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Global Markets Monthly Update

May 2022

KEY INSIGHTS

- Global markets were mixed as the Federal Reserve and other central banks signaled their intensifying resolve to tamp down inflation.
- The European Union announced new limits on imports of Russian oil, helping push global crude prices back near multiyear highs and adding to inflation pressures.
- China's economy slowed markedly as strict lockdowns to control COVID-19 weighed on both domestic consumption and exports.

HIGHLIGHTED REGIONS

- U.S.
- Europe
- Japan
- China
- Other Key Markets

U.S.

A late rally helped the major equity indexes end roughly flat for the month. The exception was the technology- and growth-oriented Nasdaq Composite Index, which added to April's sharp declines as rising interest rates made future earnings of high-growth companies less attractive to investors. The Cboe Volatility Index (VIX) remained slightly below its intraday peaks reached earlier in the year, but volatility stayed elevated throughout the month. Many cryptocurrencies plunged in value, further suggesting a pronounced risk-off environment. On May 20, the S&P 500 Index briefly entered a bear market in intraday trading, having fallen more than 20% from its recent peak.

Fed Raises Rates and Announces Plans to Reduce Balance Sheet

Bond returns were modestly positive overall for the month, although heightened investor caution was reflected in the underperformance of high yield issues. Early in the month, Federal Reserve policymakers announced a 50-basis-point (0.50 percentage point) increase in the federal funds target rate, the largest since 2000, to a range of 0.75% to 1.00%. The central bank also announced plans to begin reducing its balance sheet in June. Longer-term Treasury yields also increased initially, but yields fell back as investors began to anticipate that the Fed's hawkish turn might slow economic growth.

Worries that the Fed would be unable to achieve a "soft landing" by raising rates enough to curb inflation without causing a recession hampered sentiment throughout the month, even as much current and backward-looking economic data indicated continued solid expansion. Employers added a healthy number of new nonfarm jobs in April (428,000), and personal spending grew at a solid pace (0.9%).

Personal incomes grew only 0.4%, however, suggesting that consumers were dipping into savings to cope with higher prices. Indeed, the University of Michigan's gauge of consumer sentiment hit its lowest level since 2011 as Americans worried about the impact of inflation on their finances. Some major retailers reported earnings and revenue disappointments as customers reined in discretionary spending—while wage and other input costs rose—leading to a sharp pullback in consumer discretionary shares.

Inflation Pressures Ease Slightly but Remain Elevated

The month's data suggested that inflation pressures might have peaked in March, but price pressures for both consumers and businesses remained near multi-decade highs. Particularly

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worrying to investors may have been April's 0.7% surge in consumer prices for services (less energy services), indicating that inflationary pressures were moving beyond manufacturing and energy supply chains and becoming more broadly embedded in the economy. Airline fares jumped 18.6% over the month, for example—the largest increase on record. High home prices and higher mortgage interest rates seemed to take a toll on the housing sector, with new construction and sales of existing homes coming in below consensus estimates, while refinancing activity tumbled.

Fed policymakers' stated resolve to tighten financial conditions—and presumably rein in asset prices—also weighed on sentiment. At mid-month, Fed Chair Jerome Powell told *The Wall Street Journal* that taming inflation was an "unconditional need" and that policymakers wouldn't hesitate to raise rates as much as necessary, even if it meant "some pain [was] involved." In an interview with CNBC the next day, Kansas City Fed President Esther George acknowledged the recent turmoil in equity markets but seemed to welcome it as "one of the avenues through which tighter financial conditions will emerge."

Europe

Shares in Europe struggled amid concerns that rising inflation could prompt faster-than-expected interest rate increases and cause a recession. Chinese lockdowns and Russia's invasion of Ukraine added to the uncertainty. In local currency terms, the pan-European STOXX Europe 600 Index ended 1.56% lower. France's CAC 40 Index also declined, but Germany's DAX Index, Italy's FTSE MIB Index, and the UK's FTSE 100 Index gained ground.

