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MUFG Bank, Ltd.
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Mid-year emerging markets outlook

Macro focus: 2022 has witnessed a lot and we are only half way. From an EM perspective, the outlook is in a state of flux. EMs were already pricing in a long streak of stagflationary shocks and these have grown louder as months have gone by on a combination of commodity shocks, supply disruptions and a tepid post-COVID demand recovery. Our EM 2022 outlook theme we catalogued in January (see here) was centred on "stagflation trepidation" gaining traction. Persistent inflation, recession concerns and reverberations of the war in Ukraine reinforces this narrative.

FX views: It has been another mixed week for EM FX performance as the USD continues to consolidate at higher levels following strong gains in Q2 2022. The TRY was boosted by measures that encourage reduction in foreign currency exposure, whilst LatAm is proving more sensitive to recessionary fears.

Trading views: The market seems to be oscillating between buying EM on peaking US yields, to selling EM as it looks into the reasons behind the move lower in rates.

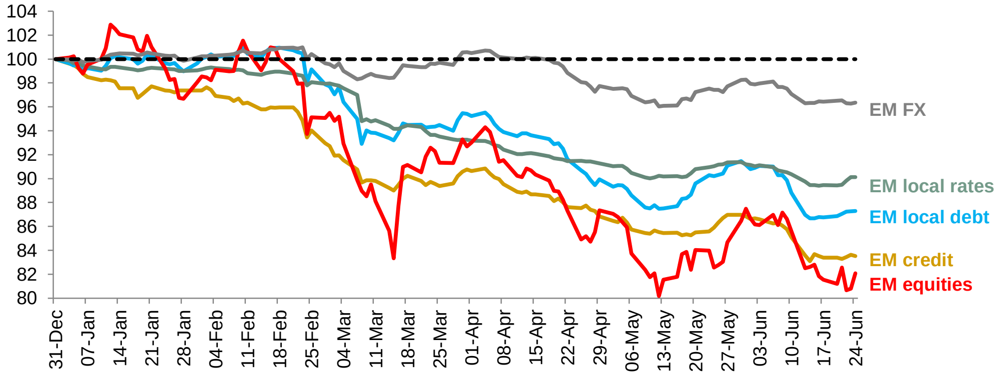
Week in review: Russia formally defaulted on its sovereign debt for the first time since 1918. The Saudi Central Bank injected SAR50bn (USD13.3bn) in time deposits with commercial banks in a bid to ease a liquidity crunch. The Czech Republic raised rates by 125bp to 7.00%, whilst both Egypt and Turkey kept rates on hold.

Week ahead and calendar: In the coming week, we have Hungary rates (MUFG: +50bp to 6.40%) and June PMI data signalling how corporates are holding up.

Forecasts at a glance: We continue to expect the easing of pandemic effects to supporting recoveries, although the going will get tougher in EMs – key risks stem from a continued tightening in global financial conditions and a lower gear in China.

Core indicators: Mounting global recession risk, anxiety over geopolitical events, tighter monetary conditions, realised inflation and apprehensions that greater risks are building up is weighing on EM securities which suffered the third consecutive monthly outflows in May (USD4.9bn) (see here).

CHART OF THE WEEK: WORST FIRST HALF PERFORMANCE FOR EM'S IN DECADES
EM EQUITIES, FX, RATES, CREDIT AND DEBT (1 JANUARY 2022 = 100)



Source: Bloomberg, MUFG Research

Macro focus

Mid-year emerging markets outlook

Stagflation trepidation remains the story across EMs

2022 has witnessed a lot and we are only half way. It's seen one of the worst financial market performances on record. It has seen an intense conflict in Europe, the re-emergence of the COVID crisis in China and the first 75bp hike by the Federal Reserve since 1994. From an EM perspective, the outlook is in a state of flux. EMs were already pricing in a long streak of stagflationary shocks and these have grown louder as months have gone by. Despite starting the year with well-above-consensus forecasts, we have continued to revise our inflation estimates higher and growth projections lower on a combination of commodity shocks, supply disruptions and a tepid post-COVID demand recovery. Our EM 2022 outlook theme we catalogued in January (see here) was centred on "stagflation trepidation" gaining traction this year across the EM complex. Persistent inflation, apprehensions about recession and reverberations of the war in Ukraine reinforces this narrative.

Inflation remains the key focus

Inflation has surged higher in EM over the past year, with the median headline CPI now up more than 10.1% y/y – the most in over 20 years. Latin America and EM EMEA have led the way but at this point most of EM Asia (ex. China) has joined the acceleration. Whilst we started the year with forecasts that were well above the consensus, we have revised views upwards in most EMs for several key reasons:

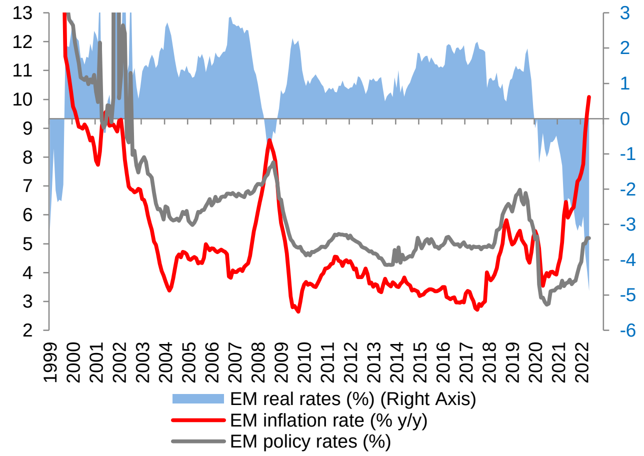
1. A growing commodity shock. Given our commodities supercycle thesis centered on decarbonisation, deglobalisation, redistribution and structural underinvestment (see here) which pre-dates the war in Ukraine but has been turbo-charged because of it, prices across the energy, metals and agricultural complex have remain elevated.
2. A rapid rebound in global activity. The Omicron wave of COVID was large but generally transitory, and many economies weathered it with lower restrictions than prior waves. The Oxford University Stringent index has now fallen to near pre-pandemic levels in more than half of major EMs, with the swift return in demand increasing pressure on resources, notably in some service sectors.
3. Supply chain bottlenecks. COVID-related disruptions, tariffs and sanctions have contributed to marked interruptions in supply chains, with challenges showing up in supplier delivery indexes within PMI readings.

Pace of rate tightening across EMs has been accelerated inflation prints

Higher-than-expected inflation has brought an associated upward shift in our rate forecasts across most economies. A key exception is Turkey, which is pursuing an

EM INFLATION IS AT 20 YEAR HIGHS, PUSHING REAL RATES INTO DEEP NEGATIVE TERRITORY

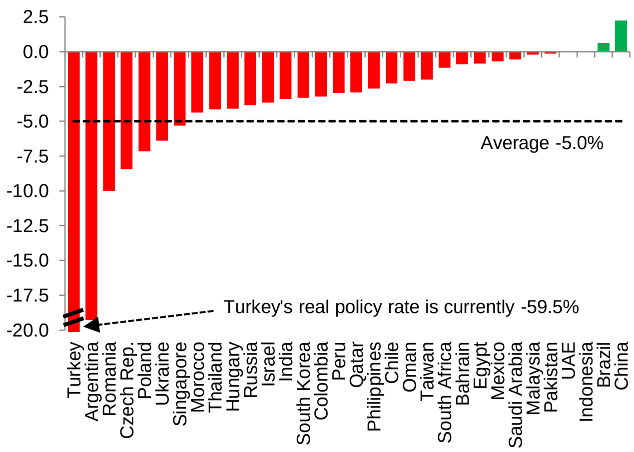
EM WEIGHTED AVERAGE RATES (%) VS INFLATION – EM CPI (% Y/Y)



Source: Bloomberg, EM Central Banks, MUFG Research

IN REAL TERMS, THE ROOM FOR MANOEUVRE IS LIMITED WITH NO REAL RATE BUFFER IN MOST EM'S

EM REAL POLICY RATES (%)



Source: Bloomberg, EM Central Banks, MUFG Research unorthodox set of macroprudential measures instead of conventional monetary tightening to anchor inflation expectations. What's more, we have revised down the path for Russia, where economic weakness and a swift currency rebound have allowed the Central Bank of Russia (CBR) to unwind all of its wartime tightening. It is challenging to hold a strong conviction about where rates need to peak when inflation is still moving higher. Relative to the drivers of past EM tightening cycles, the developed market (DM), led by the Fed, monetary policy cycle has been by and large less central, with countries' own output gap and inflation conditions relatively more paramount. The sharp capital outflows and currency depreciation that have accompanied some past episodes of Fed tightening, such as during the 2013 taper tantrum, have been less acute, though still a source of pressure on policymakers in some economies.

