GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

THURSDAY, MARCH 4, 2021

- **Inflation expectations in US hit multi-year highs** (link)
- **US markets at tipping point as Treasuries test confidence** (link)
- **UK budget stimulus measures stronger than expected** (link)
- **Long-end JGB yields higher after weakest debt auction in five years** (link)
- **Chinese stocks extend decline** (link)
- **Foreigners continue to sell South African bonds** (link)

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

Goldilocks vs. the Bears

Falling infection rates, rising vaccination totals, strong corporate profits, a global economic rebound, and a flood of liquidity from central banks are contending against an unexpected spike in interest rates and sharply rising inflation expectations to produce deep anxiety in global markets. A key US measure of inflation expectations is now at its highest level since 2008. What investors fear most of all is a surge in inflation that forces the Fed and other central banks to step in with rate hikes that stop the recovery in its tracks. Fed Chair Powell has made repeated statements that rate hikes and tapering of asset purchases are a long way off, but markets have been unconvinced in recent days as last Thursday's sharp rise in Treasury yields pushed rates to new one-year highs. He will have another opportunity to explain his outlook in today's online Wall Street Journal conference. In keeping with the rising rates theme, interest rates in Australia were once again on the rise as the Reserve Bank stayed out of the market for the day, while JGB yields were up after a very weak auction. Europe is the red this morning, US equity futures are slightly lower, and many commodities are down today in the midst of a slump in base metals prices.

Key Global Financial Indicators

Last updated: 3/4/21 8:00 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		3820	-1.3	-3	-1	22	2
Eurostoxx 50		3700	-0.3	0	2	8	4
Nikkei 225		28930	-2.1	-4	2	37	5
MSCI EM		55	-0.2	-2	-2	30	6
Yields and Spreads					bps		
US 10y Yield		1.46	-2.1	-6	32	41	55
Germany 10y Yield		-0.31	-2.6	-8	14	32	26
EMBIG Sovereign Spread		353	-1	5	8	-12	2
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		56.8	0.1	0	-1	-3	-2
Dollar index, (+) = $ appreciation		91.2	0.3	1	0	-6	1
Brent Crude Oil ($/barrel)		64.2	0.2	-4	9	26	24
VIX Index (%, change in pp)		26.3	-0.3	-3	5	-6	4

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

United States

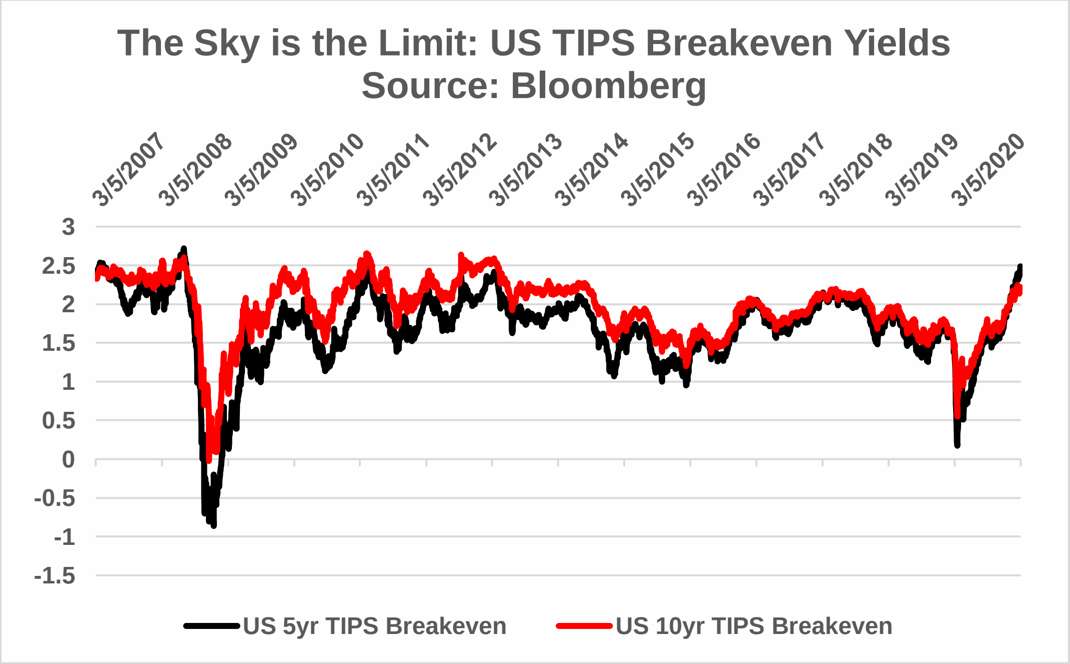
back to top

This morning's US jobless claims data came in very close to forecasts, leaving markets little changed immediately following the data.

