



- **ECB in spotlight amid verbal intervention and scrutiny of QE purchases** ([link](#))
- **US bond market investors seek inflation protection** ([link](#))
- **Equity premium at 19-month low relative to Treasuries** ([link](#))
- **Markets predict policy tightening in major emerging markets** ([link](#))
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Global markets remain cautious

The major European indexes are mostly in the red and US equity futures are pointing to a fifth consecutive decline as technology stocks continue to lead the broader markets lower. Caution prevails as Treasury and bund yields remain elevated, while investors debate whether the recent interest rate increases are justified by the recovery or whether they pose a threat to further market gains. However, the recent losses mask sector rotations that have more positive implications. Higher rates have benefited bank stocks, while energy companies have enjoyed a major boost as commodities continue their dramatic rebound this year on hopes that the global economy will continue to improve. Meanwhile, the ECB is in the spotlight a day after President Lagarde's verbal intervention to stabilize the bond market as investors wait to see if her words are followed up by ECB bond purchases. Markets are pricing rate hikes in several major emerging markets even as bonds in areas such as Eastern Europe are under growing pressure.

Key Global Financial Indicators

Last updated: 2/23/21 7:55 AM	Level		Change from Market Close				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		3877	-0.8	-1	1	16	3
Eurostoxx 50		3675	-0.7	-1	2	-3	3
Nikkei 225		30156	0.5	0	5	29	10
MSCI EM		56	-2.9	-3	0	29	8
Yields and Spreads			bps				
US 10y Yield		1.36	-0.2	5	28	-11	45
Germany 10y Yield		-0.30	3.6	5	21	13	27
EMBIG Sovereign Spread		349	5	9	-6	42	-2
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		57.8	-0.1	0	1	-2	0
Dollar index, (+) = \$ appreciation		90.1	0.1	0	0	-9	0
Brent Crude Oil (\$/barrel)		65.6	0.6	4	18	12	27
VIX Index (% change in pp)		24.8	1.4	3	3	8	2

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

United States

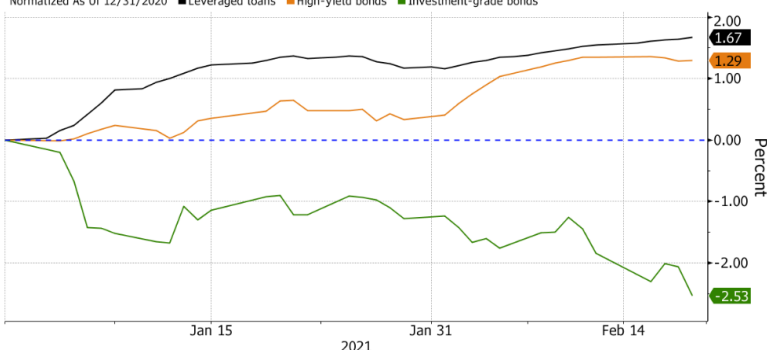
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Investors seeking protection from inflation risk are buying bonds that will outperform in rising rate environments. So far in 2021, high yield (HY, “junk bonds”) and leveraged loans have done much better than investment grade (IG) corporate bonds, as the latter are expected to do worse if interest rates rise sharply in the face of growing inflationary pressures. HY bonds have higher coupons than IG bonds, making them less vulnerable to interest rate increases as higher coupon bonds have lower modified durations (price sensitivity to interest rates) than lower coupon bonds. Leveraged loans have also done better because they have floating rate coupons that move higher over time as rates go up. Inflation hedging has also spurred inflows to Treasury Inflation Protected Securities (TIPS).