EU Agrees on Partial Ban on Russian Oil; Russia Cuts Gas Supplies

European Union (EU) leaders agreed at the end of the month to ban all seaborne Russian oil deliveries, covering about two-thirds of such imports, within months. Hungary, Croatia, Slovakia, and the Czech Republic—countries that rely heavily on Russian energy supplied via pipelines—were exempted temporarily from the embargo. Part of the agreement also includes a coordinated ban with the UK on insuring ships carrying Russian oil.

Earlier, the European Commission (EC) announced a EUR 300 billion plan to end the EU's dependence on Russian energy imports before 2030. Unused loans from the pandemic recovery program will provide much of the funding for the plan.

Meanwhile, Russia's state-owned energy company Gazprom cut off gas supplies to the Netherlands, Finland, Poland, and Bulgaria for refusing to pay in rubles rather than dollars.

ECB's Lagarde, Lane Signal Positive Rates in Euro Area

European Central Bank (ECB) President Christine Lagarde and Chief Economist Philip Lane appeared to suggest policymakers could back an end to the asset purchase program early in the third quarter, followed by a series of gradual 25-basis-point interest rate increases starting in July. Lagarde said that "based on the current outlook, we are likely to be in a position to exit negative interest rates by the end of the third quarter." The ECB's key deposit rate is currently -0.5%.

European Economy More Resilient Than Thought; Inflation at Record High

The eurozone economy was more resilient than previously thought in the first quarter, with the revised data showing a 0.3% expansion. The previous estimate had pegged the growth in gross domestic product (GDP) at 0.2%. Official data showed that inflation accelerated more than expected in May to another record high of 8.1% and spread more broadly across the economy. The EC cut its forecast for 2022 GDP growth to 2.7% from 4.0% and raised its estimate for inflation to 6.1% from 3.5% to reflect higher energy prices.

BoE Raises Interest Rates, Inflation Soars, Economy Shrinks

The Bank of England (BoE) raised its key interest rate 25 basis points to 1.0%, the highest level since 2009, in a bid to dampen inflation. The central bank also suggested that the UK could slip into recession by year-end and warned that inflation could exceed 10% in the fourth quarter.

UK GDP unexpectedly contracted 0.1% in March, after stalling in February, as service sector activity slowed. Inflation quickened to 9.0% in April, the highest level since 1982.

Japan

Japanese equities gained in May, with the MSCI Japan Index returning 1.65%. Additional monetary easing in China and signs that the authorities there would allow segments of the economy to reopen following stringent coronavirus lockdowns, as well as the imminent relaxation of Japan's strict border controls in June, supported sentiment. The U.S. Federal Reserve's decision to implement the first 50-basis-point interest rate rise since 2000 induced some market volatility, however. The yield on the 10-year Japanese government bond rose to 0.24%, from 0.21% at the end of the April.

With Japan's economic recovery lagging global peers, the Bank of Japan (BoJ) reiterated its commitment to massive monetary stimulus, despite some concerns about a buildup of inflationary pressure. The yen remained at very depressed levels but strengthened over the month to around JPY 128.70 against the U.S. dollar from about JPY 129.76 at the end of the previous month. BoJ Governor Haruhiko Kuroda described the recent moves in the yen as "quite sharp" and suggested that they could

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hurt companies' business plans. However, he reiterated that, overall, a weak yen benefits the economy by boosting the value of companies' overseas earnings.

Japan's Economy Contracts in Q1; Inflation Exceeds BoJ's 2% Target

Japan's GDP contracted by an annualized 1% quarter on quarter during the first three months of 2022. Factors behind the contraction included deteriorating trade as import prices soared and sluggish consumer spending due to the coronavirus restrictions that had been in place. The BoJ has repeatedly said that it will continue with its massive monetary stimulus to support the post-pandemic recovery—the relatively weak GDP data are likely to reinforce this stance. Inflation exceeded the BoJ's 2.0% target in April, as the core consumer price index (CPI) rose 2.1% from a year earlier. However, consumer price pressures remained far weaker in Japan than elsewhere in the world, also supporting the case for continued easing.