US Jobless Claims Data 8.30 am

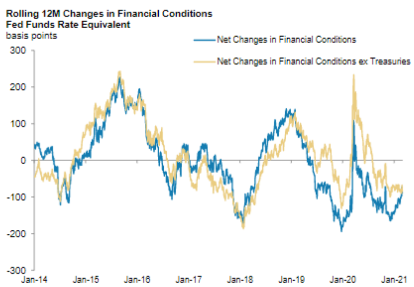
Data Release	Consensus Forecast	Actual Data
Initial Jobless Claims	755k	745K
Continuing Claims	4300K	4295K
Source: Bloomberg.		

Treasury Inflation Securities (TIPS) breakeven yields have continued their relentless rise, with the five-year breakeven at 2.49%, its highest since 2008 and the 10-year at its highest since 2014, as investors position for faster inflation as the recovery gains steam. Meanwhile, the increase in real yields has slowed down this week, suggesting that inflation rather than growth is the main focus for markets at the moment. Yields on eurodollar interest rate futures jumped by as much as 10 bps for the 2024 and 2025 maturities, indicating that markets are bringing forward their estimates of when the first Fed rate hike will occur, as well as marking up expectations for the pace of future rate hikes. In other news, the on-the-run 10-year Treasury note traded "special" as low as -4% before closing at -3.5% in the repo market. A security is said to trade "special" in the repo market if the interest rate to repo it is below the general collateral (GC) repo rate. Negative repo rates are not uncommon if a security is in very high demand. A very large short base in the on-the-run 10-year note is the likely cause of its current "specialness," according to analysts.



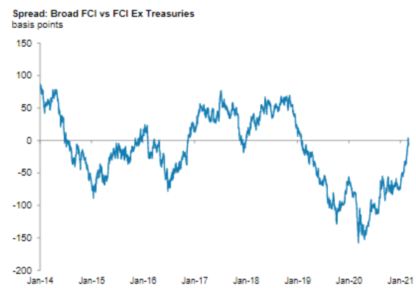
US markets are at a tipping point as the rise in interest rates threatens to make financial conditions tighter. So far, the fallout from the Treasury yield spike has been relatively contained, as credit markets continue to function smoothly, and equity prices are still not far from their all-time high closes set back in February. However, a continued rise in Treasury yields will lead to tighter financial conditions as they offset the easing seen in other markets. Morgan Stanley reports that the spread between its overall financial conditions index and the index without Treasuries has now closed to zero. A sustained break above the one-year high level for the benchmark 10-year Treasury of 1.61% seen last Thursday could trigger a broader selloff and put financial markets under pressure. It could also have negative spillovers into other rate sensitive sectors such as housing which have helped lead the post-pandemic recovery.

Exhibit 3: The spillover from higher rates into other markets has been more limited



Source: Morgan Stanley Research

Exhibit 4: The spread between broad FCI and FCI ex Treasuries has closed



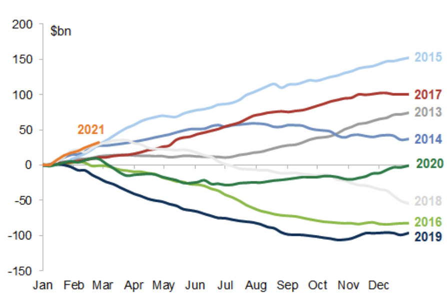
Source: Morgan Stanley Research

Europe

back to top

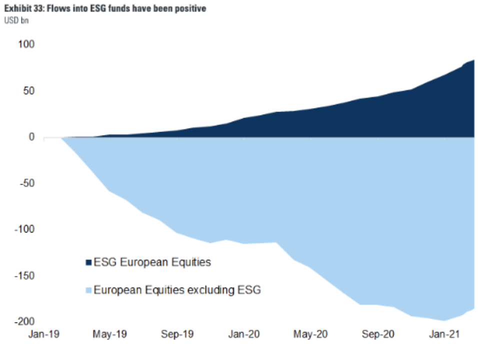
European equities were heading lower today with Euro STOXX benchmark down 0.7%. The technology sector (-2.7%) was underperforming, mostly following yesterday's Nasdaq losses. Materials (-2.2%) also traded lower, tracking the drop in the base metals. German air carrier Lufthansa posted a record €6.7 annual loss coupled with a downbeat projection for the coming year. On the positive side, **analysts note that equity flows into Europe have enjoyed a particularly strong start this year** with continents exposure to ESG chares providing additional competitive advantage.