Diverging Fates

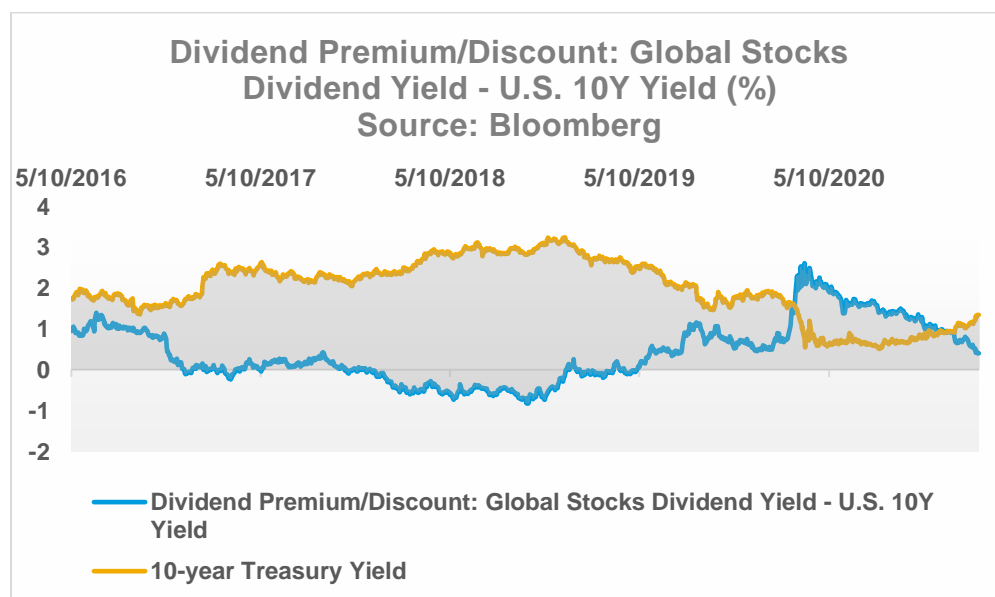
Leveraged loan, junk-bond returns trounce high-grade debt to start 2021

Normalized As Of 12/31/2020 ■ Leveraged loans ■ High-yield bonds ■ Investment-grade bonds



Source: S&P/LSTA, Bloomberg Barclays indices

The shift upwards in Treasury yields has made Treasury valuations more attractive relative to stocks. The spread between the dividend yield on global stocks and the 10-year Treasury yield has narrowed to its lowest point in 19 months, indicating that the yield advantage of owning stocks rather than Treasuries has shrunk significantly. Some analysts think investors will swoop in to buy Treasuries at these levels, limiting the potential for further yield increases. Other disagree, arguing that the ongoing economic rebound and potential for higher inflation justifies even higher levels for Treasury yields.



Investors are worried by the significant steepening in yield curves, fearful that they could be early warnings to a breakout to much higher levels of interest rates. However, the latest episode of Treasury curve steepening remains moderate by historical standards. While it is true that portions of the yield curve have steepened to multi-year highs, the pace of the move has been relatively slow. The Treasury 2/5/10 butterfly trade, a key vehicle for curve steepening trades involving selling two-year and ten-year Treasuries while buying twice the number of five-year Treasuries, has moved just 38 bps since the Treasury selloff began on January 4th. With the economy rebounding, markets fear a repeat of the Taper Tantrum of 2013, when then-Fed Chair Bernanke delivered a shock to markets by discussing tapering or slowing the purchases of Treasuries and mortgage-backed securities. This led to a rapid increase in Treasury yields that inflicted heavy losses on investors. However, current Fed Chair Powell described any talk of tapering as “premature” at the January 27 FOMC press conference.

The Largest Episodes of Curve Steepening Since the GFC: The 2/5/10 Treasury Butterfly

Start	Finish	Cheapening
September 9, 2008	October 15, 2008 (Lehman/AIG)	137 bps
November 4, 2010	December 20, 2010	123 bps
May 1, 2013	July 5, 2013 (Taper Tantrum)	114 bps
March 18, 2009	May 27, 2009	114 bps
January 4, 2021	February 22, 2021	38 bps
Source: Bloomberg.		

