



- Fed's quantitative tightening could be more aggressive this cycle ([link](#))
- US bond markets start to reprice ahead of potential quantitative tightening ([link](#))
- ECB minutes marginally hawkish ([link](#))
- Bank of Japan minutes reveal continued dovish bias ([link](#))
- Survey finds investors expect fewer Fed rate hikes than current market pricing ([link](#))
- Ukraine surprises with 100 basis point rate hike ([link](#))

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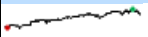



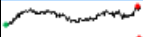



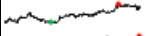
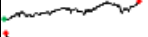
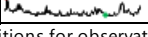
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Markets retreat as pivotal FOMC meeting looms

Stocks were down across most of the globe today as the late selloff in the US yesterday weighed on sentiment. The Stoxx 600 in Europe is down to its worst level in a month, while the Nasdaq 100 index in the US has suffered a "correction," having fallen 10% from its peak in November last year. Most Asian markets also lost ground, and Eastern Europe is also trading lower. Even oil prices, which have been on a tear recently, fell back today on news that US inventories were higher than expected. The mood has turned dark ahead of next week's pivotal FOMC meeting, where the Fed is expected to signal a rate hike in March and the commencement of quantitative tightening (QT), possibly as early as June according to some analysts. There are also worries that the pace of QT may be more aggressive this time, with uncertain consequences for markets. Further tightening is expected from the Bank of England this year as well as many other central banks in both advanced and developing economies. Treasury and bund yields were lower for a second day, with the 10-year bund yield pulling back from its brief sojourn in positive territory.

Key Global Financial Indicators

Last updated: 1/21/22 7:58 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		4483	-1.1	-5	-4	16	-6
Eurostoxx 50		4229	-1.6	-1	1	17	-2
Nikkei 225		27522	-0.9	-2	-4	-4	-4
MSCI EM		50	0.6	-2	3	-12	2
Yields and Spreads			bps				
US 10y Yield		1.77	-3.4	-1	31	66	26
Germany 10y Yield		-0.06	-4.0	-2	24	43	11
EMBIG Sovereign Spread		382	-4	1	4	25	15
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		53.4	0.1	0	2	-8	2
Dollar index, (+) = \$ appreciation		95.6	-0.2	1	-1	6	0
Brent Crude Oil (\$/barrel)		87.1	-1.4	1	18	55	12
VIX Index (% change in pp)		26.8	1.2	6	6	5	10

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

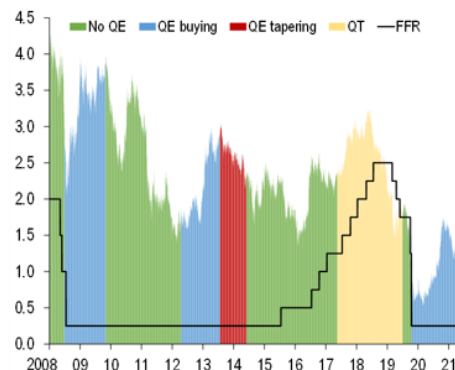
Mature Markets

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United States

The previous episode of quantitative tightening (QT) saw 10-year yields rise as the process began but end up below where they were when QT started. This gives some analysts hope that there might be a similar outcome in 2022 and 2023. Others disagree, pointing out that last time the Fed proceeded very cautiously because QT was new to markets, only gradually increasing the pace of tightening over an extended period of time. This time, the balance sheet is much larger and the Fed is more experienced with the process, so there is scope for a more aggressive QT. In addition, the Fed has to contend with high inflation, which was not the case last time. These circumstances could lead the Fed into a more aggressive QT in 2022 and 2023. Faster QT could also have the additional benefit of reducing the number of rate hikes required in the current cycle.