Exhibit 32 : The YTD flows into Europe are strong so far compared to history



Source: EPFR, Goldman Sachs Global Investment Research

Exhibit 33: Flows into ESG funds have been positive



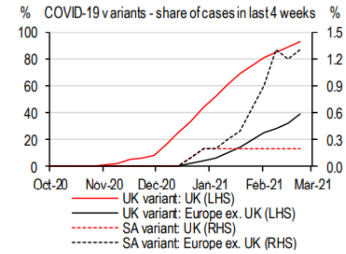
Source: EPFR, Goldman Sachs Global Investment Research

European sovereign bond yields were edging lower (-2 bps) after increasing 7-8 bps yesterday. Southern European spreads were trading mixed with some underperformance out of Spain and Portugal following a somewhat **weak bond auction in Spain** with 10-year bid-to-cover ratio falling to 1.59, the lowest since June 2020.

German Chancellor Merkel presented a gradual re-opening plan for the economy. Starting from this week, some non-essential business would be allowed to re-open with further review carried out every two weeks. The hospitality sector will remain shut at least until March 28. New cases have been stable in

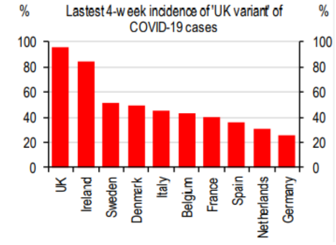
Germany with the proportion of new cases attributed to the UK-strain lower than in rest of Europe. By contrast, new cases are rising again in France and Italy as well as parts of Eastern Europe.

3. The UK variant accounts for around 40% of cases in Europe outside the UK…



Source: GISAID, HSBC

4. …but the share is not as high in Germany



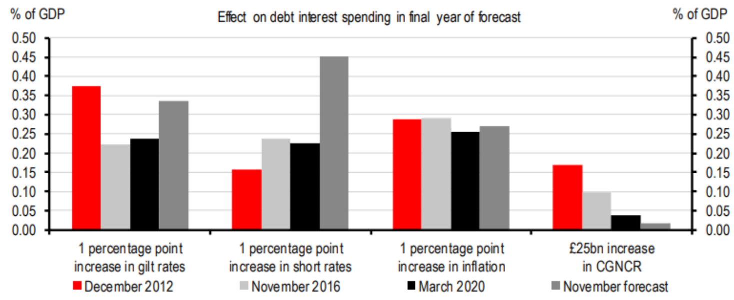
Source: GISAID, HSBC

On the data front, **Eurozone retail sales came well below consensus estimate, contracting 6.4% yoy in January (-1.2% expected)**. The decline was particularly large (-13.6% yoy) in the non-food goods category, which was severely affected by the closure of non-essential businesses.

United Kingdom

The UK Budget delivered above expected near-term stimulus, but also a more hawkish fiscal consolidation in the following years. The Covid-19 support measures were extended throughout the summer, including the furlough scheme, VAT cuts for the hospitality sector and reduced stamp-duty on property purchases. This resulted in 2021/22 fiscal stimulus coming about £40bn (2% of GDP) above analysts' estimates. The generous super deduction scheme, allowing companies to offset 130% of investments against profits, was also a big surprise. At the same time, freezing of income tax thresholds and projected corporate tax increase from 19% to 25% starting from 2023, came as a hawkish surprise to most contacts. **Markets reacted primarily through higher bond yields (10-year gilt +7 bps) as the overall increase in bond supply was £50bn above consensus**. Higher supply and higher yields also further increase the importance of Bank of England support for the bond market, both in the context of market capacity to absorb new debt and the increase of budget sensitivity to a rise interest rates. **The Bank of England received a new mandate to drive towards net zero goals for its bond portfolio.**