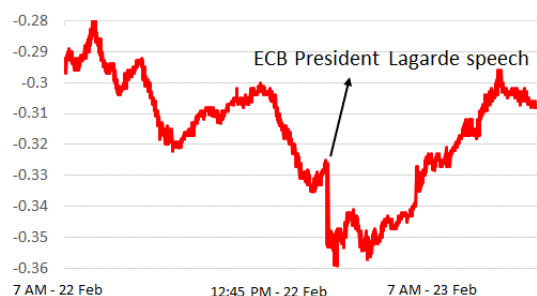
Europe

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Euro area

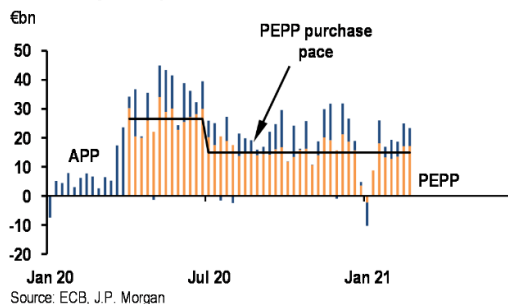
10-yr bund yields (+3 bps -0.31%) traded higher after closing lower in response to verbal intervention by the ECB President yesterday. ECB president Lagarde said that the ECB is looking at a broad set of indicators to assess whether financing conditions are still favorable, and that risk-free OIS rates and sovereign yields play a particularly important role in this. She also added that “the ECB is closely monitoring the evolution of longer-term nominal bond yields.” **Contacts see the ECB President’s comments as a first attempt at verbal intervention to contain further increases in long-term yields, but some believe that the ECB will have to step up its weekly QE purchases to be successful.** The euro is little changed today at \$1.22.

Germany: 10-yr bund yield on Mon 22 Feb and Tue 23 Feb
(%, tick data)



Note: GMT time
Source: Bloomberg and IMF staff

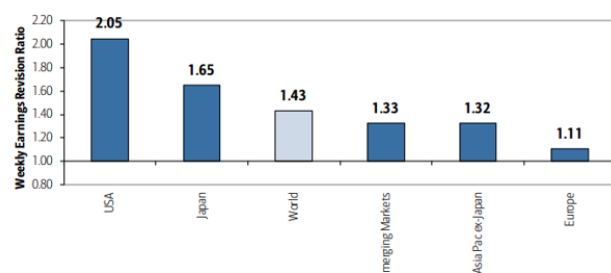
ECB weekly asset purchases



Investors will closely follow weekly QE purchases to gauge the ECB's willingness to respond to changes in long-term yields. Most recent ECB purchase data shows PEPP purchases of € 17.2bn for the week spanning February 11-17 (from €17.1bn the week prior), taking total QE purchases to €22.5 bn (from €22.9bn the week prior). Note that these data do not include purchases last Thursday and Friday when core rates were increasing.

European equities (-1.2%) are weaker. Analysts at Bank of America write that the Global Earnings Revision Ratio rose to its highest weekly reading in the last 11 years (to 1.43 from 1.390, but European earnings have been lagging. The European cross-over high-yield CDS index, a widely watched measure for financial stress, rose 4 bps today (to 255 bps).

Equities: Weekly Earnings Revision Ratio



Note: Earnings ratio is calculated as the number of earnings estimates up minus the number of estimates down, expressed as a percentage of total number of earnings.
Source: MSCI, BofA

Other Mature Markets

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Japan

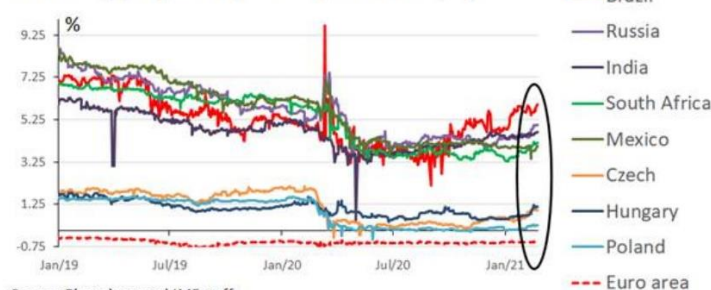
Japanese markets were closed for a holiday.

