GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, FEBRUARY 7, 2022

- **Markets project faster Fed rate hikes** (link)
- **US Treasury yields surge above pre-pandemic levels** (link)
- **Euro area peripheral bond yields break higher on hawkish ECB** (link)
- **Japanese government bond yields at highest since 2015** (link)
- **50 bps rate hike expected in Mexico this week** (link)

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Rising bond yields challenge global markets

The very strong US jobs report on Friday accelerated the recent trend towards higher interest rates. Treasury yields are now back to pre-pandemic levels and have pushed government bond yields higher across the globe. The benchmark 10-year Japanese government bond yield is at its highest since 2015 and benchmark 10-year German bunds are trading at a positive yield of 24 basis points, the highest since early 2019. The move in bunds has put the spotlight on bonds in the euro area periphery, where Greek 10-year yields are up 60 bps since the ECB meeting last week and Italian yields are up 45 bps. Emerging market bond yields are also sharply higher. In addition, flatter yield curves in many countries are signaling the advent or extension of central bank rate hike cycles. US equity index futures and European bourses are mixed as investors confront the challenge of higher interest rates. Meanwhile, the confrontation between Russia and Ukraine simmers in the background, threatening to upset markets if a military conflict were to break out.

Key Global Financial Indicators

Last updated: 2/7/22 7:59 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		4501	0.5	2	-4	16	-6
Eurostoxx 50		4098	0.3	-2	-5	12	-5
Nikkei 225		27249	-0.7	1	-4	-7	-5
MSCI EM		49	0.2	3	0	-13	0
Yields and Spreads				bps			
US 10y Yield		1.92	1.3	14	16	76	41
Germany 10y Yield		0.23	2.7	22	28	68	41
EMBIG Sovereign Spread		376	0	-11	17	33	9
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		53.3	0.2	0	1	-7	1
Dollar index, (+) = $ appreciation		95.4	-0.1	-1	0	5	0
Brent Crude Oil ($/barrel)		93.0	-0.3	2	14	57	20
VIX Index (%, change in pp)		23.9	0.7	-1	5	3	7

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

With the US jobs report in the rear view mirror, market focus shifts to Thursday's all important CPI report, where the consensus forecast is for gains of 0.5% each in the headline and core monthly prints, and 7.3% and 5.9% respectively for the annualized data. In the euro area, German industrial production and especially CPI data will attract attention in the wake of the recent surge in German inflation. The UK reports GDP and industrial production data this week, while PPI data is due from Japan. President Biden has a meeting with German Chancellor Scholz later today, where Ukraine is likely to be a major topic of discussion. Bank earnings are due from Credit Suisse, BNP Paribas, Société Générale, and Credit Agricole. Markets in China have reopened after the Lunar new Year holidays. There will be central bank meetings in several emerging markets including India, Russia, Indonesia, and Mexico.

Mature Markets

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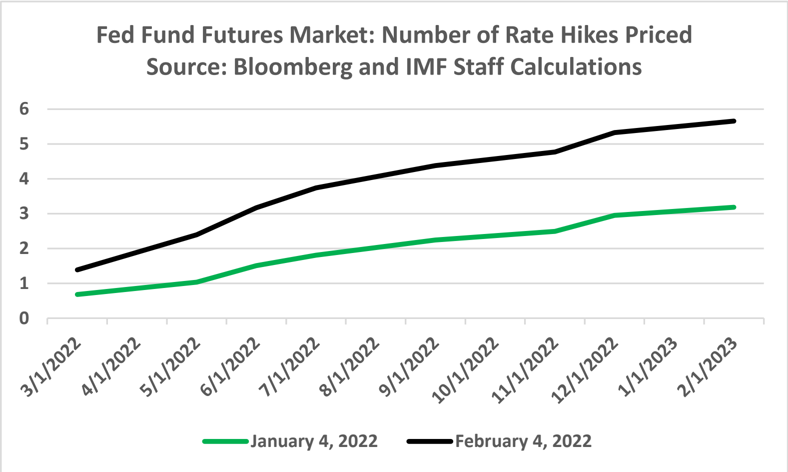
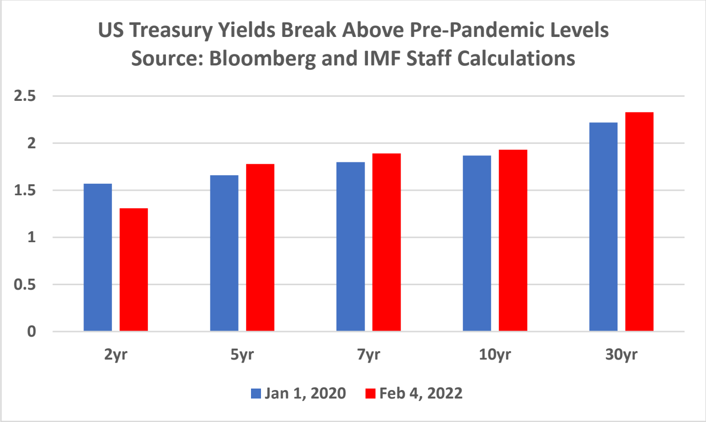
United States

