GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

WEDNESDAY, JANUARY 13, 2021

- **US rate rise led by real rates as well as inflation breakeven yields** (link)
- **Japan lockdown extended to more than half the economy** (link)
- **Rising US rate differentials could spark strong buying from foreign investors** (link)
- **Incoming US administration faces constrained policy choices** (link)
- **China credit slows on shadow banking decline** (link)
- **Portugal sells 10-year bonds at a negative rate for the first time** (link)
- **Higher inflation in Brazil raises odds of rate hike** (link)

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

Global markets in cautious mood

A mood of caution prevails this morning as the virus crisis takes center stage. The US saw a record one-day death toll yesterday, while Japan is extending its lockdown to cover more than half of the economy. ECB President Lagarde expressed worries about the euro area economy if lockdowns are extended into Q2. Meanwhile, an impeachment vote is imminent in the US, raising worries that stimulus negotiations could get delayed by political maneuvering. US equity futures point to a negative open, European markets are mostly lower, and the dollar is once again appreciating against most currencies on safe haven buying. Several Fed officials are due to speak today, placing the US Treasury market in focus.

Key Global Financial Indicators

Last updated: 1/13/21 7:53 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		3800	0.0	2	4	16	1
Eurostoxx 50		3603	-0.3	0	3	-5	1
Nikkei 225		28457	1.0	5	7	19	4
MSCI EM		55	1.0	2	7	18	5
Yields and Spreads					bps		
US 10y Yield		1.17	-0.9	9	22	-73	21
Germany 10y Yield		-0.47	-2.6	3	14	-34	8
EMBIG Sovereign Spread		355	8	5	-9	62	5
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		57.4	-0.4	-1	0	-6	-1
Dollar index, (+) = $ appreciation		90.2	0.2	1	-1	-7	0
Brent Crude Oil ($/barrel)		56.7	0.2	4	13	-12	9
VIX Index (%, change in pp)		23.3	0.7	-1	1	12	1

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

United States

back to top

Tuesday's trading was dominated by the price action in the Treasury market. The morning featured a continuation of the steady rise in yields, with the benchmark 10-year hitting a new post-March high of 1.19%. Stocks took their cue from the Treasury market and were fairly weak. However, the 1pm auction of $38 bn 10-year notes met very heavy demand as bargain hunters snapped up cheap paper, sending the 10-year yield down to 1.13%. Comments from Fed officials pushing back against talk of tapering asset purchases in 2021 also helped bonds. This in turn caused stocks to reverse course, allowing them to post fractional gains and pushing the dollar into negative territory for the session. Banks and airlines outperformed in keeping with the recent reflation theme in US market. **This morning's US inflation data came in close to forecasts, with little impact on the market.**

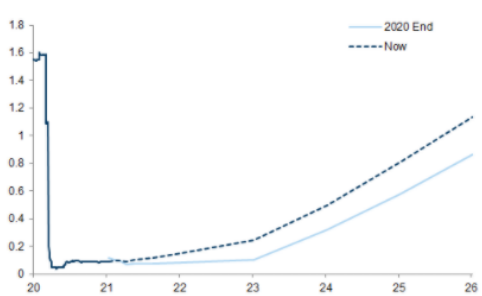
US Inflation Data 8.30 am NY time

Source: Bloomberg

Data Release	Consensus Forecast	Actual Data
CPI mom	0.4%	0.4%
Core CPI mom	0.1%	0.1%
CPI yoy	1.3%	1.4%
Core CPI mom	1.6%	1.6%

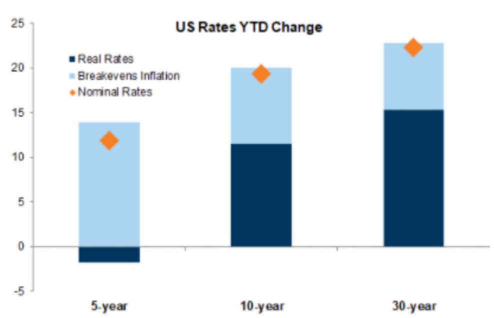
The rise in US interest rates has pulled forward expectations for Fed rate actions and the overall move higher is being led by real interest rates as well as inflation breakeven yields. This is in marked contrast to 2020, where real yields remained subdued as risk assets rallied and breakeven yields increased, especially at the longer end of the yield curve. Goldman thinks this change is highly significant, as the positive correlation between real rates and breakevens has important implications for a variety of asset classes. Elevated breakevens and real yields are likely to favor "reflationary assets" such as commodities and cyclical equity sectors. Small cap stocks and financial stocks are also expected to benefit. The recent record in the Dow Transportation Index is viewed as symptomatic of the expectation that the US economy will recover, and the reflationary trade will dominate in the months ahead.

