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- **Markets price more hawkish Fed than previous cycles** ([link](#))
- **But US rates may have to rise further than current expectations** ([link](#))
- **Analysts increase ECB terminal rate forecast to 4%** ([link](#))
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Strong data from China boosts global markets

Stronger than expected economic data from China pushed global markets higher. Asia made notable gains overnight and European markets are also up, along with US equity index futures. US stocks are actually higher for the week on the most recent price action. The US technology sector stood out, with HP raising its forecast for the quarter and Tesla announcing better than expected car shipments from China. Strong corporate balance sheets are another source of confidence for investors. Meanwhile, US Treasury yields dipped a day after the benchmark 10-year Treasury yield hit a three-month high of 4.09%, although the two-year Treasury yield remains close to its highest level since 2007, well above the Fed Funds rate at 4.87%. The entire US Treasury curve now offers yields above 4%. The recent Treasury selloff increased market forecasts for the terminal Fed Funds rate to around 5.5%. Risk assets seem comfortable with this level, but remain vulnerable to a significant move upwards. Anecdotal evidence suggest that some investors are betting that the Fed Funds rate may hit 6% or go even higher.

Key Global Financial Indicators

Last updated: 3/3/23 8:03 AM	Level		Change from Market Close				YTD	Since 23-Feb-22
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		
Equities			%				%	
S&P 500		3981	0.8	-1	-4	-9	4	-6
Eurostoxx 50		4276	0.8	2	0	14	13	8
Nikkei 225		27927	1.6	2	1	7	7	6
MSCI EM		39	0.4	0	-4	-14	3	-17
Yields and Spreads			bps					
US 10y Yield		4.02	-3.9	7	49	218	14	203
Germany 10y Yield		2.73	-2.0	19	54	271	16	250
EMBIG Sovereign Spread		453	5	5	26	-23	1	41
FX / Commodities / Volatility			%					
EM FX vs. USD, (+) = appreciation		50.5	0.0	1	-1	-2	1	-5
Dollar index, (+) = \$ appreciation		104.8	-0.2	0	2	7	1	9
Brent Crude Oil (\$/barrel)		84.3	-0.6	1	5	-24	-2	-13
VIX Index (% change in pp)		19.6	0.0	-2	1	-11	-2	-11

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

Mature Markets

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Global Corporate Earnings

Global corporate earnings are likely to weaken further with earnings per share (EPS) growth expected to fall into negative territory, according to analysis by Bank of America. So far, global EPS forecasts have been falling but remain positive or at least flat, but the analysts think this is unsustainable in the face of multiple headwinds facing the global economy. One main challenge is the decline in exports from Japan, Korea, Singapore, and Taiwan POC. Growth sensitive assets such as cyclical and defensive stocks and commodities have already given back much of the gains made since October. Global manufacturing PMI new orders are in contractionary territory at 47.8. In the US, stronger than expected corporate guidance is fading quickly. The analysts predict an EPS decline of 5% for global stocks in 2023.

Exhibit 4: Earnings: brace for further consensus downgrades

Leading indicators anticipate a contraction of about 5% in 2023, short of consensus expectations of 0.4% growth - expect downgrades

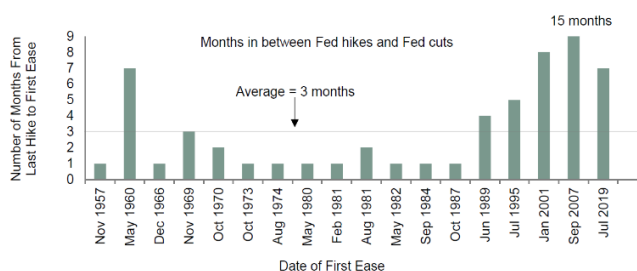


Source: BofA Global Research, MSCI, IBES, FactSet. *Note: Based on growth-sensitive asset prices, Asian exports growth, global manufacturing PMI, global manufacturing new orders, global earnings revisions ratio, corporate guidance for the US, and BofA China Financial Conditions Indicator.