Markets are actively recalibrating their expectations for future Fed rate hikes, predicting a faster pace of moves. With speculation growing about a possible 50 bps move in March, the Fed Funds futures and eurodollar futures markets are now predicting nearly six rate hikes by February 2023, up from three hikes just one month ago. However, the markets are simply front loading the same short and shallow cycle they have predicted for many months. Despite the striking recent rise in yields, the eurodollar futures markets still expects the Fed to hike by around 200 bps by the end of 2023 and then hold steady for 2024 and 2025. This is at odds with a growing number of analysts who think that 200 bps will not be enough to tame inflation. They point out that the Fed's dot plot median for the terminal rate already calls for 250 bps of hikes, while persistent high inflation could require 300 bps or even more. The fear is that asset markets could face heavy losses if expectations are forced into an abrupt change, with potential negative effects for financial stability. This is the first rate hike cycle since 1994-95 where the market may be underestimating the size of the hiking cycle, and the shock to bond markets on that occasion was very severe. Typically, markets tend to overestimate the extent of rate hikes.



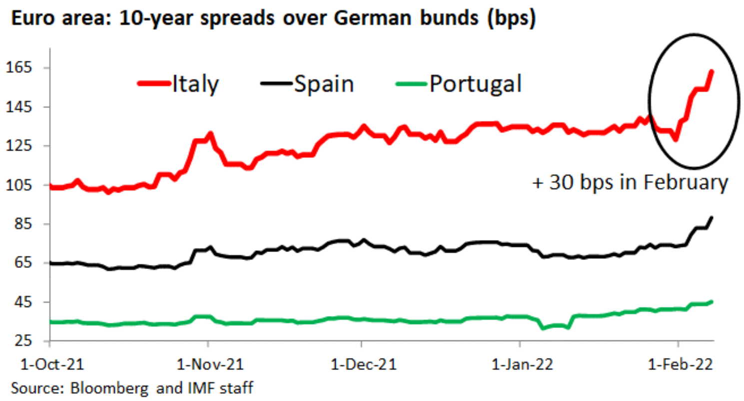
The surge in US Treasury yields following the blowout jobs report pushed most US Treasury yields above pre-pandemic levels for the first time, with the two-year Treasury the only laggard. In addition to the 467K jobs gained in January (the consensus forecast was for 125K), there was massive upward revision for the previous report in December from 199K to 510K. With two very strong jobs reports in a row, the Fed is likely to have a free hand to begin rate hikes in March. The Treasury yield curve continued its flattening trend on Friday as investors positioned for Fed action. The spread between the two-year and ten-year Treasury yields has fallen from 80 bps on December 31 to 61 bps, while the five-year/ten-year spread fell from 24 bps on December 31 to 14 bps on Friday.



Euro area

German 10-yr bund yields (+4 bps to 24 bps) are higher as markets continue to price over 40 bps of ECB hikes by December 2022, implying a much sharper tightening path than suggested by official commentary. Dutch central bank governor Knot, for example, said that he expects a first hike of 25 bps as early as in Q4, followed by a second hike of 25 bps in spring 2023. Bank of Latvia governor Kazaks said that a July rate hike would imply an extreme and unlikely quick pace of tapering. In contrast, markets have full priced in a hike by July.

