GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, FEBRUARY 22, 2021

- **US forward curve predicts first Fed rate hike in 2023** (link)
- **Markets debate future of risk rally** (link)
- **China curbs bank lending to internet trading platforms** (link)
- **Reserve Bank of Australia intervenes to stabilize bond markets** (link)
- **South Africa sees biggest bond outflows since March 2020** (link)
- **Brazil markets lower after the President replaces the head of Petrobras** (link)

US | Europe | Other Mature | Emerging Markets | Market Tables

Rising bond yields challenge global markets

The sharp rise in bond yields from the US to Australia, South Africa, Spain and beyond is building up as a potential challenge to the global rally. Risk asset valuations have benefited from historically low interest rates and remain close to record high levels, but the current rise in rates has exceeded most forecasts and investors are worried that it now threatens to put the rally at risk. Higher rates benefit some sectors such as banks, but previous market leaders such as the technology sector are now under pressure, and their massive market capitalizations have the potential to drag the broader indexes down with them. Continued challenges to the vaccine rollout worldwide present another threat to the Goldilocks narrative that pushed markets to new records through the early part of February. Meanwhile, the US administration is stepping up its efforts to pass the $1.9 tn stimulus package. US equity futures are pointing to a fifth consecutive day of losses. However, commodity prices are continuing their ascent, suggesting that bullish sentiment is still intact.

Key Global Financial Indicators

Last updated: 2/22/21 7:44 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		3907	-0.2	0	2	17	4
Eurostoxx 50		3687	-0.7	-1	2	-3	4
Nikkei 225		30156	0.5	0	5	29	10
MSCI EM		58	0.6	0	3	33	11
Yields and Spreads					bps		
US 10y Yield		1.36	4.6	17	30	-9	47
Germany 10y Yield		-0.31	0.5	8	21	13	27
EMBIG Sovereign Spread		344	-2	4	-14	43	-7
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		57.5	-0.7	-1	0	-3	-1
Dollar index, (+) = $ appreciation		90.3	-0.1	0	0	-9	0
Brent Crude Oil ($/barrel)		63.5	0.9	0	15	9	23
VIX Index (%, change in pp)		24.1	2.1	4	2	7	1

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

The coming week is expected to be quite busy, even as the virus remains front and center and markets keep a wary eye on US Treasury yields. US Treasury Secretary Yellen will speak at a New York Times conference later today, while Fed Chair Powell will deliver his semi-annual addresses to the US Senate and House on Tuesday and Wednesday respectively. EU leaders are scheduled to attend a video summit on Thursday to discuss travel restrictions and vaccine policy. Friday features the meeting of the G-20 Finance Ministers. Central bank meetings for the week include the RBNZ on Wednesday, the Bank of Korea on Thursday and Hungary and Nigeria on Friday. OPEC+ meets on March 4.