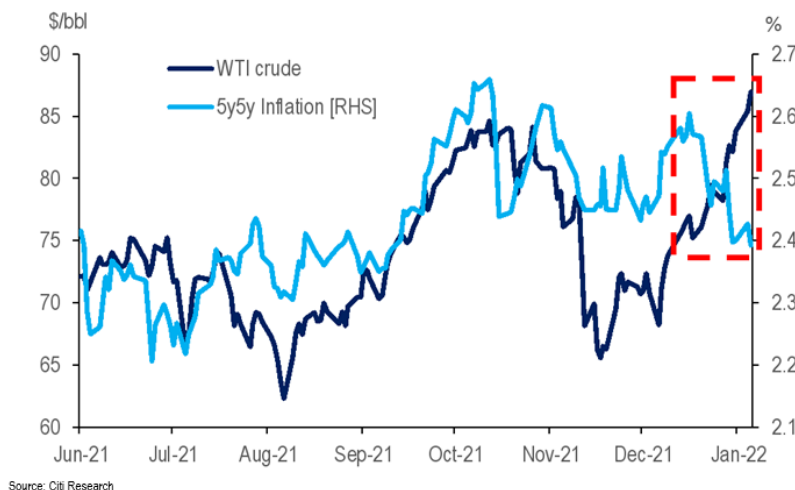
US 10-yr Treasury Yields and Fed Fund Rate (Percent)



Source: Bloomberg, Federal Reserve and IMF Staff Calculations

Concerns about quantitative tightening are spilling over into the broader US fixed income market. Breakeven yields for Treasury Inflation Protection Securities (TIPS), that is the spread between the TIPS bond and nominal Treasury bond of the same maturity, have narrowed. This has occurred despite the steep rise in oil prices. TIPS breakeven yields and oil prices are usually well correlated.

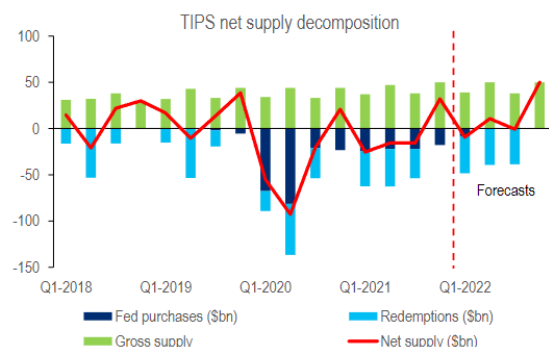
5y5y inflation and crude oil have diverged recently as oil has made new highs



Source: Citi Research

The divergence has occurred because the Fed is a major player in the TIPS market and the tapering process has pushed many investors to either stay away from the market or even to go short TIPS breakevens on the assumption that real yields will rise and breakevens decline, which is what ultimately occurred. The Fed was such a large buyer that TIPS supply was negative last year, but its withdrawal means that supply will turn positive this year and investors will have to contend with much higher volumes of TIPS issuance. Mortgage-backed securities (MBS) have also started to widen on QT concerns, with the mortgage basis (the spread between the MBS yield and the equivalent Treasury yield) turning positive for the first time in many months.

Figure 3. Net TIPS supply is set to turn positive in 2022 – a bearish driver, but the recent cheapening provides a buffer near term



Source: Citi Research

Figure 4. The MBS basis has widened by about 30bp recently on balance sheet taper concerns; overall, the rates market is reasonably priced for QT at least in the near term, suggesting a pause in the real yield sell-off



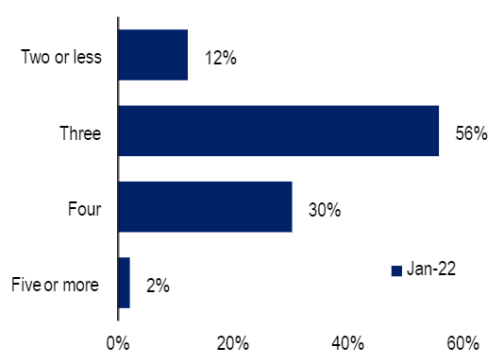
Note: see [US Agency MBS Strategy - Take Profits on Underweight and Turn Neutral](#)

Source: Citi Research

The latest investor survey from Bank of America finds that investors expect fewer Fed rate hikes in 2022 than currently being priced in interest rate futures markets. The data show that 68% expect three or fewer rate hikes in the coming year, and just 30% expect the four hikes the market is predicting. Rate hikes are usually bearish for credit spreads, as they tend to be accompanied by greater interest volatility. In addition, rising US rates means that hedging costs for foreign investors goes up, lowering demand for US credit. ETF inflows also drop off during rate hikes, and falling equity prices are also bad for the corporate bond market. If Treasury yield keep rising, investors may have to rethink their optimistic views, which could put upwards pressure on spreads. So far credit spreads have been well behaved, with the Bloomberg Investment Grade Index spread up just 5 bps in January, despite the sharp rise in Treasury yields. The high yield index spread is up just 12 bps so far, and it is well below where it was trading in mid-December.