Separate data showed that Japan's exports rose 12.5% year on year in April, led by U.S.-bound shipments of cars, while shipments to China fell sharply as the economic slowdown caused by the country's coronavirus lockdowns weighed on demand. Imports increased by 28.2% after energy prices soared due to the war in Ukraine.

Japan Agrees on Ban of Russian Oil Imports With Other G-7 nations

Against the backdrop of the war between Russia and Ukraine, Japan's government agreed in principle on a ban of Russian oil imports with other Group of Seven (G-7) developed nations, with Prime Minister Fumio Kishida stressing the importance of coordination. However, he emphasized that it had been a difficult decision given the resource-poor country's dependence on Russian fuel and that Japan will take its time to reduce or suspend imports as part of a phased approach, to minimize the negative impact on people's lives and business activities. Kishida did not offer a specific road map on the import ban.

China

Chinese markets advanced after Beijing rolled out measures to support an economic slowdown worsened by pandemic lockdowns under the country's zero-COVID policy. The broad, capitalization-weighted Shanghai Composite Index rose 4.5% and the blue chip CSI 300 Index, which tracks the largest listed companies in Shanghai and Shenzhen, added 1.8%. The MSCI China Index, which includes overseas listings, climbed 1.19%. The yuan fell 1.05% against the U.S. dollar amid concerns about China's weakened growth outlook.

Renewed Emphasis on Growth

Details of an economic stimulus package, which was flagged by China's State Council in a routine meeting, were disclosed on May 31 with the announcement of 33 measures covering fiscal, financial, investment, and industrial policies. It underscored officials' renewed emphasis on growth as doubts swirled around China's ability to achieve its 5.5% growth target this year. The stimulus package capped a month of disappointing economic data as Beijing's zero-COVID policy led many economists to slash their annual growth forecasts.

Chinese government officials are reportedly conflicted between the views of President Xi Jinping, who continues to emphasize a zero-tolerance approach to the coronavirus, and of Premier Li Keqiang, who recently warned of a worse economic crisis than that of early 2020 and called for a better balance between pandemic controls and economic growth. Shanghai, China's most populous city, moved to end its lockdown with gradual easing measures, while Beijing was slower to lift movement restrictions.

U.S.-China relations were tense after U.S. President Joe Biden said his country would defend Taiwan if the island were attacked by China. Separately, the U.S. Securities and Exchange Commission added more companies to its provisional list of Chinese firms that face delisting from U.S. exchanges under the Holding Foreign Companies Accountable Act. In a yearslong dispute over auditing standards, U.S. regulators have sought access to audit working papers of U.S.-listed Chinese companies, a request that China has denied citing national security reasons.

Exports Fall Sharply

Economic data in May pointed to slowing growth. Retail sales and industrial output data for April lagged estimates, and fixed asset investment missed the consensus forecast. Home prices in April fell for the eighth straight month, marking the fastest decline in five months. Credit demand weakened as lockdowns across China restrained economic activity. Export growth in U.S. dollar terms plunged in April from a year earlier, while import growth was flat. Factory gate (the price wholesalers pay for materials) and consumer inflation both rose more than expected in April, driven by higher food and fuel prices.

Despite the downbeat economic data, the People's Bank of China (PBOC) left its medium-term lending facility rate unchanged. However, the central bank signaled its support for the country's cash-strapped property developers by cutting mortgage interest rates for first-time homebuyers, followed by a bigger-than-expected cut in the five-year loan prime rate, which serves as a reference for home mortgages.

Other Key Markets

High Commodity Prices Weigh on Turkish Markets

Turkish stocks, as measured by MSCI, returned -6.62% versus 0.47% for the MSCI Emerging Markets Index.

Turkish assets struggled for much of May amid weakness in U.S. and most

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global equity markets. Turkey is a major importer of energy commodities, so continued upward pressure on oil and natural gas prices weighed on the country's markets. Energy costs continued to climb as Ukraine—Turkey's neighbor across the Black Sea—decided to curtail Russian natural gas flows through its territory into Europe due to invasion-related interference from the Russian military. Also, toward the end of the month, the European Union agreed to ban Russian oil imports by sea by the end of 2022.