Emerging Markets

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EMEA markets are mostly lower, while Asian equities rose +0.5% on net, erasing earlier losses. Thailand outperformed (+1.5%) as the government considers scrapping mandatory quarantine rule for vaccinated foreign tourists to revive tourism. Vietnam's central bank announced it had cut the frequency of its foreign exchange interventions to allow the Vietnamese dong to move with the market. **In Latin America,** all eyes are on Brazil today to see how its market performs after Monday's selloff in the wake of President Bolsonaro's replacement of the head of Petrobras. The Chilean peso leads regional peers as its vaccination drive pulls ahead. **Meanwhile, traders have priced in about 30-50 bps of future policy rate tightening in several economies** (such as South Africa, Russia, Hungary, and Brazil) this month. The pick-up reflects concerns about inflation surprises as oil prices (+0.7%) continue to head higher.

EM: Monetary policy rates a year ahead (from forwards, %)



Source: Bloomberg and IMF staff

Key Emerging Market Financial Indicators

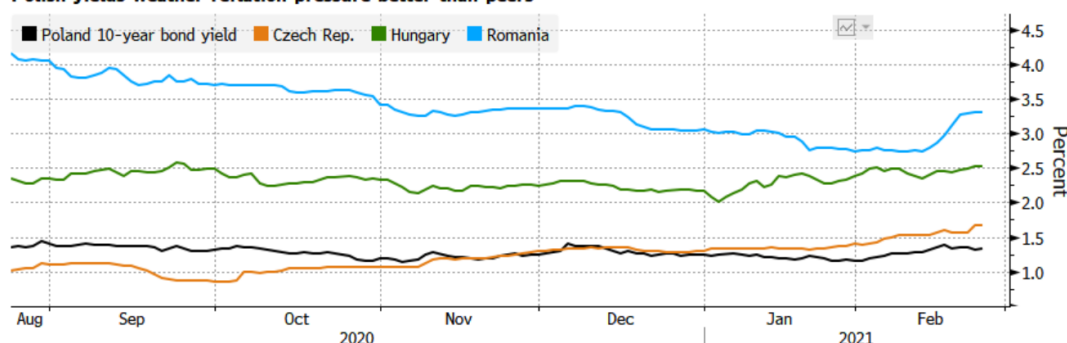
Last updated: 2/23/21 7:58 AM	Level		Change				YTD
	Last 12m	index	1 Day	7 Days	30 Days	12 M	
Major EM Benchmarks			%				%
MSCI EM Equities		55.84	-1.1	-3	0	29	8
MSCI Frontier Equities		29.29	-1.0	-1	-1	-1	3
EMBIG Sovereign Spread (in bps)		349	5	9	-6	42	-2
EM FX vs. USD		57.79	-0.1	0	1	-2	0
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.46	0.0	0	0	9	1
Indonesian Rupiah		14093	0.2	-1	0	-2	0
Indian Rupee		72.47	0.1	0	1	-1	1
Argentina Peso		89.44	-0.3	-1	-3	-31	-6
Brazil Real		5.45	0.2	-1	0	-19	-5
Mexican Peso		20.71	0.1	-3	-3	-8	-4
Russian Ruble		73.94	0.5	0	2	-12	0
South African Rand		14.68	0.0	0	4	3	0
Turkish Lira		7.05	-0.4	-1	5	-13	6
EM FX volatility		10.02	0.0	0.4	-0.3	3.1	-0.7

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

Eastern European Bond Markets

Investor demand declines in primary bond auctions amid increase in local bond yields. The bid-to-cover ratios in local government bond actions have fallen in Hungary, Czech Republic, and Poland whereas Romania had to cancel yesterday's bond placement due to insufficient demand. **Yields of local government bonds have increased, mostly in line with German bonds in February (20-30 bps for 10-year notes) except for Romania, where 10-year local bond yields jumped by 55 bps.** Contacts point out that aside from global yield curve dynamics, rising domestic inflation accompanied by shifting monetary policy expectations have reduced investor appetite. Romania and Czech Republic have also increased bond supply over the last few weeks. Poland stands out as more resilient as the government has prefinanced more than 50% of its 2021 borrowing needs while market participants also continue to expect support from the National Bank of Poland through its asset purchase program.