Figure 1: How many Fed rate hikes do you expect in 2022?

The majority (56%) expected 3 hikes, followed by 30% expected 4 hikes.



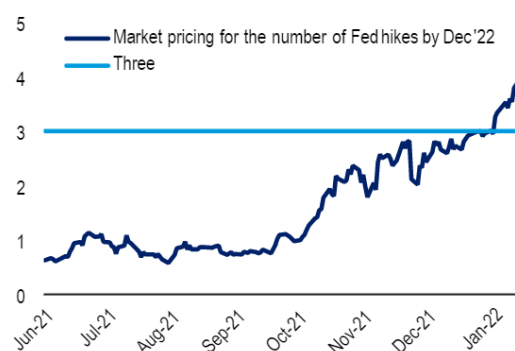
Note: our US Credit investor survey was conducted from Jan 10 to Jan 13. The results are based on 149 responses.

Source: BofA US Credit Investor Survey

BofA GLOBAL RESEARCH

Figure 2: The market is pricing 4 Fed hikes currently.

The market pricing of Fed hikes in 2022 rose to 4 currently from 3 at the start of the year.



Source: Bloomberg

BofA GLOBAL RESEARCH

Euro Area

Contacts argue that the ECB accounts of its December meeting were marginally hawkish given references to upside risks to inflation that could “easily” push inflation projections in 2023 and 2024 above 2%. Citi notes that the ECB Governing Council sees downside risks to growth from the pandemic

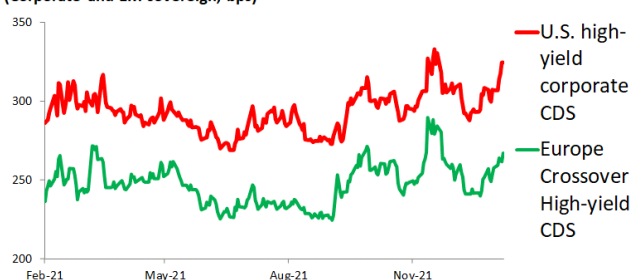
and supply constraints, both of which are temporary, but not from the sharp increases in energy and goods prices. **In contrast to market pricing of 20 bps of ECB hikes in the year ahead, Bank of Spain governor de Cos said yesterday that he does not expect any increase in interest rates in 2022.**

Italian 10-yr spreads (+2 bps to 134 bps) ticked higher again head of the start of the election of a new president on Monday. Greek 10-yr spreads (+2 bps to 176 bps) are also higher.

Poor risk sentiment was also reflected in euro area credit markets. The cross-over high yield European CDS spread, a widely watched spread to help track lowly rated corporates, rose 7 bps to 269 bps. This cross-over spread has risen 27 bps so far in 2022.

Euro area: Corporate CDS Credit spreads

(Corporate and EM sovereign, 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).

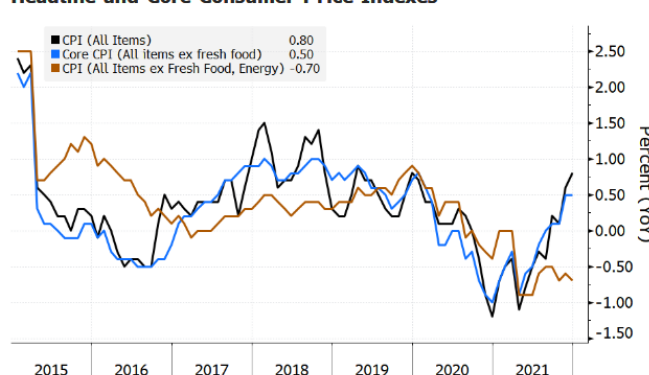
Source: Bloomberg, and IMF staff

Some investors are concerned that the EU's Delegated Act to include nuclear and gas to the list of acceptable technologies might compromise the Sustainable Finance Taxonomy. Any feedback received by today will be considered by the Commission prior to the adoption of the Delegated Act later in 2022. **Preventing the inclusion of gas and nuclear would require at least 20 member states representing at least 65% of the EU's population to object.**

Japan

Japanese stocks declined -0.6%. The Bank of Japan (BOJ) December minutes revealed persisting dovishness. The Board members thought adjustments to monetary easing were premature, as they could cause an economic downturn and dampen prices. One member continued to support additional rate cuts. Separately, **inflation came in below forecasts in December.** Headline consumer price inflation was 0.8% yoy (consensus: 0.9%) from 0.6% yoy in November driven mainly by energy prices. Core inflation (excluding fresh food) was unchanged at 0.5% yoy.

