46	3.4	6	4	19	13
Yields and Spreads			bps				
US 10y Yield		3.76	3.2	6	-4	-77	-12
Germany 10y Yield		2.17	2.6	-2	-5	-62	15
EMBIG Sovereign Spread		373	1	-4	-23	-48	-10
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		46.3	-0.1	0	0	-2	-4
Dollar index, (+) = $ appreciation		100.5	0.1	0	0	-5	-1
Brent Crude Oil ($/barrel)		74.3	-1.2	1	-6	-20	-4
VIX Index (%, change in pp)		15.7	0.3	-3	0	-1	3

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

Mature Markets

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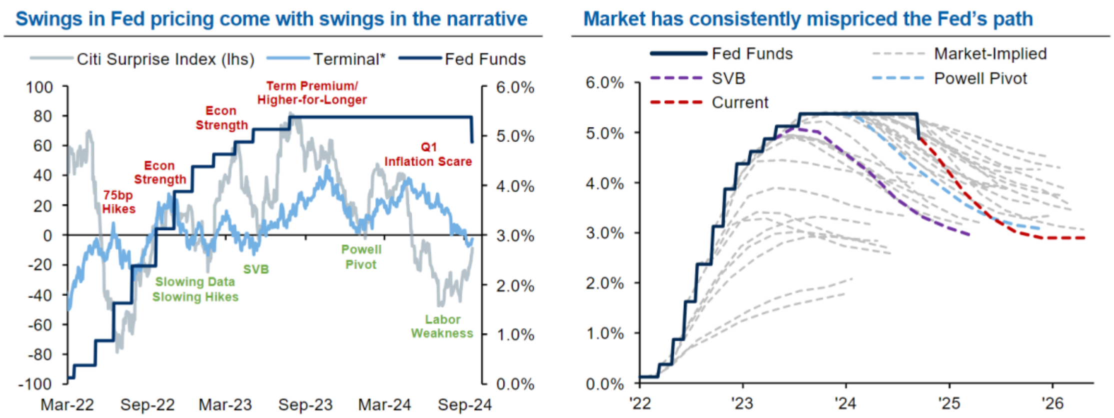
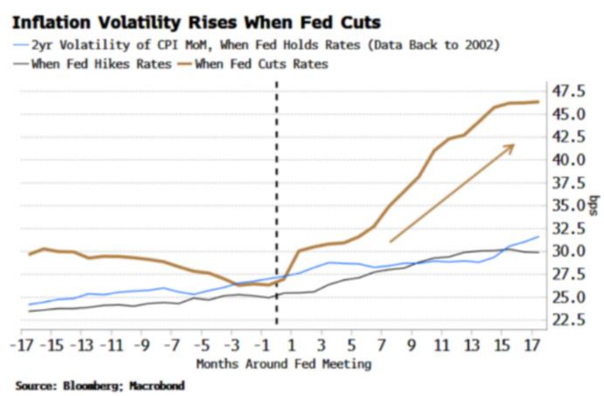
United States

Markets may turn more positive on the economy in the wake of the Fed's first rate cut, which could lead to higher long term interest rates. The Citi Economic Surprise Index (positive when economic data are better than expected and negative when they are worse than expected) is trending higher, while the market's estimate of the Fed terminal rate is at its lowest level since the collapse of Silicon Valley Bank early in 2023. The market's estimate of the terminal rate and the Surprise Index tend to move in the same direction, so growing confidence in the economy could increase the market's estimate of the terminal rate, which could in turn push longer term interest rates higher. So far in the current cycle, the market has consistently been more dovish than the Fed, leaving room for a more hawkish stance by investors. RBC points out that US consumption is robust, corporate balance sheets are in good shape, and household wealth remains high, so a more optimistic view on the US economy could easily be justified.



