GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

THURSDAY, FEBRUARY 25, 2021

- **Rates volatility has surged higher, leaving credit spreads exposed** (link)
- **Brainard delivers dovish comments on full employment framework** (link)
- **Gilt yields continue to rise ahead of budget announcement** (link)
- **Reserve Bank of Australia buys more three-year bonds, second time this week** (link)
- **Markets welcome South Africa's budget projection** (link)

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Yields march higher as commodity prices continue to surge

Sovereign bond yields continue to push higher this morning, with the 10-yr treasury rate reaching a new 1 year high and the Bund 10-yr up 5 bps. Increasing optimism on the global recovery has also driven many commodity prices toward record levels. Aluminum is at a new 2-year high, iron ore is at its highest level in at least 5 years, copper is approaching a new record and Brent crude is over $67 per barrel for the first time since last January. Positive vaccine developments and signals of continued monetary accommodation are driving higher growth and inflation outlooks. Equity markets are little changed overall this morning; however, US tech stocks appear weaker with futures on the Nasdaq 100 almost 1% lower. Emerging market currencies are mixed this morning but with some notable underperformers, as the South African rand and Mexican peso are down about 2% and 1.5% respectively versus the dollar.

Key Global Financial Indicators

Last updated: 2/25/21 8:14 AM	Level: Last 12m	Level: Latest	Change from Market Close: 1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		3925	1.1	0	2	25	5
Eurostoxx 50		3704	-0.1	1	4	4	4
Nikkei 225		30168	1.7	0	5	33	10
MSCI EM		56	-0.6	-4	-1	35	8
Yields and Spreads					bps		
US 10y Yield		1.45	7.5	16	42	10	54
Germany 10y Yield		-0.26	4.9	9	30	26	31
EMBIG Sovereign Spread		348	-3	2	-7	30	-2
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		57.7	-0.6	0	1	-2	0
Dollar index, (+) = $ appreciation		89.7	-0.5	-1	-1	-9	0
Brent Crude Oil ($/barrel)		67.2	0.2	5	20	22	30
VIX Index (%, change in pp)		22.7	1.4	0	0	-5	0

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

United States

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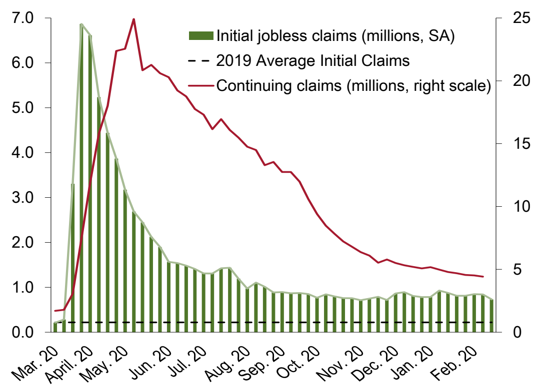
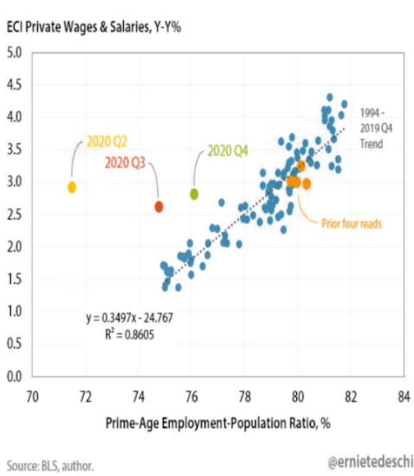
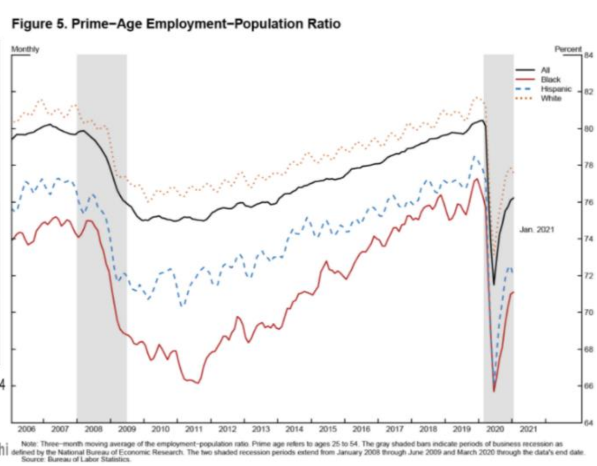
US equities rallied as the Treasury sell off continued. The S&P 500 gained 1.1% as tech stocks bounced back after a tough 2 week stretch, with equities bolstered by comments from several Fed officials pushing an aggressive stance on continued accommodation. The Nasdaq gained 0.9%, while the Russell 2000 was up over 2%. Treasury yields continued to march higher, with the 10-year and 30-year up 3 and 5 bps respectively, amid reports of renewed corporate hedging. The 10-year finished the day at 1.38%, the highest since February 2020.