2. Rising rates could prove very expensive for the UK



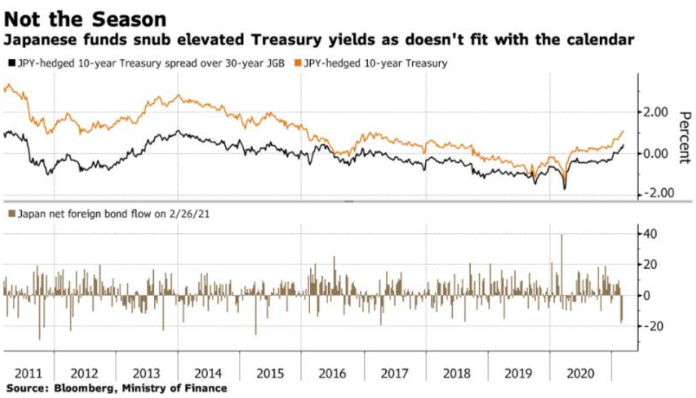
Source: OBR. Note: All increases are assumed to take effect at the beginning of the first year of the forecast and continue until the final year.

Other Market Markets

back to top

Japan

Long-end JGB yields increased (10-year: +1.4 bps; 30-year: +3.6 bps) as the 30-year debt auction today drew the weakest demand in nearly five years. The renewed sell-off in U.S. treasuries also weighed on market sentiment. **Japanese investors sold a record $34 bn of foreign bonds in the two weeks ending February 26.** One analyst noted that what started out as a rebalancing of books by Japanese funds has added to the volatility in global markets. Reportedly, Japanese funds were also selling off-the run U.S. treasuries. This in turn led dealers to absorb the Japanese supply in off-the-run bonds by shorting on-the-run bonds to hedge their positions, driving the repo rate for 10-year U.S. treasuries to close at -3.75% on Wednesday.



Emerging Markets

back to top

Asian markets were sharply lower after yesterday's declines in the USD (-2.3% on aggregate). Malaysia stayed on hold at 1.75% as expected, even as PM **Yassin said earlier that the government plans to adopt a more targeted approach to the pandemic** by imposing lockdowns in areas with infection clusters while allowing the rest of the economy to operate. The US Heritage Foundation dropped Hong Kong SAR and Macau SAR from its Economic Freedom Index as both are now considered part of China. EMEA markets were weaker, while Latin American markets did better with strong gains in Mexico (+1.5%) and Chile (+1.4%) and many regional currencies appreciating against the dollar.

Key Emerging Market Financial Indicators

Last updated:	Level		Change				
3/4/21 8:03 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		54.52	-1.1	-2	-2	30	6
MSCI Frontier Equities		29.11	-0.5	0	-1	4	3
EMBIG Sovereign Spread (in bps)		353	-1	5	8	-12	2
EM FX vs. USD		56.85	0.2	0	-1	-3	-2
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.47	0.0	0	0	7	1
Indonesian Rupiah		14267	-0.2	-1	-2	-1	-2
Indian Rupee		72.84	-0.2	-1	0	1	0
Argentine Peso		90.22	0.0	-1	-3	-31	-7
Brazil Real		5.61	0.2	-2	-3	-18	-7
Mexican Peso		20.81	0.7	0	-2	-6	-4
Russian Ruble		73.61	0.5	2	3	-10	1
South African Rand		15.01	0.5	0	0	2	-2
Turkish Lira		7.43	0.4	-1	-4	-18	0
EM FX volatility		10.30	0.0	0.1	0.3	2.3	-0.4

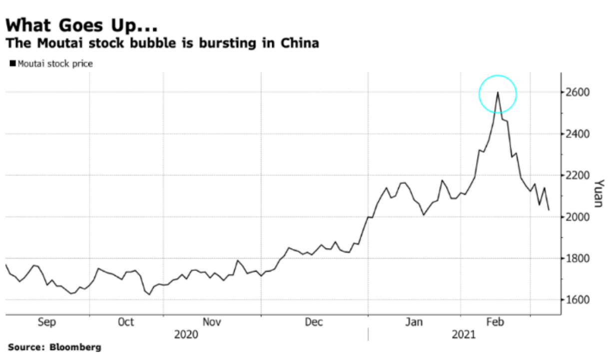
Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

Brazil

The economy expanded 3.2% q/q sa in the fourth quarter, above the market estimates (+2.8%) but slower than the recovery recorded in the previous quarter (+7.7% q/q). In annual terms, the economy contracted 4.1% y/y in 2020. Analysts commented that the slowing economic recovery might provide support for the fresh emergency relief package to mitigate the impact of the second wave of the coronavirus pandemic. Senators started to vote late on Wednesday, and the currency market tumbled intra-day as investors were worried that policymakers would remove spending rules which were to designed keep public finances in check. **The Brazilian real dropped as much as 1.7% but recovered from the losses** after the Lower House confirmed that the vote on the emergency bill wouldn't threaten the spending cap rule. The real closed 0.7% stronger against the dollar yesterday, and the equity index was little changed.

