



- **US markets tend to underperform after Fed rate hikes begin** ([link](#))
- **Markets are predicting a very shallow Fed rate hike cycle** ([link](#))
- **Mexico surprises with 50 bps rate hike** ([link](#))
- **Turkey intervenes again in FX market as currency hits new low** ([link](#))
- **Special Feature: Fiscal and Monetary Policy Interactions in US Money Markets** (attached)
- **Special Feature: Corporate Earnings Monitor** (attached)

The GMM is going on its holiday break and will return on January 10th

[Mature Markets](#)

| [Emerging Markets](#)

| [Market Tables](#)

Markets end turbulent week in a bleak mood

US equity futures are lower and European markets are in the red as the omicron variant continues to gain momentum, dashing hopes for an end to the global pandemic. Travel restrictions are being reimposed in Europe and other parts of the world, heightening worries about the potential impact on local economies due to the importance of tourism revenue during the northern hemisphere winter. Meanwhile, a week packed with central bank news delivered more headlines, with the Bank of Japan remaining highly accommodative but Mexico surprising markets with a 50 bps hike to counter inflation and Turkey intervening in the FX for the fifth time as its currency hit yet another all-time low. The Chief Economist of the Bank of England made it clear that more rate hikes are on the horizon. As global markets head into the holidays, prospects for 2022 remain very unclear. Continued uncertainty about the virus, economic challenges and tightening central banks make for an uncertain new year.

Key Global Financial Indicators

Last updated: 12/17/21 7:48 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				
S&P 500		4669	-0.9	0	0	25	24
Eurostoxx 50		4157	-1.1	-1	-6	17	17
Nikkei 225		28546	-1.8	0	-4	7	4
MSCI EM		48	0.1	-3	-6	-5	-6
Yields and Spreads			bps				
US 10y Yield		1.39	-2.0	-9	-20	46	48
Germany 10y Yield		-0.38	-3.3	-4	-14	19	19
EMBIG Sovereign Spread		372	4	10	22	15	22
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		51.3	-0.5	-2	-5	-11	-11
Dollar index, (+) = \$ appreciation		96.1	0.0	0	0	7	7
Brent Crude Oil (\$/barrel)		73.6	-1.9	-2	-8	43	42
VIX Index (% change in pp)		21.5	1.0	3	4	0	-1

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

Mature Markets

[back to top](#)

United States

US markets tend to underperform six months after the first Fed rate hike, based on data compiled by Morgan Stanley going back to 1980. The exception is the US investment grade (IG) bond market. Emerging markets get the biggest boost once the hiking cycle gets underway after underperforming in the months leading into the first hike. The dollar tends to rally into the first hike before weakening afterwards. As can be expected during a rate hike cycle, Treasuries deliver very negative returns.

Asset Returns vs. Average Six Months After First Fed Rate Hike

Source: Morgan Stanley

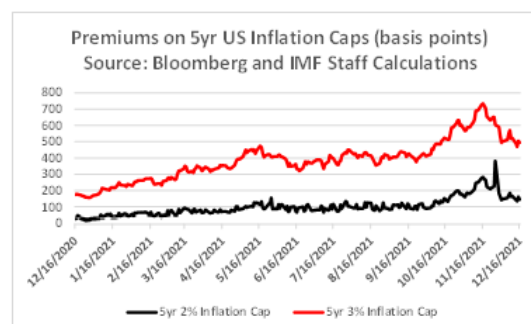
S&P 500	+1.00%
Euro Stoxx 50	+1.30%
MSCI Emerging Markets	+9.60%
Dollar Index DXY	-4.80%
10-year Treasuries	-3.70%
10-year Bunds	-1.7%
US IG (excess return)	+60 bps
EU IG (excess return)	+30 bps

Markets are predicting a shallow path for the upcoming Fed rate hike cycle, in contrast to previous cycles. Even the 2015-2108 cycle looks extreme compared to current market expectations. The eurodollar futures market is pricing in less than 150 bps of hikes and the Fed is expected to be largely done by the end of 2024. Such an outcome presumes that the Fed is able to rein in inflation with just a few rate hikes. Although the US inflation derivatives market has marked down the perceived risk of inflation in recent days, many contacts think the risk is much higher than markets seem to expect. They think the market is too complacent, and that the Fed may have to hike much more aggressively, potentially sparking a market meltdown. On the other hand, if the economy is so weak that the Fed has to end its hiking cycle quickly, the stretched levels of current asset valuations may no longer be justified. The consensus is for a strong recovery that keeps the market rally going, but if that does not occur, markets could face a major reversal as valuations readjust.