The room for manoeuvre is limited with no real rate buffer in most EMs

A key point worth flagging, though, is that even with our expected rate hikes, the real policy rates in many places will likely remain in negative territory by end-2022. This is particularly true for EM EMEA with deep negative rates in the likes of Czech Republic, Poland, Hungary and Turkey. This implies that the risks are for even higher rates within the region that what our forecasts imply. As we have catalogued in the past, even though EM central banks are expected to stick to the policy normalisation path, the real policy rates are unlikely to turn positive for many (see here). This means that the real policy rate cushion will remain quite small, leaving these economies vulnerable to increasing external headwinds and falling global liquidity.

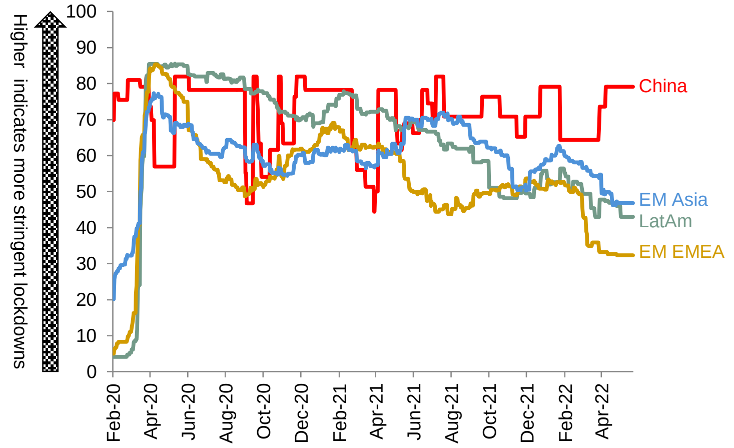
Growth across the EM space looks fragile at best

From an economic growth perspective, it is quite challenging at the current juncture to be optimistic about the direction of economic activity across the EM space. While there's no need for panic, upside surprises in economic activity are likely to be few and far between for the time being, the pressure is in the opposite direction.

1. External environment. The external environment looks increasingly fragile, thanks to rising recession risk in the US and EU, as well as the difficulty that Chinese authorities are having in shoring up domestic confidence and aggregate demand.
2. War in Ukraine. The war in Ukraine is adding new pressure to supply chains globally, and the inflationary shock it has produced is likely to be eroding domestic purchasing power and confidence in a number of emerging economies.
3. Capital flows. The diminished availability of external financing is also, on balance, growth-negative.
4. Tightening in liquidity. The tightening of the domestic policy across EM –

CHINA'S ZERO-COVID STRATEGY HAS KEPT LOCKDOWNS STRINGENT – WEAKENING EM GROWTH

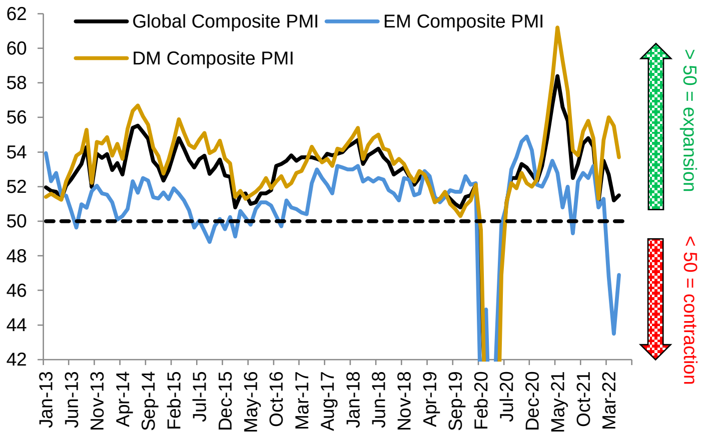
OXFORD UNIVERSITY STRINGENCY INDEX (0-100; 100 = FULL LOCKDOWN)



Source: Bloomberg, Oxford University, MUFG Research

WAR AND CHINA LOCKDOWNS HAS COLLAPSED EM ACTIVITY, WIDENING THE DIFFERENTIAL WITH DM'S

COMPOSITE PMI'S – GLOBAL, DM, EM (1-100; 100 = HIGHEST)



Source: Bloomberg, Markit, MUFG Research tightening monetary policy and a withdrawal of COVID-era fiscal support – does little to support sentiment and spur domestic consumption.

China's economy remains heterogeneous to the rest of the EM complex on inflation and rates

What has taken us (and broader markets) by surprise is the longevity of China's COVID lockdowns thus far this year. From an inflation perspective, whilst most EMs are witnessing high and rising inflationary pressures with corresponding rate hikes, China is in a very different economic trajectory. China's COVID restrictions remain the sternest in the world at present which have been especially a large drag on services activity. The ongoing property market downturn and a decelerating export impulse have also played a key role. Constructively, a tactical rebound appears underway, both in the economy and markets. Policymakers have publicly doubled-down on zero-COVID but have equally emphasised the importance of stabilising the economy. The nascent easing in COVID restrictions should also lift an obstacle to the effectiveness of policy easing, making it easier to deploy previously-raised funds for infrastructure and allowing a partial thawing in the property market. Even so, China is expected to lag the rest of EM markedly in terms of inflation and monetary tightening.

EMs remain spread out between "early" to "late" cycle

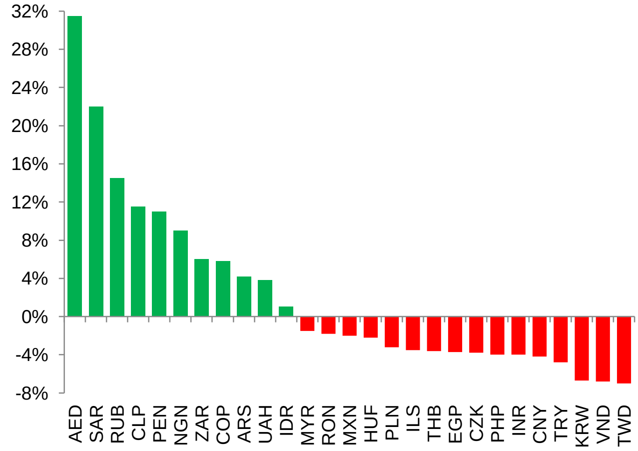
The uneven timing of reopening, inflation, and rate hikes has spread out the various EMs along a continuum of "early" to "late" cycle. China is at the early end where policymakers are still in easing mode and trying to reduce COVID-related restrictions, with inflation still in-check which should lead to better growth in coming months. Parts of Southeast Asia are also in this relatively benign category where policymakers have yet to tighten (Indonesia, Thailand) or have barely begun (Philippines). Reopening consistently brings a period of acceleration in growth but also (core) inflation pressures. Eventually this prompts policy tightening (higher-income EM Asia such as in South Korea and Taiwan) which in some cases becomes aggressive (EM EMEA and LatAm) and eventually may result in a rollover in growth and some easing in inflation in the months ahead.

Commodity exporters across EMs remain the most attractive plays in the second half of 2022

Looking ahead, it is fairly clear that the top-down investment backdrop has turned quite unpleasant for many EMs, given weak global business cycle, increasing external headwinds, upside inflation risks, and less supportive financial conditions. In such a state of flux with too many moving parts, we believe it is prudent to look at bottom-up narratives and take only selective, calculated risk in EMs for the remainder of the year. We stick to the winners from elevated commodity prices and to those with responsible macro policies, hence offering a sizeable risk premium. With this, the net commodity trade balance is the largest for countries in the GCC region, Latin America (notably the likes of Chile and Brazil), whilst key mining producing nation South Africa is also a relative winner.

