GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

THURSDAY, JANUARY 20, 2022

- **Markets continue to forecast a short and shallow Fed rate hike cycle** (link)
- **PBOC rate cut smaller than expected** (link)
- **US stocks tend to rally after rate hike cycles begin** (link)
- **Survey finds investors expect Fed hike in March** (link)
- **Chilean peso is strongest among emerging markets this month** (link)
- **Special Feature: Drivers of Global AE Interest Rates** (attached)

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Markets make gains on positive economic news

Markets were cautiously optimistic this morning as a series of strong economic reports in several countries, and rate cuts from a number of central banks, brought the week's global selloff to a temporary halt. In Japan, robust exports led to a narrowing of the trade gap, while in Australia the jobs report was stronger than expected, with unemployment falling to a 13-year low. Inflation in some emerging markets is showing the first signs of moderation. In Turkey, the central bank finally ended its series of rate cuts, giving the lira a much needed breather. US equity futures are up, along with most exchanges in Europe. However, the pandemic continues unabated, with infection rates remaining very high in the US, parts of Europe and elsewhere, and sentiment remains fragile. Inflation remains one of the main worries for global markets and with the Fed expected to begin its rate hikes in March and quantitative tightening later in the year, investors are likely to face challenging conditions ahead. The continued rise in commodity prices is another worry, as it could force central banks to tighten more aggressively to combat inflation.

Key Global Financial Indicators

Last updated: 1/20/22 7:46 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		4533	-1.0	-4	-1	18	-5
Eurostoxx 50		4279	0.3	-1	4	18	0
Nikkei 225		27773	1.1	-3	-3	-3	-4
MSCI EM		49	0.4	-1	4	-12	1
Yields and Spreads				bps			
US 10y Yield		1.83	-3.4	13	41	75	32
Germany 10y Yield		-0.03	-1.9	6	34	50	15
EMBIG Sovereign Spread		386	-1	12	11	29	19
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		53.3	0.1	0	2	-8	1
Dollar index, (+) = $ appreciation		95.6	0.1	1	-1	6	0
Brent Crude Oil ($/barrel)		88.0	-0.5	4	23	57	13
VIX Index (%, change in pp)		23.1	-0.8	5	0	2	6

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

Mature Markets

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United States

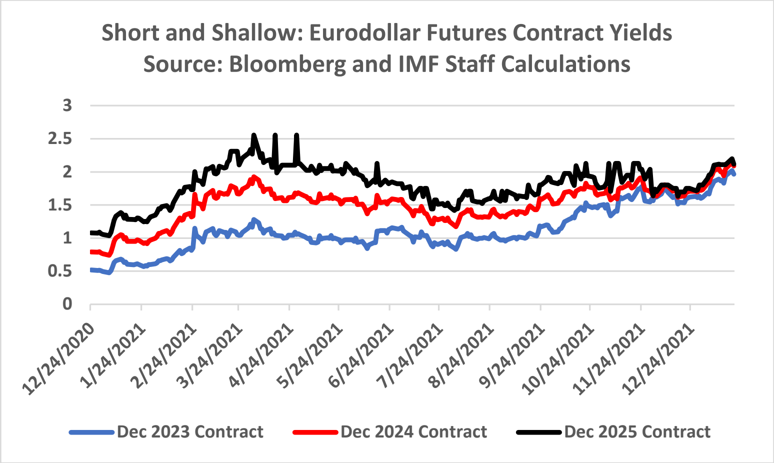
The latest jobless claims data were much higher than expected and up sharply from the week before. In contrast, the Philadelphia Fed business outlook number was stronger than expected. US equity index futures gave back some of their gains shortly after the reports, but Treasuries and the dollar held steady.

Key US Data 8.30 a.m.