BofA GLOBAL RESEARCH

United States

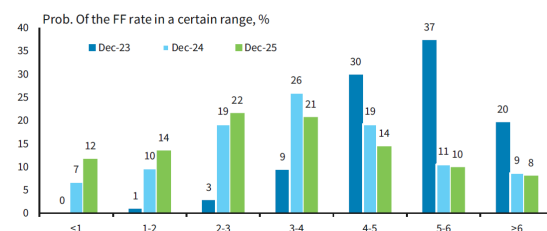
Markets are pricing a much more hawkish Fed compared to previous rate hike cycles. The historical record shows that the average time gap between the last Fed rate hike and the first Fed rate cut is three months. In addition, previous rate hike cycles have been less aggressive than the current cycle. However, markets currently expect the Fed Funds rate to peak in July and do not expect the first rate cut to occur before January. Contacts did not find this surprising, pointing out that a continued rise in Treasury yields could push out rate cut expectations even further. The benchmark 10-year Treasury yield has broken above 4% for the first time since November, and continued strength in economic data is likely to keep the Fed under pressure to remain hawkish. The 10-year yield hit a post-crisis high of 4.24% last October.



Source: FRB, Haver, SMBC Nikko

Despite this greater hawkishness on the part of markets, investors may be underestimating the true extent of potential Fed rate hikes. According to analysis by Barclays based on options for Fed Funds futures, markets are assigning just a 20% chance of the policy rate going above 6% by December 2023. With the recent inflation reports including CPI and PPI repeatedly coming in higher than expected, the Fed may be forced to raise the Fed Funds rate well above the 5.5% peak currently being predicted by the markets. The latest core PCE deflator of 4.7% y/y released on February 24 suggests that the Fed may still be behind the curve on inflation. In addition, markets are forecasting a mild recession if there is one, assigning exceptionally low probabilities to a sharp reduction in the policy rate by December 2025. If the Fed is forced to hike well above 6%, the resulting recession could be much more severe than currently anticipated.

FIGURE 13. Markets are not pricing in enough probability on higher rates in the short term and lower rates in the medium term



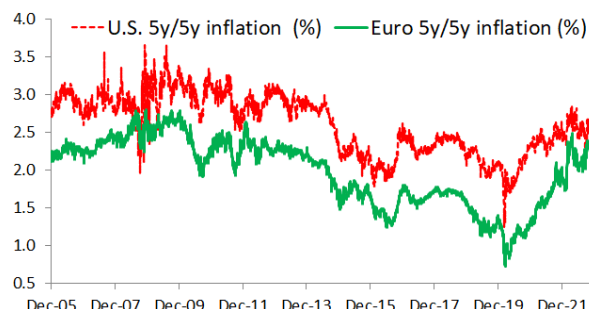
Source: Barclays Research

Euro area

Equities (+0.9%) gained as 10-yr German bund yields traded 4 bps lower. Bund yields will nevertheless close the week almost 20 bps higher after euro area core inflation surprised to the upside.

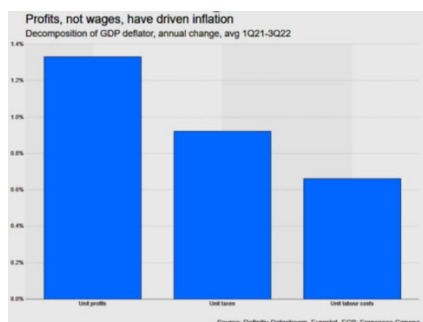
Several banks including Barclays, Bank of America, BNP, Danske Bank and Morgan Stanley expect the ECB to hike its depo rate to 4% (from 2.5% currently). Analysts at Morgan Stanley point out that the ECB is likely to face still rising core inflation in May. National Bank of Belgium governor Wunsch also said that ECB will have to do more if there are no “clear signals” that core inflation is coming down and “4% would not be excluded.” **Some contacts also expect euro area 5-year/five-year inflation swaps to trade above high of the 2000s in coming months.** These inflation swaps rose +10 bps to 2.58% in the past week.

Five-year Forward Five-year Inflation Swaps (%)



Source: Bloomberg, and IMF staff

A Reuters article based on ECB sources suggests that the ECB Governing Council is likely to discuss the role of elevated profits as a driving force for inflation more actively going forward. According to several sources, the governing council was presented with evidence that company profit margins have been increasing rather than shrinking. The article adds that a new inflation narrative focused on margins could lead to a more dovish tone, presumably because firms could digest future wage increases without having to increase inflation. In any case, an ECB survey also showed that companies expect to slow the pace of price increases in 2023 as the outlook for costs and demand becomes less clear.