Initial jobless claims beat expectations at 730k (vs 825k expected), down from 861k last week. Continuing claims were in line with consensus at 4.4 mn (vs 4.5 mn expected). **Durable goods orders crushed expectations for January** at 3.4% m/m (vs 1.1% expected).



Governor Brainard delivered dovish comments on the Fed's new, more comprehensive, full employment framework. Investors had been seeking more clarity on how the Fed would approach its new employment framework, with the Federal Reserve now seeking to minimize "*shortfalls* of employment from its maximum level", in contrast to previous policy that sought "to minimize *deviations* when employment is too high as well as too low". Brainard highlighted the importance of a more inclusive recovery and aggressive stance, noting that "removing accommodation preemptively as headline unemployment reaches low levels in anticipation of inflationary pressures that may not materialize may result in an unwarranted loss of opportunity for many Americans". She highlighted prime age EPOP, racial and gender disparities, and the U-6 unemployment rate (11.1% in January) as more comprehensive metrics over the vanilla U-3, with the quits rate and ECI also providing valuable context for labor market slack.

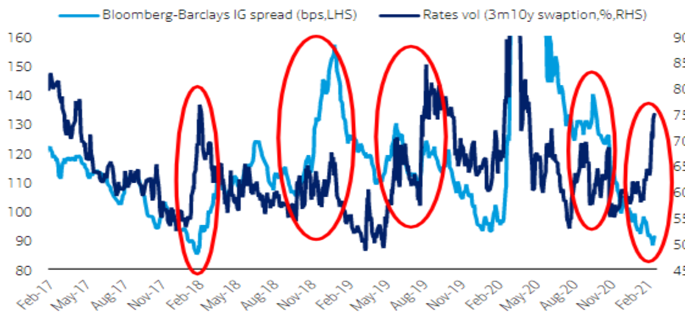




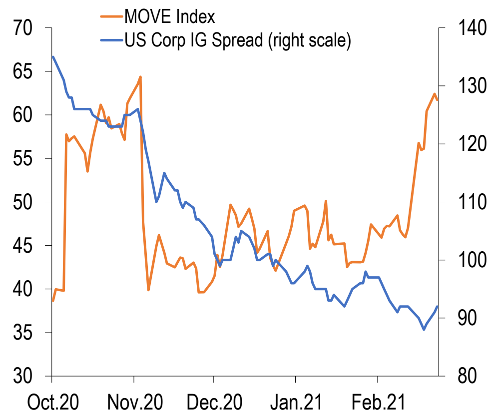
Rates volatility has surged higher, leaving credit spreads exposed. Uncertainty around interest rates and higher volatility have tended to intensify pressure on credit spreads. Swaptions volatility has jumped to the highest level since the peak of the COVID-19 crisis, while implied volatility in the Treasury market (measured by the MOVE Index) has returned to levels last seen leading up to the election. Contacts note that among fixed income investors, insurance and pension funds have tended to be the most cautious during times of heightened rates uncertainty. 10- and 30-year Treasury yields are up about 40 bps and 50 bps respectively over the last month.

Figure 1: Higher interest rates and high rates vol is not a good combination for IG credit spreads

Since 2017 there was widening pressure on IG credit spreads during periods where interest rate volatility was high.



Source: Bloomberg, Bloomberg-Barclays



Source: Bloomberg

Europe

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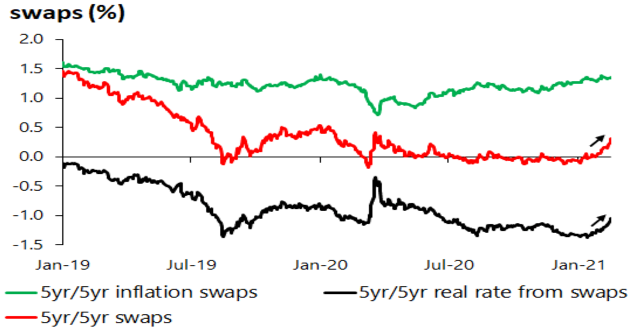
Bank stocks (+2%) outperformed as 10-yr bund yields rose 6 bps to -0.25%. The euro (+0.5%) gained and equities (+0.2%) edged higher.