NET COMMODITY EXPORTS ARE PREDOMINANTLY POSITIVE FOR THE GCC AND LATAM REGION

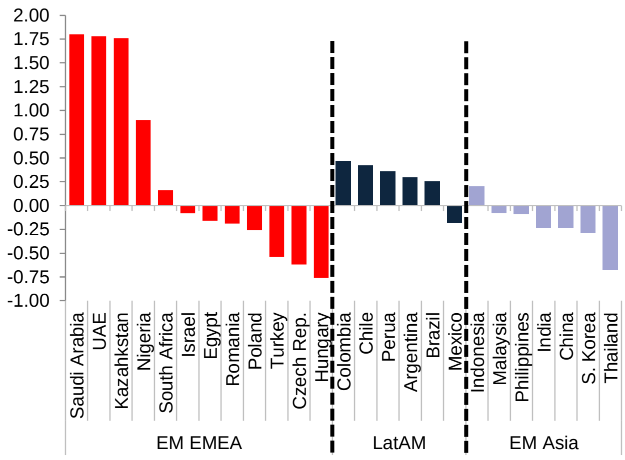
NET COMMODITY TRADE BALANCES (% OF GDP)



Source: Bloomberg, MUFG Research

EM WINNERS ARE MAINLY COMMODITY EXPORTERS WHILST MOST COMMODITY IMPORTERS WILL TRAIL

EM COMPARATIVE TRADE ADVANTAGES WITH RUSSIA-UKRAINE (UNITS)



Source: Macrobond, UN Comtrade, MUFG Research

FX views

EM FX: Fears over sharper global slowdown offset relief from lower US yields

Mixed performance again for EM FX over past week as USD consolidates close to year to date highs

It has been another mixed week for EM FX performance as the USD continues to consolidate at higher levels following strong gains in Q2 2022. The best performing EM currencies over the past week have been the TRY (+3.6% vs. USD), RUB (+3.6%), MXN (+1.9%) and ZAR (+0.7%). At the opposite end of the spectrum the worst performing EM currencies have been the COP (-5.7% vs. USD), CLP (-3.9%), PEN (-1.3%) and BRL (-1.0%). The recent period of consolidation for the USD has resulted in EM FX volatility dropping back from the highs in the middle of this month. The USD has lost some upward momentum in recent weeks as US yields have corrected sharply lower. The 10-year UST yield has dropped back towards 3.00% after hitting a recent peak close to 3.50%. The pullback in US yields has helped to provide more support for EM carry currencies such as the MXN and ZAR. The MXN's carry appeal was reinforced as well by Banxico's decision to follow the Fed and deliver a 75bps hike.

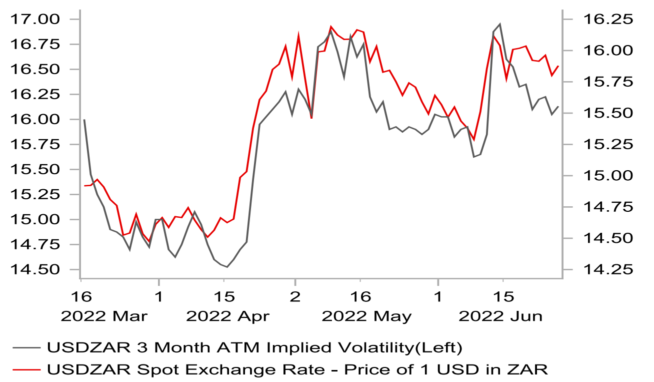
TRY temporarily boosted by policy measures that encourage reduction in foreign currency exposure

The TRY has outperformed following the announcement from Turkey's banking regulator on Friday that it will restrict commercial lira loans to corporate borrowers if they hold more than TRY15 million in foreign currencies and if the amount exceeds 10% of total assets or annual sales. The firms can buy Eurobonds or invest in foreign exchange-protected deposit accounts to avoid restrictions. The move will encourage companies flush with foreign currency to reduce exposure if they want to access new credit in lira. The new potential source of demand for TRY has initially contributed to USD/TRY falling sharply from around 17.350 back towards the 15.000-level. However, we doubt that the measure will support a more sustained reversal of the TRY's fundamental bearish trend. The CBRT's decision to leave policy unchanged last week even in the face of increasingly elevated inflation (June CPI & PPI reports released on 4th July) leaves the TRY vulnerable to further weakness ahead.

LatAm FX is proving more sensitive to building fears over global slowdown/correction lower or commodity prices

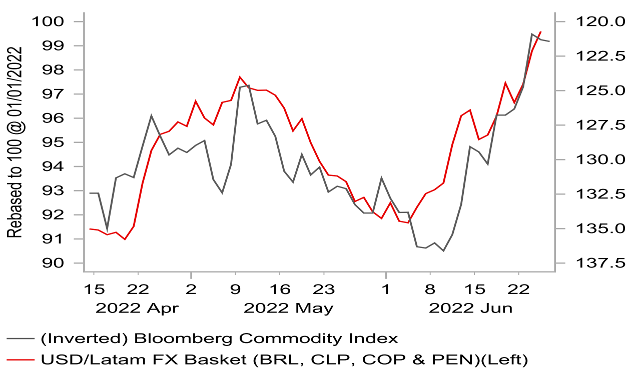
The worst performing currencies have been the LatAm currencies of the COP, CLP, PEN and BRL that have proven more sensitive to intensifying fears over a sharper slowdown in global growth. Those fears have triggered a correction lower for commodity prices and related currencies in recent weeks. Bloomberg's commodity price index has recorded its largest sell-off (-11%) since the COVID shock first hit in early 2020. On top of building global growth concerns, LatAm currencies have been hit by negative domestic drivers as well in the near-term. The COP has weakened sharply to price in a higher political risk premium following the election (click here).

RECENT PULLBACK IN EM FX VOL SUPPORTS ZAR



Source: Bloomberg, Macrobond & MUFG Research

GLOBAL GROWTH CONCERNS WEIGH ON LATAM FX



Source: Bloomberg, Macrobond & MUFG Research

Trading views

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Trading views: Starting to turn bullish on EMFX as negativity looks overdone

Market is one day buying EMFX on peaking US yields only to sell it back later as it worries about the reasons for the peak yields

The market seems to be oscillating between buying EM on peaking US yields, to selling EM as it looks into the reasons behind the move lower in US rates. It is the classic barbell of the USD smile with EM normally better placed somewhere in the middle. Certainly it is much easier to argue that lower US yields are due to the market reassessing growth prospects than being representative of a shift in dovishness from the Fed. While we have sympathy to the potential of a recession, we nevertheless are getting more bullish EMFX overall.

We think EMFX may have a little rally as prospects are reassessed

The main reason for our turn is our feel that negative sentiment on EM prospects or long positioning in the USD has gone too far. A lot of times money can be made from the prospects in EM universe going from very bad to just bad. A simple reassessment of things not actually being quite as disastrous as feared can provide quite a significant rally especially in those places where the selling has been quite large and positioning already underweight. Particularly in Asia where China stimulus is coming through, slowly but surely, we feel there is room for the likes of KRW and TWD especially to outperform. While a tariff reduction by the US on Chinese goods may be expected now we still feel it will help push sentiment favourably at a point where things may be turning. Certainly equity outflows in these two countries have been pronounced. Furthermore in KRW's case with the BOK becoming vocal on FX levels, some of the domestic foreign equity buying by state pension funds may be slowed.

Sentiment seems too negative for us on several counts but especially on EM with negative scenarios almost fully priced perhaps

When we think of positive catalysts from here it is hard to find any. That however is exactly the point for us. In a year where consensus has been surprised several times there is very little hope for any good news out there. The geopolitical situation is almost "guaranteed" to get worse for most commentators. Oil forecasts, like with inflation seem to only have upside forecasts while the term stagflation is so well entrenched that it's not "if" we have a recession but rather "when" for many. In fact the mood seems to have a whiff of episodes like Brexit or when Covid hit. During both times, the actual growth that ensued, while negative, was way above the forecasts at the time. We feel such a scenarios is possible again, even if we cant work out what will trigger it.

Local stories will play out especially as USD story becomes less entrenched

With the big USD story maybe taking a back seat with less immediate focus on the Fed, local stories will take on more importance. Turkey is increasing it's defence mechanism and once again is looking at having a very interesting summer. Meanwhile other currencies are starting to see more aggressive leaning against currency weakness. We think it will prove to be quite an interesting summer for us in EMFX. They should be plenty to keep us focussed on.

Week in review

EM capital flows: investors sharply reduced exposures to EM assets last week

EM sentiment remains gloomy

There has been some respite for EM risk assets last week, as a leg down in core bond yields, along with some moderation in commodity prices led to a recovery in market sentiment. Having said that, the investment environment remains bleak as the prospects of further rate hikes by global central banks, given sticky inflation, will keep financial conditions tight. A key component worth highlighting is the real effective exchange rate (REER), which has turned quite negative across the EM space, as higher inflation readings out of EM have led to a real appreciation of the currencies. Given the lagged relationship between financial conditions and EM economic activity, this implies some significant slowdown in EM economic activity in H2 2022.