Exhibit 3 : US rates curve priced higher FED policy rates YTD



Source: Bloomberg, Goldman Sachs Global Investment Research

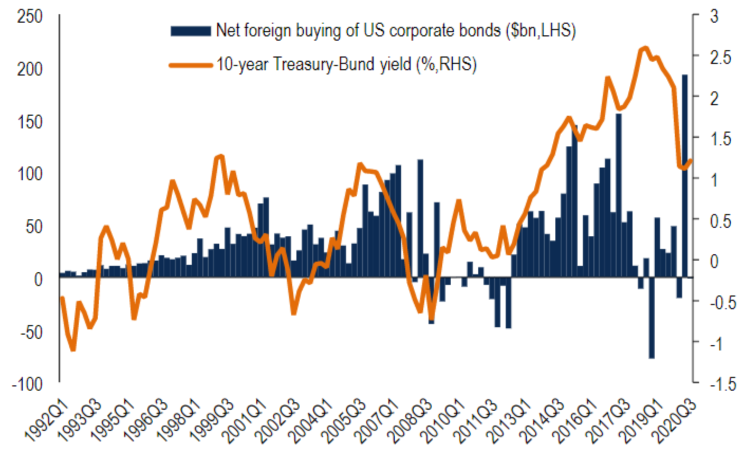
Exhibit 4 : The rates increase was driven by real rates and breakeven inflation for long term maturities



Source: Datastream, Goldman Sachs Global Investment Research

Higher interest rates in the US could attract more foreign buyers of Treasuries and corporate bonds as rising interest rate differentials make US assets more attractive. For example, recent data shows heavy Japanese buying of US Treasuries and corporate bonds. This could be a mitigating factor for the threat posed by US higher rates to risk asset valuations. The US yield curve has steepened to multi-year highs and the benchmark 10-year yield is up by 25 bps since January 4th, while the long bond yield is up 23 bps over the same period.

Figure 4: ... but interest rates differentials appear the real drivers of foreign buying

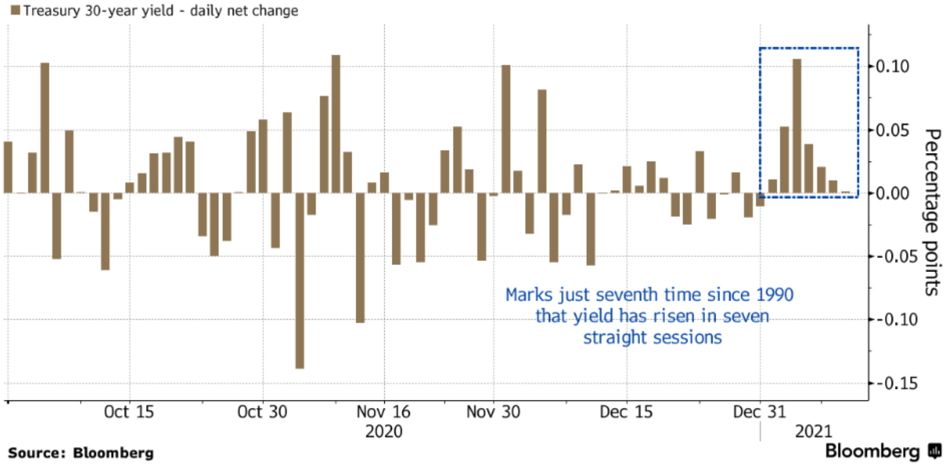


Source: Bloomberg, Federal Reserve, BofA Global Research

The flood of new curve steepening trades signals that investors are speculating that rates could climb even higher, which has made markets nervous as significantly higher interest rates could trigger selloffs in risk assets across the globe as the expensive levels of valuations are predicated on interest rates remaining relatively contained. With interest rates in the euro area and Japan expected to stay very low, the hope is that moderately higher US rates sparked by a strong economic rebound will lead to strong foreign buying. This is in turn could keep a lid on US rates more generally and prevent a potentially dangerous breakout to significantly higher interest rates.

Lucky Seven

Yield on Treasury long bond has risen every single trading day this year

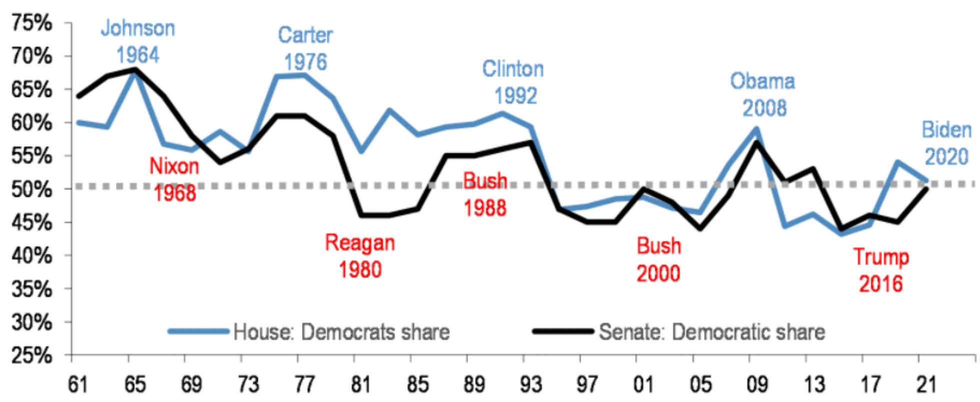


Source: Bloomberg

With the weakest party control of Congress in 60 years, the incoming US administration could be constrained in its policy choices. A slim majority in the House of Representatives and a 50-50 split in the Senate means that the new government is likely to face limited flexibility in the legislation it will be able to pass. Analysts think the looming 2022 midterm elections will also help prevent overreach in terms of potentially controversial new policies. Markets view this constraint as a positive development, leading to a Goldilocks environment in which the government passes a major new stimulus package that will jumpstart the US economy while being unable to pass large tax increases. Although marginally higher corporate tax rates are expected, this is likely to be less of a drag on corporate profitability in an environment where companies are prospering in the midst of a rebound. In addition, the consensus is that the new government will be more efficient in managing the pandemic and the vaccine rollout, another plus for the economy.