China and Hong Kong SAR

Chinese equities declined (CSI 300: -3.1%), led by materials and consumer firms. On top of deteriorating global market sentiment, the decline was associated with the collapse in the share price of Kweichow Moutai (a liquor maker and the largest market cap firm in mainland exchanges). Its share price fell 5% today; its market cap has dropped $111 bn following a 22% decline after its February height. Some analysts noted concerns about lofty valuations of institutional investors' favorite stocks. A number of popular mutual funds have posted significant losses recently. **Chinese government bonds yields have been largely insulated from rising U.S. treasury yields,** with 10-year CGB yield increasing just 12 bps year-to-date (vs. U.S. treasuries: +57 bps).

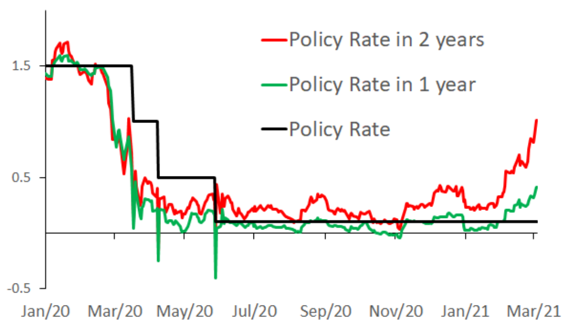


Poland

The National Bank of Poland (NBP) left its benchmark rate unchanged at 0.1% and reiterated its willingness to intervene in FX markets, but markets priced in further tightening as contacts argue that growth and inflation projections signal a likely shift to a more hawkish stance. Yesterday, the NBP revised its growth and inflation projections higher for 2021. GDP growth is expected to be in the 2.6-

5.3% range (from 0.8–4.5% previously) and CPI inflation in the 2.7-3.6% range (from 1.8–3.2%). The NBP governor will hold a press conference on Friday.

Poland: Current and implied policy rates (%)



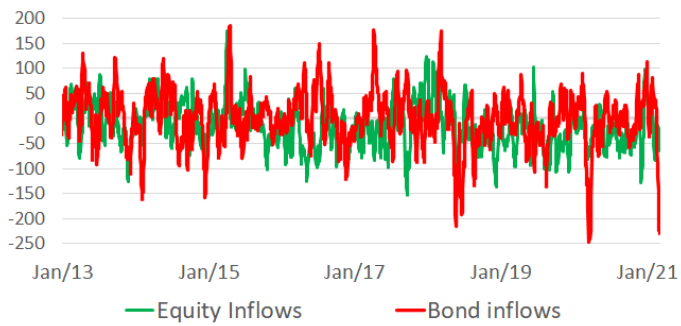
Source: Bloomberg and IMF staff

South Africa

Local 10-yr bond yields (+5 bps to 9.12%) are trading at a new 2021 high as foreign investors are continuing to sell South African government bonds (SAGBs)**.** Analysts have welcomed the pledge of FM Mboweni to reduce bond issuance in the coming fiscal year but remain concerned about South Africa's debt trajectory. The pace of sale of SAGBs by foreigners has accelerated to a 10-day moving average of +200 mn per day. Contacts report that banks have absorbed the latest bout of foreign SAGB selling, with net purchases of primary dealers reaching the highest amount since June 2020.

South Africa: Daily Portfolio flows

(mn U.S. dollar, 10-day moving average)