Exhibit 7: Rate hikes during the previous rate hiking cycles

Past Fed Hiking Cycles							
Date		Months	Level (%)		Total (bp)	Hikes	
Start	End		Start	End		# of 25bp	Pace (p.a.)
May-83	Aug-84	15	8.50	11.75	325	13	10
Dec-86	Feb-89	26	5.88	9.75	387	15	7
Feb-94	Feb-95	11	3.00	6.00	300	12	13
Jun-99	May-00	10	4.75	6.50	175	7	8
Jun-04	Jun-06	23	1.00	5.25	425	17	9
Dec-15	Dec-18	36	0.25	2.50	225	9	3
Average					306	12	8
Current					0.25	145*	6* 2*

Source: Bloomberg, Morgan Stanley Research. Note: *Based on Eurodollar futures pricing for December 2024.



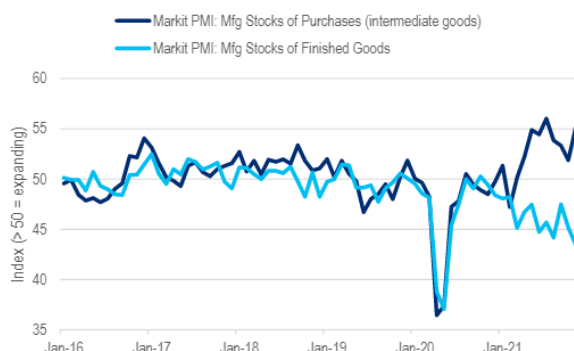
US PMI data highlight the risk of growing inflation, as delivery times have not improved and manufacturers are running down their inventories to meet strong consumer demand. Although December PMIs were slightly lower than forecasts, they remain in strong expansionary territory. The input price index hit a new record high of 77.4. This points to continued problems with the supply chain in the months ahead.

Figure 1. Supplier delivery times are not improving for the large majority of surveyed firms



Source: Citi Research, Markit

Figure 2. Finished goods inventories continue to decline

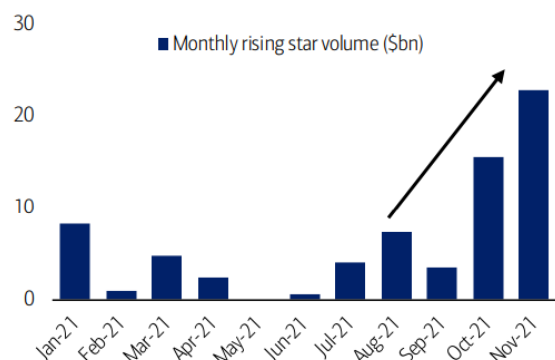


Source: Citi Research, Markit

A wave of upgrades of companies from high yield (HY) to investment grade (IG) has already begun, and Bank of America forecasts that there will be a further \$70 bn over the next 12 months. Companies that are upgraded from HY to IG are known as “rising stars.” Stronger business conditions have led to higher profits and greater reserves of cash, improving the balance sheets of many companies. Despite current worries about the omicron variant, most analysts expect another strong year in 2022 for many US corporations. Credit spreads on many of these companies have tightened in anticipation of these upgrades, and companies that have already been upgraded have seen significant outperformance in terms of credit spreads.

Figure 1: The wave of upgrades to IG has started

The volume of rising stars accelerated to \$23bn in November from \$16bn in October and \$3bn in September.

