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22ND SEPTEMBER, 2023
ANDY CATES

Summary

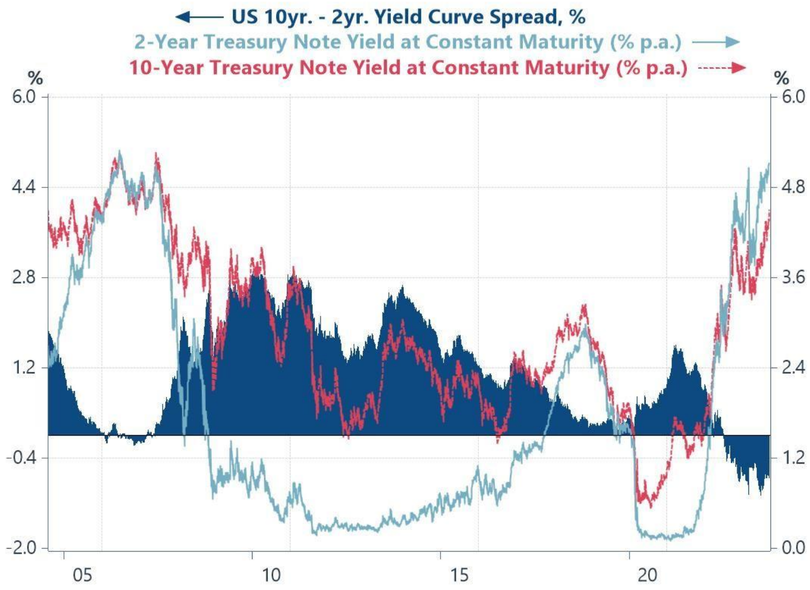
Financial markets have been on the back foot in recent days with some oil-related inflation jitters combined with a “tighter for longer” message from the Fed a couple of contributory factors. In our first two charts this week, we made a nod to these with some colour on US Treasury yields (in chart 1) and the recent behaviour of consumer energy prices (chart 2). With this week’s UK BoE decision in mind, we next focus on the more settled nature of UK financial markets over the last few months (chart 3). Then, ahead of tomorrow’s BoJ decision, and with recent changes to its Yield Curve Control policy in mind, we offer some colour on the evolution of Japan’s JGB yields (chart 4). Subsequently we turn to emerging economy matters with some aggregate perspective on these economies’ dwindling foreign exchange reserves (chart 5). India is a noteworthy exception to this, however, one reason for which concerns its inflows of foreign direct investment which we additionally underscore (in chart 6).

US Treasury yields

While the Federal Reserve’s decision to hold interest rates steady was widely expected, its “dot plot” nevertheless suggested that another hike remains probable by the end of the year. In addition to this fewer rate cuts than previously indicated have been pencilled in for next year.

Unsurprisingly, this has rattled investors as 2-year yields climbed sharply in the aftermath of the Fed's meeting. That the spread between 10-year and 2-year yields widened again additionally suggests that US recession odds have been marked higher by investors as well (chart 1).

Chart 1: US 2-year and 10-year Treasury yields

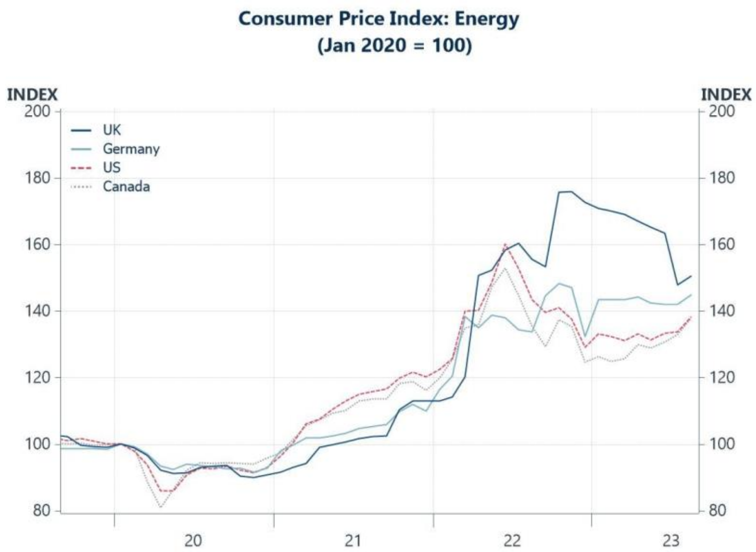


Source: Federal Reserve Board/Haver Analytics

Energy prices

One key reason why central banks may be a little more alarmed about the inflation outlook at present concerns the oil price. The consumer price of energy has started climbing again in most major economies thanks to the spike higher in the oil price in recent weeks (see chart 2). That incoming inflation data have begun to post positive surprises relative to consensus forecasts again can in large part be traced to these energy price issues.