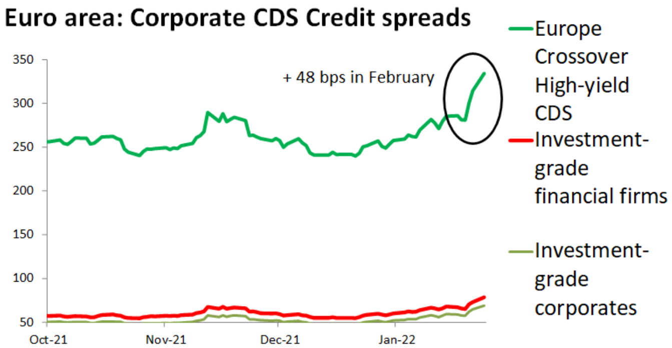
Italian 10-yr spreads (+8 bps to 164 bps) widened further as contacts ponder the implications of hawkish shifts in ECB policy. Bank of America estimates that €7-70bn of cash in the PEPP program could be shifted from core/semi-core to Southern Europe in 2022 given the flexibility in PEPP reinvestments announced by the ECB. **According to Bank of America, the flexibility in the PEPP reinvestments can provide meaningful support for Southern European bonds but could lead to higher yields elsewhere.**



Greek bonds are sharply underperforming, with some contacts pointing to a liquidation of positions. Greek 10-yr yields rose 30 bps to 2.57% and spreads widened to 232 bps.

Inflation forecasts in the ECB's survey of professional forecasters (SPF) for 2022 jumped to 3.0%. The longer-term forecast is at 2.0%, the highest since 2013.

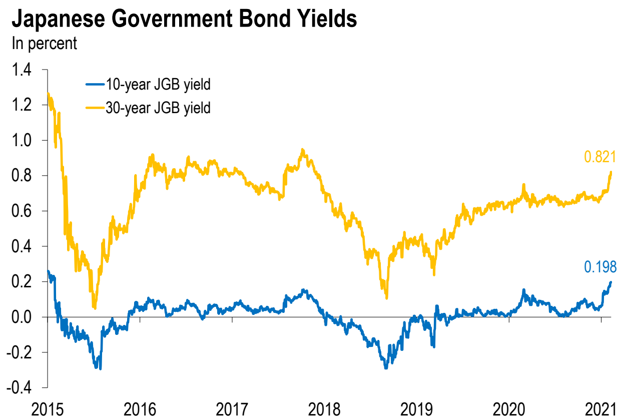
Poor risk sentiment has prompted contacts to take out hedges in credit markets. The cross-over high yield European CDS spread, a widely watched spread to help track lowly rated corporates, rose 13 bps to 328 bps.



Note: Europe Crossover high-yield index comprises 75 equally weighted credit default swaps on the most liquid sub-investment grade European corporate entities.
U.S. high-yield is composed of 100 non-investment grade corporates (B and BB).
Source: Bloomberg, and IMF staff

Japan

Long-end JGB yields rose as the Bank of Japan did not step in after a large selloff last week (10-year: +0.4 bp; 30-year: +1.9 bps). The benchmark 10-year yield rose to 0.198%, the highest level since early 2015, as the Bank of Japan (BOJ) refrained from conducting an unscheduled bond purchase operation to stem the recent rise in yields. Meanwhile, the super-long segment faced stronger selling due to the prospect for higher U.S. treasury yields.



Source: Bloomberg.