Headline and Core Consumer Price Indexes



Source: Source: Ministry of Internal Affairs and Communications

Emerging Markets

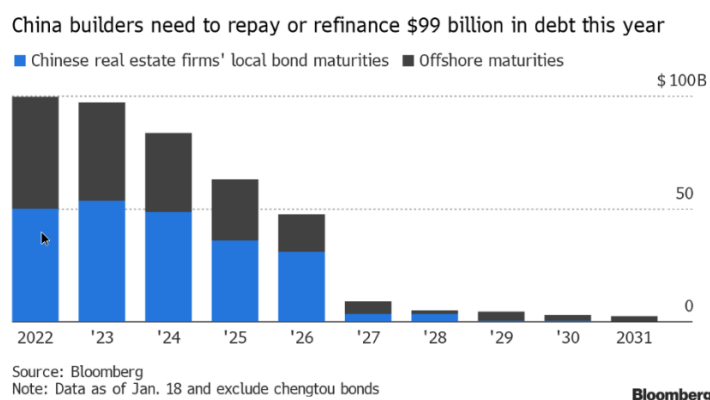
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Most emerging markets are lower today as yesterday's US selloff extends to Asia, EMEA and Europe. However, in **Latin America**, regional currencies were generally stronger yesterday. The **Chilean peso** (+0.9%) continued its recent outperformance (+9% since Dec 20th) as investors await the announcement of a fiscally prudent new finance minister today. Besides Chile, Peru is another recent strong

outperformance story, with asset markets paring previous losses inflicted by market concerns on the policies of the newly elected President Castillo. **The Central Bank of Russia proposed banning cryptocurrency operations in Russia, citing potential financial stability risks and environmental concerns.** The use of crypto to make payments is already banned, and mutual funds were been banned from investing in crypto since December. The new draft proposals, released in a report on Thursday, do not ban ownership of cryptocurrencies by private citizens.

China

China's central bank pushes to increase bank lending. The PBOC has issued "window guidance" to large state-owned banks in a bid to boost lending to companies and households, according to Bloomberg. Separately, **Country Garden dollar bonds recovered following a bond placement.** The builder issued a 3.9 bn Hong Kong SAR dollar (\$500 mn) secured guaranteed convertible bond. Net proceeds will be used "for the refinancing of existing medium to long term offshore indebtedness, which will become due within one year", exchange filings reveal. **Evergrande commenced bondholder identification in a key restructuring step.** The move comes after a bondholder group made threats to "seriously consider enforcement actions" and criticized the developer for "lack of engagement and opaque decision-making," Bloomberg reports. Meanwhile, **more downgrades were announced in the property sector.** S&P moved Sunac China from BB to BB-with a negative outlook, expecting the developer to partially rely on asset sales over the next six months to repay maturing short-term debt amid "tightened funding access." Fitch Ratings has downgraded Aoyuan Group Ltd. to 'Restricted Default'.



Peru

Peruvian assets continue to outperform as market concerns on political risks dissipate. The Sol has been the best performing EM currency since early October (+8%) after the new President announced market friendly cabinet changes, according to Bloomberg. The positive sentiment was reinforced in December, when lawmakers rejected a motion for impeachment proceedings against the President. Investors have also been encouraged by the very strong economic growth (12.7% 2021 consensus) and the hawkish shift by the central bank in H2 2021. Not all analysts are as cheerful however, as for example Bank of America notes that impeachment risks are still present and significant, while the central bank has fallen "behind the curve" given the upside risks to inflation and would have to step up the pace of its hiking cycle to 75 bps in the following two meetings.