ECB GC member Schnabel warned that an overly abrupt increase in real interest rates on the back of improving global growth prospects could jeopardize the economic recovery. She reiterated that the ECB will ensure that there is no unwarranted tightening of financing conditions. **5yr/5yr real rates from swaps have risen 30 bps in February**.

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

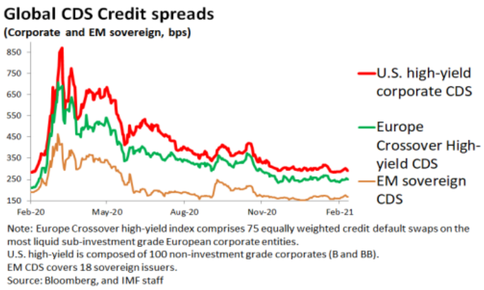


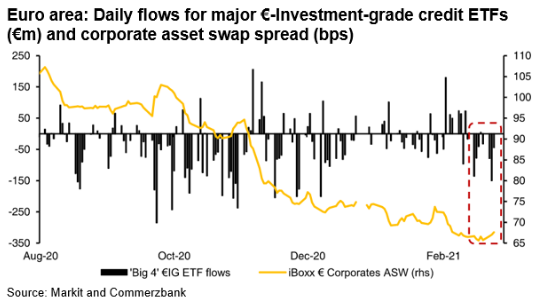
Source: Bloomberg and IMF staff

Italian 10-yr spreads (+2 bps to 101 bps) are trading once again above the widely watched level of 100 bps as banks report that investors have been reducing long positions in the past couple of weeks.

Euro area annual growth in adjusted bank lending to the private sector declined to 4.5% yoy in January (from 4.7% in December). Non-financial businesses saw borrowing grow by €4.3bn, down from €14.2bn in December. Households also borrowed less at €15.1bn in January, down from €19.4bn in December.

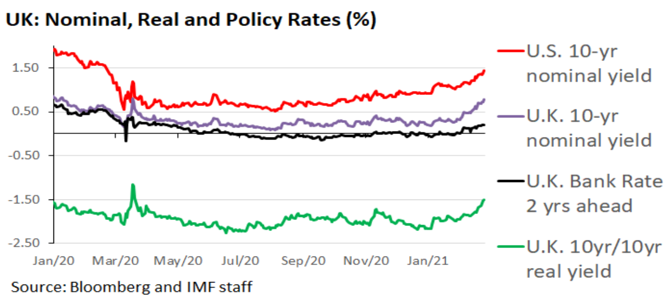
Euro area credit spreads have not moved much in February, but Commerzbank warns that ETF funds registered daily outflows in the first half of the week.





United Kingdom

10-yr gilt yields (+7 bps to 0.80%) continue to rise sharply ahead of next week's budget announcement and as contacts believe that the BoE may reduce the pace of its QE purchases in August 2021. The BoE is currently purchasing about £4.4 bn of assets per week but analysts believe that the BoE will taper its QE purchases later in 2021 to ensure that the current QE envelope lasts for the full calendar year (otherwise it would run out at the current pace around September 2021). The rapid vaccine rollout and expectations of an end of lockdown in spring have lifted **U.K. 10-yr yields by 47 bps in February, compared to an increase of 44 bps in measures of real yields and a gain of 4% for equities**.



BoE governor Bailey said that EU demands to settle euro derivatives by clearinghouses inside the block would be a "very serious escalation."