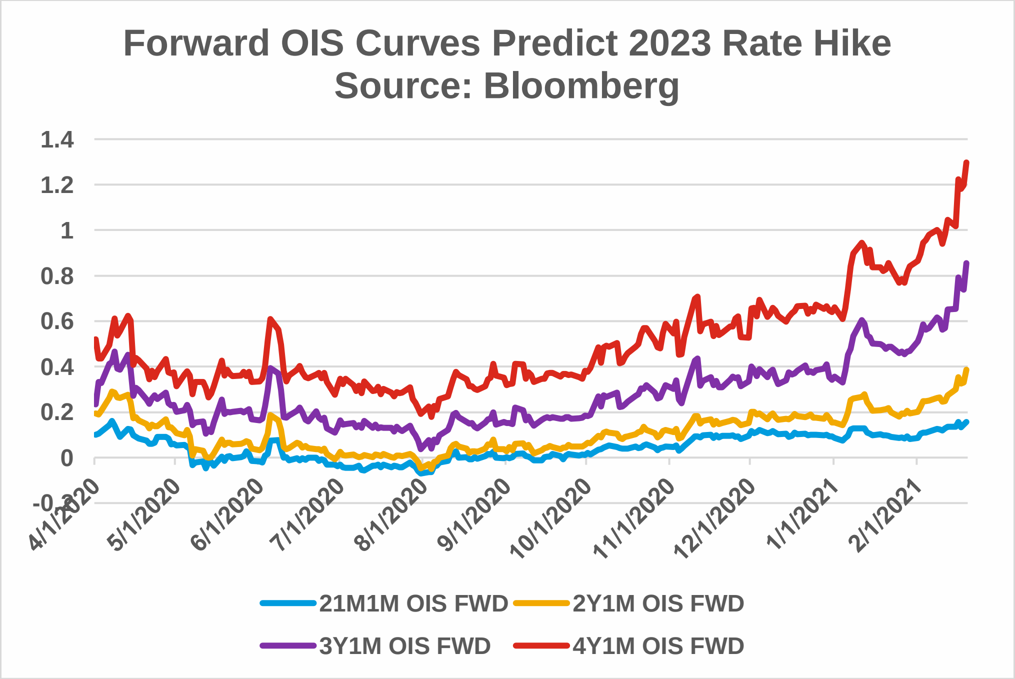
Selected Economic Data for the Week February 22-26

Country	Indicator	Consensus Forecast
US	Core PCE Deflator mom (Fri.)	0.1% mom, 1.4% yoy
Eurozone	CPI (Tue.)	0.2% mon, 0.9% yoy
Eurozone	German GDP (Wed.)	0.1% qoq, -2.9% yoy
Japan	Retail Sales (Thu.)	-1.3% mom, -2.6% you
UK	ILO Unemployment Rate (Tue.)	5.1%
Source: Bloomberg.		

United States

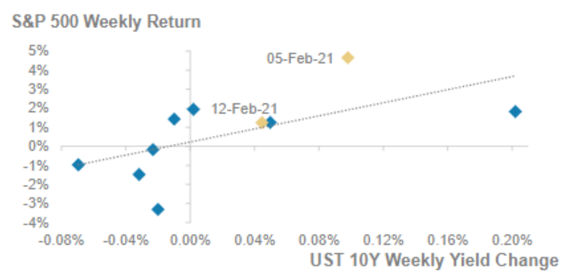
back to top

The forward curves in the US overnight index swap markets are now pricing a Fed rate hike in the first part of 2023. The one-month swap two years forward is trading at 35 bps compared to the spot level of 7 bps on Friday. The equivalent swap four years forward is trading at 125 bps, showing that the market expects nearly five more rate hikes going into the first part of 2025. These levels are at variance with the Fed's own stated expectations, with the dot plot in December showing that the median expectation was for no hikes in 2023. The March 17 FOMC meeting takes on special significance in this context.



The market is debating the implications of another large stimulus package, a rebounding economy, and the prospect of higher inflation on the Fed's future policy actions. Recent public debates between prominent US economists centered around whether the large stimulus will stoke inflation and force the Fed to step in with rate hikes, or whether the package will be absorbed by the economy without significant inflation. If the Fed has to act, the result might be another recession. Market expectations of Fed rate hikes are playing a key role in the market debate. The question takes on special significance amidst this year's rapid increase in Treasury yields, which could derail the global rally in risk assets. However, some analysts remain quite optimistic, predicting that the unique nature of the virus crisis will lead to a stronger than expected rebound in the global economy that will easily take in its stride moderately higher interest rates or even a few rate hikes. They point out that it is quite normal for markets to do well when rates are rising, provided that the economy is doing well.

