GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, JANUARY 10, 2022

- **Markets confront surge in US interest rates** (link)
- **US stocks retreat as interest rates rise** (link)
- **Euro area inflation at multi-decade high** (link)
- **Argentina raises policy rate** (link)
- **Sri Lanka asks China for debt restructuring** (link)
- **Special Feature Recirculated: Fiscal Cash Management in US Money Markets** (attached)
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Rising interest rates challenge global markets

Interest rates in the US and Europe are up sharply as the new year begins, challenging expensive equity market valuations and raising fears that the rallies of 2020 and 2021 might not be repeated in 2022. The US five-year Treasury yield is back to pre-pandemic levels and US real yields have risen steadily since late December, although they still remain very negative. In the euro area, the benchmark 10-year bund yield is at -5 bps, its highest level since June 2019. With 30-year bunds trading at a yield of 27 bps, the era of negative interest rates in Europe may be coming to an end. These interest rate increases in developed markets come in the wake of months of rising interest rates in emerging markets, where many central banks have been raising rates aggressively to combat inflation. As policy support is withdrawn across the globe, the next few months could be challenging for world markets.

Key Global Financial Indicators

Last updated: 1/10/22 7:47 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		4677	-0.4	-2	-1	22	-2
Eurostoxx 50		4281	-0.6	-1	2	17	0
Nikkei 225		28479	0.0	-1	0	1	-1
MSCI EM		49	0.9	0	-2	-11	0
Yields and Spreads					bps		
US 10y Yield		1.77	1.3	15	29	66	26
Germany 10y Yield		-0.05	-0.6	7	30	47	13
EMBIG Sovereign Spread		367	-1	0	1	20	0
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		52.7	0.1	0	1	-8	0
Dollar index, (+) = $ appreciation		96.0	0.2	0	0	7	0
Brent Crude Oil ($/barrel)		81.3	-0.6	3	8	45	5
VIX Index (%, change in pp)		20.6	1.9	4	2	-1	3

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

Global Markets in 2021: A Recap

There were five major trends last year in global markets. First of all, central banks began to signal the withdrawal of policy support and in some emerging markets they began to aggressively hike rates. Developed markets such as the UK, New Zealand, Norway, and Korea also began rate hikes. This reversal of policy was in response to the second major trend for global markets, which was the surge in inflation, both in emerging and developed markets.

The third major trend was the strength of the dollar, which hit emerging markets especially hard. Their central banks had to hike even more aggressively in their efforts to fight inflation. The macroeconomic impact of these moves will be felt in the year ahead. The fourth major market trend was the surge in commodity prices. The increase in energy prices was especially large, but food prices were also very sharply higher.

Finally, on a more positive note, 2021 turned out to be a banner year for many equity global markets despite all these challenges. A large number hit all-time highs and many are still close to record levels. Credit spreads remain very tight and the search for yield remains alive and well. Corporate earnings were very strong and fiscal support from governments helped both companies and individual consumers. There were some exceptions such as China and Japan where markets did not do so well, and a number of emerging also fell behind, but overall, markets did very well. The S&P 500 had 70 record closes in 2021 and delivered a third consecutive year with returns higher than 15% for only the second time since 1929.

Selected 2022 Market Moves (As of 4pm December 31, 2021)
Source: Bloomberg

Market Variable	2021 Movement	This Year (4pm, 1/7/22)
10yr US Treasuries	+68 bps	+26 bps
2yr US Treasuries	+61 bps	+14 bps
US 2-20 Treasury Yield Curve	+ 0 bps	+ 13 bps
US 5yr/5yr Forward Inflation Swap	+ 26 bps	-7 bps
10yr Bund	+38 bps	+14 bps
Euro Area 5yr/5yr Forward Inflation Swap	+73 bps	-10 bps
EUR	-6.85% (EUR depreciation)	-0.088 (EUR depreciation)
JPY	-10.82% (yen depreciation)	-0.44% (Yen depreciation)
BRL	-6.78% (real depreciation)	-1.1% (BRL depreciation)
CNH	+2% (yuan appreciation)	-0.43% (Yuan depreciation)
Bloomberg Commodity Index	+27.05%	+2.13%
S&P 500	+26.89%	-1.87%
Stoxx 600	+22.25% (+13.86% in dollar terms)	-0.32%
Nikkei	+4.91% (-5.86% in dollar terms)	-2.81%
China CSI 300	-5.56% (-3.28% in dollar terms)	-2.39%
MSCI Emerging Markets Index	-5.55%	-0.50%