The 52 week rolling cumulative outflows into EM bond and equity funds declined to USD-55.3bn from USD-51.0bn a week ago – this figure is the lowest since December 2020

According to IIF data, EMs witnessed a second consecutive week of outflows (USD-5.6bn – week ending 17 June) this year, led by outflows of equity (USD-4.6bn) and debt (USD-1.0bn), with investor apprehension continuing to linger, stemming from geopolitical events, tighter financial conditions, realised inflation and anxieties that some EMs will not recover quickly enough from COVID (see here, here and here). Following the latest IIF estimates, the 52 week rolling cumulative outflows into EM bond and equity funds declined to USD-55.3bn from USD-51.0bn a week ago. This figure is the lowest since December 2020, and we expect this trend to continue given the ongoing deterioration in the global liquidity backdrop. From an asset markets perceptive, EM credit historically outperforms into Fed lift-offs, but this time around EM local rates is doing better.

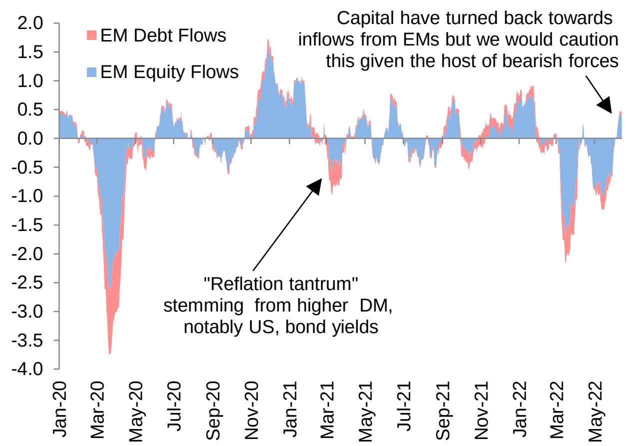
Saudi Arabia: SAMA injects USD13.3bn in liquidity with commercial banks

Saudi Arabia has injected USD13.3bn in liquidity with commercial banks in a bid to ease tight liquidity despite benign oil prices

The Saudi Central Bank (SAMA) placed SAR50bn (USD13.3bn) as time deposits with commercial banks in a bid to ease a liquidity crunch, according to unconfirmed reports. The injection consisted of capital provided to banks at a discount to the three month Saudi Interbank Offered Rate (SAIBOR) – used to price loans. Liquidity conditions as measured by SAIBOR are the tightest since December 2008 when Brent crude was ~USD40/b, with the spread over LIBOR as tight as in December 2016. The extent of the funding stress among Saudi banks has little precedent

CAPITAL IS RETURNING TO EM'S ON A 28 DAY ROLLING BASIS BUT HEIGHTENED RISK AVERSION REMAINS

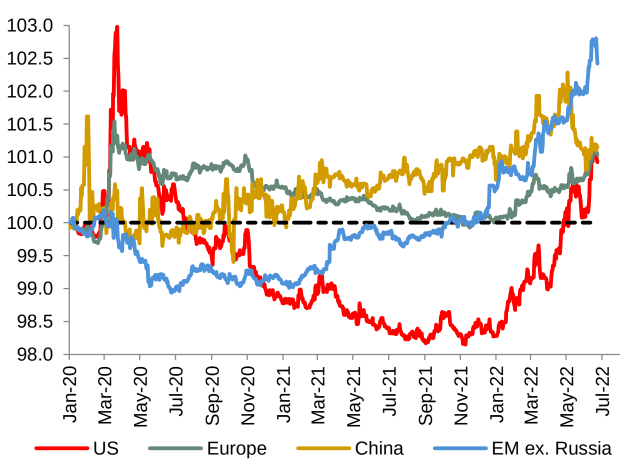
EM EQUITY AND DEBT FLOWS (USD BN), 28 DAY ROLLING AVERAGE



Source: IIF, MUFG Research

GLOBAL FINANCIAL CONDITIONS ARE TIGHTENING WHICH IS A CORE EM RISK (CAPITAL FLIGHT) IN 2022

FINANCIAL CONDITIONS INDICES (FCI), REBASED 100 = JANUARY 2020



Source: Bloomberg, MUFG Research

outside periods of precipitously low oil prices and ample funds should signal borrowing should be cheap, accounting for higher US dollar rates. Growth in bank deposits has lagged behind Saudi credit expansion driven largely by a surge in mortgages which has squeezed the money market while the government withholds its oil windfall as part of a more conservative approach to fiscal spending. Saudi Finance Minister, Mohammad Al Jadaan, stated last month that the government would hold excess oil revenues in its current account until at least early next year, as it aims to rebuild reserves depleted during eight years of subdued oil prices. According to reports, the funding from SAMA has come in at least three tranches, with the first and second injection consisting of three month deposits that totalled ~SAR15bn each, with another placement more recently that included both shorter and longer maturities. In a sign that the latest injections by SAMA are already having an impact, the SAIBOR rate has fallen 17bp from 24 June to stand at 3.13%.

Czech Rep.: CNB raises rates by 125bp with laser focus on restoring price stability

Czech Republic hikes rates aggressively to 7.00% with bringing down inflation the key priority

The Czech National Bank (CNB) raised its key policy rate (the two-week repo rate) by 125bp, from 5.75% to 7.00%, below our (150bp) but above consensus (100bp) expectations. This move comes amid ongoing increases in inflation, Czech Krona (CZK) depreciation pressures, as well as an increasingly hawkish external environment, reflecting rising expectations of more DM tightening. In the press release, the Monetary Policy Committee (MPC) stated that the risks to its inflation forecasts from the May MPC meeting are "markedly inflationary", implying the need for a more decisive step at last week's meeting. It highlighted that the upside inflation surprises to its expectations in recent months were due to stronger core and underlying inflation dynamics. Compared to the previous statement, the press release also included stronger language and emphasised that restoring price stability is a priority for the CNB.

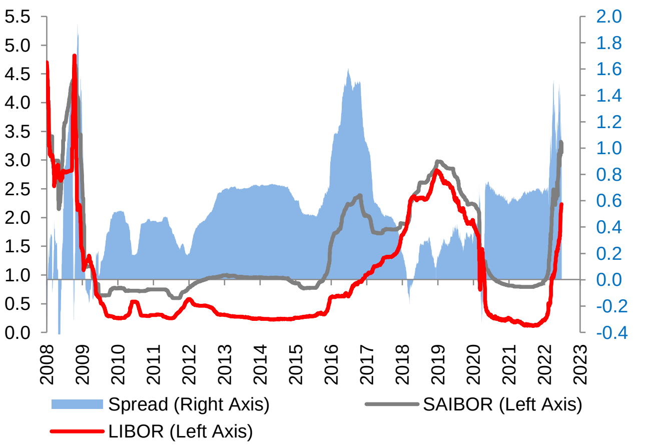
Egypt: CBE maintains rates in a surprise dovish decision despite high inflation

Egypt keeps rates on hold but hikes remain on the agenda

In a surprise decision, the Central Bank of Egypt (CBE) kept all its policy rates on hold (MUFG and consensus +100bp), citing a moderation in the pace of inflation increases and the transient nature of inflationary pressures, which it attributed to the war in Ukraine. Since the March devaluation, the CBE has tightened by 300bp, and that it continues to monitor inflation expectations, but that it will tolerate temporary

HIGHER OIL PRICES HAVE DONE LITTLE TO EASE SAUDI INTERBANK RATES WITH LIQUDITY AS TIGHT AS IN 2016

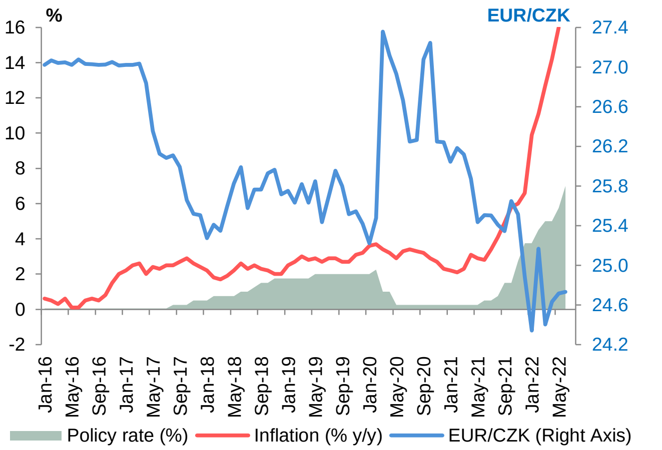
SAUDI SAIBOR, US LIBOR AND SPREAD (SAIBOR – LIBOR), %



Source: Bloomberg, SAMA, MUFG Research

EGYPT SURPRISED US AND MARKETS BUT KEEPING RATES ON HOLD DESPITE HIGHER INFLATION

CZECH REPUBLIC INFLATION (% Y/Y), RATES (%) AND EUR/CZK



Source: Bloomberg, CNB, MUFG Research

deviations from its inflation target of 7% ± 2ppt under the current circumstances. While we recognise that inflationary pressures in Egypt would appear transient, predominantly led by the devaluation of the Egyptian Pound (EGP) and higher global food prices, we had been expecting further tightening in monetary policy to lean against pressures building on the currency. A rate rise would not mitigate existing supply side shocks, but further policy tightening would have bolstered the CBE's inflation targeting credibility and help re-anchor inflation expectations that have been pushed higher by recent FX weakness. An additional rate rise would also have helped address core price pressures, which rose by 13.3% y/y –the steepest gain since January 2018. From an inflation perspective, we still see headline inflation remaining in double digits and above the CBE's upper target band of 5% ± 2ppts until Q2 2023, peaking ~18% y/y. The CBE reiterated in its May policy statement that future policy rates remain a function of inflation expectations rather than the prevailing rates. Given we still see headline inflation inching higher over the coming months amid higher energy prices and continued FX depreciation pass-through, the CBE should continue to hike, albeit at a tempered pace.