Emerging Markets

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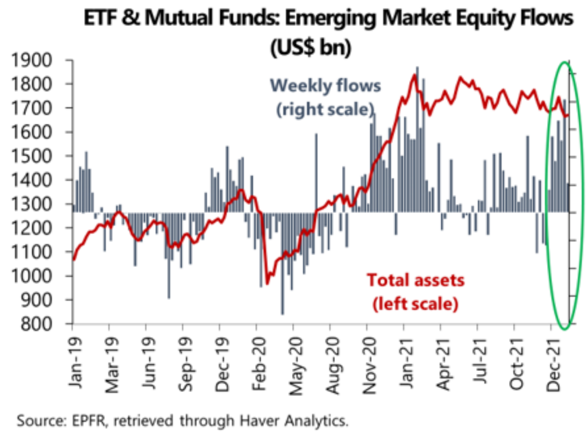
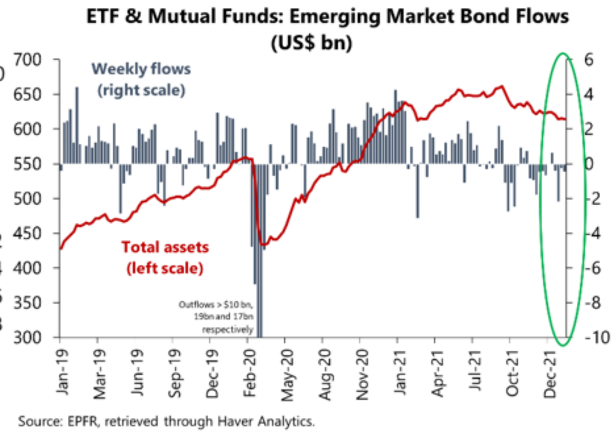
Rate hikes are the primary focus in Eastern Europe this week. The National Bank of Poland is expected to raise its policy rate by 50 bps to +2.75% tomorrow, while the National Bank of Romania is expected to increase its policy rate by 25 bps to +2.25% on Wednesday, and the Central Bank of Russia by 100 bps to +9.5% on Friday. **Asian stocks** were generally lower and government bond yields were mostly higher in step with Friday's US Treasury price action, but this could not prevent currencies from depreciating. **In Indonesia,** the economy grew 5.0% y/y in 2021Q4 (consensus: +4.8%), recording annual growth of 3.7% for 2021. **In Latin America, equities were mixed** and currencies also weakened.

EM funds

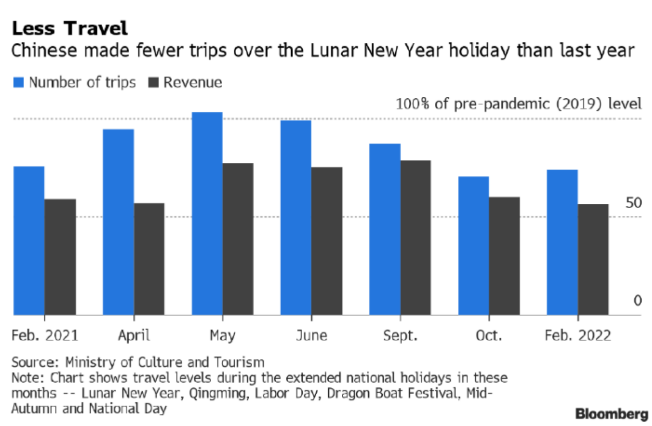
Investors poured $1.7 bn into EM funds last week. EM equity funds received inflows of $2.2 bn, while bonds funds registered outflows of $0.5 bn, predominantly from hard currency and Chinese local currency mutual funds, with EM bond ETFs still attracting $0.7 bn of inflows.





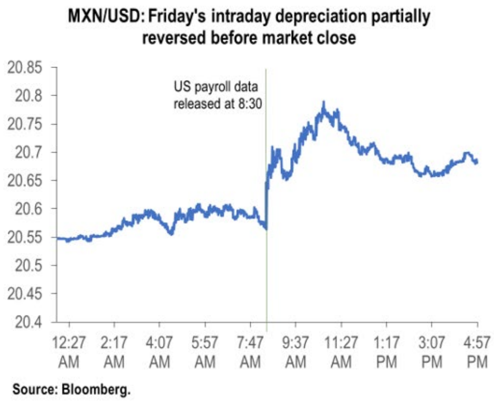
China

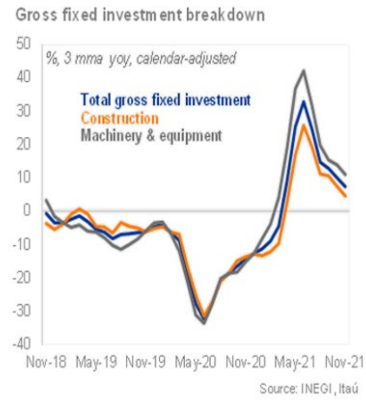
Growth momentum looks weaker on the back of efforts to contain the virus transmission. Pandemic-related restrictions limited travel and consumption during the Lunar New Year holiday. The number of trips and the amount of tourism revenue were below the pre-pandemic levels in 2019 by 26% and 44%, respectively, and were even lower than 2021 levels. Local authorities discouraged travel during the holiday to reduce virus transmission. The Caixin PMI composite dropped to 50.1 in January, from 53.0 in December. Services PMI fell to 51.4 from 53.1, although this was stronger than market expectations at 50.5. Manufacturing PMI fell to 49.1 from 50.9, weaker than forecasts (consensus 50.0). The People's Bank of China (PBC) set the RMB fixing 252 pips weaker than market expectations, the largest change since 2018 when the survey started. However, analysts this down, noting it was not unexpected after the week-long Lunar New Year holiday. Chinese equities gained (CSI 300: +1.5%), catching up with the global gains over the last week. The PBC withdrew liquidity of 130 bn RMB ($20.5 bn) that it injected prior to the Lunar New Year to meet larger cash demand.