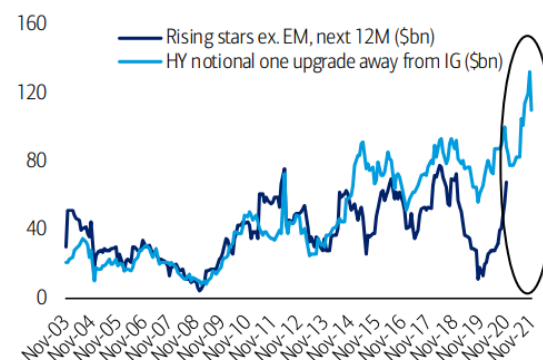


Source: BofA Global Research, ICE Data Indices, LLC

BofA GLOBAL RESEARCH

Figure 2: Our indicator points to \$70bn of rising stars next 12M

Our upgrade indicator increased to \$110bn currently from \$78bn at the start of the year.



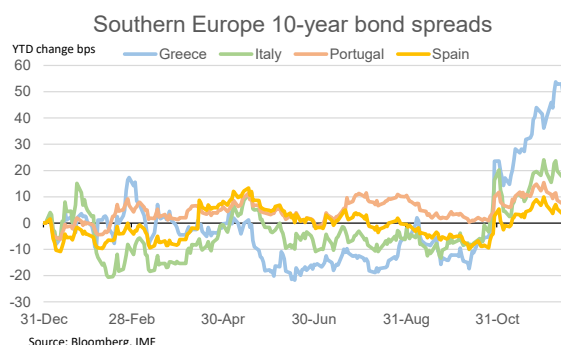
Note: HY notional one upgrade away from IG excludes issuers with a negative rating outlook or watch.

Source: BofA Global Research

BofA GLOBAL RESEARCH

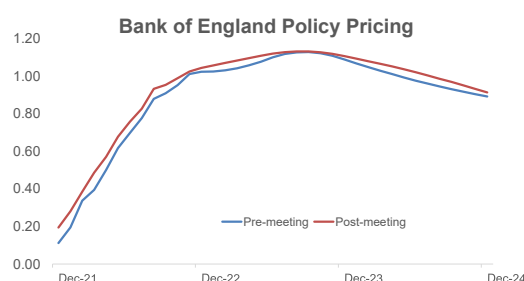
Euro Area

European bond yields were lower by another 1-3 bps this morning. German bunds have reversed all the post-ECB announcement gains while Southern European spreads remain around 4-5 bps wider still. Market pricing for rates tightening is also almost unchanged as compared to pre-ECB with roughly 10 bps priced in for the of 2022 and another 20 bps for 2023. **While many analysts brought forward their rate hike expectation into late 2023 in their post-meeting reviews,** market pricing remains notably more hawkish. On the data front, the **Germany IFO** survey surprised to the downside today as current assessment as well as expectations gauges fell by more than expected with the 4th wave of the pandemic hitting business confidence.



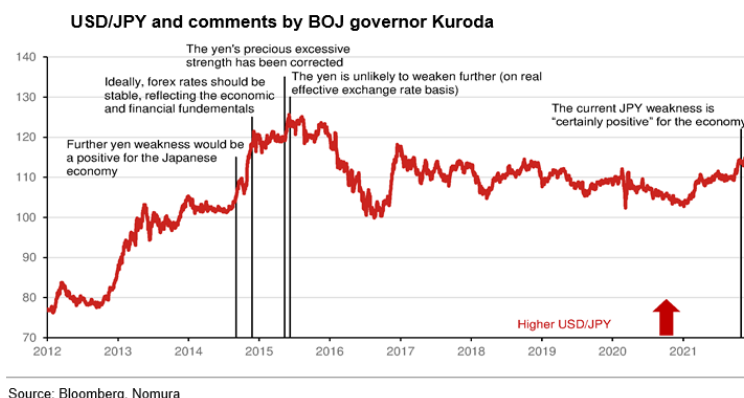
United Kingdom

Bank of England Chief Economist Pill confirmed that further rate hikes are coming, and the central bank is uncomfortable with the current level of inflation and well as accumulating evidence of more domestically generated price pressures. Economist have mostly marked-to-marked their policy rate outlooks with most expecting three 25 bps hikes in 2022. In terms of market pricing, the forwards shifted to reflect a somewhat more front-loaded hiking cycle while cumulative pricing was little changed.