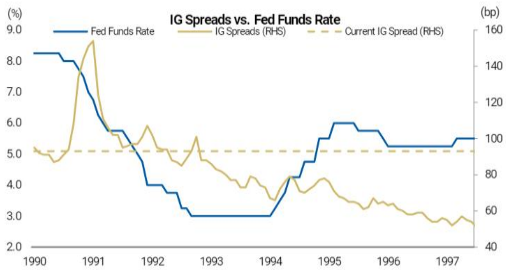
Source: Bloomberg, Citi, Federal Reserve, RBCCM. *Low point in cutting cycle implied by 3m SOFR futures.*

Inflation volatility tends to go up when the Fed cuts the policy rate, compared to when it stays on hold or hikes. Looking at Fed moves and inflation dating back to 2002, some analysts think that it was unnecessary for the Fed to have started a new rate cut cycle due to the resilience of the US economy. They fear that doing so increases the risk that inflation will return and force the Fed into a tightening cycle that would hurt the economy. They think the Fed should have used forward guidance to keep rates anchored at both the long and the short end of the curve without actually having to cut the policy rate. The Fed's choice could lead to a significant bear steepening of the yield curve, in which rates rise across the board but long term rates rise more than short term rates, especially if inflation does show signs of coming back. Such an outcome might trigger a recession. Other analysts are more sanguine, asserting that inflation was a product of the disruptions caused by the pandemic and the Russian invasion of Ukraine rather than factors intrinsic to the US economy, and that some degree of accommodation is justified because the economy is slowing.



Tight US credit spreads could be justified by fundamental factors, according to analysis by Morgan Stanley. Their analysts took a look at investment grade (IG) credit spreads during the last example of a soft landing, which was in 1995 after the surprise Fed hikes of 1994, and found that IG credit spreads were tighter than current levels during that episode. Thus, credit spreads could have further room to tighten. In addition, they argue that tight spreads are justified by improvements in fundamental factors that make today's bonds look better than the 1995 cohort. These include lower dollar prices and better credit ratings. The start of the Fed rate cut cycle should provide a boost to the fixed income market overall, and the strong credit profile of US IG corporations make them more capable of withstanding any potential bumps in the road for the economy.

Exhibit 1: Spreads were much tighter than current levels through the mid-90s cycle



Source: Bloomberg, Morgan Stanley Research

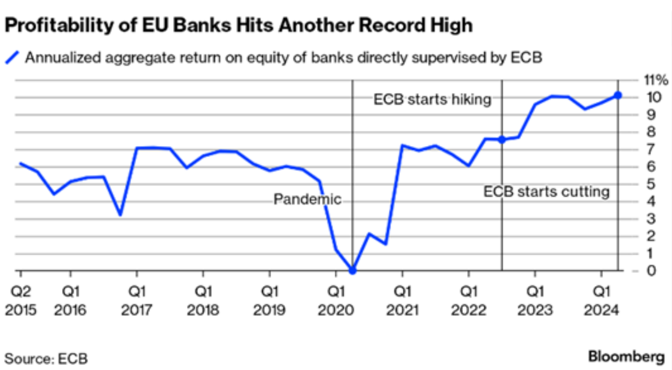
Exhibit 2: Credit spreads are less rich than indices suggest after adjusting for composition shifts

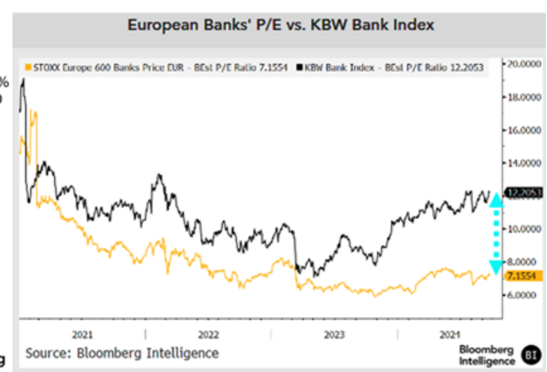
IG Cycle or Local Tights	Oct-97	Mar-05	Feb-07	Jun-14	Feb-18	Jan-20	Jun-21	Jul-24
Index OAS (bp)	49	79	86	107	90	99	86	92
Index Yield (%)	6.57	5.10	5.66	2.99	3.56	2.76	2.05	5.38
Average Credit Quality	A+/A	A/A-	A/A-	A/A-	A-/BBB+	A-/BBB+	A-/BBB+	A-/BBB+
% BBB	30%	39%	35%	45%	48%	50%	52%	46%
Index Duration (yr)	5.9	5.8	6.0	6.8	7.2	7.7	8.3	6.7
Index Avg. Dollar Price ($)	106	106	103	110	104	111	113	94
Median IG Net Leverage	1.27x	1.22x	1.12x	1.08x	1.72x	1.97x	1.61x	1.76x
Median IG Interest Coverage	10.26x	11.95x	11.58x	12.01x	10.52x	9.74x	11.30x	10.61x