Bouncing Back

Political jitters put the Peruvian sol under pressure in 2021



Changes since October 2021

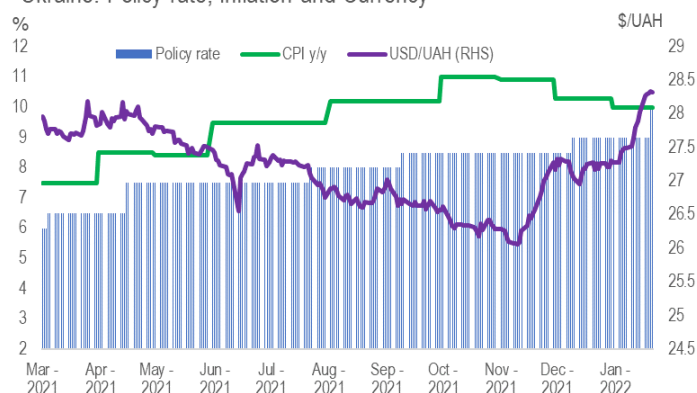
	FX	Local Yield	Equities
	%	bps	%
PEN	8	-6	27
CLP	2	22	9
ZAR	-2	-33	19
CNY	2	-16	0
THB	3	34	2
INR	1	29	0
IDR	-1	10	3
MXN	0	27	3
RON	-2	101	4
PHP	-1	74	3
MYR	0	14	-2
BRL	1	129	-1
COP	-5	144	12
TRY	-33	357	47
HUF	-1	153	-2
PLN	-2	182	-2
RUB	-6	175	-16

Source: Bloomberg

Ukraine

The National Bank of Ukraine surprised the markets with a 100 bps policy rate increase, taking the policy rate up to 10%. The majority of market participants expected a 50 bps hike. After peaking in September 2021, inflation eased to 10% yoy in December, mainly as a result of lower food and utility prices as well as the stronger hryvnia in the previous months. Governor Kyrylo Shevchenko noted that the central bank will continue its tightening cycle, as high global energy prices and the pass through to goods and services kept inflation elevated. The central bank raised its 2022 inflation forecast to 7.7% and projects that inflation will only return to the target range, of $5\% \pm 1$ pp, in 2023. Contacts note that a weaker currency could add to inflationary pressures – with the hryvna having weakened 3.5% against the dollar this year amid heightened geopolitical tensions. The yields of 10-yr sovereign bonds remain about 150 - 200 bps higher than end-November levels.

Ukraine: Policy rate, Inflation and Currency



Source: Bloomberg and IMF staff calculations

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.

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Global Financial Indicators

Last updated: 1/21/22 8:00 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		4467	-1.1	-4	-4	16	-6
Europe		4228	-1.7	-1	1	17	-2
Japan		27522	-0.9	-2	-4	-4	-4
China		4779	-0.9	1	-3	-14	-3
Asia Ex Japan		84	1.0	-2	3	-15	2
Emerging Markets		50	0.6	-2	3	-12	2
Interest Rates			basis points				
US 10y Yield		1.77	-3.2	-1	31	67	26
Germany 10y Yield		-0.06	-3.9	-2	24	43	11
Japan 10y Yield		0.14	-1.0	-1	8	9	7
UK 10y Yield		1.19	-3.8	4	31	86	22
Credit Spreads			basis points				
US Investment Grade		120	2.1	4	0	26	8
US High Yield		351	8.4	6	-16	-15	13
Europe IG		55	2.0	3	5	6	8
Europe HY		269	7.7	12	15	20	27
Exchange Rates			%				
USD/Majors		95.60	-0.1	1	-1	6	0
EUR/USD		1.13	0.2	-1	0	-7	0
USD/JPY		113.8	-0.3	0	0	10	-1
EM/USD		53.4	0.1	0	2	-8	2
Commodities			%				
Brent Crude Oil (\$/barrel)		87	-1.4	1	18	55	12
Industrials Metals (index)		184	-1.0	3	9	34	6
Agriculture (index)		63	-0.6	3	4	26	4
Implied Volatility			%				
VIX Index (% change in pp)		26.8	1.3	6.5	5.8	5.5	9.6
US 10y Swaption Volatility		84.4	-0.3	5.5	4.2	29.2	5.3
Global FX Volatility		7.2	0.0	0.0	-0.5	-0.4	-0.3
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		176	2.6	18	17	60	24
Italy		134	1.6	2	3	16	-1
Portugal		62	0.2	2	-3	5	-2
Spain		69	0.2	1	-6	7	-5