Exhibit 4: US stock-bond correlation has been negative over the last 10 weeks



Source: Bloomberg, Morgan Stanley Research

Exhibit 5: US stock-bond correlation is negative and has been so over the last 20 years

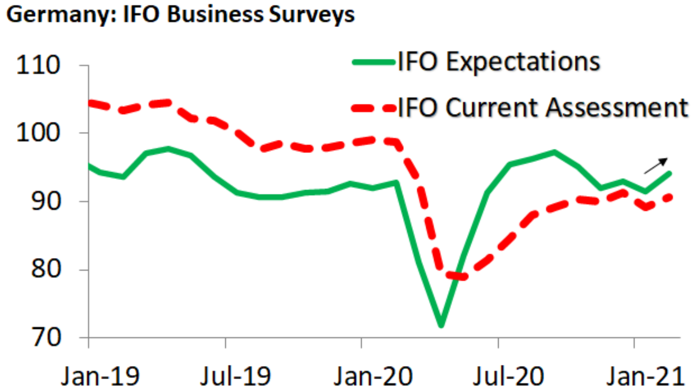
Source: Bloomberg, Morgan Stanley Research; Note: Correlations based on weekly changes.

Europe

back to top

European stocks (-0.8%) and bank stocks (-0.9%) are lower even as the IFO index tracking German business expectations was better than expected at 94.2 (compared to 91.7 expected). Both the current assessment and the expectations component improved, with expectations posting the largest monthly increase since June last year. The improvement was broad-based, led by a gain in manufacturing. **The European cross-over high-yield CDS index, a widely watched measure for financial stress, rose 7 bps today** (to 253 bps).

Germany: IFO Business Surveys

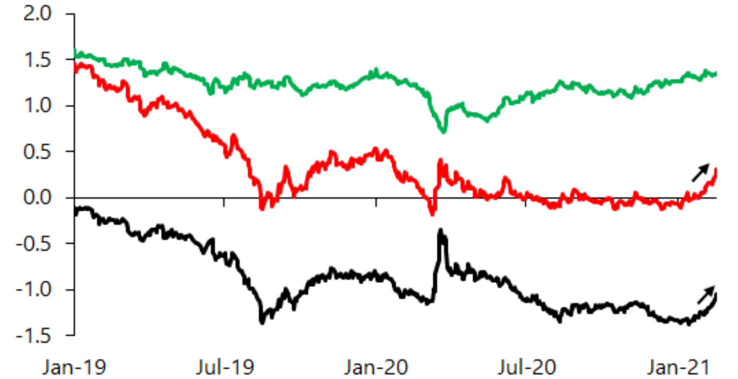


Source: Bloomberg and IMF staff

10-yr bund yields (-1 bps) are little changed today (at -31 bps). The euro (+0.2%) is also little changed. Italian 10-yr spreads are 2 bps higher (at 95 bps) after tightening sharply on Friday. Contacts argue that last week's issuance had put some upward pressure on Italian yields.

Measures for medium-term real rates have increased in the euro area. Market-based measures for euro area inflation expectations such as 5-yr/5-yr inflation swaps are little changed in February but 5yr/5yr nominal rates have increased about 30 bps this month, translating into a similar move higher for the 5yr/5yr real rate.

Euro area: 5yr/5yr inflation and 5yr/5yr interest rate swaps (%)