Chart 2: Consumer energy prices in the US, Canada, Germany and the UK

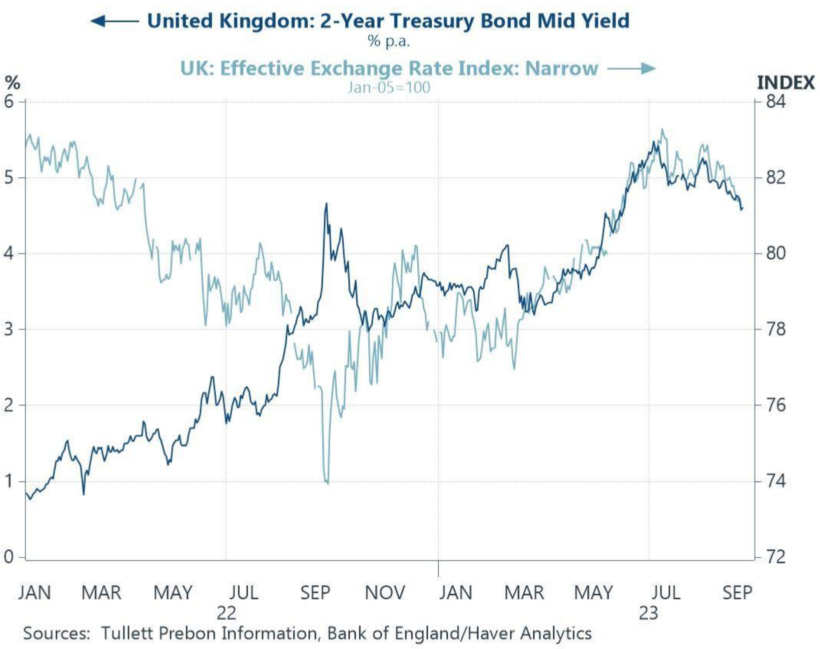


Sources: ONS, Bbk, BLS, StatCan/Haver

UK financial markets

This week's decision by the BoE to leave policy rates unchanged echoed the Fed's decision but there has arguably been more willingness from UK policymakers to admit that their tightening cycle is at, or near, its completion. Coupled with more friendly UK inflation data this week this is why 2-year gilt yields in the UK have, on the whole, been falling of late and why sterling has been depreciating as well. The path that financial markets in the UK have taken more generally over recent months stands in vivid contrast to last year and the immediate aftermath of PM Truss's mini budget. That generated a sharp sell-off in UK financial markets as the risk premium that was attached to UK assets was lifted sharply thanks, in turn, to the highly unorthodox –and very loose - fiscal policy that was announced at that time.

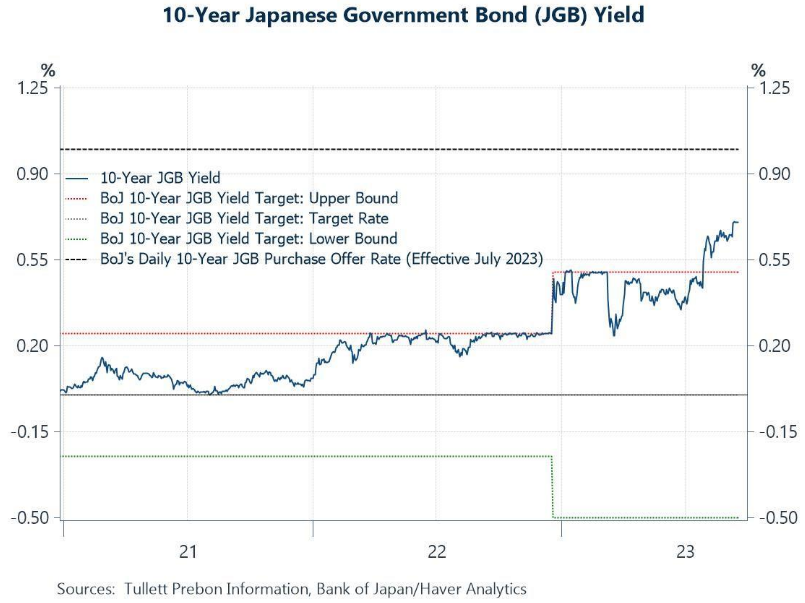
Chart 3: UK 2-year gilt yields and the trade weighted value of the pound



Japan's JGB yields

Ahead of this week's BoJ decision, JGB yields have been advancing and are now closer to their new implied upper limit of 1%. The upward pressures on yields of late are probably in anticipation of additional Yield Curve Control policy (YCC) tweaks, and on speculation of subsequent monetary policy normalization by the central bank. While no major tweaks are expected this week, subsequent shifts could be significant given the hefty role that Japan's savings an investment flows play in global financial market reverberations.