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

Last updated: 1/21/2022 8:02 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)						
	Level		Change (in %)				YTD	Level		Change (in basis points)				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
	vs. USD		(+) = EM appreciation					% p.a.						
China		6.34	0.0	0.2	1	2	0		2.7	-2.5	-14	-22	-41	-13
Indonesia		14336	0.0	-0.3	0	-2	-1		6.4	0.6	4	3	17	4
India		74	0.1	-0.4	2	-2	0		6.8	45.0	45	58	106	45
Philippines		51	-0.1	-0.5	-3	-6	-1		4.6	0.0	5	0	138	8
Thailand		33	0.0	0.9	2	-9	1		2.2	-2.0	8	31	76	31
Malaysia		4.19	0.1	-0.2	1	-4	0		3.7	-0.6	4	13	97	9
Argentina		104	0.0	-0.5	-2	-17	-2		49.0	-12.7	80	-136	-301	-152
Brazil		5.46	-0.4	1.3	5	-2	2		11.4	9.0	14	97	318	72
Chile		801	0.2	2.4	9	-10	6		5.6	-17.0	-31	-1	291	14
Colombia		3975	0.0	0.8	1	-12	2		7.5	-0.5	20	97	337	104
Mexico		20.46	0.4	-0.7	2	-4	0		7.6	0.0	1	32	220	11
Peru		3.8	0.7	1.5	6	-6	4		6.1	0.0	2	14	245	22
Uruguay		45	0.0	-0.2	-1	-5	0		8.7	-2.3	9	4	149	2
Hungary		316	-0.1	-1.0	3	-7	3		4.7	0.0	9	45	293	21
Poland		3.99	0.2	-0.4	3	-7	1		3.8	0.0	-4	37	259	23
Romania		4.4	0.2	-0.7	1	-8	0		5.0	-1.4	2	14	256	17
Russia		76.4	0.0	0.1	-3	-3	-2		9.7	1.5	-19	92	324	88
South Africa		15.1	0.6	1.7	5	-1	5		7.7	-1.3	-2	37	101	22
Turkey		13.41	-0.4	0.9	-7	-45	-1		22.6	-3.0	-137	-98	924	-172
US (DXY; 5y UST)		96	-0.1	0.9	-1	6	0		1.57	-1.6	1	35	113	31

	Equity Markets							Bond Spreads on USD Debt (EMBIG)					
	Level		Change (in %)				YTD	Level		Change (in basis points)			YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		Last 12m	Latest	7 Days	30 Days	12 M	
								basis points					
China		4779	-0.9	1	-3	-14	-3		198	-2	-6	-29	-5
Indonesia		6726	1.5	0	2	7	2		177	2	6	-14	12
India		59037	-0.7	-4	3	21	1		140	4	7	-16	8
Philippines		7294	0.7	0	2	4	2		105	-3	0	6	4
Malaysia		1527	0.0	-3	1	-4	-3		118	1	3	-17	1
Argentina		85126	1.9	0	1	76	2		1899	43	158	495	219
Brazil		109102	1.0	2	3	-8	4		311	-10	-20	34	0
Chile		4569	1.8	2	10	0	6		149	2	5	-4	9
Colombia		1547	-2.2	8	12	7	10		343	-3	-10	113	-5
Mexico		52508	-0.6	-3	1	17	-1		337	-5	-8	-36	5
Peru		23327	-0.6	-1	13	9	10		155	-5	2	25	5
Hungary		51791	-1.1	-2	2	17	2		124	-1	-2	-19	0
Poland		69047	-1.9	-5	3	21	0		16	-4	-20	-17	-16
Romania		12819	-2.4	-6	4	24	-2		195	0	6	-6	2
Russia		3476	-1.2	-3	-6	2	-8		240	31	57	68	63
South Africa		74879	-1.8	0	5	17	2		363	4	-11	-22	8
Turkey		1998	-0.8	-4	6	29	8		546	-14	-108	83	-32
Ukraine		523	0.0	0	0	5	0		912	34	159	410	153
EM total		50	-1.1	-2	3	-12	2		411	3	6	62	24

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

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