Source: Bloomberg and IMF staff

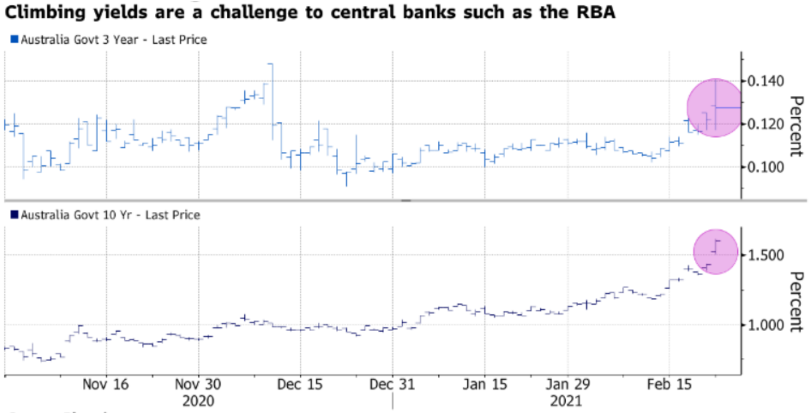
Other Mature Markets

back to top

Australia/New Zealand

Australia's and New Zealand's 10-year bond yields rose +16.9bps and +13bps to 1.6% and 1.64%, respectively, levels last seen during the bond sell-off in March 2020. The Reserve Bank of Australia (RBA) stepped back into the market to purchase AUD1 bn ($790 mn) of the April 2024 three-year bonds following a hiatus of two months. The central bank will now hold 47.1% of the face value of the April 2024 notes, according to Bloomberg. In addition to purchases to control the 3-year bond yield, the RBA also bought AUD2 bn under its regular purchases of longer-dated bonds of its quantitative easing program. **Separately, New Zealand long-term foreign currency debt rating was upgraded by S&P to AA+ from AA.** S&P said that the upgrade was due to New Zealand's quicker recovery than most advanced economies due to its better containment of COVID-19. It also said that the country's credit metrics can withstand negative shocks to the economy, including a weakening of the real estate market and its fiscal position at the AA+ rating level.

Climbing yields are a challenge to central banks such as the RBA



Source: Bloomberg

Emerging Markets

back to top

The negative market tone is weighing on most regional bourses. EMEA equities are down and most currencies are weaker. Asian markets were down for a third consecutive day, losing 1.2% in aggregate, with China's bourses leading the way down. In Latin America, markets were more mixed on Friday, but Brazil is sharply lower this morning after the President replaced the head of the state oil company Petrobras over the weekend due to a dispute over oil prices. Bloomberg reported that contacts viewed this as another turn away from "market friendly policies…to boost his popularity."

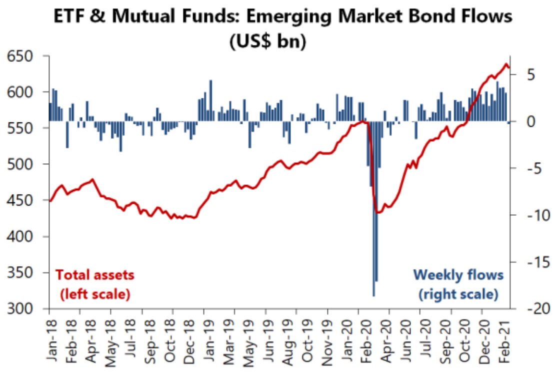
Key Emerging Market Financial Indicators

Last updated:	Level		Change				
2/22/21 7:59 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		**%**
MSCI EM Equities		57.53	-2.6	0	3	33	11
MSCI Frontier Equities		29.60	-0.7	0	0	0	4
EMBIG Sovereign Spread (in bps)		344	-2	4	-14	43	-7
EM FX vs. USD		57.53	-0.8	-1	0	-3	-1
Major EM FX vs. USD				**%, (+) = EM currency appreciation**			
China Renminbi		6.46	-0.1	0	0	9	1
Indonesian Rupiah		14118	-0.4	-1	-1	-2	0
Indian Rupee		72.50	0.2	0	1	-1	1
Argentine Peso		89.15	-0.1	-1	-3	-31	-6
Brazil Real		5.51	-2.2	-2	-1	-20	-6
Mexican Peso		20.74	-1.5	-4	-4	-8	-4
Russian Ruble		74.95	-1.2	-2	0	-13	-1
South African Rand		14.90	-1.4	-3	2	2	-1
Turkish Lira		7.05	-1.2	-1	5	-13	5
EM FX volatility		9.68	0.9	0.1	-0.7	2.8	-1.1

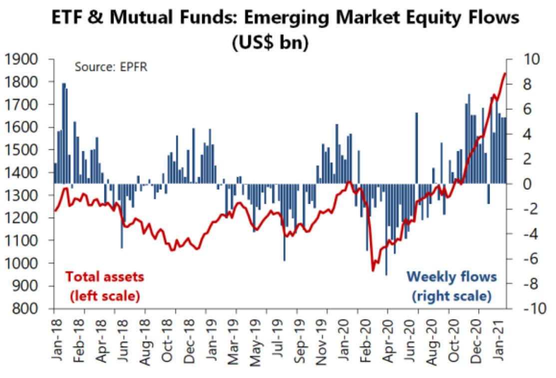
Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

Emerging Market Fund Flows

Last week, emerging market bond flows were slightly negative, while equity inflows remained solid. Total bond inflows during 2021 is now at \$19.6 bn. Equity flows were positive (\$5.3 bn) for the 6th consecutive week. Cumulative equity inflows since the beginning of the year hit \$32.8 bn.