Source: Bloomberg, Morgan Stanley Research

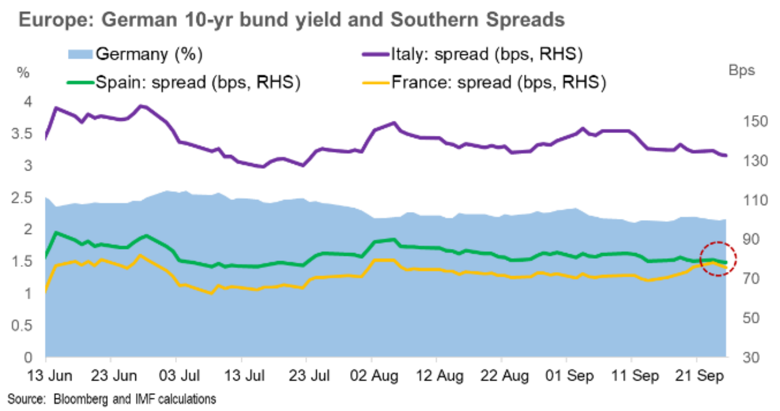
Euro Area

European banks' equities were little changed today, while the sector has outperformed the market so far in 2024 (Stoxx 600 Banks +19.9% YTD, vs. Stoxx 600 index +8.3%) with the profitability of the largest European banks hitting a record high in Q2. The average return on equity for the 110 "significant" banks directly supervised by the ECB reached 10.11% in Q2 2024 according to data published this week, the highest level since the ECB took on its prudential supervisory mandate in 2014. Yet, European banks continue to be affected by a valuation gap vis-à-vis US peers (average P/E of about 7x for Stoxx 600 Banks index compared to 12x multiple for the US KBW bank index), with analysts at Bloomberg pointing to different economic prospects, as the US economy is expected to grow by 2.5% in 2024 and 1.7% in 2025, while the eurozone's envisaged growth rates are 0.7% and 1.3% respectively for 2024 and 2025. Analysts note that stricter regulation and threat of taxes on banks' profits are additional drags on European banks.



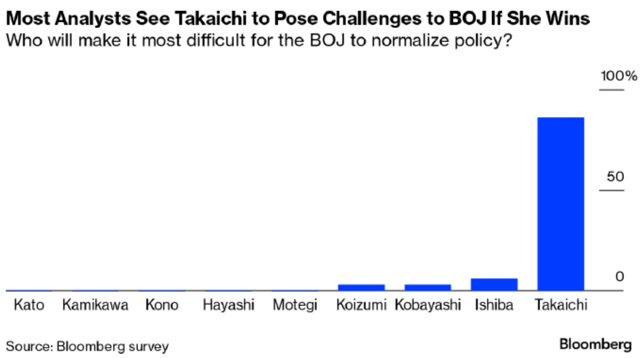


The spread between France's 10y sovereign bonds and those of Germany slightly retraced today to 75bps, boosted by stronger risk appetite**.** Prime Minister Michel Barnier's request for a delay in EU fiscal compliance plans has heightened investor skepticism about France's ability to implement budget cuts. France's debt is 111% of GDP, with a budget deficit expected to reach 5.6% in 2024. Today Bank of France Governor Villeroy de Galhau warned on the urgency for the country to deal with its deficit and debt challenges as bond markets are increasingly sending warnings about mounting risks.



Japan

Investors are keenly watching the leadership election of Japan's ruling Liberal Democratic Party, scheduled this Friday, due to its potential impact on the monetary policy outlook. The focus is on Sanae Takaichi, a strong advocate of maintaining an easing stance, who opposes further rate hikes by Bank of Japan (BoJ) Governor Ueda, while other candidates haven't indicated any strong opposition. The latest survey conducted by Nippon Television indicates that former defence minister Ishiba and Takaichi are the two leading candidates among the nine, with only a three ppt gap in their support. Investors expect that a victory for Ishiba will likely lead to a stronger yen and higher interest rates, while Takaichi's victory may cause some market volatility with a weaker yen and better risk asset performance. **The yen depreciated** (-0.5%), as traders assessed the BoJ's rate path after Governor Ueda indicated on Tuesday that the BoJ is in no hurry to raise interest rates. Japanese equities declined (Nikkei 225: -0.2%).