Mature Markets

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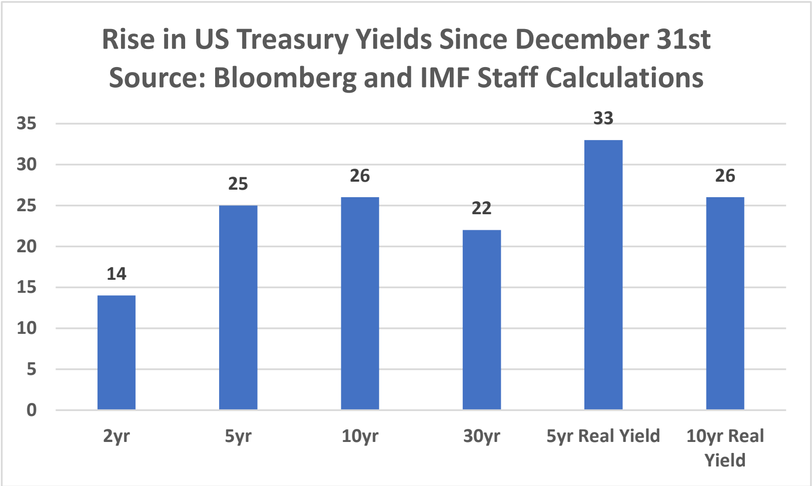
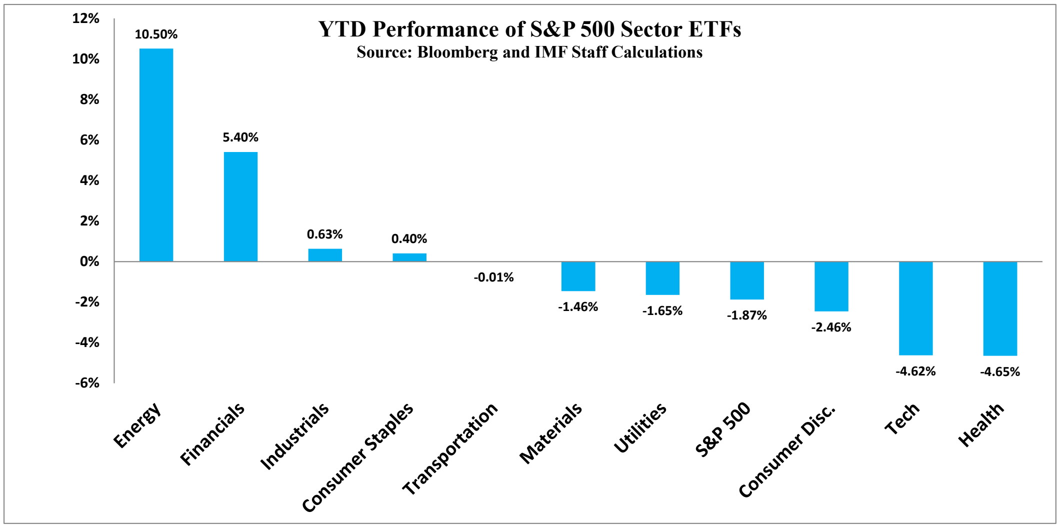
Inflation data will be the main focus for US markets this week. The consensus forecast is for US December CPI on Wednesday to come in at 7% annualized (0.5% month-on-month), the highest in 40 years. Fed Chair Powell is likely to face questions on inflation at his Senate confirmation hearings this week. The euro area will also have CPI releases for many countries, with today's data printing at multi-decade highs. China will publish industrial production and retail sales data on Thursday. Meanwhile, talks between the US and Russia are ongoing on the Ukraine situation, with further discussions with NATO due later this week. Q4 earnings season gets underway, with US banks among the first to report.

United States

The first week of the year saw a surge in US Treasury yields, spurred further by the latest FOMC minutes which showed that the Committee is actively discussing quantitative tightening. The minutes revealed that the Fed may be closer to letting its bond holdings roll off the books when they mature, rather than the earlier practice of replacing maturing bonds with new purchases. Markets were surprised by the news, and a rise in yields that began on Monday continued through the end of the week. The five-year is now back at pre-pandemic levels. In addition, Fed Funds futures markets are now pricing nearly a full rate hike in March compared to late December when the first hike was expected in June. The rise in real yields is especially notable, although they remain well below pre-pandemic highs. The weaker than expected US jobs report failed to reverse the rise in yields, as markets looked through the headline numbers to focus on the decline in the unemployment rate to 3.9% and the strong wage growth numbers.