Exhibit 1: Recent administrations have all begun with a "trifecta" of unified control, though Biden's party control of Congress is one of the slimmest in 60 years

Share of House and Senate seats held by Democrats after each Presidential and mid-term election (%)



Source: J.P. Morgan

Europe back to top

Euro area

10-yr bund yields fell 3 bps to -0.50% in the wake of comments by ECB President Lagarde and Bank of France Villeroy de Galhau. President Lagarde said that the ECB's December forecasts would still stand if lockdowns are lifted by end-March but that it would be a concern if curbs continued in Q2. **Bank of France governor Francois Villeroy de Galhau told French parliament that the ECB needs to have the capacity to let inflation temporarily go beyond 2%** without any tightening of monetary policy (as compared to the ECB's current policy target of inflation close to but below 2%). 10-year French yield fell 2 bps to -0.28%.

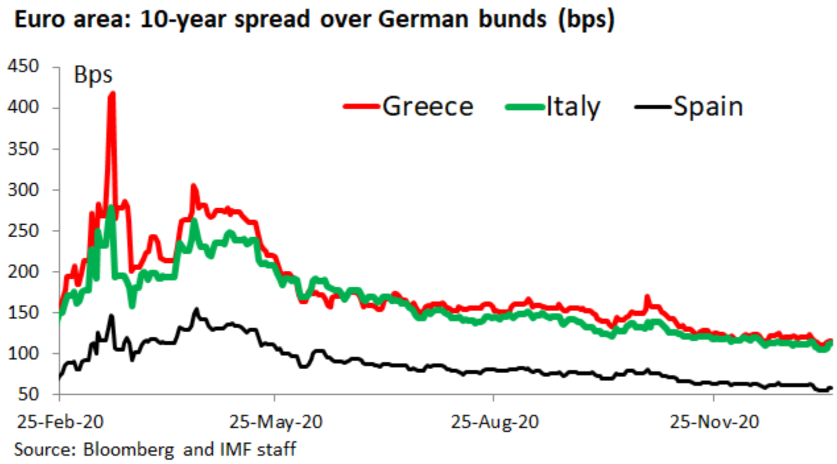
Bank stocks (-1%) underperformed as core yields fell. Equities (-0.2%) and the euro (-0.2%) edged lower.

Euro area industrial production is approaching pre-pandemic levels. Industrial production grew a better-than-expected 0.5% mom (0.2% expected) or 0.6% yoy (-3.2% yoy expected) in November.

In contrast, industrial production disappointed in Italy with a contraction of 1.4% mom (-0.4% mom expected) or 4.2% yoy (-2.6% yoy expected). The contraction was widespread and included consumer goods in line with disappointing retail sales data and new curbs.

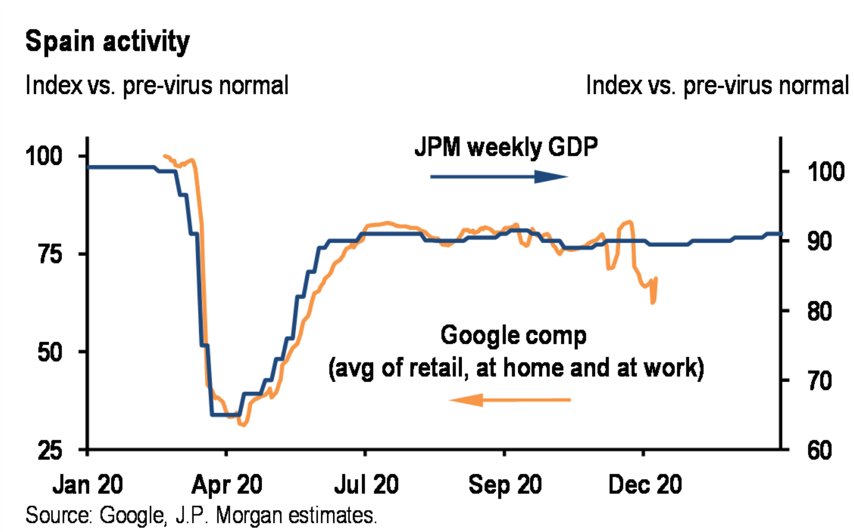
Italian bonds continue to trade with a cautious tone on political concerns. Former PM Renzi will hold a press conference later today (at 5:30 PM local time) on whether to pull his ministers out of the coalition. Overnight the government approved a new Recovery and Resilience Plan but the two ministers from

Renzi's Italia Viva abstained. Press reports are that the plan does not include use of ESM funding, despite Renzi's demand to ask for ESM support.10-yr spreads are 2 bps higher at 114 bps today.