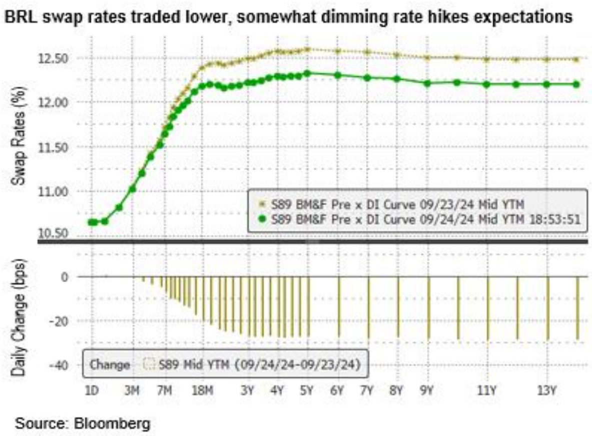


Emerging Markets back to top

EMEA equities were mostly trading higher while currencies were mixed. Equities outperformed in South Africa (+1.1%) with analysts pointing to stimulus measures from China, while the rand outperformed against the dollar (+0.4% to 17.19/$). **Asian currencies advanced (EM Asia: +0.2%), spurred by gains in the RMB.** The gains were led by the Indonesian rupiah (+0.6%), Philippine peso (+0.6%), and Malaysian ringgit (+0.4%). The Philippine peso gained despite the central bank governor signaling a more aggressive easing cycle with two more rate cuts in 2024. Stocks in China and Taiwan POC were up again today. **Markets in Latin America benefited from the China-led global rally yesterday.** Local currencies also appreciated, led by the real (1.5%) and the Chilean peso (1.4%).

Brazil

Minutes from the September meeting revealed unanimous support for a rate hike but did not provide specific guidance about future rate moves. The minutes cited a resilient economy, a strong labor market, and above-target inflation as reasons to initiate policy tightening. Central bank chief Roberto Campos Neto later acknowledged that "investor want guidance, but that's not always feasible." Markets read the minutes as slightly dovish due to the lack of explicit commitment for a quicker pace of rate hikes. BRL swap rates traded marginally lower but continue to price a +50 bps hike to the policy rate, at the next meeting in November.



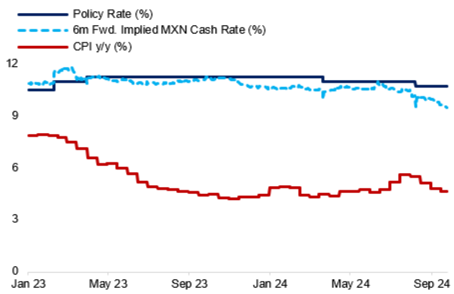
China

Options pricing indicates increasing bullishness on the RMB amid an extended rally in Chinese markets. One-month risk reversals on USD/CNH fell deeper into negative territory to -0.77, indicating traders are increasingly paying more for dollar put options than for call options, betting on further appreciation of the RMB. Today, offshore RMB briefly advanced past the key level of 7.0 to reach its strongest level in 16 months. It then weakened to fluctuate around 7.01 after the RMB fixing was announced at 7.0202, signaling the People's Bank of China's (PBC) intention to slow RMB appreciation. Onshore RMB gained (+0.2%). **Chinese equities continued to rally** (CSI 300: +1.5%, Hong Kong SAR +0.5%) on hopes of fiscal support from the authorities. According to Bloomberg, options betting on a 10% drop in Chinese shares listed in Hong Kong over the next three months are at their cheapest level since July compared to bullish contracts. Some analysts view fiscal support as key for a sustained rally, while others caution that market focus could soon return to economic fundamentals. **Today, the PBC cut the 1-year medium-term lending facility rate by 30 bps to 2.0%**, as part of the stimulus package announced yesterday.