Source: EPFR



Source: EPFR

China

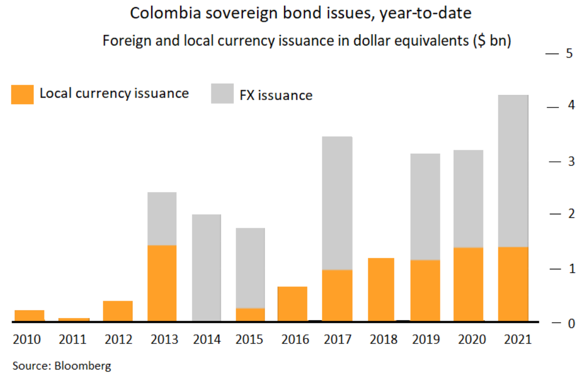
Equities (Shanghai -1.5%; Shenzhen -2.1%) fell, dragged lower by consumer staples. China said that it is ready to reopen constructive dialogue with the US. Chinese Foreign Minister Wang Yi also mentioned the need to remove 'unreasonable tariffs', 'abandon irrational suppression of China's technological progress' and noted curbs on Chinese media and students as another issue, according to various media reports. **The People's Bank of China (PBOC) meanwhile kept the one-year and five-year Loan Prime**

Rate unchanged at 3.85% and 4.65%, respectively, as expected. The RMB (onshore -0.2%; offshore -0.3%) weakened while 10-year bond yield was little changed.

Chinese regulators announced new rules, curbing banks' joint lending with internet platforms or other partners. Banks are to cap overall co-lending with such partners at no more than 50% of outstanding loans, according to the China Banking and Insurance Regulatory Commission (CBIRC). Co-lending with one platform should not exceed 25% of the bank's tier-1 net capital. An internet platform will be required to provide at least 30% of the funding in any single joint loan with a bank, starting from January 1, 2022. The latest rules would also apply to foreign banks, trust firms, consumer finance and auto finance companies.

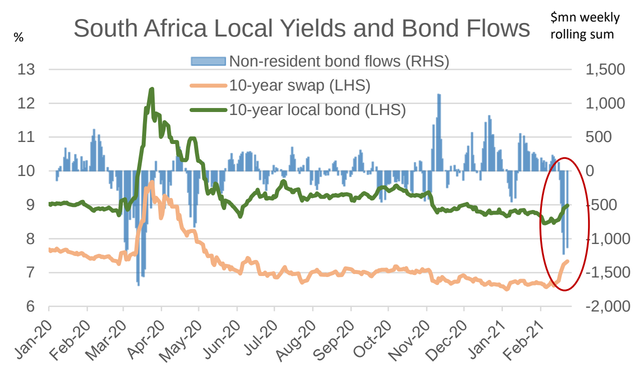
Colombia

Colombia sold bonds worth $4.2 bn in 2021 as of February 18, based on Bloomberg calculations. Issuance was about 30% higher relative to the same period. The dollar value of the peso bond sales was around $1.4 bn, close to the issuance in the same period of 2020. However, foreign-currency issuance was around $2.8 bn, around $1 bn higher than the same period in 2020.