Turkey: CBRT maintains rates as widely expected but pressure continues to build

Turkey maintains rates as expected with emphasis on heterodox policies

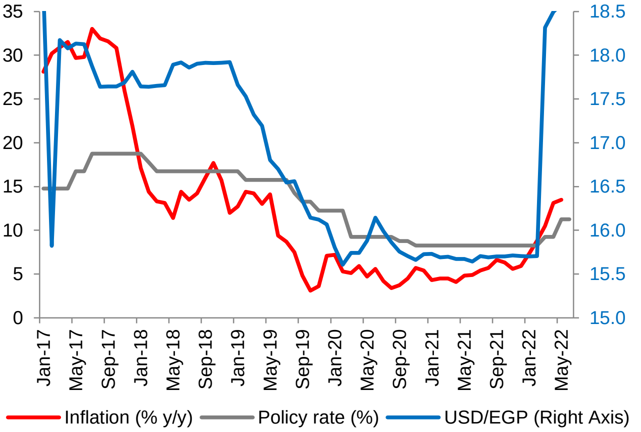
The Central Bank of Turkey (CBRT) kept the key rate unchanged at 14.00% last week with negligible changes in the post-meeting statement, reinforcing the message that it will continue to implement the collateral and liquidity policy actions and additional macroprudential measures introduced earlier. The Monetary Policy Committee (MPC) also stated that additional measures will be taken "when needed", which we believe is guidance that no new measures will be introduced in the immediate future but that the CBRT remains resolute to the utilisation of additional heterodox measures for the purpose of policy tightening with no reversion as of yet to interest rates as its main policy tool. As a result, the markets have shifted focus towards what other instruments the authorities could use to slow the pace of currency depreciation given the deteriorating external dynamics. Most recently, the Treasury and Finance Ministry issued a revenue-indexed bond to incentivise lira savings while another available option would be for the central bank to become more active in the FX market.

Our base case is that the CBRT will reluctantly change course with a pivot back to conventional policy

Looking ahead, we reiterate our conviction that the CBRT will likely change course and tighten policy in an orthodox manner later this year, but do so reluctantly – our base case is for the CBRT to raise rates from a trough of 14% to 20% by end-2022

EGYPT SURPRISED US AND MARKETS BUT KEEPING RATES ON HOLD DESPITE HIGHER INFLATION

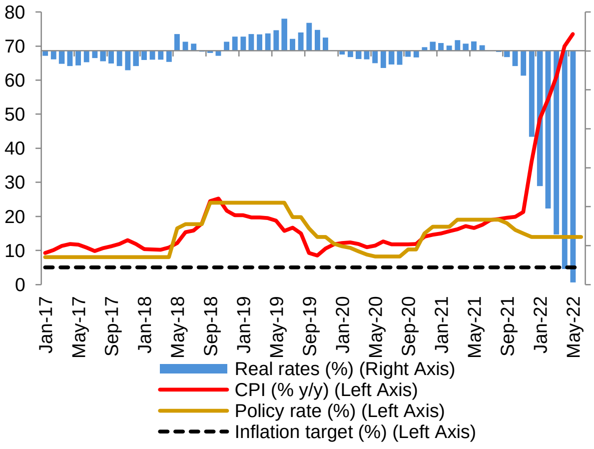
EGYPT INFLATION (% Y/Y), RATES (%) AND USD/EGP



Source: Bloomberg, CBE, MUFG Research

HUNGARY RAISES RATES FURTHER WITH THE HAWKISH INFLATIONARY SETTING SIGNALLING MORE TO COME

TURKEY INFLATION (% Y/Y), NOMINAL AND REAL RATES (%)



Source: Bloomberg, MNB, MUFG Research

(see here and here). Our rationale is centred on the premise that the acute deterioration in the inflation outlook, in tandem with the fragility of the TRY, as well as the risk premium since the inception of the rate cuts in September 2021, necessitates a significantly tighter monetary policy stance to anchor expectations and promote price stability. With real policy rates so deeply negative (-56%), the current monetary policy stance is unambiguously unsustainable and the pressure on the TRY is likely to continue in the absence of a policy U-turn.

In the interim, we acknowledge that a host of heterodox policies will continue to be adopted to help stabilise the TRY

Whilst our core scenario is that the policy adjustment will be in an orthodox fashion, we acknowledge that a continuation of heterodox measures could materialise over the near-term to encourage de-dollarisation, bolster reserves and manage other aspects of the economy (even if this has negative reverberations on the budget or adds significantly to the government's contingent liabilities). As the authorities push for more lending and growth – as seen with the expansion of the Credit Guarantee Fund, the recapitalisation of state banks and the focus on long-term TRY credits – we view that pressures will build on the CBRT to take action to significantly opt for a tighter monetary policy stance. Central will be the performance of the TRY and the more pressure that builds in the months ahead, the more likely it will be for the CBRT to revisit its monetary policy strategy.

Russia: formal default on sovereign bonds for the first time since 1918

With the grace period on two Eurobond coupons expiring on 26 June, Russia has now formally defaulted

Russia formally defaulted on its foreign currency sovereign debt for the first time since 1918 – the culmination of stern sanctions that shut down payment routes to foreign creditors. Ever since the war began, Russia has found innovative avenues around the penalties imposed but the grace period on ~USD90m of snared interest payments on two sovereign bonds (USD 2026 and EUR 2036) due 27 May expired (Russia cannot engage with a US entity clearing bank) – a deadline considered an event of default if missed. Russian Eurobonds have traded at distressed levels since early March, the Central Bank of Russia's (CBR) foreign reserves remain frozen and the largest systemic banks remain severed from the global financial system. With this in mind, the default is mostly symbolic at face value and thus, given the relatively low CDS net exposure, low notional amount of bonds, and general anticipation, we believe that the impact will not be significant in the coming days.

Week ahead

PMI: June PMI readings to signal the impact of war, supply chains and commodities

The health of corporate activity in the spotlight as June PMI readings to signal how entities are dealing with the fallout of war, supply chains and commodities

Purchasing Managers' Indices (PMIs) for June will be published this week. The aggregate EM EMEA PMI edged up from 50.0 in April to 50.7 in May (on a PPP-weighted basis), fundamentally driven by a continued rebound in Russian activity data. Discounting Russia, readings were notably softer in Central and Eastern Europe (CEE) – Czech Republic from 54.4 to 52.3, Hungary from 58.9 to 51.5. Poland from 52.4 to 48.5. Activity indicators were robust up until May in the CEE region despite the war, supply chain disruptions and elevated commodity prices. However, the softer CEE PMI data may be a first sign of what lies ahead, and we expect a slowdown in activity to take place across the region in the second half of the year, reflecting ongoing tightening in financial conditions and fading post-COVID tailwinds.

Hungary: MNB to continue hiking owing to elevated inflation and currency pressures

Hungary to tighten policy further

Given ongoing elevated inflationary pressures and currency depreciation, we believe the National Bank of Hungary (MNB) will step up its tightening this week and raise the base rate by 50bp to 6.40% (in line with consensus). Critically, we view that the communication will be left open for more rate hikes to offer the Monetary Policy Committee (MPC) flexibility in its reaction function. Inflation in May further surprised to the upside at 10.7% y/y, and underlying inflation dynamics have only strengthened in recent months. With no signs to date that inflation is stabilising, we consider the MNB will see the need for further rate hikes at an accelerated pace. While challenging inflation dynamics are not unique to Hungary and are seen elsewhere in the CEE region, the additional concern in the case of Hungary is its external vulnerability as a considerable net energy commodity importer. With added concerns over the low level of reserves, as well as the ongoing dispute over the EU fund disbursement, this has translated into depreciation pressures on the Hungarian Forint (HUF), which continues to test 400 level versus the Euro.