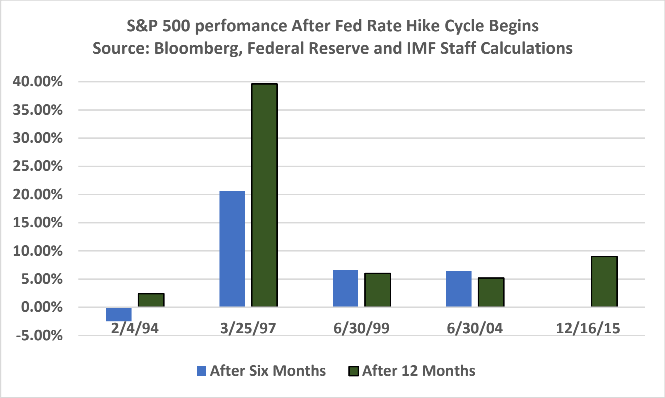
Indicator	Consensus Forecast	Actual Result
Weekly Jobless Claims	225K	286K
Continuing Claims	1563K	1635K
Philadelphia Fed Business Outlook	19.0	23.2

Source: Bloomberg

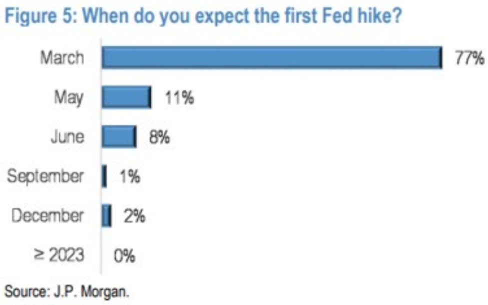
Interest rate futures markets continue to price a short and shallow Fed interest rate hike cycle. The eurodollar futures markets has been little changed over the past two weeks despite both the 10-year and five-year yields surging up to pre-pandemic levels over the same period. The market is still predicting that the Fed policy rate will hit 2% by the end of 2023 and stay close to that level through 2024 and 2025. This equates to four 25 bps rate hikes each in 2022 and 2023 and no more after that. Built into this forecast is the assumption that inflation is brought under control relatively quickly so that further rate hikes are unnecessary. The fact that the eurodollar market has held steady despite the recent Treasury selloff indicates that investors believe that Treasury yields are not likely to move much higher. The risk is that if this prediction is wrong and yields do move higher, a bearish repricing in the eurodollar futures market is likely. This would probably trigger spillover effects to other markets, causing a potentially dangerous surge in volatility. There is also the risk that markets are understimating the Fed's determination to fight inflation, as indicated by the fact that eurodollar futures pricing remains well below the levels of the FOMC's dot plot.

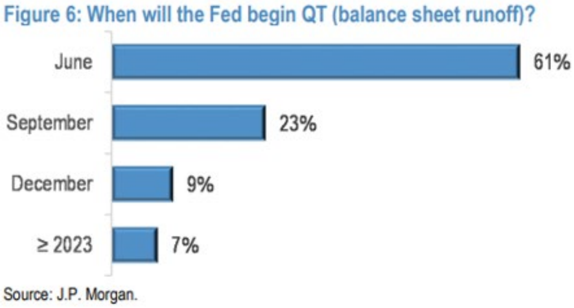


US stocks tend to do quite well after rate hike cycles begin, historical data show. Over the past five cycles, the S&P 500 rallied 12 months after the cycle began, and posted gains on three of five occasions six months after rate hikes began. This is probably because of successful market guidance from the Fed, providing a clear message to markets about how it is likely to proceed. As markets are forward looking, the impact of rate hikes is priced into market expectations and investors move on from there. Analysts are hopeful that a similar dynamic will prevail this time, and that the early selloff so far this year will give way to more positive results for equities and other risk assets. However, inflation is the big wildcard, as today inflation is higher than it was in those previous cycles.



The latest JP Morgan investor survey found that a strong majority of investors expect the first Fed rate hike to be announced at the March 16 FOMC meeting. In addition, 61% expect quantitative tightening to be announced at the June 15 meeting. However, despite this hawkish view on rates, they remain very bullish on the stock market. 77% of those polled said their equity allocations were higher than the 50th percentile, and 74% said they were likely to increase their equity allocations over the next few weeks. Investors were also optimistic about the pandemic, with 73% expecting the virus crisis to recede after the omicron variant. On President Biden's Build Back Better plan, 74% expect some version of the package to pass through Congress. However, they remain very bearish on bonds, with 79% expecting to decrease their duration exposure in the near future.