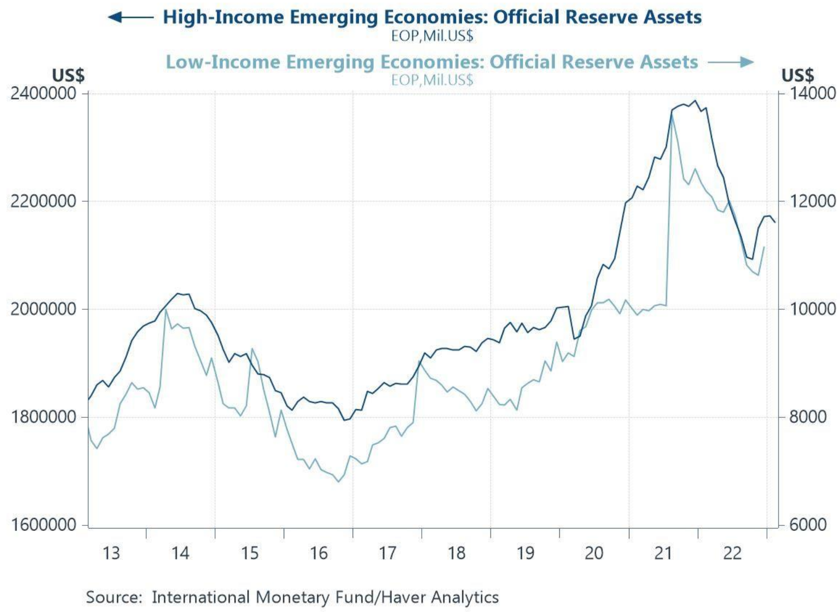
Chart 4: Japan's JGB yields and its target ranges



FX reserves in emerging economies

Our newly calculated aggregations for foreign exchange reserves in emerging economies (EM) suggest that many of those economies have been confronting bigger financing pressures. As chart 5 below indicates, FX reserves in high-income and low-income EM economies declined sharply through the course of 2022 as a deteriorating outlook combined with capital outflows, rising risk premia and US dollar appreciation.

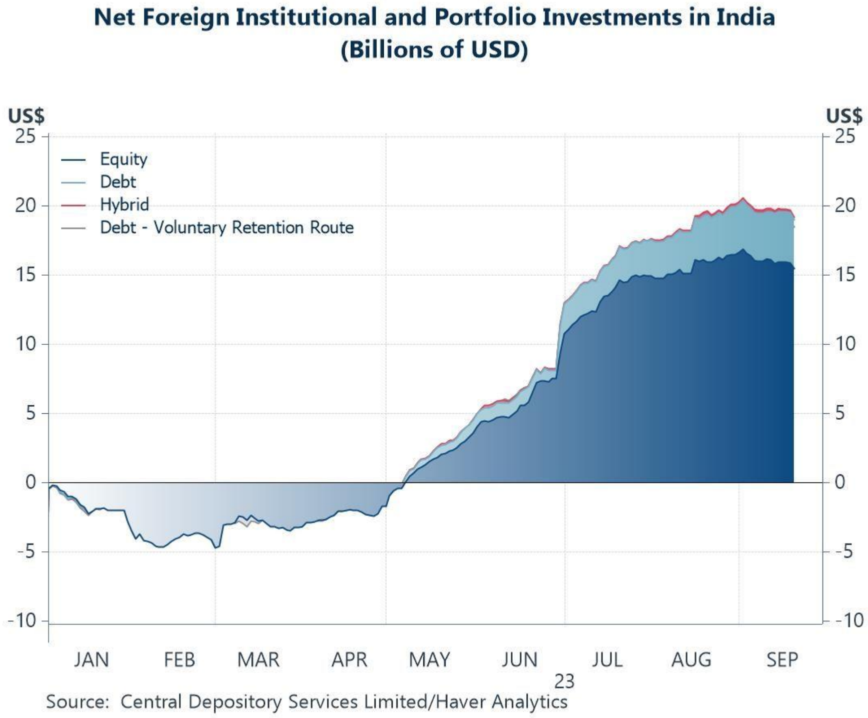
Chart 5: Foreign exchange reserves in high and low income emerging economies



India's capital flows

One noteworthy exception to that aggregate rule of thumb, however, concerns India. Foreign institutional and portfolio investors have poured around a net $19 billion into India's financial markets so far this year, lending support to India's FX reserves.

Chart 6: Net FDI flows in India



ABOUT THE AUTHOR

Haver Analytics is pleased to bring [Andrew Cates's] commentaries on the state of the global economy to its clients.

Andy Cates has more than 25 years of experience forecasting the global economic outlook and in assessing the implications for policy settings and financial markets. He has held various senior positions in London in a number of Investment Banks including as Head of Developed Markets Economics at Nomura and as Chief Eurozone Economist at RBS. These followed a spell of 21 years as Senior International Economist at UBS, 5 of which were spent in Singapore. Prior to his time in financial services Andy was a UK economist at HM Treasury in London holding positions in the domestic forecasting and macroeconomic modelling units.

He has a BA in Economics from the University of York and an MSc in Economics and Econometrics from the University of Southampton.