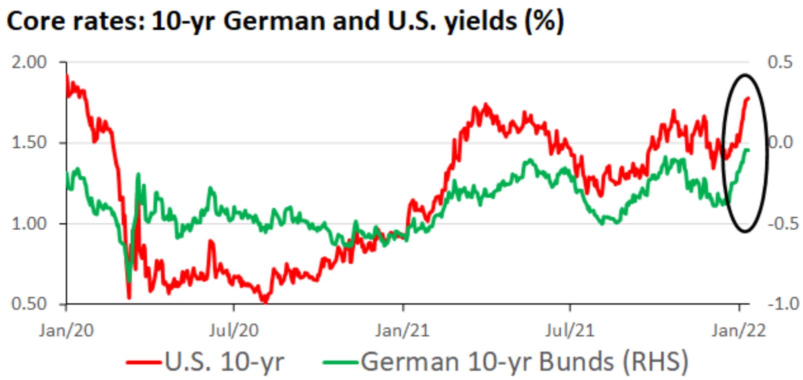
US stocks retreated in the face of rising yields and are down for the year, although the moves have been relatively muted except for the technology and health sectors which have a taken a beating in the first week of 2022. Tech stocks are widely seen as candidates for underperformance when rates rise due to their very high valuations. The major exceptions to the downtrade are the energy and financial sectors which have rallied strongly. Surging energy prices have boosted energy stocks, while bank stocks do well in a rising rate environment where the yield curve is steepening, as these factors tend to increase banks' net interest margins. A similar trend can be observed in Europe, where the Euro Stoxx 600 index is down 0.3% for the year while the Stoxx Europe bank index is already up 5.76%.



Euro area

Equities (-0.5%) traded with a cautious tone but bank stocks (+0.1%) continue to outperform as euro area yield curves have steepened. European bank stocks are up +6% so far in 2022.

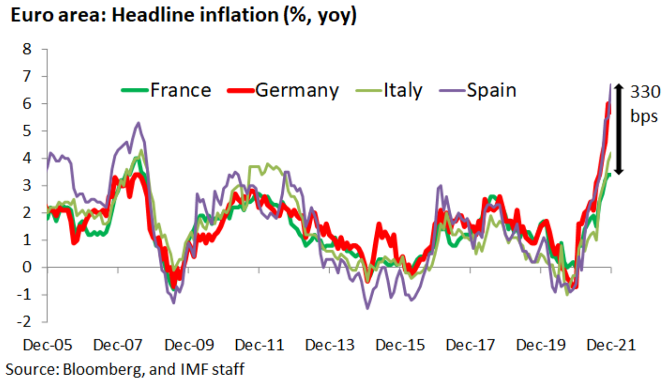
German 10-yr bund yields are little changed today at -0.05% but are up 13 bps in 2022. The German yield curve has steepened so far in 2022.



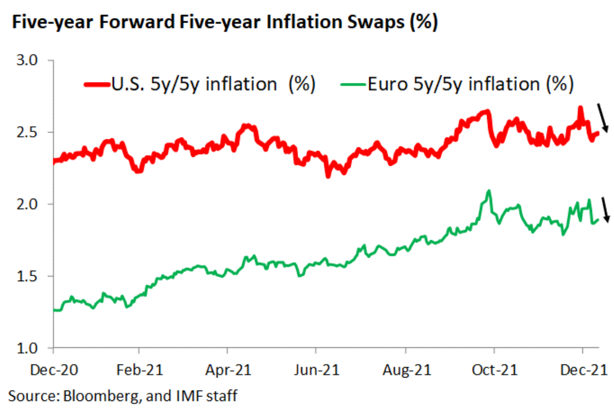
Source: Bloomberg and IMF staff

Italian 10-yr spreads edged 3 bps lower to 132 bps but contacts warn that the outcome of the presidential election could lead to more volatility in coming months. The first voting round for the election of a new president will be held on 24 January, with further iterations until a candidate achieves the majority threshold.