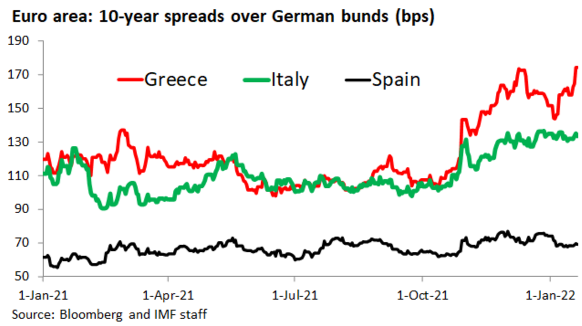
Euro area

German 10-yr bund yields (-2 bps to -0.03 bps) fell as ECB President Lagarde said that the ECB has every reason not to respond as quickly as the Federal Reserve to increasing prices, pointing to weaker inflation and a less advanced recovery.

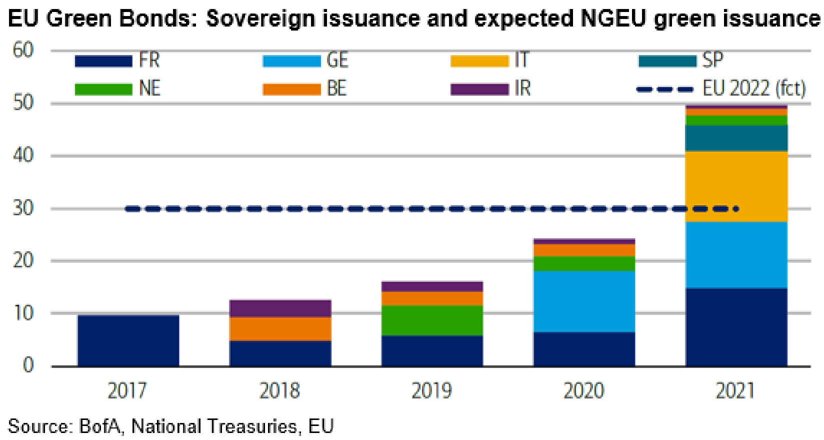
Rising prices pressures remain a concern ahead of the release of ECB accounts of the December meeting. German price producer price inflation (PPI) unexpectedly rose to 24% yoy (19% expected) or 5% mom (0.8% mom expected) in December. Energy producer prices were the key driver. Nevertheless, analysts at Citi point out that even excluding energy, PPI inflation rose from 9.9% to 10.4% yoy.

Italian 10-yr spreads (-2 bps to 133 bps) fell ahead of the start of the presidential election on 24 Jan. Some commentators argue that the election of PM Draghi has become more likely after Berlusconi withdrew his candidacy.

Greek spreads stabilized at higher levels of 175 bps after Greece issued €3 bn of a new 10-yr bond (with a reported book of €15 bn). Greek 10-yr spreads are up 23 bps so far in 2022. **Some contacts expect that spreads that could widen further as the ECB tapers its pandemic asset purchases.** The ECB has bought +€35 bn of Greek bonds in its pandemic purchase program.



Analysts expect that the EU could issue about €30 bn of green Next Generation (NGEU) bonds as part of total NGEU issuance of around €100 bn in 2022. In 2021-26, NGEU could issue as much as €250 bn of green bonds. **Turning to specific euro area countries, green issuance is expected to stabilize at around 5% of total issuance**, with euro area countries issuing a total of €70 bn of green bonds compared to €50 bn in 2021. Demand is expected to remain strong.