Japan

Bank of Japan (BOJ) prolongs COVID lending aid to small firms. At its final meeting of 2021, the BOJ extended loan assistance program for small businesses for six months to September 2022. Other pandemic support programs will end in March 2022 as scheduled; these include COVID lending aid for large firms and housing loans, and purchases of commercial paper and corporate bonds. Otherwise, key policy parameters were left unchanged (short-term rate: -0.1%, 10-year JGB yield target: 0%). Governor Kuroda said normalization was not in sight for the BOJ. He stated that Japan has no inflation compared with other countries, as companies are reluctant to pass costs to customers, Bloomberg reports. BOJ will gradually reduce holdings of corporate bonds and commercial paper on its balance sheet. It will take about five years to return to pre-COVID level of around ¥5 tn (\$44 bn).



Emerging Markets

[back to top](#)

In EMEA, equities were mixed, while the rand outperformed. Asian equities were lower and currencies were mixed. In **South Korea**, the central bank said it will continue to normalize policy. Governor Lee Ju-Yeol did not rule out an interest rate hike in 1Q 2022 but stressed the decision will be driven by domestic

conditions rather than Fed policy. Most Latin American markets were higher, with Chile leading the way as local polls showed a shrinking lead for the leftist candidate.

China

China raised the quota for domestic investments in offshore assets to a new record.

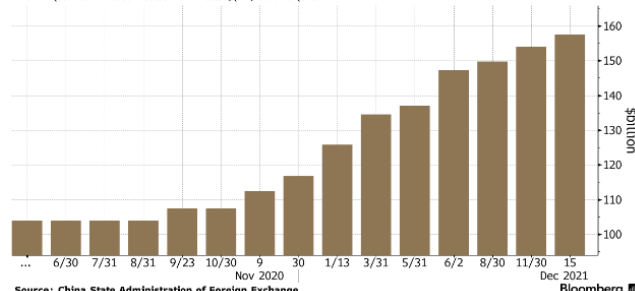
The quota under the Qualified Domestic Institutional Investor (QDII) scheme was increased to a record \$157.5 bn, up by \$3.5 bn from November. Some analysts view the move an effort to cool recent appreciative RMB pressures.

Meanwhile, the property sector remained under pressure. S&P followed Fitch and assigned a “selective default” rating to Evergrande. The move can trigger cross defaults on the developer’s \$19.2bn dollar debt. Guangzhou R&F’s long-term issuer rating was downgraded by Fitch to C from B- and by Moody’s to Caa2. Shimao lost its investment-grade status after Fitch downgraded it to BB from BBB-. Separately, China announced a 1.46 bn yuan (\$230 mn) local government special bond quota for Q1 2022. The move reflects China’s determination to spur growth via public infrastructure investment, according to analysts. Meanwhile, analysts expect the government to target a GDP floor of 5%.

Encouraging Outflows

China grants more quota for onshore investors to buy foreign assets

China Qualified Domestic Institutional Investor (QDII) Scheme Quota



Source: China State Administration of Foreign Exchange

Bloomberg

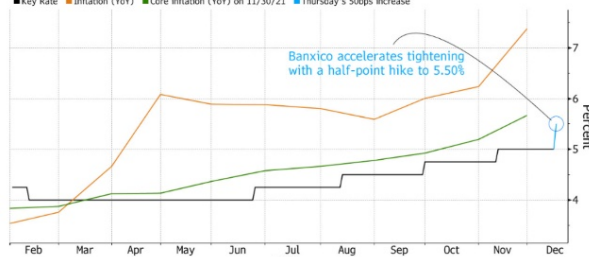
Mexico

Mexico’s central bank surprised the market by raising the key rate by 50 bps to 5.5% on Thursday, the biggest rate hike in nearly five years. Mexico’s annual inflation reached 7.37% in November, a two-decade high. Although lower than Brazil’s, it exceeds the price growth seen in Chile, Peru, and Colombia. The target inflation rate for Banxico is 3%, plus or minus 1 bps. Another reason for the hike was the tighter global financial conditions driven by the Fed and ECB. Banxico’s decision sent the Mexican peso rallying more than 1.1% past its 50-day moving average.