Mexico

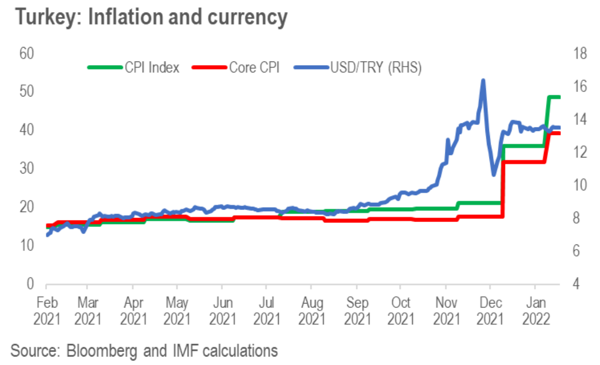
Markets expect Mexico's monetary policy committee to lift the policy rate by 50 bps to 6% this week as the economy faces low growth and rising inflation. A 5.9% y/y November growth in gross fixed investments, 20 bps more than expected but 60 bps down from October, highlighted Mexico's currently low growth trajectory (GDP contracted in the third and fourth quarter of 2021). Meanwhile J.P. Morgan's analysts expect inflationary pressures to continue, especially for core inflation. Separately, better than expected US payroll data fueled last Friday expectations for higher US interest rates and weakened the Mexican peso, which depreciated as much as 1% intraday before partially recovering by the market close.





Turkey

Analysts see Turkey's annual inflation remaining above 50% for most of 2022. S&P analysts attribute December's inflation data surprise (+48.07% yoy) to the pass-through from the weaker exchange rate and now see annual average inflation at 49.5% in 2022 and 14.5% in 2023. JP Morgan's analysts sees inflation peaking at +55% yoy in May. S&P notes that President Erdogan's introduction of economic policy measures in the past few weeks, including a forex-protected currency deposit program, have stabilized conditions in the country, but note limited room for nominal appreciation. Contacts caution that Turkey remains vulnerable to external tightening given widely negative real yields. Separate data releases show that the central bank's foreign currency sales to the state-run energy importer Botas increased to $4.15 bn in January, while deposits in FX-protected accounts reached $21.4 bn as of February 3rd, according to Bloomberg.



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.

Global Financial Indicators

Last updated: 2/7/22 8:00 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4506	0.5	0	-4	16	-5
Europe		4098	0.3	-2	-5	12	-5
Japan		27249	-0.7	1	-4	-7	-5
China		4634	1.5	-3	-4	-17	-6
Asia Ex Japan		82	0.6	3	-1	-17	-1
Emerging Markets		49	0.2	3	0	-13	0
Interest Rates					basis points		
US 10y Yield		1.92	1.5	15	16	76	41
Germany 10y Yield		0.23	2.8	22	28	68	41
Japan 10y Yield		0.20	-0.1	2	6	14	13
UK 10y Yield		1.43	1.4	12	25	94	45
Credit Spreads					basis points		
US Investment Grade		127	1.1	1	14	36	15
US High Yield		386	7.4	-2	47	30	48
Europe IG		68	4.1	9	17	20	20
Europe HY		326	18.0	39	74	82	84
Exchange Rates					%		
USD/Majors		95.36	-0.1	-1	0	5	0
EUR/USD		1.15	0.0	2	1	-5	1
USD/JPY		115.0	-0.2	0	-1	9	0
EM/USD		53.3	0.2	0	1	-7	1
Commodities					%		
Brent Crude Oil ($/barrel)		93	-0.3	2	14	57	20
Industrials Metals (index)		183	0.4	3	5	35	6
Agriculture (index)		66	1.1	3	6	31	9
Implied Volatility					%		
VIX Index (%, change in pp)		23.9	0.7	-0.9	5.1	3.0	6.7
US 10y Swaption Volatility		81.0	0.0	-0.2	-0.6	18.8	1.9
Global FX Volatility		7.6	0.1	0.2	0.4	0.2	0.2
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		233	25.9	44	74	112	81
Italy		164	9.7	35	28	66	29
Portugal		82	5.4	16	19	31	17
Spain		88	5.2	15	19	31	14