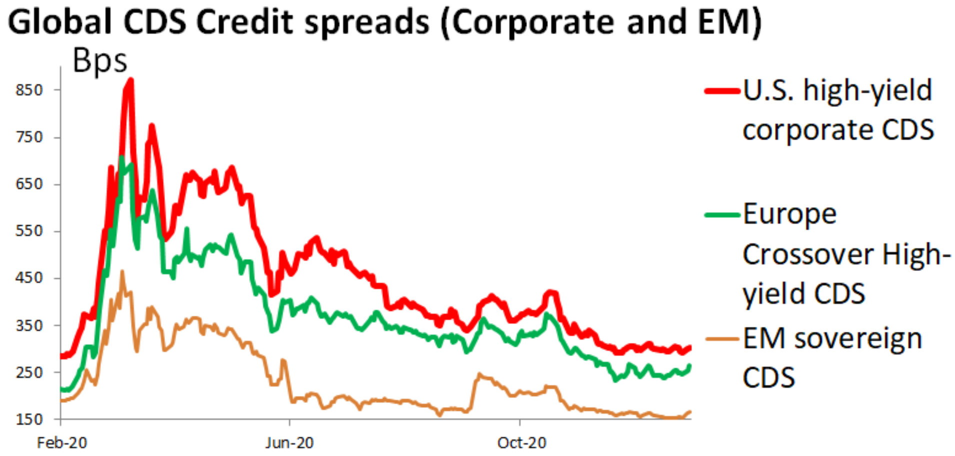


Portugal sold €500 mn of 10-yr bonds a negative yield of -0.012% for the first time ever as demand for European government bonds remains strong. Spanish 10-yr spreads are little changed at 57 bps after Spain saw a record book size of €130 bn for a new 10-yr syndication reportedly offered at 4 bps above current market yield. The previous record size was an interest of €97 bn in April 2020 (of which €15 bn was issued).

Banks expect Spanish growth to disappoint in 2020Q1 given a resurgence of covid-19 cases after economic activity was better than expected in 2020Q4. Analysts point out that Spain has maintained a looser set of Covid restrictions over the past month compared to other countries. JP Morgan, for example, raised its 2020Q GDP forecast to -2% annualized (up from -8%) but lowered 2021Q1 GDP growth to 0% annualized, down from 3.5% annualized.



Crossover high-yield spreads fell 6 bps to 258 bps (up 16 bps YTD). Investment-grade CDS spreads are little changed at 50 bps. CDS credit spreads have been relatively stable following the tremor in U.S. yields.



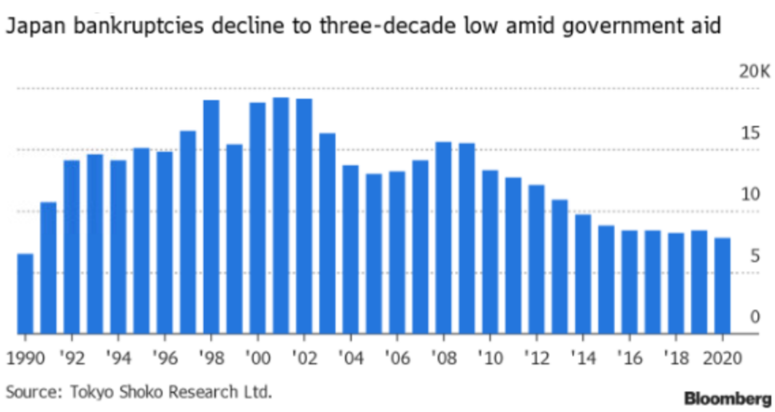
Note: Europe Crossover high-yield index comprises 75 equally weighted credit default swaps on the most liquid sub-investment grade European corporate entities.
U.S. high-yield is composed of 100 non-investment grade corporates (B and BB).
EM CDS covers 18 sovereign issuers.
Source: Bloomberg, and IMF staff

Other Mature Markets

back to top

Japan

Prime Minister Suga will extend the state of emergency to seven additional prefectures. Together with Tokyo and three neighboring prefectures that were put under the state of emergency last week, the 11 areas account for more than half of the country's output. **The Bank of Japan (BOJ) is reportedly considering cutting its growth outlook for the fiscal year ending March 2021.** Given the emergency declaration, the current forecast of -5.5% may be reviewed at the BoJ's upcoming policy meeting next week, according to Nikkei. Separately, Japanese bankruptcies fell to the lowest level in 30 years in 2020, according to Bloomberg. 792 companies that failed attributed the bankruptcy to the virus. **Equities rose for the fifth consecutive day by +0.4%. The yen was little changed while 10-year JGB yield fell -0.5bps.**



Emerging Markets

back to top

EMEA equities were trading mixed with stocks up in the UAE (+0.7%) and Turkey (+0.6%) but down in Poland (-1.2%). Currencies gave back some of yesterday's gains versus the dollar. **Asian equities rose +0.5%, with wide dispersion.** Southeast Asia outperformed, with Thailand and Malaysia rising by more than 1%. In North Asia, China (Shanghai -0.3%; Shenzhen -1.1%) and Hong Kong SAR (-0.2%) underperformed while Korea (+0.7%) and Taiwan Province of China (+1.7%) rose. Regional currencies were mixed. **In Latin America, equities and currencies were mostly stronger while interest rates**

continued to increase. Sovereign yield curves continued to steepen in most countries, except for a flatter local currency yield curve in Peru.