Emerging Markets

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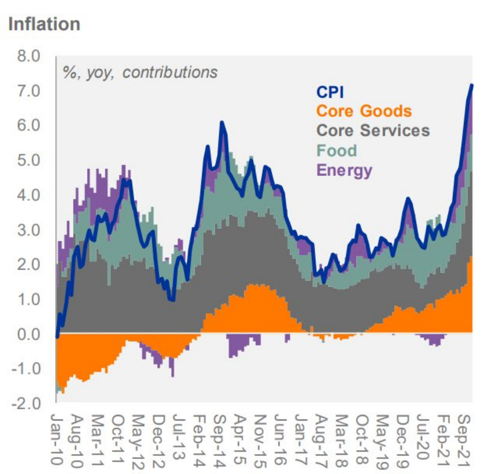
EMEA markets were mixed, with Russia and Turkey up modestly while Hungary and the Czech Republic were lower. Asian markets shrugged off the US selloff yesterday to post solid gains. Asian currencies also did well versus the dollar. The central bank of Indonesia surprised markets when it announced that it would begin raising reserve requirements for banks starting in March, while keeping its policy rate unchanged at 3.5%. In Sri Lanka, the central bank hiked more than expected, while in Malaysia the central bank stayed on hold as forecasted by analysts. In **Latin America,** regional currencies also appreciated as oil reached its highest value since October 2014 boosting, commodity linked currencies. The Brazilian real lead the gains with a strong 2.2% rally, likely boosted by comments by ex-President Lula that he is willing to collaborate with more moderate forces in the upcoming election.

China

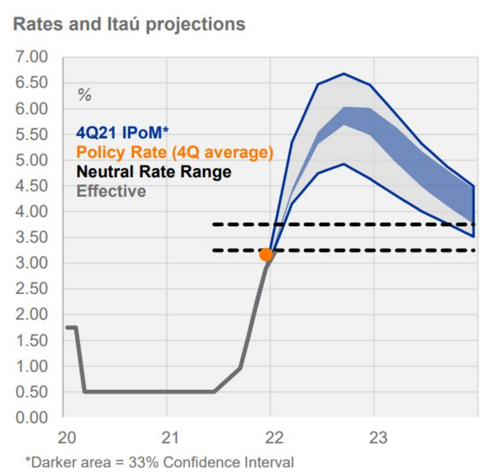
The Peoples Bank of China (PBOC) cut loan prime rates (LPR), in keeping with an earlier pledge to ease financial conditions. The one-year LPR was lowered by 10 bps to 3.7% as expected, but the 5-year LPR was cut by only 5 bps to 4.6% (consensus: 4.55%). The move followed an easing pledge made by PBOC official yesterday and a one-year medium-term loan facility (MLF) rate cut on Monday. Analysts expect more easing steps in the future, including further reduction of policy rates and bank reserve ratio requirement. Separately, **China's property developer Aoyuan declared imminent default on four of its dollar notes.** The company will skip remaining principal and interest instalments on two senior notes due this week and will skip incoming interest instalments on two senior notes due in 2023 and 2024, exchange filings revealed. The developer said the move is to “preserve limited cash resources” and that it “intends to adopt the same principle” for other offshore debt. **Equities were mixed (CSI 300 +0.9%, Shanghai: -0.1%, Shenzhen: -0.9%),** property developer shares broadly extended rallies on the fresh LPR cuts and the central bank easing pledge. **Renminbi was broadly unchanged,** following the PBOC decision yesterday to set the RMB fixing at the strongest level strongest since May 2018.

Chile

The peso is the best performing EM currency over the last month (+8%) as markets wait for the announcement of a moderate cabinet on Friday. Following the election result in December analysts highlight that President-elect Boric has toned down his rhetoric. Additionally, the makeup of Congress, in which the President-elect’s coalition is a minority, is seen as another factor that can lead to more moderate policy proposals. Finally, even though inflation is expected to continue its upward path in the first half of 2022, forecasters expect inflation to return close to target by 2023 on the back of a tight macro policy mix. The central bank is priced in to hike another 125 bps next week and keep the policy rate well above neutral in 2022, encouraging investors to add/maintain long FX positions.