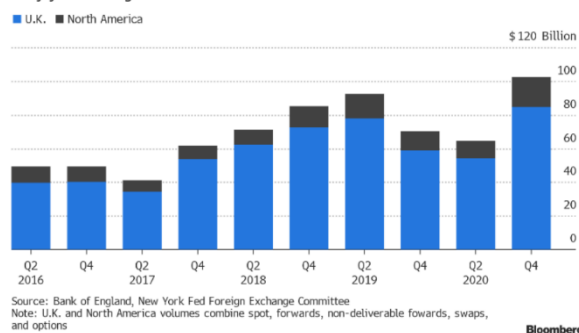
Polish yields weather deflation pressure better than peers



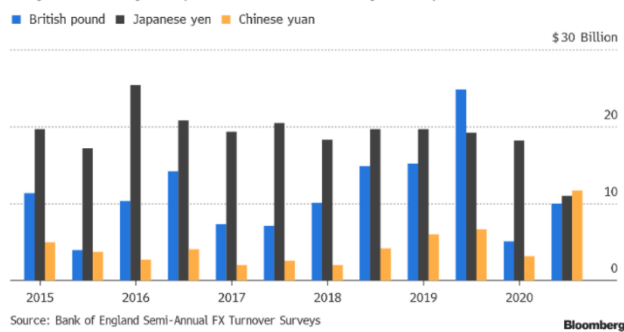
China

Trading activity in the RMB is rising. Turnover of daily yuan trading hit a fresh record high of around \$100 bn in 2020Q4 in the UK and North America, according to Bloomberg. In London, the daily turnover of the Chinese currency has increased across different contract types – spot, non-deliverable forwards, outright forwards, swaps, and options, reaching a record high of \$84.5 bn in October 2020. This represented an increase of 43% yoy. Options on the RMB in London, for example, exceeded the yen and the pound for the first time.

Daily yuan trading turnover hits fresh record in offshore centers



Daily turnover of yuan options in London exceeds yen and pound for first time



Kenya

Moody's (B2) sees the IMF support programs as credit positive. The agency expects the program to reduce liquidity risks and support government fiscal consolidation efforts. At the same time, implementation risks were cited as an ongoing concern. Sell-side analysts have broadly adopted a similar view with progress towards fiscal consolidation to be closely monitored in the coming months. Kenya's external bond spreads remain close to pre-pandemic levels.



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Global Financial Indicators

Last updated: 2/23/21 7:56 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities							
			%				%
United States		3877	-0.8	-1	1	16	3
Europe		3676	-0.7	-1	2	-3	3
Japan		30156	0.5	0	5	29	10
China		3636	-0.2	1	1	20	5
Asia Ex Japan		98	-2.9	-3	0	38	10
Emerging Markets		56	-2.9	-3	0	29	8
Interest Rates							
			basis points				
US 10y Yield		1.36	-0.2	5	28	-11	45
Germany 10y Yield		-0.30	3.6	5	21	13	27
Japan 10y Yield		0.13	0.0	4	8	18	10
UK 10y Yield		0.71	3.3	9	40	14	52
Credit Spreads							
			basis points				
US Investment Grade		88	2.2	0	-6	-22	-7
US High Yield		346	0.8	-1	-24	-78	-34
Europe IG		49	0.8	2	-1	1	1
Europe HY		255	4.5	12	-9	14	13
EMBIG Sovereign Spread		349	5.1	9	-6	42	-2
Exchange Rates							
			%				
USD/Majors		90.15	0.2	0	0	-9	0
EUR/USD		1.21	-0.1	0	0	12	-1
USD/JPY		105.3	0.2	-1	1	-5	2
EMUSD		57.8	-0.1	0	1	-2	0
Commodities							
			%				
Brent Crude Oil (\$/barrel)		66	0.5	4	18	12	27
Industrials Metals (index)		149	-0.5	5	9	40	12
Agriculture (index)		53	0.5	2	9	33	10
Implied Volatility							
			%				
VIX Index (% change in pp)		24.8	1.4	3.4	2.9	7.8	2.1
US 10y Swaption Volatility		79.3	0.6	5.9	24.0	-4.4	19.2
Global FX Volatility		7.6	0.0	0.3	-0.1	1.7	-0.5
EA Sovereign Spreads							
			10-Year spread vs. Germany (bps)				
Greece		122	-0.3	10	1	-17	2
Italy		97	3.0	5	-30	-38	-15
Portugal		57	1.0	3	-1	-10	-3
Spain		68	1.3	4	4	2	6