Key Emerging Market Financial Indicators

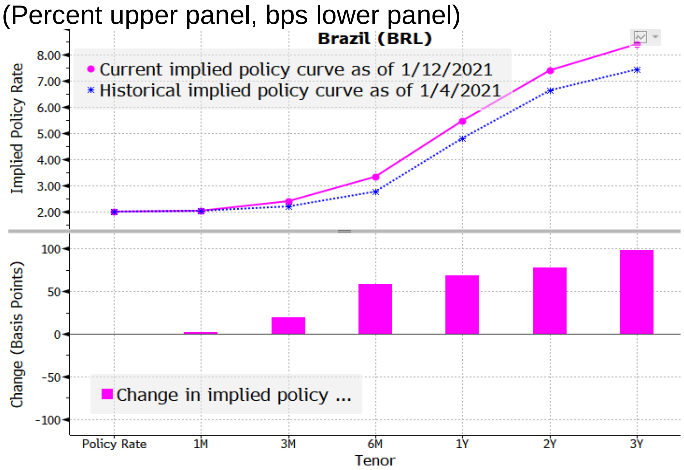
Last updated: 1/13/21 7:55 AM	Level: Last 12m	Level: index	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		54.50	-0.5	2	7	18	5
MSCI Frontier Equities		29.59	0.5	2	6	-4	4
EMBIG Sovereign Spread (in bps)		355	8	5	-9	62	5
EM FX vs. USD		57.40	-0.4	-1	0	-6	-1
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.47	-0.1	0	1	7	1
Indonesian Rupiah		14060	0.5	-1	0	-3	0
Indian Rupee		73.15	0.1	0	1	-3	0
Argentine Peso		85.47	-0.1	-1	-4	-30	-2
Brazil Real		5.32	0.0	0	-4	-22	-2
Mexican Peso		19.82	-0.1	-1	2	-5	0
Russian Ruble		73.79	-0.4	0	0	-17	0
South African Rand		15.31	-0.5	-2	-2	-6	-4
Turkish Lira		7.44	0.2	-2	6	-21	0
EM FX volatility		10.59	0.0	0.1	0.3	4.2	-0.2

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

Brazil

December's high inflation print signals potential for tighter monetary policy and higher interest rates ahead. Brazil's inflation printed in December at 4.5% y/y, exceeding the 4.4% expected by market consensus and up from 4.3% in November. As in the months before, the main drivers included food prices, but housing and household goods contributed also to higher than expected inflation. The surprise led J.P. Morgan analysts to increase their inflation projections for the next three months by 14 to 21 bps per month to 0.33%, 0.54% and 0.4%, all mom, for January, February and March, respectively. Similarly, the investment bank adjusted its inflation forecast for the end of the year to 3.75% yoy. However, markets seem to have anticipated the higher print, as over the week ahead of the data release Brazil's market-implied monetary policy rate curve moved up by 22 bps for the 3-month tenor. This short term anticipation of markets was also reflected in yesterday's downward shift in Brazil's local yield curve, with 10-year yields declining by 5 bps. However, expectations of higher interest rate longer term added to the strong rally of the real over the day.

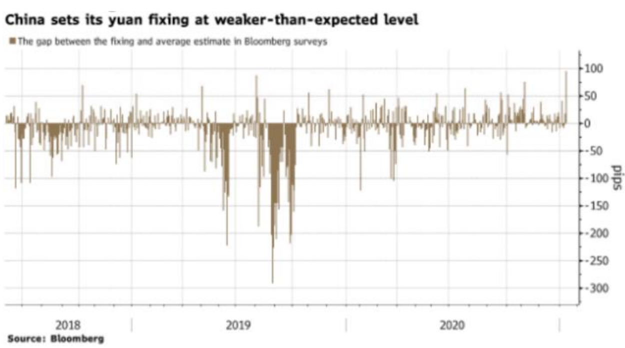
Brazil's Market-implied Policy Rate Curve
(Percent upper panel, bps lower panel)