Other Mature Markets

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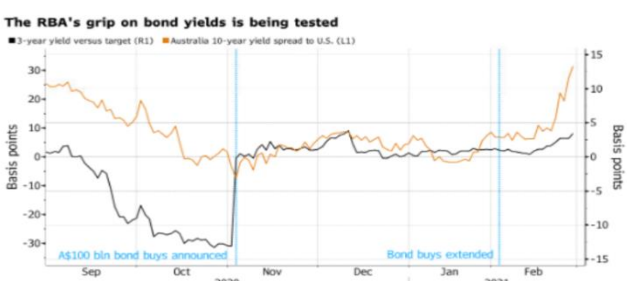
Australia

The Reserve Bank of Australia (RBA) bought additional bonds, aiming to bring short-term yields in line with target. The central bank purchased AUD3 bn ($2.4 bn) of April 2023 and April 2024, returning to the market for three-year bonds for the second time this week. These were on top of a scheduled AUD2 bn purchases of long-term bonds under the RBA's quantitative easing program. The total purchases today matched the record set in March 2020 when the central bank began buying bonds. **10-year bond yield rose +12bps, the Australian dollar was unchanged, and equities rose +0.8%.**



Sources: Bloomberg, RBA

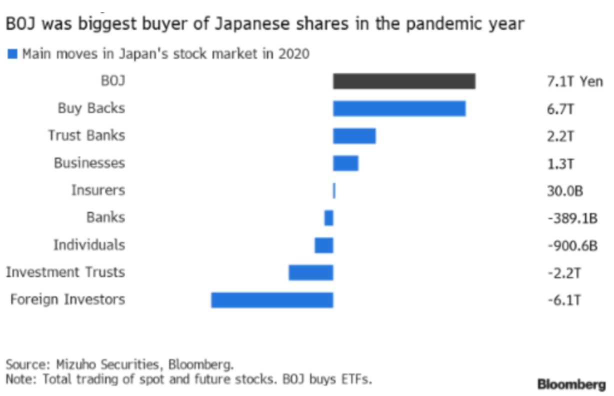
New Zealand

The Reserve Bank of New Zealand (RBNZ)'s remit will be amended to consider the impact of housing in its monetary policy decision. The updated remit will replace the existing April 2019 version and will come into effect on March 1. The RBNZ's objectives and mandate remain the same: to maintain price stability, support fully employment and promote a sound and stable financial system. **10-year bond yield rose +18.4bps, the New Zealand dollar was unchanged, and equities fell -1.2%.**

Sources: Bloomberg, CoreLogic, RBNZ

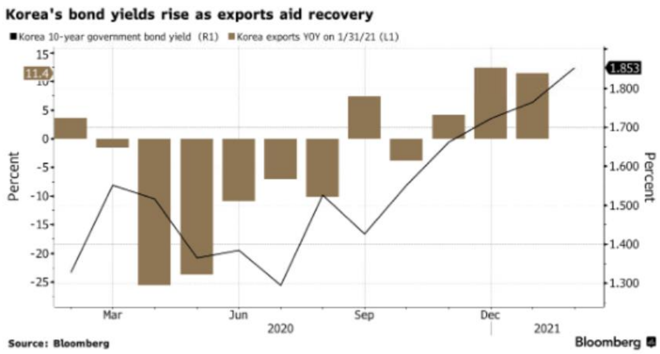
Japan

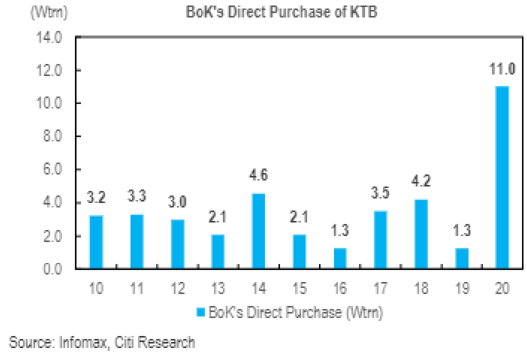
Equities rose +1.2%, except for three sectors. Regarding ETF purchases, consensus expectations are for the Bank of Japan (BOJ) to hint that it would not buy when equities are high, with it signaling via fewer purchases this year, according to Bloomberg. The BOJ was the biggest buyer of Japanese stocks in 2020, purchasing ¥7.1 tn. With its ETF holdings, the BOJ indirectly owned more than 5% of shares at 485 Japanese companies based on NLI Research Institute estimates. **10-year JGB yield rose +2.4bps to 0.14%, the highest level in more than 2 years, while the yen was little changed.**