Weekly calendar

	Country	Day	GMT	Indicator/Event	Period	MUFG Forecast	Consensus	Previous	Market Moving
	Hungary	28/06/2022	13:00	Monetary policy meeting (%)	---	6.40%	6.40%	5.90%	!!!
	Russia	29/06/2022	17:00	Industrial production (% y/y)	May	---	-3.0%	-1.5%	!!
	Kenya	30/06/2022	---	Real GDP (% y/y)	Q1-22	---	5.5%	7.4%	!!
	Czech Rep.	30/06/2022	08:00	Real GDP (% y/y)	Q1-22F	4.8%	4.8%	4.8%	!!
	Russia	01/07/2022	07:00	PMI	Jun	---	49.8	50.8	!!!
	Poland	01/07/2022	08:00	PMI	Jun	---	48.0	48.5	!!!
	Hungary	01/07/2022	08:00	PMI	Jun	---	52.4	51.5	!!!
	Turkey	01/07/2022	08:00	PMI	Jun	---	---	49.2	!!!
	Czech Rep.	01/07/2022	08:30	PMI	Jun	---	51.1	52.3	!!!
	Poland	01/07/2022	09:00	CPI (% y/y)	Jun	---	15.5%	13.9%	!!!
	S. Africa	01/07/2022	10:00	PMI	Jun	---	---	54.8	!!!
	Russia	01/07/2022	17:00	Real GDP (% y/y)	Q1-22F	3.5%	3.5%	3.5%	!!!

Source: Bloomberg, MUFG Research

Forecasts at a glance

EM EMEA economic growth, fiscal balance and current account balance

	Real GDP (%, y/y)			Fiscal balance (% of GDP)			Current account (% of GDP)		
	Latest	2021	2022	Latest	2021	2022	Latest	2021	2022
Bahrain	18.44	6.00	3.50	-10.61	-8.00	-8.02	-2.06	-2.90	-2.87
Czech Rep.	4.60	2.90	3.00	0.27	-8.03	-5.47	5.02	1.57	0.82
Egypt	4.63	3.30	5.50	-7.41	-7.33	-6.33	-4.17	-3.88	-3.66
Greece	13.17	6.50	4.30	0.57	-10.25	-4.29	-2.70	-7.41	-5.14
Hungary	8.20	7.30	4.30	-2.05	-6.60	-5.94	-4.59	0.60	0.88
Iraq	4.43	3.60	6.70	0.86	-1.55	-2.53	1.12	6.16	4.00
Israel	9.60	7.00	5.00	-3.91	-6.81	-4.33	5.61	4.46	3.82
Jordan	1.96	2.00	2.20	-5.98	-7.69	-5.94	-8.59	-8.93	-4.45
Kenya	5.37	5.50	5.60	-7.73	-8.01	-6.67	-5.82	-5.04	-5.10
Kuwait	0.43	4.50	6.40	5.38	-1.47	0.99	3.06	15.51	13.27
Lebanon	-6.90	-5.20	2.00	-10.50	---	---	-27.45	---	---
Libya	9.89	123.20	5.30	2.19	6.77	12.46	-0.30	19.23	15.39
Morocco	6.60	5.70	3.10	-4.13	-6.49	-5.91	-3.95	-3.07	-3.25
Nigeria	3.11	2.50	5.60	-4.76	-6.11	-5.96	-3.49	-3.22	-2.25
Oman	-0.83	2.70	0.90	-7.06	-2.57	1.11	-4.38	-5.75	-0.94
Poland	8.50	5.00	4.50	-0.74	-4.25	-1.90	1.08	2.26	1.56
Romania	6.50	7.60	3.00	-4.56	-6.70	-5.59	-10.07	-5.71	-5.53
Qatar	2.00	2.90	6.00	4.93	2.78	5.68	-27.67	8.20	11.56
Russia	5.02	4.40	-7.00	1.92	-0.56	0.02	1.11	5.74	4.41
Saudi Arabia	9.60	4.50	11.20	-4.45	-3.05	2.79	-0.39	3.87	3.79
South Africa	1.70	5.10	1.60	-2.27	-8.44	-6.99	1.22	2.88	-0.86
Turkey	9.14	9.80	1.60	-5.65	-4.92	-5.58	0.00	-2.42	-1.61
Ukraine	6.10	4.00	-28.00	-2.04	-4.50	-3.50	1.35	-0.69	-2.44
UAE	5.30	5.00	5.00	-0.76	-0.54	-0.22	2.44	9.67	9.37

EM EMEA inflation, interest rates and FX

	Inflation (% y/y, average)			Policy interest rates (%)			FX (against USD)		
	Latest	2020	2021	Latest	End-2021	End-2022	Latest	End-2021	End-2022
Bahrain	3.50	3.90	1.90	3.75	3.75	3.00	0.377	0.377	0.377
Czech Rep.	16.00	3.90	11.30	7.00	3.75	5.50	24.744	24.886	21.380
Egypt	13.50	5.40	7.90	11.25	7.75	11.50	18.762	15.723	15.420
Greece	11.33	-0.10	0.40	0.00	0.00	0.40	1.058	1.137	1.132
Hungary	10.70	4.90	7.80	5.90	2.40	5.50	381.2	324.5	314.70
Iraq	5.10	6.40	5.00	4.00	4.00	5.00	1460	1460	1460.000
Israel	4.15	1.50	2.80	0.75	0.75	0.50	3.402	3.103	3.100
Jordan	4.39	1.60	2.00	4.50	4.50	2.00	0.710	0.709	0.709
Kenya	7.10	6.00	5.90	7.50	7.50	9.50	117.890	113.140	113.040
Kuwait	4.71	2.90	3.40	2.25	2.25	3.00	0.306	0.303	0.303
Lebanon	211.43	124.10	85.00	2.75	2.75	7.75	1509.380	1512.330	1512.330
Libya	4.56	21.10	8.00	3.00	3.00	3.00	4.811	4.597	4.597
Morocco	5.90	1.40	1.20	1.50	1.50	1.50	10.009	9.252	9.250
Nigeria	17.70	17.30	12.00	13.00	13.00	14.00	419.340	424.830	440.500
Oman	2.40	1.30	2.00	0.63	0.63	14.00	0.385	0.385	0.385
Poland	13.90	4.90	10.00	6.00	1.75	5.50	4.437	4.035	3.948
Romania	14.49	5.30	11.90	3.75	3.75	5.50	4.673	4.353	4.388
Qatar	5.18	1.60	4.00	2.50	2.50	2.50	3.641	3.642	3.642
Russia	17.10	6.60	16.60	9.50	5.75	15.00	118.690	74.679	71.130
Saudi Arabia	2.24	3.10	2.20	1.75	1.75	2.50	3.754	3.755	3.755
South Africa	6.50	4.50	6.20	4.75	3.50	4.75	15.847	15.937	15.800
Turkey	73.50	17.90	62.00	14.00	14.00	20.00	16.717	13.317	14.250
Ukraine	18.00	9.40	15.30	25.00	25.00	14.00	29.650	27.285	29.800
UAE	2.50	0.10	1.20	0.65	0.65	2.00	3.673	3.673	3.673

Core indicators

EM EMEA sovereign bond yields (%)