Mexico

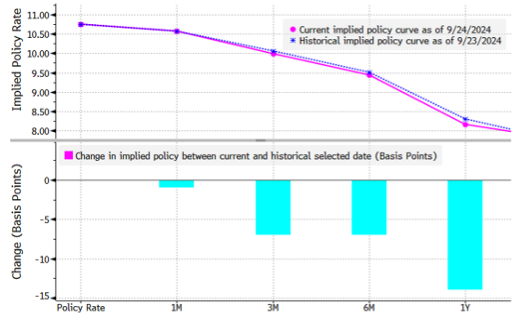
Weaker-than-expected inflation spurred bets for more rate cuts. Mexico's headline inflation slowed to 4.66% y/y for the first half of September, below expectations (4.71%), while core inflation eased to 3.95%, possibly setting the stage for a second consecutive rate cut (*left chart*). While some analysts speculate that Banxico could follow the Fed by slashing rates by 50 basis points later this week, others cautioned that Mexico's core inflation remains stubbornly above target. Bank of America analyst noted that the tight labor market and political uncertainties also suggest that a more conservative 25-basis-point cut is more probable, adding that uncertainty remains elevated reform process and upcoming US election. MXN swap rates continue to expect a -25 bps cut for the upcoming meeting this week, but the three-month through one-year rates traded 7 to 14 bps lower (*right chart*), implying deeper rate cuts over the next year.

Mexico inflation continue to ease in early September, setting the stage for further rate cuts



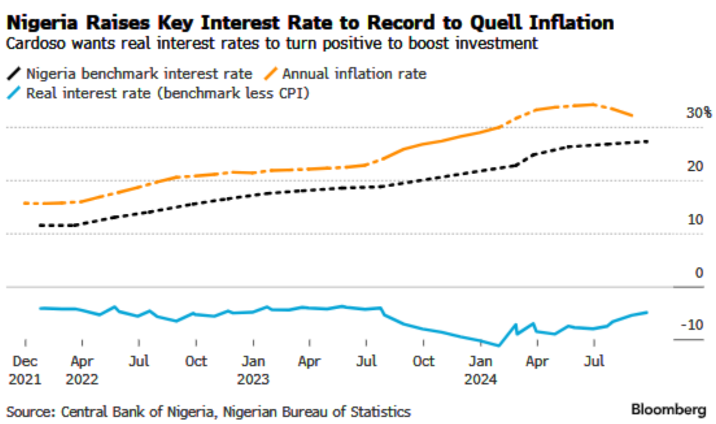
Source: Bloomberg, IMF staff calculations

MXN swap rates traded lower, with rate cuts continued to be priced-in through the next year



Nigeria

Nigeria surprised markets and continued increasing interest rates. Defying consensus expectations for rates to remain on hold yesterday, the central bank of Nigeria hiked its policy rate for the 13th consecutive time—with the 50bps rate hike taking the policy rate to 27.25%. The MPC also increased the cash reserve ratio for deposit money banks by 500 bps to 50.0%. The committee also noted that the real policy rate remains negative and highlighted the need for more efforts to achieve positive real interest rates to attract investment into the economy. Bloomberg economists expect further tightening, with 150bps of rate hikes forecast over the next three central bank meetings. Bloomberg's indicative pricing shows that Nigeria's Eurobonds gained across the curve yesterday.



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Global Financial Indicators

9/25/24 7:43 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		5733	0.3	2	2	32	20
Europe		4929	-0.2	2	0	18	9
Japan		37870	-0.2	5	-1	17	13
China		3402	1.5	7	2	-8	-1
Asia Ex Japan		77	3.7	7	5	21	16
Emerging Markets		46	3.4	6	4	19	13
Interest Rates					basis points		
US 10y Yield		3.76	3.2	6	-4	-77	-12
Germany 10y Yield		2.17	2.6	-2	-5	-62	15
Japan 10y Yield		0.82	-0.1	-1	-9	8	20
UK 10y Yield		3.97	2.5	12	5	-36	43
Credit Spreads					basis points		
US Investment Grade		129	0.2	-4	-4	-15	-5
US High Yield		366	5.5	-5	-4	-52	-19
Exchange Rates					%		
USD/Majors		100.52	0.1	0	0	-5	-1
EUR/USD		1.12	0.1	1	0	6	1
USD/JPY		144.4	0.8	1	0	-3	2
EM/USD		46.3	-0.1	0	0	-2	-4
Commodities					%		
Brent Crude Oil ($/barrel)		74.3	-1.2	1	-5	-11	-1
Industrials Metals (index)		150	-0.5	2	2	6	5
Agriculture (index)		57	-0.6	2	8	-12	-8
Implied Volatility					%		
VIX Index (%, change in pp)		15.7	0.3	-2.5	-0.2	-1.2	3.2
Global FX Volatility		8.4	0.0	-0.1	-0.1	0.4	0.3
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		97	-1.6	-3	-7	-49	-7
Italy		133	-0.1	-5	-1	-53	-34
Portugal		56	-0.2	-3	-2	-18	-7
Spain		79	-0.2	-2	-1	-29	-18