South Korea

The Bank of Korea (BOK) kept its policy rate on hold at 0.5%, as expected. Governor Lee said that 'now is not the time to discuss full normalization like a rate hike'. The BOK kept its 2021 growth forecast at 3% and revised up its inflation forecast to 1.3% from 1% due to supply-side pressures such as global oil prices. Lee kept a cautious tone on regulatory purchase of KTBs noting that the central bank is monitoring the recent increase in bond yields. He reiterated that the BoK is not considering direct purchase from the primary market, as that could interfere with central bank's independence stating that the BOK is ready to step in should secondary market volatility increase. **10-year bond yield rose +2.7bps, the won appreciated +0.4% and equities rallied +3.5%.**





Emerging Markets

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Asian equities rose +1.6%, following overnight gains in the US. Gains were broad-based, with Korea (+3.5%) outperforming. China (Shanghai +0.6%; Shenzhen -0.5%) was mixed while Philippines (-0.9%) and Vietnam (-0.5%) fell. **Regional bond yields rose while currencies were stronger on Korean won and Vietnamese dong strength (both +0.4%). EMEA equities were mostly trading higher** with indices up in South Africa (+1.3%) and Czech Republic (+1.2%) while stocks in Turkey were underperforming (-1.1%). **EMEA currencies mostly depreciated** with the South African rand (-1.9%) and the Turkish lira (-1.0%) underperforming. **In EMEA credit, investors also watched developments in Armenia** as political tension grew following the military's demand of Prime Minister Pashinyan's resignation with Eurobond credit spreads widening 30 bps. **Latin American equity markets were mostly higher on Wednesday.** Equities in Argentina (3.7%) and Chile (1.9%) advanced. Currency markets were relatively quiet.

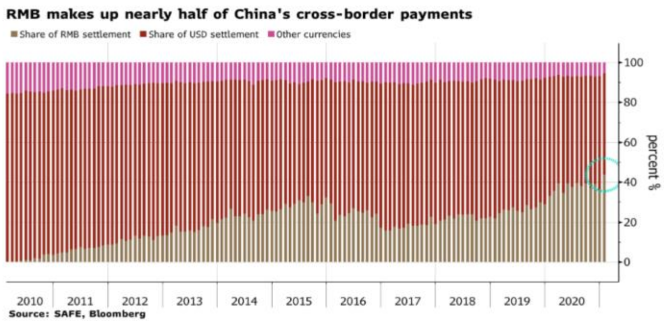
Key Emerging Market Financial Indicators

Last updated: 2/25/21 8:23 AM	Level: Last 12m	Level: index	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		55.73	0.4	-4	-1	35	8
MSCI Frontier Equities		29.23	-0.3	-2	-1	4	3
EMBIG Sovereign Spread (in bps)		348	-3	2	-7	30	-2
EM FX vs. USD		57.72	-0.6	0	1	-2	0
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.45	0.0	1	0	9	1
Indonesian Rupiah		14083	0.0	0	0	-1	0
Indian Rupee		72.42	-0.1	0	1	-1	1
Argentine Peso		89.76	-0.1	-1	-3	-31	-6
Brazil Real		5.44	-0.5	0	0	-19	-5
Mexican Peso		20.69	-1.5	-2	-3	-8	-4
Russian Ruble		73.89	-0.5	0	2	-12	0
South African Rand		14.80	-2.0	-1	3	3	-1
Turkish Lira		7.22	-0.8	-3	3	-15	3
EM FX volatility		9.93	0.0	0.3	-0.4	2.8	-0.8