The Last Hike of the Year

Mexico’s central bank raises borrowing costs amid quickening inflation

Key Rate Inflation (YoY) Core Inflation (YoY) on 11/30/21 Thursday’s 50bps increase



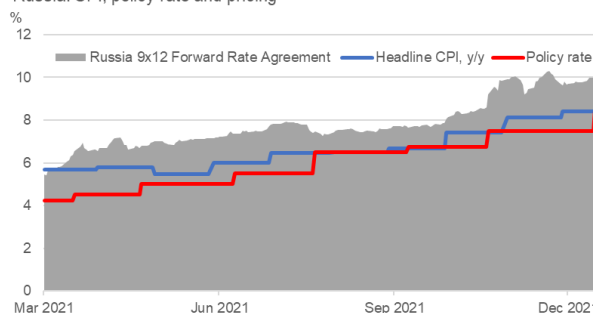
Source: Banco de Mexico, Instituto Nacional de Estadística y Geografía, Bloomberg

Bloomberg

Russia

The Central Bank of Russia increased its policy rate by 100 bps to 8.5% as expected. The CBR also signaled potential further tightening, noting that inflation risks are markedly tilted to the upside. Analysts note that while the rhetoric remained hawkish, the tone was seen as slightly softer given the central bank’s improved view on supply chain disruptions. Contacts note the possibility that the end of the hiking cycle has been reached if inflation continues to show signs of easing. The market continues to price in further hikes in the current cycle, with the start of the rate cutting cycle seen in the second half of 2022.

Russia: CPI, policy rate and pricing

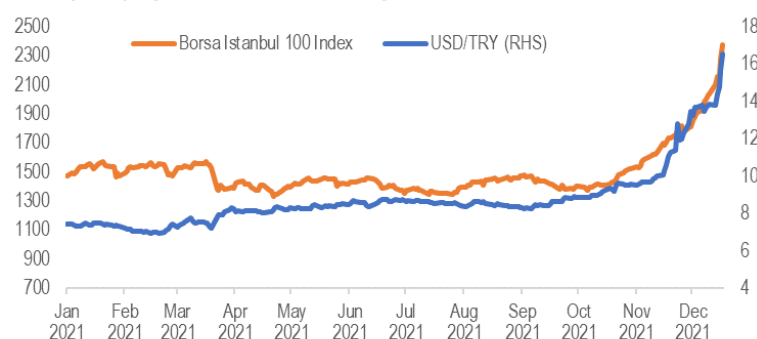


Source: Bloomberg and IMF calculations

Turkey

The Turkish central bank intervened in the FX market for the fifth time this month after the Turkish lira fell to a new record low of 17.13 per dollar this morning. The currency reversed some losses after the intervention to trade at around 16.80. The lira has weakened despite the central bank hinting that the easing cycle has come to an end following yesterday's 100 bps rate cut. In other news, the President announced yesterday that the minimum wage will increase by 50% to address inflation. **Turkey's equity index is up 17% this week**, on course for its best weekly performance since the 2008 financial crisis according to Bloomberg, as investors are reportedly using equities to protect their savings against the lira's depreciation and high levels of inflation. **Analysts at ING expect inflation to maintain its uptrend in the near term, possibly exceeding 30% in the first half of 2022.**