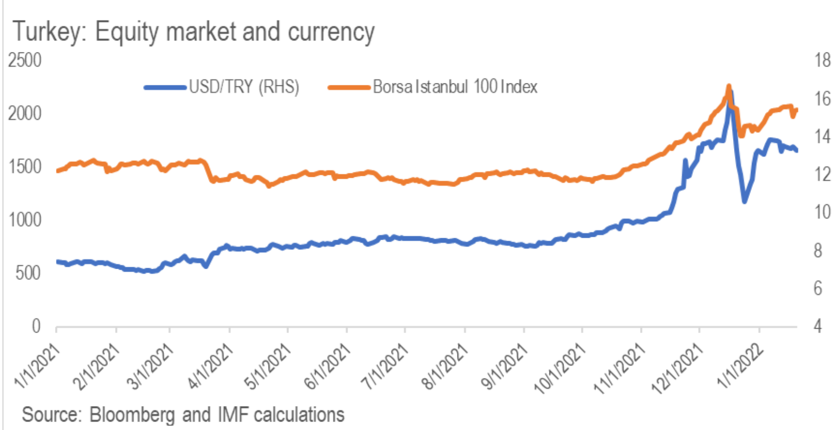
Source: Itaú, INE and Central Bank of Chile.



Source: BCCh.

Turkey

The Turkish lira appreciated (+0.7%) after the Central Bank of Turkey kept rates on hold at 14%, as expected. The central bank has lowered interest rates by 500 bps since September and hinted in December that the easing cycle will be paused until the end of March to assess the outcome of lower rates. **Today’s** press release did not commit to a time frame for keeping rates on hold, and attributed the recent increase in inflation, that reached 36% yoy in December, to distorted pricing behavior as a result of unhealthy price formations in the foreign exchange market, as well as supply side factors. Disinflation is seen to start as a result of measures taken for sustainable financial and price stability, but also due to base effects. **Some contacts caution that the view of disinflation is notably at odds with analyst expectations,** and expect policy using non-standard tools instead of rate increases going forward.



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Global Financial Indicators

Last updated: 1/20/22 7:48 AM	Level Last 12m	Level Latest	Change 1 Day	Change 7 Days	Change 30 Days	Change 12 M	YTD
Equities					%		%
United States		4533	-1.0	-4	-1	18	-5
Europe		4278	0.2	-1	4	18	0
Japan		27773	1.1	-3	-3	-3	-4
China		4824	0.9	1	-2	-13	-2
Asia Ex Japan		83	0.2	-1	4	-16	1
Emerging Markets		49	0.4	-1	4	-12	1
Interest Rates					basis points		
US 10y Yield		1.83	-3.0	13	41	75	32
Germany 10y Yield		-0.03	-1.8	6	34	50	15
Japan 10y Yield		0.15	0.3	2	11	10	8
UK 10y Yield		1.24	-1.9	13	47	94	27
Credit Spreads					basis points		
US Investment Grade		118	1.3	1	-2	24	6
US High Yield		342	1.0	4	-22	-28	5
Europe IG		54	0.4	3	3	5	6
Europe HY		264	1.2	11	6	16	21
Exchange Rates					%		
USD/Majors		95.63	0.1	1	-1	6	0
EUR/USD		1.13	0.0	-1	1	-6	0
USD/JPY		114.3	-0.1	0	1	10	-1
EM/USD		53.3	0.1	0	2	-8	1
Commodities					%		
Brent Crude Oil ($/barrel)		88	-0.6	4	23	57	13
Industrials Metals (index)		183	1.1	2	11	35	6
Agriculture (index)		63	-0.2	1	6	26	4
Implied Volatility					%		
VIX Index (%, change in pp)		23.1	-0.8	5.5	0.2	1.5	5.9
US 10y Swaption Volatility		84.1	2.1	7.6	3.9	28.7	5.0
Global FX Volatility		7.2	0.0	0.1	-0.5	-0.3	-0.2
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		174	0.1	12	14	57	23
Italy		134	-1.4	3	4	19	-1
Portugal		62	-0.6	0	-1	7	-2
Spain		69	-0.4	2	-3	9	-5