	Maturity	27-May	03-Jun	10-Jun	17-Jun	24-Jun	Change in yield (basis points) Week	MTD	YTD
Bahrain	10 years	4.40	4.46	4.99	5.34	5.21	-12.34	73.36	267.84
Czech Rep.	10 years	5.14	4.78	5.36	5.85	5.37	-48.37	61.50	228.72
Egypt	9 years	11.34	11.40	11.57	12.22	12.30	8.66	197.35	514.26
Greece	8 years	2.97	3.23	3.78	3.61	3.31	-29.63	34.32	220.16
Hungary	8 years	7.36	6.94	7.76	8.52	8.28	-23.65	109.02	381.54
Israel	8 years	1.99	2.01	2.29	2.83	2.77	-5.53	76.10	255.84
Jordan	5 years	7.40	7.30	7.44	8.24	8.39	14.91	178.36	411.88
Kenya	7 years	11.22	11.58	12.42	13.42	13.60	18.74	353.93	789.73
Kuwait	6 years	3.27	3.24	3.16	3.51	3.53	2.07	54.66	183.79
Lebanon	9 years	62.74	65.01	72.53	79.83	82.83	299.54	1279.36	1882.60
Morocco	11 years	4.70	4.79	4.96	5.62	5.72	10.25	92.63	331.99
Nigeria	9 years	11.36	11.82	11.68	12.78	13.02	23.46	254.21	562.65
Oman	9 years	6.23	6.13	6.22	6.55	6.26	-29.58	62.72	150.49
Poland	8 years	2.05	2.26	2.54	3.01	2.82	-19.53	55.45	264.57
Romania	7 years	4.20	4.48	5.09	5.76	5.63	-12.29	118.93	408.25
Qatar	9 years	3.77	3.68	3.81	4.07	3.99	-7.72	52.24	174.42
Russia	5 years	48.69	63.33	62.63	62.86	61.90	-95.50	15.70	-90.63
Saudi Arabia	8 years	3.85	3.78	3.79	4.11	4.08	-2.95	55.44	193.51
South Africa	9 years	6.35	6.45	6.65	7.17	6.81	-35.52	84.11	259.38
Turkey	7 years	9.26	9.14	10.50	10.48	9.52	-95.01	63.08	230.59
Ukraine	8 years	34.22	31.44	35.16	38.53	43.74	520.78	1074.49	3,426.08
Abu Dhabi	6 years	3.45	3.29	3.29	3.63	3.54	-9.39	50.44	178.60
Dubai	8 years	4.18	4.18	4.09	4.17	4.16	-0.64	8.94	158.28

EM EMEA equity market (index)

	20-May	27-May	03-Jun	10-Jun	17-Jun	24-Jun	Change (%) Week	MTD	YTD
Bahrain	1,963	1,889	1,909	1,884	1,850	1,810	-2.14	-5.74	0.74
Czech Rep.	107,005	111,890	112,393	107,094	102,807	98,672	-4.02	-11.39	-5.87
Egypt	10,439	10,416	10,150	10,048	9,981	9,432	-5.51	-7.08	-21.07
Greece	867	873	900	894	839	839	0.05	-5.76	-6.04
Hungary	41,473	41,517	40,513	40,350	39,319	39,800	1.22	1.02	-21.53
Israel	1,919	1,836	1,920	1,908	1,822	1,851	1.58	-2.67	-6.41
Jordan	2,425	2,468	2,455	2,440	2,430	2,446	0.66	-1.05	15.47
Kenya	140	128	129	130	128	117	-8.59	-8.96	-29.59
Kuwait	7,938	7,584	7,809	7,630	7,390	7,332	-0.78	-6.28	4.11
Lebanon	658	658	658	658	658	658	0.00	0.83	39.06
Morocco	12,680	12,394	12,393	12,672	12,258	12,015	-1.98	-2.63	-10.06
Nigeria	52,721	52,591	52,974	53,194	52,411	51,706	-1.35	-3.60	21.04
Oman	4,156	4,122	4,130	4,131	4,121	4,109	-0.30	-0.17	-0.50
Poland	1,802	1,797	1,823	1,793	1,707	1,698	-0.51	-7.84	-25.08
Romania	12,093	12,207	12,510	12,456	12,076	12,558	3.99	0.39	-3.85
Qatar	13,020	12,859	12,833	12,965	12,562	12,116	-3.55	-6.22	4.22
Russia	2,445	2,340	2,375	2,319	2,319	2,396	3.31	1.69	-36.74
Saudi Arabia	12,713	12,589	12,766	12,596	12,053	11,569	-4.02	-10.47	2.54
South Africa	62,494	61,176	64,237	63,449	61,163	61,586	0.69	-5.88	-8.15
Turkey	2,394	2,418	2,569	2,540	2,531	2,535	0.15	-0.48	36.46
Ukraine	519	519	519	519	519	519	0.00	0.00	-0.68
Abu Dhabi	9,908	9,559	9,895	9,710	9,459	9,268	-2.02	-7.82	9.19
Dubai	3,437	3,258	3,407	3,396	3,287	3,231	-1.70	-3.47	1.10

EM EMEA FX against USD*

	20-May	27-May	03-Jun	10-Jun	17-Jun	24-Jun	Change (%) Week	MTD	YTD
USD Index	102.724	101.829	101.824	103.223	104.700	103.874	-0.79	2.09	8.58
Bahrain**	0.379	0.379	0.379	0.379	0.379	0.379	-0.03	0.00	0.18
Czech Rep.	23.307	23.004	23.010	23.480	23.546	23.383	-0.69	-1.53	-6.43
Egypt	18.282	18.587	18.622	18.727	18.762	18.762	0.00	0.75	19.32
Greece***	1.056	1.074	1.072	1.052	1.050	1.058	0.79	-1.42	-6.93
Hungary	363.840	367.070	365.590	378.800	380.760	381.190	0.11	-2.92	-14.88
Israel	3.363	3.348	3.333	3.392	3.454	3.401	-1.54	-2.43	-8.76
Jordan**	0.710	0.710	0.710	0.710	0.710	0.711	0.07	-0.06	-0.20
Kenya	116.279	116.279	0.009	0.009	0.009	0.009	0.00	1.18	3.53
Kuwait	0.306	0.306	0.306	0.306	0.306	0.306	0.00	-0.21	-1.24
Lebanon	1,512.44	1,511.87	1,512.12	1,509.38	1,509.38	1,509.38	0.00	0.10	0.20
Morocco	10.023	9.899	9.861	9.958	10.091	10.009	-0.82	-1.45	-7.56
Nigeria	415.940	415.940	415.820	416.960	417.880	419.340	0.35	-0.83	1.31
Oman**	0.385	0.385	0.385	0.385	0.385	0.385	0.00	0.03	0.29
Poland	3.759	3.761	3.761	3.760	3.756	3.756	0.01	0.13	-0.06
Romania	4.683	4.604	4.612	4.699	4.711	4.673	-0.80	-1.45	-6.85
Qatar**	3.664	3.661	3.662	3.661	3.661	3.661	0.02	-0.04	0.36
Russia	62.140	66.345	63.360	58.187	57.500	53.611	-6.76	16.55	40.21
Saudi Arabia**	3.759	3.761	3.761	3.760	3.756	3.756	0.01	0.13	-0.06
South Africa	15.842	15.590	15.548	15.857	16.018	15.846	1.08	-1.30	0.57
Turkey	15.909	16.223	16.447	17.114	17.331	16.718	3.67	-1.88	-20.42
Ukraine	29.400	29.463	29.400	29.528	29.538	29.650	0.38	0.00	-7.98
UAE**	3.672	3.673	3.673	3.673	3.673	3.673	0.00	0.01	0.04

Note: * Exchange rate quoted as amount of USD per currency in line with market convention, other exchange rates are amount per USD; ** 12 month forward given pegged against USD; *** EUR per USD

EM EMEA 5 year CDS spreads (basis points)