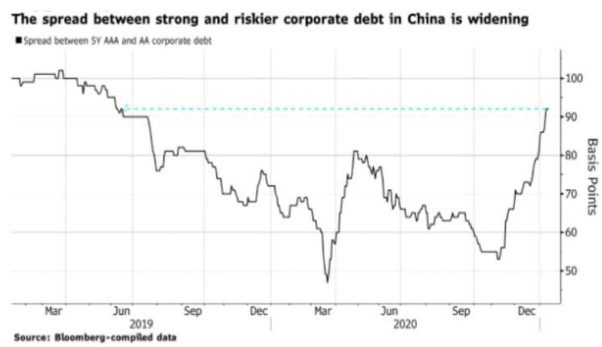


Source: Bloomberg

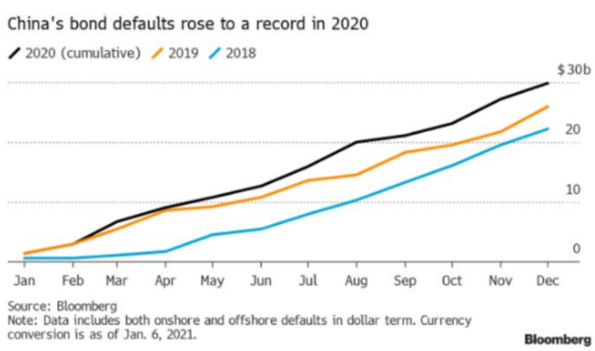
China

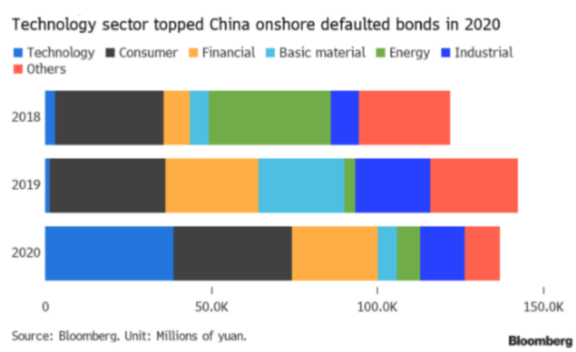
Credit slowed in December, driven by a drop in shadow banking activities. Aggregate total social financing (TSF) flow came in at RMB1.72 tn ($266 bn), compared with RMB2.13 tn in November. Shadow banking credit fell the most in four years by RMB738 bn, while new bank loans also fell compared with November. **Separately, the central bank set its currency's fixing at the weakest level relative to analysts' expectations since 2018, or 0.15% weaker.** Some analysts interpreted this as a sign that policymakers are trying to limit RMB appreciation and expected announcements of further measures to allow for more outflows to help balance the strong capital inflows (both trade and portfolio inflows). The currency surged over 8% against the USD over the past six months. On January 12, PBOC asked onshore financial firms, including local foreign lenders, to limit the amount of foreign-currency debt they raise via certain channel in the overseas market, Bloomberg reported. **The onshore RMB was little changed, while the offshore renminbi depreciated by 0.3%.**





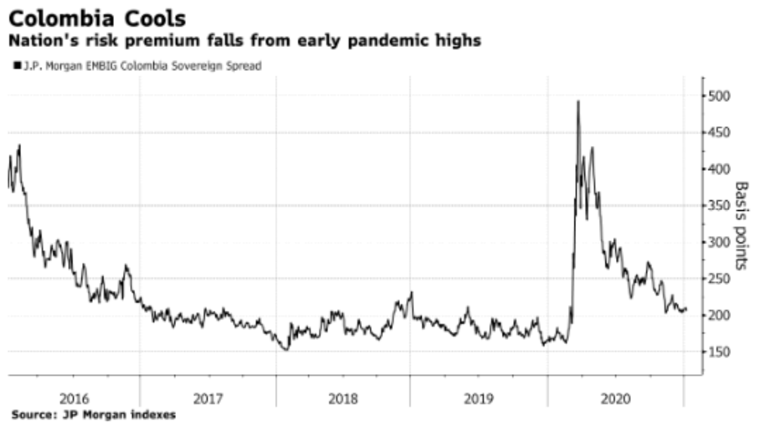
Onshore credit spreads have widened amid rising defaults. The spread between five-year AAA and AA-rated bonds rose to 92bps, the highest since June 2019. Defaults by Chinese companies increased to a record high in 2020, with around 39 firms, domestically and offshore, defaulting on almost $30 bn, 14% higher than in 2019, according to Bloomberg. The technology sector accounted for the most onshore defaults at 28%, followed by consumer and financials, while financials accounted for 43% of overall defaults in the dollar bond market. **Equities (Shanghai -0.3%; Shenzhen -1.1%) fell**.





Colombia

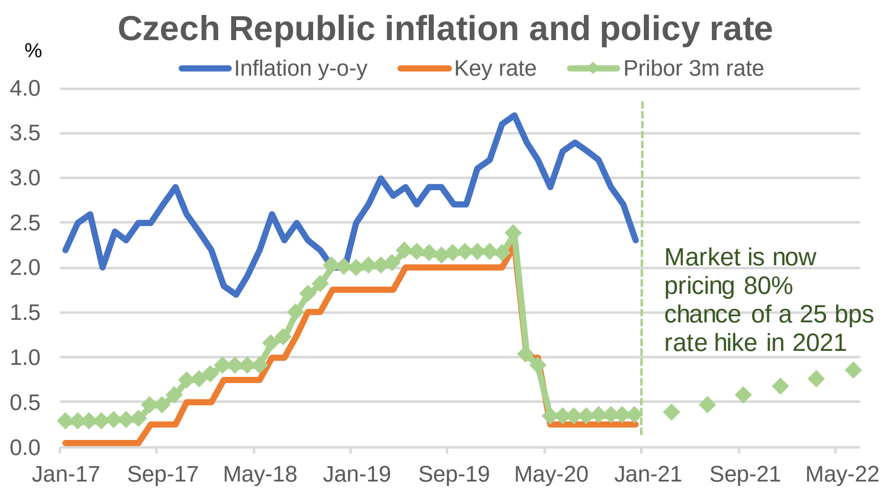
Colombia's sovereign yield rise, as the government taps into currently cheap debt markets. In the current environment of low US treasury yield levels, Colombia is selling $1.3 bn of 40Y sovereign dollar bonds and $0.8 bn of 10Y sovereign dollar bonds. According to Bloomberg, pricing guidance indicates that the long term bond will price with a spread of 210 over US treasury yields, 7 bps lower than yesterday's EMBIG spread of 217 bps for Colombia's sovereign. The 10Y bond is expected to be issued with a yield of 2.8%. Colombia's USD debt yield curve reacted by steepening, with the 15Y yield increasing by 7 bps to 3.98%. The 5Y sovereign CDS spread to the US widened by 4 bps to 100 bps.



Source: Bloomberg.