Japan

Tokyo CPI inflation moderated to 3.4% y/y in February, down from 4.4% in January. Tokyo inflation is a leading indicator for national inflation. The figure came out stronger than expected (consensus: +3.3%). The slowdown in CPI inflation was largely due to a slew of government measures to curb price pressures; otherwise, inflation could be around 4.5% according to analysts. Separately, the unemployment rate edged down to 2.4% in January from 2.5% a month earlier. **Japanese equities gained (NIKKEI: +1.6%), while the Japanese yen appreciated (+0.5%)**, following the regional trend. The 10-year JGB yield was little changed at 0.5% at the market close though it moved up above the 0.5% threshold during the day. Longer-end JGB yields edged up (30-year: +2.6 bps). Traders are positioning for a possible hawkish surprise by the Bank of Japan at its March policy meeting based on market pricing for one-week risk reversal of Japanese yen.



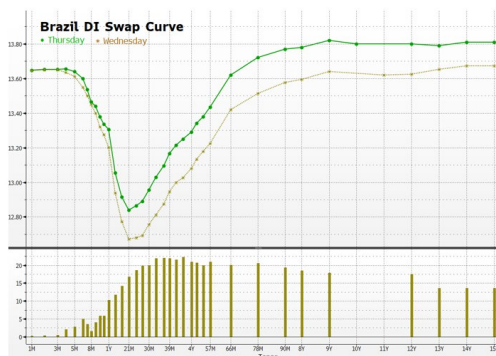
Emerging Markets

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In EMEA equity markets were mostly higher after a difficult week, with Türkiye the notable exception. The Hungarian forint, which is weaker on fears of a negative rating action when Moody's publishes its scheduled rating review after markets close today. Moody's currently rates Hungary at Baa2, one notch above investment grade, with a stable outlook. **Asian equities were mixed, rising 1.0% on net.** Asian currencies appreciated, led by the Korean won (+1.1%) and the Indian rupee (+0.8%). **In Latam, stocks were mixed but currencies were generally weaker, with the exception of the Colombian peso.**

Brazil

Brazil's GDP contracted 0.2% q/q in 2022Q4, fueling further debates on monetary policy. The GDP data is in line with market expectations, and it is the first decline since Q2 2021. The faltering of Brazil's economy is due to tight financial conditions, a weaker labor market, and above-target inflation. The deceleration of the economy adds further pressure on the central bank on whether it should raise its inflation targets and lower interest rates. The Brazilian real weakened by 0.6% and underperformed its peers in the region on Thursday. Brazilian swaps were traded higher compared with the day before and the primary stock index was down by 1%.

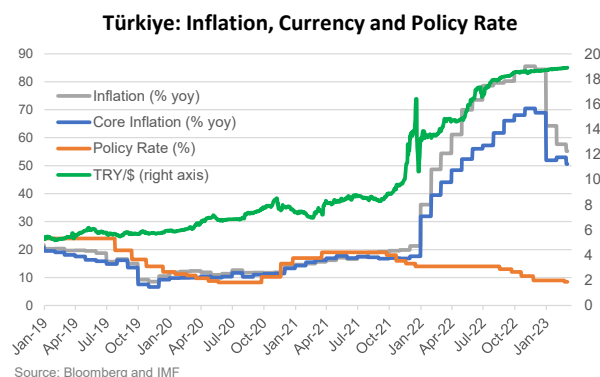


China

The Caixin PMI composite improved to 54.1 in February from 51.1 in January. Its services PMI component, which improved to 55.0 from 52.9, beat expectations (consensus: 54.5) and boosted market sentiment, as Chinese equities gained (CSI 300: +0.3%). Governor Yi Gang of the People's Bank of China signaled that monetary policy will largely be stable this year in a rare media briefing. He also noted that interest rates are at a relatively appropriate level while mentioning that inflation remains under control. The US administration added dozens of Chinese entities on the so-called Entity List, including Inspur which is a computer server company. US firms are banned from exporting to the listed entities, which are deemed to acquire US-origin items in support of China's military modernization efforts.

Türkiye






















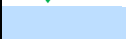



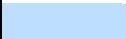


Turkish inflation came in broadly as expected at 55.2% y/y in February, marginally down from 57.7% in January, in large part due to base effects. While inflation has come significantly down from its 85% y/y peak in October, markets are worried that it could accelerate again after the central bank loosened monetary policy at its last meeting (-50 bps to 8.5%) and planned additional fiscal expenditure after the devastating earthquakes in the south of the country last month.