Euro area inflation unexpectedly rose to 5% yoy in December (4.8% expected), the highest level recorded since the introduction of the euro. Core inflation was unchanged from November at 2.6% yoy (2.5% expected). Energy and services inflation fell as some analysts had forecasted but unprocessed food prices unexpectedly rose to 4.6% yoy. Non-energy industrial goods inflation rose to a fresh all-time high of 2.9% yoy. **There are substantial variations across countries, with Spanish headline inflation rising to 6.7% yoy and inflation in France remaining unchanged at 3.4% yoy.**



Contacts generally expect euro area inflation to fall from current levels throughout 2022 given limited signs of broader second-round effects. Euro area inflation is expected to fall back to 2% by 2024 if energy prices stay at current levels. Nevertheless, ECB Governing Council member Schnabel warned that the green transition poses upside risks to medium-term inflation, and more persistent energy price inflation may require a departure from a "looking through" policy. **Interestingly, five-year/five-year inflation swaps have traded 6-7 bps lower in both the U.S. and euro area as nominal rates increased sharply.**



Emerging Markets

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Most emerging markets were higher today despite US and European markets opening lower. Technology stocks listed in Hong Kong SAR underpinned gains in China as investors stepped in on the back of attractive valuations. According to press reports, the Chinese authorities are encouraging state-owned enterprises to to acquire assets from distressed real estate companies. **Latin American** equity markets were mostly higher last Friday. Brazil led the gains as the equity index rose 1.1%, followed by Colombia (+0.9%) and Argentina (+0.8%). The Romanian leu depreciated ahead of today's central bank meeting.

EM Fund Flows

EM bond funds had inflows of $391 mn and EM equity funds saw the largest inflows in seven weeks (+$1.8 bn). For EM bond funds, inflows were driven by hard currency bond funds (+$455 mn), partially offset by outflows from local currency bond funds (-$65 mn). From a regional perspective, Asia ex-Japan equity funds observed inflows (+$638 mn), while equity funds in EMEA (-$47 mn) and Latin America (-$8 mn) saw redemptions. Flows to EM bonds and equities in 2021 were +$52.6 bn and +$99.6 bn, respectively.

Exhibit 1: Weekly Cross-Asset Flows

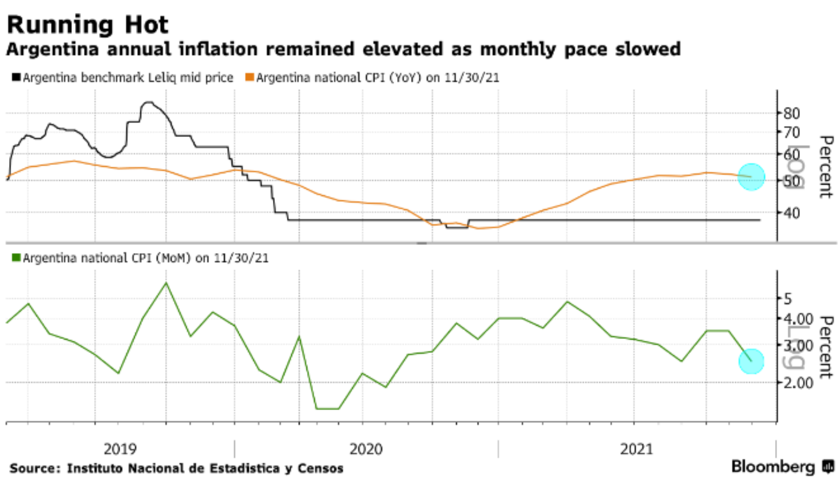
USD billion

	Asset	8w flows (8w ago → current)	This wk	YTD
Fund Flows	**EM Bonds and Equities**		2.2	2.2
	EM Bonds		0.4	0.4
	Hard Ccy		0.5	0.5
	Local Ccy^		-0.1	-0.1
	o.w. EM ex-China		-0.2	-0.2
	o.w. China		0.1	0.1
	EM Equities		1.8	1.8
	US HG		2.3	2.3
	US HY		0.3	0.3
	Global Equities		17.6	17.6
	EM Bond and Equity ETFs		1.4	1.4
	EM Bond ETFs		0.4	0.4
	EM Equity ETFs		1.0	1.0
	Non-resident EM flows*		3.3	3.0

*High frequency non-resident EM portfolio flow data where available. ^Local ccy split is retail only. Source – All charts and data in this report: J.P. Morgan, EPFR Global, Bloomberg Finance L.P

Argentina

Argentina's central bank raised its key rate to 40% from 38% last week for the first time in over a year. Argentina has been an outlier in the region as other Latin American central banks raised rates aggressively to counter inflation. However, the policy rate is still negative in real terms as the nation's inflation rate printed at around 50%. Bloomberg reports that IMF officials called for the policy rate to exceed inflation during December talks to renegotiate payments on Argentina's $40 bn program with the IMF. Analysts expect that further rate hikes will be forthcoming this year.