Czech Republic

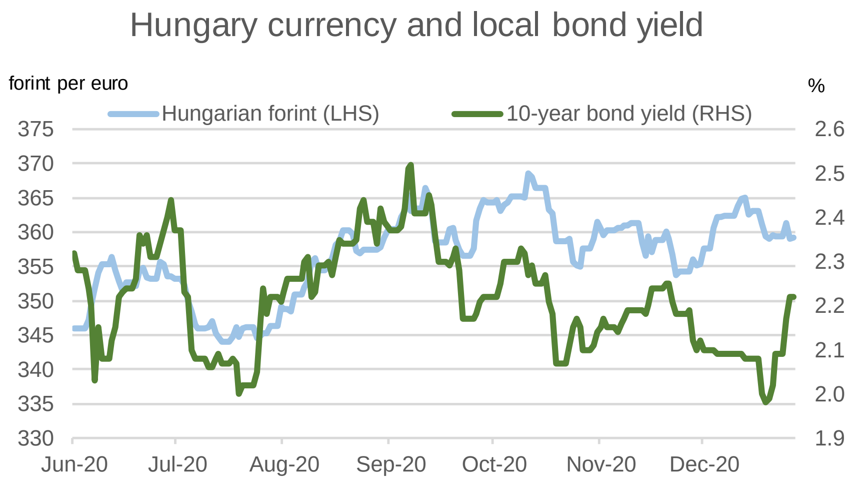
Inflation slowed to below consensus in December, paring back market rate hike expectations. The headline decelerated to 2.3% yoy from 2.7% in November, notably below market expectations of 2.6% as well as Czech National Bank forecast of 3%. That said, most of the decrease comes on the back of volatile food prices. The 12-month interest rate forward agreements dropped by 8 bps following the release with market participants now pricing 20 bps of policy tightening in 2021 as compared to 35 bps of tightening priced throughout December. By contrast, the latest Czech National Bank policy rate forecast projected a 25 bps rate hike in Q2 2021 with the key rate moving closer to 1% by the end of 2021.



Source: Bloomberg, IMF

Hungary

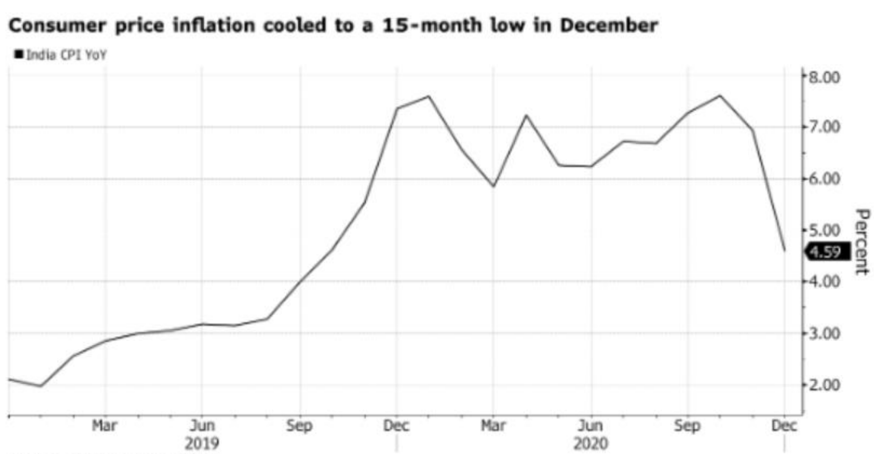
The National Bank of Hungary expanded its corporate bond purchases program. The program envelope was increased from HUF 750 bn to 1150 bn ($ 3.9bn or 2.3% of GDP) while now allowing purchases of securities with 30 years to maturity. The corporate bond purchase program, launched initially in July 2019, has provided companies with HUF 900 bn of funding. Hungary also maintained the pace of its government bond purchases program around HUF 40-50 bn per week with a total program size reaching HUF 1130 bn. **Hungarian government 10-year bond yield climbed 20 bps over the past week,** mostly following global yield curve dynamics, while the forint has been stable as the central bank maintains tight liquidity in short-end of the yield curve. Markets are pricing unchanged policy rate on a 1-year horizon.



Source: Bloomberg

India

India's inflation cooled to a 15-month low in December. Consumer prices grew 4.6% yoy in December, surprising to the downside (consensus: 5%), from 6.9% yoy in November on easing food prices. This also marked the first time in nine months that inflation returned to the central bank's target range of 2%-6%. The inflation print is the last before the Reserve Bank of India meets on February 5. Separately, industrial production contracted -1.9% yoy in November versus an upward revised rate of +4.2% yoy in November. **10-year bond yield fell -3bps, equities rose +0.4% while the currency was little changed.**