This monitor is prepared under the guidance of Charles Cohen (Acting Division Chief), Nassira Abbas (Deputy Division Chief), and Antonio Garcia-Pascual (Deputy Division Chief). Fabio Cortes (Senior Economist), Reinout De Bock (Senior Economist-London Representative), Sanjay Hazarika (Senior Financial Sector Expert), Esti Kemp (Financial Sector Expert-London Representative), Tom Piontek (Senior Financial Sector Expert) and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Mustafa Oguz Caylan, Yingyuan Chen (Financial Sector Expert), Deepali Gautam (Research Officer), Frank Hespeler (Senior Financial Sector Expert), Shoko Ikarashi (Externally Financed Appointee), Phakawa Jeasakul (IMF Resident Representative in Hong Kong SAR), Johannes S Kramer (New York Representative), Harrison Kraus (Research Assistant), Yiran Li (Research Assistant), Aurelie Martin (Senior Economist-London Representative), Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), Silvia Ramirez (Senior Financial Sector Expert), Patrick Schneider (Financial Sector Expert), Ying Xu (Economist), Dmitry Yakovlev (Senior Research Officer), and Akihiko Yokoyama (Senior Financial Sector Expert). Javier Chang (Senior Administrative Assistant) Olga Lefebvre (Staff Assistant), and Srujana Sammeta (Staff Assistant) are responsible for the word processing and production of this monitor.

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Global Financial Indicators

3/3/23 8:04 AM	Level		Change				YTD	Since 23-Feb-22
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		
Equities			%				%	%
United States		3985	0.8	0	-4	-9	4	-6
Europe		4276	0.8	2	0	14	13	8
Japan		27927	1.6	2	1	7	7	6
China		4131	0.3	2	1	-8	7	-11
Asia Ex Japan		67	0.7	1	-4	-12	4	-15
Emerging Markets		39	0.4	0	-4	-14	3	-17
Interest Rates			basis points					
US 10y Yield		4.02	-3.9	7	49	218	14	203
Germany 10y Yield		2.73	-2.0	19	54	271	16	250
Japan 10y Yield		0.51	0.1	0	1	33	8	31
UK 10y Yield		3.89	0.6	23	83	259	22	241
Credit Spreads			basis points					
US Investment Grade		144	-0.5	-2	7	-5	-15	1
US High Yield		436	1.2	-10	21	27	-44	29
Europe IG		79	-1.4	-2	6	2	-12	7
Europe HY		408	-7.4	-10	28	37	-65	57
Exchange Rates			%					
USD/Majors		104.81	-0.2	0	2	7	1	9
EUR/USD		1.06	0.1	1	-2	-4	-1	-6
USD/JPY		136.2	-0.4	0	4	18	4	18
EM/USD		50.5	0.0	1	-1	-2	1	-5
Commodities			%					
Brent Crude Oil (\$/barrel)		84.3	-0.5	2	6	-6	-1	1
Industrials Metals (index)		163	0.6	3	-5	-21	-2	-13
Agriculture (index)		68	0.2	-1	-1	-8	-1	-3
Implied Volatility			%					
VIX Index (% change in pp)		19.6	0.0	-2.1	1.2	-10.9	-2.1	-11.5
US 10y Swaption Volatility		123.9	0.0	2.3	21.1	12.2	-1.8	29.6
Global FX Volatility		9.8	0.0	-0.4	-0.4	1.0	-0.9	2.4
EA Sovereign Spreads			10-Year spread vs. Germany (bps)					
Greece		177	-1.6	-8	-5	-59	-28	-63
Italy		184	-3.0	-7	0	28	-31	12
Portugal		86	-1.0	-2	2	2	-15	-6
Spain		95	-1.7	-2	3	-3	-14	-8