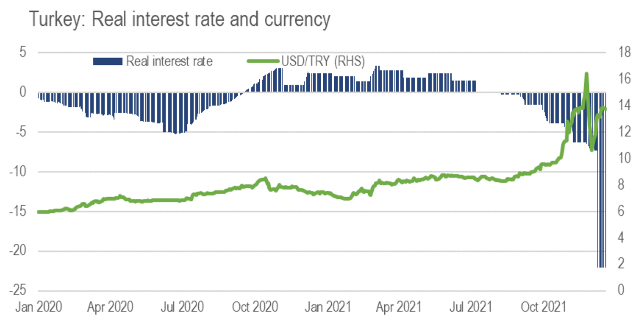


Sri Lanka

Sri Lanka asked China for a debt restructuring. President Gotabaya Rajapaksa made a request to China's Foreign Minister Wang Yi on Sunday, noting that a debt restructuring would be a big relief to Sri Lanka as the country strives to overcome the pandemic. Furthermore, a concessionary trade credit line provided by China would help keep local factories running. Analysts noted that Sri Lanka is searching for funds to bolster its foreign reserves and repay loans amid spiraling import costs. Reportedly, Sri Lanka had about $3.5 bn in debt from China at end-2020, excluding loans to state-owned enterprises. In December 2021, Sri Lanka tapped a $1.5 bn currency swap with China; it is also negotiating a $1.9 bn economic aid package with India. Some major asset managers reportedly expect Sri Lanka to default in the near term; government bond prices are trading at distressed levels.

Turkey

An Inflation surprise renewed pressure on the lira, boosting rate hike expectations. Inflation reached 36% in December, well above the 27.3% consensus forecast, pushing real interest rates to -22%. The two-year bond yield increased by 150 bps as markets priced in policy tightening by the Central Bank of Turkey. Inflation is being worsened by the depreciation in the currency, which was the worst performing currency in the world in 2021, losing 44% of its value against the dollar. The central bank intervened in the FX market five times in December, spending roughly \$7.3 billion to support the lira. President Erdogan also announced a support package in late December including a government pledge to compensate for FX depreciation losses for selected deposits in lira. The plan involves paying holders of lira deposits the differential rate if the lira's decline against hard currencies is larger than the banks' interest rates. The announcement was followed by a strong rally in the lira to around 11 versus the dollar, although media reports suggest limited appetite for the new products.



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Global Financial Indicators

Last updated: 1/10/22 7:48 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		4677	-0.4	-2	-1	22	-2
Europe		4281	-0.6	-1	2	17	0
Japan		28479	0.0	-1	0	1	-1
China		4844	0.4	-2	-4	-11	-2
Asia Ex Japan		83	0.9	0	-3	-13	0
Emerging Markets		49	0.9	0	-2	-11	0
Interest Rates					basis points		
US 10y Yield		1.77	1.3	14	29	66	26
Germany 10y Yield		-0.05	-0.6	7	30	47	13
Japan 10y Yield		0.14	0.0	7	8	11	7
UK 10y Yield		1.17	-0.4	20	43	89	20
Credit Spreads					basis points		
US Investment Grade		112	0.6	0	-3	16	0
US High Yield		346	4.2	8	-9	-26	8
Europe IG		51	0.9	4	-1	3	4
Europe HY		256	3.5	14	-4	3	13
Exchange Rates					%		
USD/Majors		95.96	0.3	0	0	7	0
EUR/USD		1.13	-0.4	0	0	-7	0
USD/JPY		115.3	-0.2	0	2	11	0
EM/USD		52.7	0.1	0	1	-8	0
Commodities					%		
Brent Crude Oil ($/barrel)		81	-0.6	3	8	45	4
Industrials Metals (index)		175	0.2	1	7	27	1
Agriculture (index)		62	-0.3	2	4	27	2
Implied Volatility					%		
VIX Index (%, change in pp)		20.6	1.9	4.0	1.9	-0.9	3.4
US 10y Swaption Volatility		79.2	-2.4	-0.8	1.2	18.3	0.1
Global FX Volatility		7.3	0.1	-0.1	-0.7	-0.5	-0.1
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		161	2.9	17	-12	49	9
Italy		132	-3.9	-1	1	27	-3
Portugal		62	0.1	-1	-3	13	-2
Spain		69	-0.7	-3	-2	12	-6