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

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Emerging Market Financial Indicators

Last updated: 2/23/2021 7:59 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		6.46	0.0	-0.1	0	9	1		3.4	-0.6	3	11	44	9
Indonesia		14093	0.2	-1.2	0	-2	0		6.7	14.8	41	33	3	59
India		72	0.1	0.3	1	-1	1		6.4	7.5	13	35	-19	46
Philippines		49	0.1	-0.9	-1	5	-1		3.5	0.6	-2	-15	-69	-17
Thailand		30	-0.1	-0.2	0	5	0		1.7	13.0	19	32	47	38
Malaysia		4.04	0.0	-0.4	0	5	-1		2.9	2.0	14	33	-1	36
Argentina		89	-0.3	-1.0	-3	-31	-6		42.5	2.6	-219	-911	-1088	-1361
Brazil		5.45	0.2	-1.3	0	-19	-5		6.9	21.0	40	28	108	134
Chile		707	0.1	1.6	4	14	0		3.0	8.1	23	21	-71	24
Colombia		3594	-0.7	-2.9	-2	-5	-5		5.4	13.7	27	31	-10	32
Mexico		20.71	0.1	-2.7	-3	-8	-4		6.0	8.7	40	40	-58	45
Peru		3.7	0.0	-0.2	0	-7	-1		4.2	7.8	34	36	-2	57
Uruguay		43	-0.2	-0.7	-2	-11	-2		7.0	-0.8	-8	-23	-258	-26
Hungary		296	-0.1	0.3	0	5	0		1.8	1.6	9	26	24	30
Poland		3.71	-0.3	0.1	1	7	1		0.7	-2.9	-3	14	-110	9
Romania		4.0	-0.2	0.2	0	10	-1		2.7	4.0	29	30	-85	-9
Russia		73.9	0.6	-0.4	2	-12	0		6.3	0.0	12	36	58	63
South Africa		14.7	-0.1	-0.2	4	3	0		9.9	7.3	42	20	49	21
Turkey		7.05	-0.4	-0.9	5	-13	6		13.3	2.3	3	-8	163	21
US (DXY; 5y UST)		90	0.2	-0.4	0	-9	0		0.59	-1.1	1	16	-74	23

	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	YTD	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
								basis points						
China		5580	-0.3	-2	0	34	7		199	0	-2	-9	30	-9
Indonesia		6273	0.3	0	-1	7	5		158	0	-9	-25	-5	-29
India		49751	0.0	-5	2	21	4		152	0	-3	-3	21	1
Philippines		6815	0.1	-3	-3	-8	-5		83	0	-9	-17	13	-22
Malaysia		1565	-0.3	-3	-2	2	-4		113	0	-2	-3	9	3
Argentina		49268	-3.4	-5	2	28	-4		1459	0	19	8	-570	91
Brazil		112668	-4.9	-6	-4	-1	-5		253	0	0	-16	58	3
Chile		4541	-1.2	-2	1	0	9		126	0	-6	-16	-14	-18
Colombia		1352	0.0	-1	-5	-17	-6		207	0	-4	-15	44	2
Mexico		44947	0.1	2	1	0	2		348	0	-9	-34	55	-12
Peru		23180	1.7	4	8	18	11		133	0	-4	-3	22	1
Hungary		42987	-1.0	-4	-1	-6	2		65	0	-6	-15	-42	-31
Poland		57292	-1.5	-4	0	0	0		-22	0	-4	-11	-54	-21
Romania		10238	-0.2	-3	-1	1	4		196	4	9	-6	20	-7
Russia		3434	0.0	-2	2	11	4		159	0	-5	-3	19	-7
South Africa		66392	-1.4	-1	4	16	12		357	0	-4	-35	25	-23
Turkey		1528	-1.4	-1	-1	31	3		421	0	-5	-47	34	-24
Ukraine		521	0.0	0	4	-1	4		479	0	12	-21	127	-12
EM total		56	-1.1	-3	0	29	8		421	0	17	-10	97	128

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