Turkey: Equity market and currency



Source: Bloomberg and IMF calculations

This monitor is prepared under the guidance of Nassira Abbas (Deputy Division Chief), Antonio Garcia-Pascual (Deputy Division Chief) and Evan Papageorgiou (Deputy Division Chief). Fabio Cortes (Senior Economist), Reinout De Bock (Economist-London representative), Sanjay Hazarika (Senior Financial Sector Expert), Henry Hoyle (Financial Sector Expert), Tom Piontek (Financial Sector Expert) and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Sergei Antoshin (Senior Economist), Liumin Chen (Research Assistant), Yingyuan Chen (Financial Sector Expert), Mohamed Diaby (Economist, EP), Dimitris Drakopoulos (Senior Financial Sector Expert), Torsten Ehlers (Senior Financial Sector Expert), Deepali Gautam (Research Officer), Rohit Goel (Financial Sector Expert), Frank Hespeler (Senior Financial Sector Expert), Shoko Ikarashi (Externally Financed Appointee), Phakawa Jeasakul (IMF Resident Representative in Hong Kong SAR), Esti Kemp (London Representative), Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), Dmitry Petrov (Financial Sector Expert), Patrick Schneider (Research Officer), Juan Solé (Senior London Representative), Dmitry Yakovlev (Senior Research Officer), Akihiko Yokoyama (Senior Financial Sector Expert), and Xingmi Zheng (Research Assistant). Javier Chang (Senior Administrative Assistant) and Srujana Sammeta (Staff Assistant) are responsible for word processing and production of this monitor.

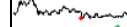

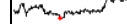
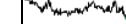


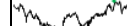



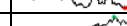
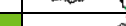




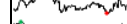





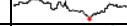
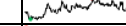

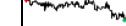

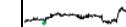
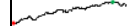
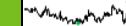


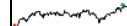





Disclaimer: *This is an internal document produced by the Global Markets Analysis Division (GA) of the Monetary and Capital Markets Department. It reflects GA staff's interpretation and analysis of market views and developments. Market views presented may or may not reflect a consensus of market participants. GA staff do not independently verify the accuracy of all data and events presented in this document.*

Global Financial Indicators

Last updated: 12/17/21 7:50 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities							
			%				%
United States		4669	-0.9	0	0	25	24
Europe		4157	-1.1	-1	-6	17	17
Japan		28546	-1.8	0	-4	7	4
China		4955	-1.6	-2	1	-1	-5
Asia Ex Japan		82	-0.2	-4	-7	-7	-9
Emerging Markets		48	0.1	-3	-6	-5	-6
Interest Rates							
			basis points				
US 10y Yield		1.39	-2.0	-9	-20	46	48
Germany 10y Yield		-0.38	-3.3	-4	-14	19	19
Japan 10y Yield		0.05	0.2	-1	-3	4	3
UK 10y Yield		0.74	-1.6	0	-22	45	54
Credit Spreads							
			basis points				
US Investment Grade		114	-4.6	-4	2	11	19
US High Yield		358	-2.6	-2	19	-42	-22
Europe IG		51	0.3	-2	2	3	3
Europe HY		254	1.6	-6	4	12	12
Exchange Rates							
			%				
USD/Majors		96.08	0.0	0	0	7	7
EUR/USD		1.13	0.0	0	0	-8	-7
USD/JPY		113.3	-0.3	0	-1	10	10
EM/USD		51.3	-0.5	-2	-5	-11	-11
Commodities							
			%				
Brent Crude Oil (\$/barrel)		74	-1.9	-2	-8	43	42
Industrials Metals (index)		166	0.6	2	3	21	25
Agriculture (index)		60	-0.2	0	-3	34	25
Implied Volatility							
			%				
VIX Index (% change in pp)		21.5	1.0	2.8	4.4	-0.4	-1.2
US 10y Swaption Volatility		73.6	1.3	-4.5	-5.0	16.8	13.4
Global FX Volatility		7.5	0.0	-0.5	0.0	-0.6	-0.5
EA Sovereign Spreads							
			10-Year spread vs. Germany (bps)				
Greece		158	1.4	-15	10	42	38
Italy		129	-3.1	-2	7	18	18
Portugal		64	-1.3	-2	0	6	4
Spain		72	-1.5	2	-1	12	10