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

Last updated: 1/10/2022 8:11 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		6.37	0.1	-0.3	0	2	0		2.9	-2.0	2	-10	-28	2
Indonesia		14299	0.4	-0.2	1	-1	0		6.5	1.0	8	15	32	9
India		74	0.4	0.3	2	-1	0		6.8	45.0	45	58	106	45
Philippines		51	0.1	-0.6	-2	-6	-1		4.5	0.0	0	-5	141	3
Thailand		34	-0.1	-1.2	0	-10	-1		2.1	3.0	23	18	62	22
Malaysia		4.20	0.2	-0.7	0	-4	-1		3.7	2.5	11	13	104	10
Argentina		104	-0.2	-0.5	-2	-18	-1		49.0	-10.0	-153	-58	-318	-153
Brazil		5.65	-0.3	0.4	-1	-3	-1		11.4	1.3	44	95	322	70
Chile		827	0.2	3.0	2	-13	3		5.7	1.0	25	54	304	32
Colombia		4050	0.0	0.3	-4	-13	0		7.0	0.5	48	52	294	60
Mexico		20.38	0.1	0.7	2	-2	1		7.8	-0.5	27	55	235	27
Peru		3.9	0.8	1.6	4	-8	2		6.1	0.5	14	16	241	15
Uruguay		45	0.3	0.0	-1	-5	0		8.7	-7.0	-7	-11	142	-7
Hungary		317	-0.3	2.5	2	-6	2		4.8	6.5	29	63	303	29
Poland		4.01	0.0	1.2	2	-7	1		4.0	5.5	41	93	283	44
Romania		4.4	-0.4	0.3	0	-8	0		5.0	-0.5	20	-7	241	20
Russia		75.1	0.7	-0.7	-2	-1	0		8.9	9.1	12	18	235	13
South Africa		15.6	-0.3	1.6	2	-1	2		7.8	10.5	38	32	109	40
Turkey		13.88	-0.1	-5.4	0	-46	-4		24.9	34.0	22	348	1178	57
US (DXY; 5y UST)		96	0.3	-0.2	0	7	0		1.51	1.5	16	26	103	25

	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		4844	0.4	-2	-4	-11	-2		196	-7	-2	-33	-7
Indonesia		6691	-0.2	0	1	5	2		163	-2	-12	-29	-2
India		60396	1.1	2	3	23	4		124	-8	-14	-30	-8
Philippines		7141	1.8	0	-1	-2	0		98	-3	-11	-9	-3
Malaysia		1550	0.5	0	4	-4	-1		114	-3	-3	-31	-3
Argentina		84402	0.8	1	-1	63	1		1793	113	102	432	113
Brazil		102720	1.1	-1	-5	-18	-2		315	4	1	50	4
Chile		4293	-0.1	0	-3	-6	0		138	-2	-2	-11	-2
Colombia		1394	0.9	-1	0	-4	-1		344	-4	17	125	-4
Mexico		53202	0.3	0	4	14	0		333	1	-8	-25	1
Peru		22355	0.8	6	10	3	6		157	7	2	33	7
Hungary		52427	0.9	1	3	18	3		113	-11	-14	-27	-11
Poland		71038	0.3	3	4	19	3		19	-13	-24	-6	-13
Romania		13233	0.6	1	6	30	1		185	-8	0	-14	-8
Russia		3756	-0.4	-3	0	9	-1		175	-2	9	-2	-2
South Africa		74102	0.2	1	3	17	1		341	-14	-22	-50	-14
Turkey		2070	1.8	7	2	34	11		576	-2	31	135	-2
Ukraine		523	0.0	0	0	5	0		773	14	139	294	14
EM total		49	#VALUE!	0	-2	-11	0		396	10	13	57	10

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

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