South Africa

The local bond market saw the biggest weekly non-resident outflows since March 2020. Last week, non-resident investors sold $1.2bn of local government bonds, with domestic banks and local real money investors absorbing the outflows ahead of the budget review on 24th of February. In contrast to the sell-off at the onset of the pandemic, **the pressure is originating from the interest rate swap markets with multiple contacts reporting hedge fund activity**. The primary driver for client interest is the increase in global yields. However, due to absent liquidity in the swap market, international dealers are hedging their exposure by selling local bonds with both bond and swap curves steepening in consequence. The 10-year swap rate increased by 65 bps whereas 10-year local bond yield by 45 bps. Contacts point out that **investors are generally expecting positive news from the budget, with reduced bond supply in the coming quarters.** However, a disappointing budget is likely to cause further significant volatility in the current environment.



List of GMM Contributors

Global Markets Analysis Division, MCM Department

Nassira Abbas
Deputy Division Chief

Antonio Garcia-Pascual
Deputy Division Chief

Evan Papageorgiou
Deputy Division Chief

Jose Abad
Financial Sector Expert

Sergei Antoshin
Senior Economist

John Caparusso
Senior Financial Sector Expert

Yingyuan Chen
Financial Sector Expert

Han Teng Chua
Economic Analyst

Fabio Cortés
Senior Economist

Reinout De Bock
Economist

Dimitris Drakopoulos
Financial Sector Expert

Deepali Gautam
Research Officer

Rohit Goel
Financial Sector Expert

Sanjay Hazarika
Senior Financial Sector Expert

Frank Hespeler
Senior Financial Sector Expert

Henry Hoyle
Financial Sector Expert

Mohamed Jaber
Senior Financial Sector Expert

Phakawa Jeasakul
Senior Economist

Sonia Meskin
Financial Sector Expert

Natalia Novikova
IMF Resident Representative in Singapore

Dmitri Petrov
Financial Sector Expert

Thomas Piontek
Financial Sector Expert

Patrick Schneider
Research Officer

Can Sever
Economist

Juan Solé
Senior Economist

Jeffrey Williams
Senior Financial Sector Expert

Dmitry Yakovlev
Senior Research Officer

Akihiko Yokoyama
Senior Financial Sector Expert

Xingmi Zheng
Research Assistant

Global Financial Indicators

Last updated: 2/22/21 7:46 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		3907	-0.2	0	2	17	4
Europe		3686	-0.7	-1	2	-3	4
Japan		30156	0.5	0	5	29	10
China		3642	-1.5	3	1	20	5
Asia Ex Japan		101	0.8	0	3	42	13
Emerging Markets		58	0.6	0	3	33	11
Interest Rates					basis points		
US 10y Yield		1.38	3.9	17	29	-10	46
Germany 10y Yield		-0.30	0.2	8	21	13	27
Japan 10y Yield		0.13	1.6	4	8	18	10
UK 10y Yield		0.72	2.2	15	41	15	52
Credit Spreads					basis points		
US Investment Grade		86	0.3	-2	-7	-20	-9
US High Yield		345	-2.0	-2	-25	-69	-34
Europe IG		49	1.2	2	0	1	1
Europe HY		253	6.1	15	-1	12	12
EMBIG Sovereign Spread		344	-1.8	4	-14	43	-7
Exchange Rates					%		
USD/Majors		90.26	-0.1	0	0	-9	0
EUR/USD		1.21	0.1	0	0	12	-1
USD/JPY		105.6	0.1	0	2	-5	2
EM/USD		57.5	-0.7	-1	0	-3	-1
Commodities					%		
Brent Crude Oil ($/barrel)		64	1.0	0	15	9	23
Industrials Metals (index)		149	0.9	5	9	41	12
Agriculture (index)		52	0.1	2	6	30	7
Implied Volatility					%		
VIX Index (%, change in pp)		24.2	2.1	4.2	2.3	7.1	1.4
US 10y Swaption Volatility		77.3	-3.0	16.3	22.8	-6.4	17.2
Global FX Volatility		7.4	0.1	0.2	-0.3	1.5	-0.7
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		123	3.2	7	1	-16	3
Italy		96	3.1	5	-30	-38	-15
Portugal		56	0.3	3	-2	-11	-4
Spain		67	0.8	3	3	1	5

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

back to top

Emerging Market Financial Indicators