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

Last updated: 1/20/2022 7:49 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		6.35	0.0	0.2	0	2	0		2.7	-1.0	-11	-21	-40	-10
Indonesia		14341	0.2	-0.3	0	-2	-1		6.4	-0.1	2	1	13	4
India		75	-0.1	-0.8	2	-2	0		6.8	45.0	45	58	106	45
Philippines		51	0.3	-0.6	-3	-6	-1		4.6	5.0	5	0	144	8
Thailand		33	0.0	1.0	2	-9	1		2.2	-1.0	11	33	78	33
Malaysia		4.19	0.1	-0.3	1	-3	-1		3.7	-2.5	5	15	101	10
Argentina		104	-0.1	-0.5	-2	-17	-1		49.2	62.3	33	-128	-312	-139
Brazil		5.45	-0.1	1.5	5	-3	2		11.4	0.8	13	88	336	73
Chile		808	0.2	1.3	8	-11	5		5.8	-5.0	-17	21	312	35
Colombia		3997	1.0	-0.6	0	-13	2		7.5	0.0	36	103	346	113
Mexico		20.46	0.2	-0.6	2	-4	0		7.7	1.0	8	42	226	14
Peru		3.9	0.1	0.9	5	-6	4		6.2	0.6	12	21	250	27
Uruguay		45	0.0	0.1	-1	-5	0		8.8	10.9	11	6	151	4
Hungary		314	-0.2	-1.5	4	-6	3		4.7	-6.5	17	45	290	21
Poland		3.99	0.0	-0.6	3	-6	1		3.8	-5.8	5	41	261	24
Romania		4.4	0.0	-1.0	1	-8	0		5.0	1.8	-5	18	251	18
Russia		76.7	-0.7	-0.4	-3	-4	-2		9.7	2.5	6	91	328	92
South Africa		15.2	0.8	1.3	4	-2	5		7.7	-1.0	1	46	102	25
Turkey		13.37	0.4	1.6	0	-44	-1		22.6	-45.0	-144	-132	910	-173
US (DXY; 5y UST)		96	0.1	0.8	-1	6	0		1.62	-3.0	15	45	118	36

	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		4824	0.9	1	-2	-13	-2		198	0	-6	-30	-5
Indonesia		6627	0.5	0	1	3	1		184	16	10	-8	19
India		59465	-1.1	-3	6	20	2		142	11	11	-15	10
Philippines		7239	-0.3	-1	1	1	2		114	11	6	11	13
Malaysia		1528	-0.2	-2	2	-4	-3		121	7	4	-16	4
Argentina		83528	0.2	-2	2	66	0		1872	45	161	457	192
Brazil		108014	1.3	2	3	-10	3		315	-2	-15	38	4
Chile		4471	0.0	-1	9	-4	4		150	6	9	-2	10
Colombia		1583	-0.2	8	15	8	12		344	0	-4	114	-4
Mexico		52823	-0.8	-2	2	17	-1		342	7	-2	-33	10
Peru		23475	0.7	0	16	9	11		158	0	5	28	8
Hungary		52562	-1.1	-2	4	19	4		125	2	-2	-18	1
Poland		70385	-0.5	-4	5	21	2		17	-1	-20	-10	-15
Romania		13083	-0.3	-3	6	28	0		201	11	13	-1	9
Russia		3437	0.0	-6	-6	-1	-9		223	40	42	50	46
South Africa		76136	-0.1	0	9	19	3		367	16	-4	-21	12
Turkey		2030	-0.6	-2	-1	29	9		562	-12	-43	97	-16
Ukraine		523	0.0	0	0	5	0		909	133	179	407	150
EM total		49	1.3	-1	4	-12	1		413	13	15	62	27

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

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