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

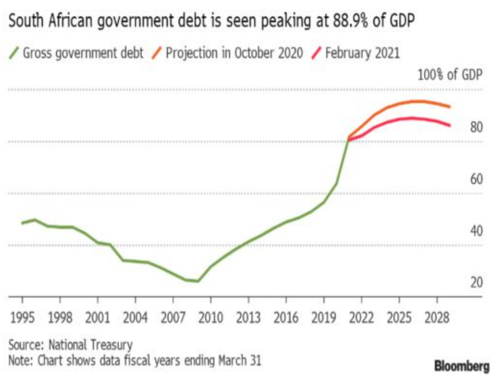
China

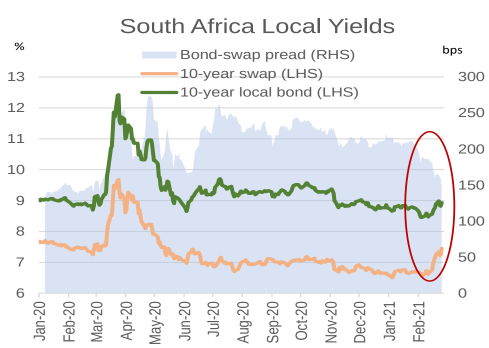
China is increasing its usage of RMB for cross-border payments. The share of yuan settlement for cross-border payments rose to a record high of 44% from nearly zero 11 years ago, according to Bloomberg calculations based on SAFE data. This has come at the expense of the usage of USD, which saw its share fall to 51% from almost 85% over the same period. **The RMB and 10-year bond yield were little changed today while equities (Shanghai +0.6%; Shenzhen -0.5%) were mixed.** Property developer equities outperformed, with the CSI 300 Real Estate index surging +8.4%. This was on the back of announcements of new land bidding regulations in at least two cities that analysts say would help large developers buy land and increase their market share.



South Arica

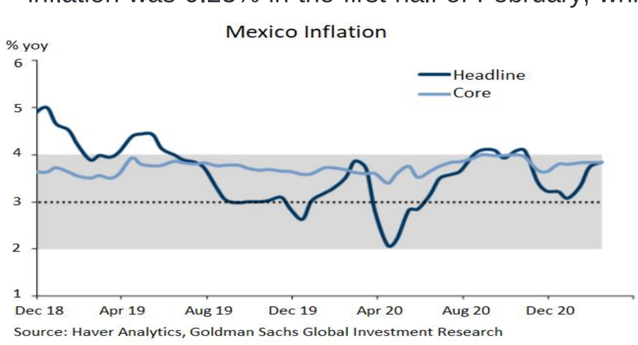
Markets welcomed South Africa's new budget projections. Analysts noted that reduced fiscal deficit and debt to GDP outlook through ambitious expenditure reduction, combined with optimized tax relief to support the economy, positively met investors' expectations. That said**, some contacts remained concerned with the ongoing implementation risk as consolidation relies on difficult cuts to public sector wages**. Analysts also questioned the downside risk to revenue projections given the upwards revision in the economic outlook embedded in the budget. **Markets reacted positively to the announcement with the South African rand (+1%), equities (+0.4%) and 10-year bond yields (-15 bps) all outperforming**. However, positive price action was short-lived with South African assets coming under pressure in the afternoon through the rise in global yields that induced some profit taking. Contacts note that investors are now primarily looking to express the positive budget outlook view through tightening of the spread between bond and swap yields, which is attributed to fiscal risk premia.





Mexico

Consumer prices increased somewhat less than market expectations in early February. Headline inflation was 0.23% in the first half of February, while core inflation printed at 0.22%. Headline inflation is still above the 3% target (at 3.84% yoy), with core annual inflation also at 3.84%. With these numbers, a Goldman Sachs report writes that the output gap and the slack in the labor market might justify a moderate additional easing in monetary policy. However, the Goldman Sachs report also argues that sticky core inflation and a stronger than expected economic performance in the second half of 2020 signal potential short-term change in the monetary policy.



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Global Financial Indicators

Last updated: 2/25/21 8:23 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		3913	1.1	0	2	25	4
Europe		3704	0.0	1	4	4	4
Japan		30168	1.7	0	5	33	10
China		3585	0.6	-2	-1	19	3
Asia Ex Japan		98	-1.1	-4	-2	42	9
Emerging Markets		56	-0.6	-4	-1	35	8
Interest Rates					basis points		
US 10y Yield		1.46	7.5	16	43	11	54
Germany 10y Yield		-0.25	5.3	10	30	26	32
Japan 10y Yield		0.15	2.7	6	10	26	13
UK 10y Yield		0.80	6.8	18	54	28	60
Credit Spreads					basis points		
US Investment Grade		91	0.3	5	-4	-27	-4
US High Yield		343	-4.4	-4	-30	-119	-36
Europe IG		49	0.5	1	-2	-1	1
Europe HY		255	2.5	5	-9	1	12
EMBIG Sovereign Spread		348	-2.7	2	-7	30	-2
Exchange Rates					%		
USD/Majors		89.78	-0.4	-1	-1	-9	0
EUR/USD		1.22	0.5	1	1	12	0
USD/JPY		106.1	0.2	0	2	-4	3
EM/USD		57.7	-0.6	0	1	-2	0
Commodities					%		
Brent Crude Oil ($/barrel)		67	0.2	5	20	22	30
Industrials Metals (index)		153	0.9	6	12	47	15
Agriculture (index)		53	0.4	4	9	38	11
Implied Volatility					%		
VIX Index (%, change in pp)		22.7	1.4	0.3	-0.5	-5.1	0.0
US 10y Swaption Volatility		77.0	0.3	6.2	21.7	-9.6	16.9
Global FX Volatility		7.7	0.0	0.3	0.1	1.5	-0.4
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		136	4.2	14	13	-21	17
Italy		103	4.0	4	-20	-47	-8
Portugal		59	0.7	0	2	-16	-1
Spain		71	1.1	2	8	-2	9