Source: Ministry of Statistics

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Global Financial Indicators

Last updated: 1/13/21 7:54 AM	Level		Change				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
United States		3801	0.0	2	4	16	1
Europe		3603	-0.3	0	3	-5	1
Japan		28457	1.0	5	7	19	4
China		3599	-0.3	1	8	16	4
Asia Ex Japan		95	0.7	2	8	24	6
Emerging Markets		55	1.0	2	7	18	5
Interest Rates					basis points		
US 10y Yield		1.17	-0.9	9	22	-73	21
Germany 10y Yield		-0.47	-2.6	3	14	-34	8
Japan 10y Yield		0.04	-0.1	2	3	4	2
UK 10y Yield		0.33	-1.8	9	16	-42	14
Credit Spreads					basis points		
US Investment Grade		96	-0.6	-3	-11	-7	0
US High Yield		374	3.5	-4	-27	-18	-2
Europe IG		50	0.0	2	0	7	2
Europe HY		259	-3.2	10	-2	52	17
EMBIG Sovereign Spread		355	8.1	5	-9	62	5
Exchange Rates					%		
USD/Majors		90.24	0.2	1	-1	-7	0
EUR/USD		1.22	-0.3	-1	0	9	0
USD/JPY		103.9	-0.1	-1	0	6	-1
EM/USD		57.4	-0.4	-1	0	-6	-1
Commodities					%		
Brent Crude Oil ($/barrel)		57	0.2	4	13	-12	9
Industrials Metals (index)		136	0.0	-1	1	17	3
Agriculture (index)		51	1.5	4	17	24	6
Implied Volatility					%		
VIX Index (%, change in pp)		23.3	0.7	-1.0	0.7	11.7	1.3
US 10y Swaption Volatility		60.7	-2.6	3.3	-1.7	1.7	0.6
Global FX Volatility		7.8	0.0	0.0	-0.4	2.4	-0.2
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		120	3.6	5	-4	-35	0
Italy		114	1.8	5	-6	-40	2
Portugal		52	1.4	-2	-8	-7	-8
Spain		58	0.0	1	-6	-6	-4

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

back to top

Emerging Market Financial Indicators

Last updated: 1/13/2021 7:56 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		6.47	-0.1	-0.1	1	7	1		3.3	0.1	-3	-10	15	0
Indonesia		14060	0.5	-1.2	0	-3	0		6.3	3.1	23	18	-71	23
India		73	0.1	-0.1	1	-3	0		6.0	2.3	9	3	-88	6
Philippines		48	0.0	0.0	0	5	0		3.7	1.4	4	2	-65	2
Thailand		30	0.0	-0.3	0	1	0		1.4	2.9	9	-8	-16	6
Malaysia		4.04	0.3	-0.8	0	0	-1		2.6	-0.5	8	-1	-69	5
Argentina		85	-0.1	-0.8	-4	-30	-2		52.2	-53.2	-127	-321	208	-398
Brazil		5.32	0.0	-0.3	-4	-22	-2		6.2	-10.0	57	45	7	67
Chile		741	-1.9	-5.7	-1	5	-4		2.8	-2.3	10	-5	-67	7
Colombia		3479	0.9	-1.0	-1	-6	-1		5.1	8.3	14	-4	-60	8
Mexico		19.82	-0.1	-0.8	2	-5	0		5.7	1.3	13	-6	-120	12
Peru		3.6	0.1	0.5	-1	-8	0		3.7	-5.2	14	2	-69	14
Uruguay		42	0.4	-0.3	0	-12	0		7.2	0.0	-2	-15	-354	-1
Hungary		296	-0.5	-1.5	-1	1	0		1.7	0.6	20	6	50	13
Poland		3.72	-0.4	-1.3	-2	2	0		0.6	1.1	-1	-8	-140	-2
Romania		4.0	-0.3	-1.3	0	7	-1		2.6	3.0	-2	-21	-127	-11
Russia		73.8	-0.4	0.2	0	-17	0		5.7	1.3	3	15	-25	3
South Africa		15.3	-0.5	-1.6	-2	-6	-4		9.7	-3.7	8	-1	19	6
Turkey		7.44	0.2	-1.7	6	-21	0		13.4	0.4	8	-2	240	29
US (DXY; 5y UST)		90	0.2	0.8	-1	-7	0		0.50	-0.2	7	13	-115	14

	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		5578	-0.3	3	14	33	7		209	1	0	3	35	1
Indonesia		6435	0.6	6	8	2	8		182	-2	5	-11	23	-5
India		49492	-0.1	3	7	18	4		156	0	6	4	29	5
Philippines		7243	-0.2	3	0	-7	1		103	-2	8	-13	32	-2
Malaysia		1637	1.5	3	-3	3	1		120	1	2	3	15	10
Argentina		51202	0.5	-1	-5	22	0		1417	1	35	24	-410	49
Brazil		123998	0.6	4	8	6	4		262	1	4	1	52	12
Chile		4623	1.0	5	13	-7	11		143	1	5	-9	4	-1
Colombia		1462	0.6	2	6	-12	2		218	1	8	3	51	13
Mexico		45952	-1.0	2	5	2	4		374	0	7	-30	79	14
Peru		21619	-0.2	3	6	6	4		137	1	10	-18	27	5
Hungary		44639	0.9	4	8	-2	6		78	0	-7	-22	-10	-18
Poland		58228	-1.6	0	5	-2	2		-12	0	-6	-17	-30	-11
Romania		10256	0.8	3	8	2	5		204	6	6	-9	30	1
Russia		3467	-0.1	3	6	10	5		161	-4	-1	-10	22	-5
South Africa		63663	0.2	3	7	11	7		383	-7	-6	-1	58	3
Turkey		1550	0.0	3	13	29	5		451	-13	7	-46	60	6
Ukraine		499	0.0	0	-2	-2	0		491	-12	9	-1	122	0
EM total		55	-0.5	2	7	18	5		421	0	17	-10	97	128

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