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

merging Market Financial Indicators

Last updated: 3/3/2023 8:06 AM	Exchange Rates						YTD	Since 23-Feb-22	Local Currency Bond Yields (GBI EM)							
	Level		Change (in %)						Level		Change (in basis points)				YTD	Since 23-Feb-22
	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		6.91	0.1	0.8	-2	-9	0	-9		3.3	-0.5	5	14	36	22	43
Indonesia		15311	-0.2	-0.5	-3	-6	2	-6		7.0	2.1	18	44	42	4	48
India		82	0.8	1.0	0	-7	1	-9		7.8	-2.1	6	53	120.9	31	
Philippines		55	0.4	0.3	-2	-6	2	-7		6.0	2.5	3	8	103	-3	100
Thailand		35	0.5	0.8	-4	-6	0	-7		2.8	-2.5	8	22	56	13	53
Malaysia		4.48	0.0	-0.9	-5	-6	-2	-7		4.1	7.8	14	29	39	1	39
Argentina		198	-0.2	-1.3	-5	-46	-11	-46		89.0	76.7	90	210	4046	82	4107
Brazil		5.20	0.2	0.0	-1	-3	2	-4		13.8	3.7	25	42	203	122	228
Chile		809	0.4	2.0	-2	-2	5	-2		5.8	-3.5	19	50	-6	42	-16
Colombia		4783	0.7	1.2	-2	-21	1	-18		10.2	0.0	17	138	229	41	231
Mexico		18.09	0.2	1.8	5	14	8	12		9.1	11.0	18	93	123	38	127
Peru		3.8	-0.2	0.4	1	-1	1	-1		8.2	0.4	18	38	185	20	217
Uruguay		39	0.4	-0.4	0	9	2	9		10.2	0.0	36	26	210	-43	210
Hungary		357	-0.5	1.0	1	-4	5	-10		8.3	-32.0	13	46	324	-126	353
Poland		4.44	-0.1	0.9	-1	-2	-1	-9		6.0	-6.0	9	85	219	-13	211
Romania		4.6	0.1	0.6	-2	-4	0	-6		7.6	5.6	19	38	205	-11	243
Russia		75.5	0.0	0.6	-6	45	-2	8		10.6	-2.3	35	27	-1370	-131	-63
South Africa		18.2	0.2	1.4	-4	-16	-6	-17		9.3	-4.5	-9	62	149	9	166
Turkey		18.90	-0.2	-0.1	0	-25	-1	-27		10.9	20.0	44	9	-1333	110	-1149
US (DXY; 5y UST)		105	-0.2	-0.4	2	7	1	9		4.28	-2.8	7	63	255	28	238

	Equity Markets							YTD	Since 23-Feb-22	Bond Spreads on USD Debt (EMBIG)							
	Level		Change (in %)				Level			Change (in basis points)				YTD	Since 23-Feb-22		
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	Last 12m			Latest	7 Days	30 Days	12 M				
									basis points								
China		4131	0.3	2	1	-8	7	-11		165	-2	-19	-51	-12	-43		
Indonesia		6814	-0.6	-1	-1	-2	-1	-2		139	-11	-3	-53	-1	-46		
India		59809	1.5	1	-1	10	-2	5		149	-2	-5	-21	7	-5		
Philippines		6655	0.5	0	-4	-9	1	-10		116	-7	7	-23	19	-21		
Thailand		1607	-0.4	-2	-4	-4	-4	-5		0	0	0	0	0	0		
Malaysia		1454	-0.1	0	-2	-9	-3	-8		96	-2	-9	-39	-4	-37		
Argentina		242749	-2.7	-2	1	165	20	166		2098	108	291	250	-107	361		
Brazil		103326	-1.0	-2	-5	-10	-6	-8		258	-3	-8	-64	-16	-73		
Chile		5432	0.6	2	2	19	3	24		137	1	2	-40	5	-37		
Colombia		1189	-0.8	0	-6	-23	-8	-21		403	3	39	21	31	11		
Mexico		53330	-0.3	0	-1	0	10	4		372	15	32	9	-9	2		
Peru		22022	0.1	2	-1	-10	3	-6		182	0	-4	-2	2	-8		
Hungary		44560	0.6	-2	-2	7	2	-7		211	0	14	46	-11	58		
Poland		59874	0.7	1	-3	-2	4	-5		67	-6	-12	2	-6	51		
Romania		12386	0.1	1	1	3	6	-6		242	3	15	2	-13	10		
Russia		2268	0.6	3	1	-8	5	-26		#N/A	#N/A	#N/A	#N/A	#N/A	#VALUE!		
South Africa		78325	1.0	2	-2	1	7	4		369	1	26	-22	2	-20		
Turkey		5145	-2.3	2	3	154	-7	155		480	-23	-9	-121	40	-83		
Ukraine		507	0.0	0	0	-2	-2	-2		4702	34	525	261	623	3229		
EM total		39	0.5	0	-4	-14	3	-17		392	8	37	-183	17	-66		

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

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