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

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Last updated: 2/7/2022 8:03 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		6.36	0.0	0.0	0	1	0		2.7	3.5	4	-14	-60	-11
Indonesia		14393	-0.1	-0.2	0	-3	-1		6.5	3.0	5	4	33	11
India		75	0.0	-0.1	-1	-2	0		6.3	0.0	0	9	75	0
Philippines		51	-0.5	-0.8	0	-6	-1		4.6	0.0	0	8	143	10
Thailand		33	0.0	0.8	2	-9	1		2.2	3.0	7	14	78	33
Malaysia		4.18	-0.1	0.0	1	-3	0		3.7	4.5	4	5	96	13
Argentina		106	-0.3	-0.7	-2	-17	-3		49.8	-7.7	80	-21	2	-77
Brazil		5.29	0.7	0.4	6	1	5		11.6	-3.1	16	17	355	86
Chile		826	0.2	-3.1	0	-11	3		5.8	-1.0	21	2	289	33
Colombia		3946	0.3	-0.1	3	-10	3		7.3	0.0	8	25	299	84
Mexico		20.59	0.4	0.2	-1	-2	0		7.6	6.0	-2	-19	202	3
Peru		3.8	0.4	0.2	3	-5	4		6.1	0.5	-3	5	233	20
Uruguay		44	0.1	0.7	2	-3	2		8.6	-6.6	-19	-13	146	-13
Hungary		309	0.3	2.4	2	-4	5		4.8	-7.8	-15	2	282	24
Poland		3.97	0.4	2.9	1	-6	2		3.9	-5.0	-13	-2	253	37
Romania		4.3	0.0	1.9	1	-6	1		5.1	0.8	8	16	278	24
Russia		75.5	0.4	2.5	0	-2	0		9.3	0.7	-6	53	300	57
South Africa		15.5	0.0	-0.5	1	-4	3		7.7	5.5	-1	-3	104	27
Turkey		13.56	-0.1	-1.9	2	-48	-2		22.6	-24.0	-118	-199	967	-176
US (DXY; 5y UST)		95	-0.1	-1.2	0	5	0		1.77	0.2	16	27	131	51

	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	7 Days	30 Days	12 M	YTD
								basis points					
China		4634	1.5	-3	-4	-17	-6		202	-1	2	-22	-1
Indonesia		6805	1.1	2	2	10	3		176	-12	19	-7	11
India		57621	-1.7	-1	-4	12	-1		141	1	13	-14	9
Philippines		7380	-1.0	2	5	5	4		113	-6	19	11	12
Malaysia		1531	0.5	1	-1	-3	-2		123	1	8	-16	6
Argentina		87934	-0.2	0	4	72	5		1775	24	54	336	95
Brazil		112245	0.5	0	9	-7	7		313	-11	5	52	2
Chile		4435	0.2	-2	3	0	3		153	-6	23	9	13
Colombia		1522	0.4	-1	9	11	8		360	-13	20	138	12
Mexico		51255	0.2	1	-4	16	-4		339	-9	12	-16	7
Peru		22280	0.3	-2	0	2	6		168	1	24	37	18
Hungary		51988	0.4	-3	0	18	2		130	1	17	-11	6
Poland		67055	-0.1	-1	-5	17	-3		10	-2	-11	-19	-22
Romania		13397	0.1	2	2	26	3		206	-2	21	11	13
Russia		3477	0.2	-2	-8	2	-8		241	-33	71	64	64
South Africa		75808	0.8	2	3	18	3		368	-2	29	-8	13
Turkey		1963	1.0	-2	-3	29	6		554	-3	-8	122	-24
Ukraine		522	0.0	0	0	0	0		845	-69	97	362	86
EM total		49	0.3	3	0	-13	0		409	-8	26	64	23

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

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