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: 2/25/2021 8:23 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		6.45	0.0	0.5	0	9	1		3.4	-0.8	3	11	46	8
Indonesia		14083	0.0	-0.4	0	-1	0		6.5	-5.8	6	19	-18	45
India		72	-0.1	0.3	1	-1	1		6.4	-0.7	7	33	-17	44
Philippines		49	0.0	-0.3	-1	5	-1		3.5	1.8	-1	-14	-64	-17
Thailand		30	-0.4	-0.5	-1	5	-1		1.7	0.7	16	32	49	39
Malaysia		4.04	0.0	0.1	0	5	0		2.9	-0.8	0	32	-8	36
Argentina		90	-0.1	-0.8	-3	-31	-6		41.7	-51.8	-216	-997	-1174	-1447
Brazil		5.44	-0.5	-0.2	0	-19	-5		7.0	18.5	37	36	116	143
Chile		704	-0.1	1.1	4	15	1		3.1	5.8	21	27	-55	30
Colombia		3585	-0.5	-1.1	0	-4	-4		5.4	2.6	26	34	-5	35
Mexico		20.69	-1.5	-1.9	-3	-8	-4		5.9	7.7	20	32	-64	36
Peru		3.6	0.2	0.2	0	-7	-1		4.2	1.7	21	34	0	55
Uruguay		43	-0.2	-0.5	-2	-11	-2		7.0	-5.7	-2	-24	-258	-26
Hungary		295	0.3	0.6	0	6	1		2.0	7.5	21	41	44	46
Poland		3.69	0.4	0.6	1	7	1		0.8	3.7	5	20	-97	15
Romania		4.0	0.5	1.1	1	11	0		2.7	-1.0	15	30	-93	-9
Russia		73.9	-0.5	0.0	2	-12	0		6.3	-1.5	4	35	56	61
South Africa		14.8	-2.0	-1.4	3	3	-1		9.7	2.5	11	6	36	7
Turkey		7.22	-0.8	-3.4	3	-15	3		13.5	11.2	6	6	130	34
US (DXY; 5y UST)		90	-0.5	-0.9	-1	-9	0		0.68	8.1	13	28	-50	32

	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		5470	0.6	-5	-3	33	5		199	0	-2	-9	30	-9
Indonesia		6290	0.6	1	0	9	5		158	0	-9	-25	-5	-29
India		51039	0.5	-1	6	27	7		152	1	-3	-3	18	1
Philippines		6756	0.0	-3	-4	-6	-5		83	0	-9	-17	13	-22
Malaysia		1582	1.5	0	0	5	-3		113	0	-2	-3	9	3
Argentina		49607	3.7	-5	5	29	-3		1459	0	19	8	-570	91
Brazil		116122	0.4	-3	-1	2	-2		253	0	0	-16	58	3
Chile		4604	1.9	2	3	6	10		126	0	-6	-16	-14	-18
Colombia		1371	1.1	1	-2	-15	-5		207	0	-4	-15	44	2
Mexico		45151	-0.3	0	0	5	2		348	0	-9	-34	55	-12
Peru		23200	0.1	2	8	23	11		133	0	-4	-3	22	1
Hungary		43619	1.0	-1	1	1	4		65	0	-6	-15	-42	-31
Poland		57814	0.4	-1	1	7	1		-22	0	-4	-11	-54	-21
Romania		10270	0.8	-1	-1	5	5		203	3	6	1	16	0
Russia		3397	0.4	0	0	13	3		159	0	-5	-3	19	-7
South Africa		67245	1.6	1	4	23	13		357	0	-4	-35	25	-23
Turkey		1479	-0.3	-4	-4	29	0		421	0	-5	-47	34	-24
Ukraine		521	0.0	0	4	-2	4		479	0	12	-21	127	-12
EM total		56	0.4	-4	-1	35	8		421	0	17	-10	97	128

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

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