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

Last updated: 12/17/2021 7:53 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		6.38	-0.1	-0.1	0	2	2		2.9	0.4	-2	-7	-27	-17
Indonesia		14355	0.0	0.1	-1	-2	-2		6.4	-3.2	12	40	47	55
India		76	0.0	-0.4	-2	-3	-4		6.2	3.0	1	-30	73	68
Philippines		50	-0.1	0.7	1	-4	-4		4.6	-2.5	0	-15	160	158
Thailand		33	0.3	0.8	-2	-11	-10		1.9	-8.5	-2	-1	62	62
Malaysia		4.22	-0.3	-0.2	-1	-4	-5		3.5	-2.3	-1	-3	85	90
Argentina		102	-0.1	-0.4	-2	-19	-17		50.8	26.3	109	43	-557	-536
Brazil		5.71	-0.4	-1.8	-3	-11	-9		10.5	10.5	-11	-110	279	314
Chile		848	-0.1	-0.7	-2	-15	-16		5.5	0.0	26	-2	289	295
Colombia		4016	-0.5	-2.8	-3	-15	-15		6.6	0.0	9	-8	243	258
Mexico		20.77	0.3	0.5	-1	-5	-4		7.2	1.0	-11	-30	182	181
Peru		4.0	0.4	1.0	-1	-11	-10		5.9	0.4	2	7	240	241
Uruguay		44	-0.1	-0.6	-1	-4	-5		8.7	0.0	-2	13	135	145
Hungary		325	0.1	-0.4	-1	-11	-9		4.3	-1.5	11	29	273	274
Poland		4.09	0.0	0.0	1	-11	-9		3.1	-3.5	3	5	186	200
Romania		4.4	0.0	0.1	0	-9	-9		4.8	0.3	-25	3	201	208
Russia		73.9	-0.2	-0.6	-2	-1	0		8.8	-1.7	12	3	260	238
South Africa		15.8	0.8	1.1	-2	-7	-7		7.3	-12.2	-22	-22	66	70
Turkey		16.90	-7.3	-17.9	-37	-54	-56		22.7	34.0	130	284	968	981
US (DXY; 5y UST)		96	0.0	0.0	0	7	7		1.14	-2.1	-11	-9	76	78

	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		Last 12m	Latest	7 Days	30 Days	12 M		
								basis points						
China		4955	-1.6	-2	1	-1	-5		206	6	8	-22	-23	
Indonesia		6602	0.1	-1	-2	8	10		172	3	9	-30	-28	
India		57012	-1.5	-3	-4	21	19		133	-3	-3	-20	-18	
Philippines		7298	0.9	1	0	0	2		106	1	4	-12	-6	
Malaysia		1502	1.2	1	-2	-9	-8		117	0	6	-21	-18	
Argentina		82995	2.5	-4	-5	56	62		1697	22	2	326	341	
Brazil		108326	0.8	2	5	-9	-9		329	14	14	68	70	
Chile		4377	-0.3	-1	2	4	5		138	4	10	-21	-18	
Colombia		1408	2.4	1	6	-2	-2		345	21	42	127	130	
Mexico		51384	0.4	0	1	16	17		342	4	11	-41	-15	
Peru		20311	2.1	-1	1	-2	-2		151	3	2	0	22	
Hungary		50497	-0.3	-1	-2	20	20		127	5	18	-21	-22	
Poland		67569	-0.6	-1	-6	20	18		46	5	-3	19	18	
Romania		12400	0.0	-1	-3	28	26		187	4	8	-22	-16	
Russia		3723	-0.7	-1	-10	13	13		178	8	24	-2	-1	
South Africa		71566	0.1	-1	1	20	20		368	8	24	-17	-16	
Turkey		2374	4.1	17	39	70	61		573	38	98	101	126	
Ukraine		523	0.0	0	0	3	5		701	51	131	221	208	
EM total		48	-1.3	-3	-6	-5	-6		392	11	20	47	53	

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

[back to top](#)