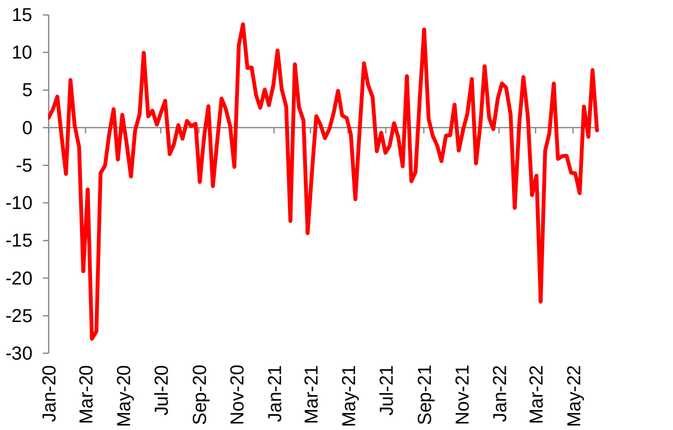
	20-May	27-May	03-Jun	10-Jun	17-Jun	24-Jun	Change in yield (basis points) Week	MTD	YTD
Bahrain	309.92	338.07	317.20	314.82	314.82	312.87	-1.95	21.15	19.04
Czech Rep.	39.73	39.97	39.69	38.10	38.10	33.70	-4.40	-5.99	-1.92
Egypt	864.13	922.60	751.43	778.14	924.42	943.00	18.58	191.57	444.96
Greece	155.29	172.61	165.17	174.12	174.12	167.87	-6.25	2.70	55.88
Hungary	120.76	125.00	128.20	129.97	129.97	160.50	30.54	32.31	115.78
Israel	41.94	45.49	46.09	46.45	46.45	48.27	1.83	2.18	8.06
Kenya	855.37	927.71	695.06	813.38	1,013.97	1,060.63	46.66	365.57	653.75
Kuwait	62.73	66.75	69.76	69.37	67.89	68.44	0.55	-1.32	23.73
Morocco	117.27	201.56	205.95	207.84	231.57	241.75	10.19	35.80	146.36
Nigeria	620.36	811.73	811.44	700.65	894.66	893.92	-0.74	82.49	438.85
Oman	257.77	267.27	259.93	261.75	259.95	260.73	0.78	0.81	4.92
Poland	103.48	107.39	100.00	104.53	107.60	108.45	0.85	8.45	68.87
Romania	217.70	244.47	240.93	219.95	263.30	264.22	0.92	23.30	189.40
Qatar	67.70	68.20	60.36	62.04	62.54	62.69	0.16	2.33	18.94
Russia	5,377.20	10,121.04	14,418.18	9,954.09	14,413.29	10,195.04	- 4,223.14	- 4,223.14	10,070.62
Saudi Arabia	67.67	69.01	61.36	66.35	66.35	62.75	-3.60	1.39	13.37
South Africa	263.35	275.53	233.66	242.93	242.93	65.60	-177.34	-168.06	-137.43
Turkey	711.58	719.02	711.43	715.33	715.33	278.45	-436.88	-432.98	-284.31
Ukraine	5,708.78	4,812.47	3,615.89	5,108.84	7,710.87	11,106.86	3396.00	7490.98	10495.97
Abu Dhabi	67.01	68.01	59.42	60.71	61.09	123.85	62.76	64.43	80.95
Dubai	118.59	123.42	119.46	118.18	122.26	123.85	1.59	4.39	29.79

Source: Bloomberg, MUFG Research

EM capital flows

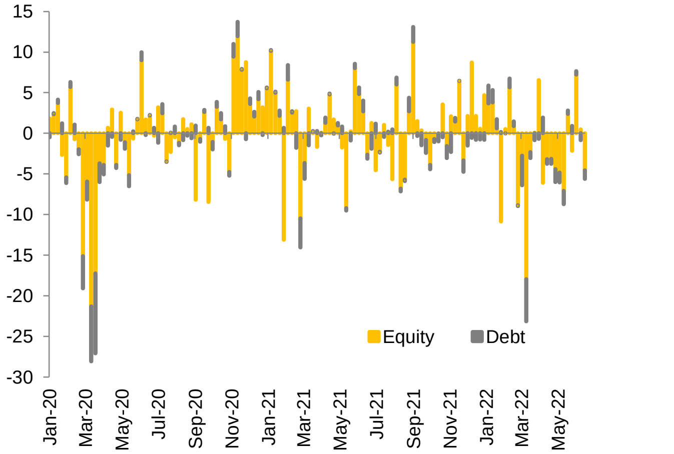
WEEKLY TOTAL EM OUTFLOWS OF USD-5.6BN – 17 JUNE

TOTAL WEEKLY PORTFOLIO FLOWS (DEBT AND EQUITY) (USD BN)



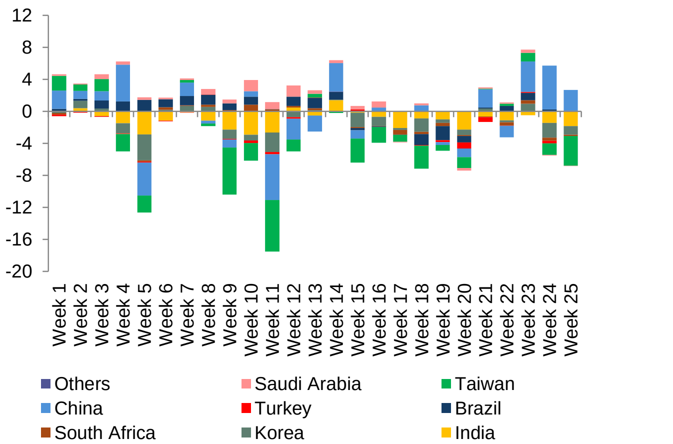
WEEKLY EM OUTFLOWS FROM EQUITY (USD-4.6BN) AND DEBT OUTFLOWS (USD-1.0BN) – 17 JUNE

WEEKLY DEBT AND EQUITY FLOWS (USD BN)



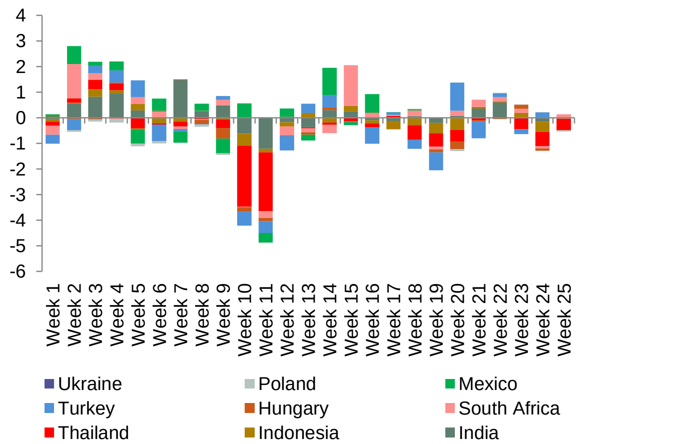
TAIWAN (USD-3.7BN) AND INDIA (USD-1.8BN) LED WEEKLY EM EQUITY OUTFLOWS – 17 JUNE

WEEKLY PORTFOLIO FLOWS BY COUNTRY, WEEK 1 = JANUARY 2022 (EQUITY) (USD BN)



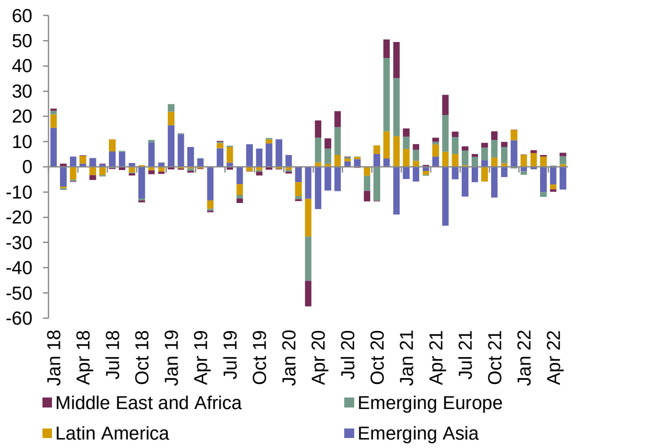
INDONESIA (USD-0.6BN) LED EM DEBT OUTFLOWS LAST WEEK – 17 JUNE

WEEKLY PORTFOLIO FLOWS BY COUNTRY, WEEK 1 = JANUARY 2021 (DEBT) (USD BN)



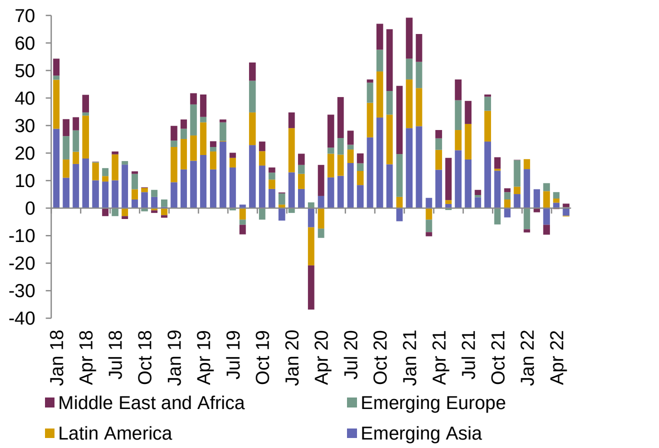
EM EQUITY OUTFLOWS TOTALLED USD-3.4BN IN MAY, LED BY EM ASIA (USD-9.0BN)

MONTHLY PORTFOLIO FLOWS BY COUNTRY (EQUITY) (USD BN)



EM DEBT OUTFLOWS TOTALLED USD-1.5BN IN APRIL, LED BY EM ASIA (USD-2.9BN)

MONTHLY PORTFOLIO FLOWS BY COUNTRY (DEBT) (USD BN)



Source: Bloomberg, IIF, MUFG Research

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