T. Rowe Price sovereign analyst Peter Botoucharov notes that the Turkish lira has continued its weakening trend—down 9% versus the U.S. dollar in May and down about 19% in the year-to-date period through May 31—due in part to recent CPI data showing year-over-year headline inflation approaching 70%. Even though real (inflation-adjusted) interest rates are deeply negative, the central bank kept its key interest rate—the one-week repo rate—at 14.0% following its May 26 monetary policy meeting, and Botoucharov does not expect the central bank to raise interest rates in the near term.

In view of the slowing economy and lagging job creation, and the aim of President Recep Tayyip Erdogan's regime to deliver growth prior to elections in June 2023, Botoucharov believes that the government and central bank remain committed to Erdogan's "New Economic Program." This is based on a highly stimulative monetary policy and an exchange rate that increases the competitiveness of Turkish exporters in world markets. Indeed, following their late-month policy meeting, central bank officials identified "credit growth" as being "important for financial stability" and committed themselves to "decisively continue to implement the strengthened macroprudential policy set by taking additional measures." The downside of these policies, however, is higher inflation and a weaker lira.

Brazilian Stocks Post Strong Gains

Stocks in Brazil, as measured by MSCI, returned 8.43% versus 0.47% for the MSCI Emerging Markets Index. Although U.S. and most global equity markets struggled throughout the month, Brazilian equities produced gains, with U.S. dollar weakness versus the real enhancing local returns to U.S. investors. Inflation remains elevated, but retail sales and service sector activity have been stronger than expected.

T. Rowe Price sovereign analyst Richard Hall believes that the Brazilian economy has been recently going "sideways." Household consumption has been solid, reflecting continued high credit growth, a recovering labor market, and fiscal stimulus measures. External demand has also been supportive, especially in agriculture, given higher global food prices. On the other hand, the mining sector has been disappointing, as heavy rains this year have limited Brazil's ability to export iron ore at elevated prices. The key offset to various growth-supportive factors, however, is monetary policy tightening. In early May, the Brazilian central bank raised its key interest rate, the Selic rate, from 11.75% to 12.75%. Since March 2021, the Selic rate has risen more than 1,000 basis points (10 percentage points).

Despite these offsets, inflation—recently measured at a rate of more than 12% year over year—could remain high for some time, particularly if the central bank pauses its interest rate increases until after the elections in October. Following its May 3–4 policy meeting, the central bank projected that "a smaller adjustment" in the Selic rate at its June 14–15 policy meeting is "probable." However, policymakers also noted "that the high uncertainty of the current situation, in addition to the advanced stage of the adjustment cycle and its impacts yet to be observed, demand additional caution in its actions."

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Major Index Returns

Total returns unless noted

As of 5/31/2022 Figures shown in U.S. dollars	**May**	**Year-to-Date**
U.S. Equity Indexes		
S&P 500	0.18%	-12.76%
Dow Jones Industrial Average	0.33	-8.43
Nasdaq Composite (Principal Return)	-2.05	-22.78
Russell Midcap	0.08	-12.87
Russell 2000	0.15	-16.56
Global/International Equity Indexes		
MSCI Europe	0.97	-11.60
MSCI Japan	1.65	-13.28
MSCI China	1.19	-16.71
MSCI Emerging Markets	0.47	-11.68
MSCI All Country World	0.19	-12.64
Bond Indexes		
Bloomberg U.S. Aggregate Bond	0.64	-8.92
Bloomberg Global Aggregate Ex-USD	0.01	-12.55
Credit Suisse High Yield	0.26	-7.31
J.P. Morgan Emerging Markets Bond Global	0.19	-14.07

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Note: Returns are for the periods ended May 31, 2022. The returns include dividends and interest income based on data supplied by third-party provider RIMES and compiled by T. Rowe Price, except for the Nasdaq Composite Index, whose return is principal only.

Sources: Standard & Poor's, LSE Group, Bloomberg Index Services Limited, MSCI, Credit Suisse, Dow Jones, and J.P. Morgan (see Additional Disclosures).

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