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

Emerging Market Financial Indicators

Last updated: 9/25/2024 7:45 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		7.03	0.0	0.8	1	4	1		1.8	-6.1	-3	-18	-95	-72
Indonesia		15102	0.6	1.5	2	2	2		6.4	-0.9	-12	-20	-33	-4
India		84	0.1	0.2	0	-1	0		6.9	-2.0	8	-1	(85.9)	-28
Philippines		56	0.6	-0.3	0	2	-1		4.9	0.0	-18	-25	-95	-75
Thailand		33	-0.1	2.0	4	11	5		2.4	-0.5	4	2	-88	-32
Malaysia		4.13	0.7	2.8	5	13	11		3.7	1.1	3	-5	-25	0
Argentina		965	0.0	-0.4	-2	-64	-16		40.9	136.9	200	173	-7507	-4545
Brazil		5.46	1.5	0.5	1	-9	-11		12.2	-28.7	23	69	46	180
Chile		912	-0.2	2.2	-1	-1	-3		4.7	0.4	13	-22	-95	-22
Colombia		4152	0.1	1.4	-3	-2	-7		7.5	0.0	14	-14	-143	-10
Mexico		19.44	-0.6	-0.8	0	-11	-13		8.6	-0.5	0	-34	-81	12
Peru		3.8	0.4	-0.2	0	0	-2		6.3	3.3	-6	-27	-82	-41
Uruguay		42	-0.4	-2.7	-5	-9	-8		10.2	-3.6	5	67	86	66
Hungary		353	-0.1	0.5	0	4	-2		5.9	-3.0	8	-3	-114	11
Poland		3.81	-0.2	0.8	1	14	3		4.5	1.3	12	4	-29	7
Romania		4.4	0.1	0.6	0	5	1		6.5	2.2	-5	4	-14	31
Russia		92.4	0.6	0.4	0	4	-3							
South Africa		17.2	0.4	2.1	3	9	7		8.4	-6.0	-4	-14	-129	-69
Türkiye		34.14	-0.1	-0.2	0	-20	-14		28.2	1.0	-64	1	206	149
US (DXY; 5y UST)		101	0.1	-0.1	0	-5	-1		3.50	3.6	2	-15	-111	-34

	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		3402	1.5	7	2	-8	-1		126	2	-27	-56	-32
Indonesia		7741	-0.5	-1	2	12	6		103	-4	-4	-32	7
India		85170	0.3	3	4	29	18		110	-3	-2	-27	-6
Philippines		7363	-0.9	3	6	18	14		88	-4	-5	-23	8
Thailand		1462	0.0	2	7	-2	3		0	0	0	0	0
Malaysia		1673	0.2	1	2	16	15		83	-6	-9	-14	-2
Argentina		1774668	-0.9	-2	10	224	91		1307	-59	-221	-1063	-606
Brazil		132156	1.2	-2	-3	14	-2		223	-5	-3	-4	8
Chile		6450	1.2	2	0	11	4		121	-4	-2	-5	-4
Colombia		1335	1.0	2	0	21	12		313	-7	-1	-12	42
Mexico		53654	2.3	3	0	4	-7		314	-11	-5	-53	-20
Peru		29808	1.5	4	5	31	15		140	-4	-3	-14	-4
Hungary		73958	0.5	2	1	34	22		156	-9	-3	-34	7
Poland		83619	0.4	1	-1	27	7		112	-3	2	-13	15
Romania		17662	0.1	1	-4	22	15		200	-8	-3	-5	-1
South Africa		86047	1.5	4	2	17	12		286	-9	-15	-94	-22
Türkiye		10041	0.1	3	4	21	34		287	-14	-13	-96	-27
EM total		46	-0.5	6	4	19	13		399	-2	-10	14	53

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

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