Note: Bloomberg and IMF staff

List of GMM Contributors

Global Markets Analysis Division, MCM Department

Nassira Abbas
Deputy Division Chief

Antonio Garcia-Pascual
Deputy Division Chief

Evan Papageorgiou
Deputy Division Chief

Jose Abad
Financial Sector Expert

Sergei Antoshin
Senior Economist

John Caparusso
Senior Financial Sector Expert

Liumin Chen
Research Assistant

Yingyuan Chen
Financial Sector Expert

Han Teng Chua
Economic Analyst

Fabio Cortés
Senior Economist

Reinout De Bock
Economist

Dimitris Drakopoulos
Financial Sector Expert

Deepali Gautam
Research Officer

Rohit Goel
Financial Sector Expert

Sanjay Hazarika
Senior Financial Sector Expert

Frank Hespeler
Senior Financial Sector Expert

Henry Hoyle
Financial Sector Expert

Mohamed Jaber
Senior Financial Sector Expert

Phakawa Jeasakul
Senior Economist

Sonia Meskin
Financial Sector Expert

Natalia Novikova
IMF Resident Representative in Singapore

Dmitri Petrov
Financial Sector Expert

Thomas Piontek
Financial Sector Expert

Patrick Schneider
Research Officer

Can Sever
Economist

Juan Solé
Senior London Representative

Jeffrey Williams
Senior Financial Sector Expert

Dmitry Yakovlev
Senior Research Officer

Akihiko Yokoyama
Senior Financial Sector Expert

Xingmi Zheng
Research Assistant

Global Financial Indicators

Last updated: 3/4/21 8:02 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		3818	-1.3	0	-1	22	2
Europe		3700	-0.3	0	2	8	4
Japan		28930	-2.1	-4	2	37	5
China		3503	-2.1	-2	0	16	1
Asia Ex Japan		96	-0.3	-2	-2	36	7
Emerging Markets		55	-0.2	-2	-2	30	6
Interest Rates					basis points		
US 10y Yield		1.46	-2.1	-6	32	41	55
Germany 10y Yield		-0.31	-2.6	-8	14	32	26
Japan 10y Yield		0.13	1.3	-2	7	26	11
UK 10y Yield		0.74	-4.0	-5	30	37	54
Credit Spreads					basis points		
US Investment Grade		91	-0.1	0	-2	-42	-4
US High Yield		347	-2.4	0	-14	-190	-33
Europe IG		49	0.8	-1	1	-15	1
Europe HY		254	3.6	-8	10	-37	12
Exchange Rates					%		
USD/Majors		91.18	0.3	1	0	-6	1
EUR/USD		1.20	-0.3	-1	1	8	-2
USD/JPY		107.4	0.4	1	2	0	4
EM/USD		56.8	0.1	0	-1	-3	-2
Commodities					%		
Brent Crude Oil ($/barrel)		64	0.2	-4	9	26	24
Industrials Metals (index)		142	-2.8	-6	6	36	7
Agriculture (index)		52	0.3	-2	3	32	8
Implied Volatility					%		
VIX Index (%, change in pp)		26.3	-0.3	-2.5	4.6	-5.7	3.6
US 10y Swaption Volatility		79.9	2.5	-8.8	19.1	-13.5	19.8
Global FX Volatility		7.7	0.0	-0.2	0.3	0.9	-0.4
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		128	-0.2	-8	18	-57	8
Italy		105	0.6	2	5	-60	-6
Portugal		58	1.0	-2	7	-30	-2
Spain		69	1.0	-2	11	-13	7

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: 3/4/2021 8:04 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	0.0	-0.2	0	7	1		3.4	0.0	-1	3	52	8
Indonesia		14267	-0.2	-1.3	-2	-1	-2		6.6	-3.6	6	42	-34	50
India		73	-0.2	-0.6	0	1	0		6.4	0.8	6	24	-10	49
Philippines		49	-0.3	0.0	-1	4	-1		3.5	-1.5	1	-3	-64	-16
Thailand		30	0.0	-0.1	-1	3	-1		1.9	5.0	18	50	64	57
Malaysia		4.06	-0.2	-0.4	0	3	-1		3.0	0.4	9	34	17	44
Argentina		90	0.0	-0.5	-3	-31	-7		42.8	33.0	117	-664	-670	-1330
Brazil		5.61	0.2	-1.6	-3	-18	-7		7.8	22.8	76	155	216	219
Chile		730	-0.3	-2.3	1	12	-3		3.1	6.9	5	36	-36	35
Colombia		3675	0.1	-1.9	-3	-5	-7		5.8	18.3	43	76	27	78
Mexico		20.81	0.7	0.2	-2	-6	-4		6.0	7.0	9	44	-47	45
Peru		3.7	-0.2	-0.8	-1	-7	-2		4.5	11.4	35	65	33	91
Uruguay		44	0.8	-1.1	-3	-8	-3		7.0	-4.6	2	-18	-339	-24
Hungary		303	-0.3	-2.0	-2	-1	-2		2.0	2.1	2	36	54	48
Poland		3.78	-0.4	-1.9	-1	2	-1		0.9	8.3	16	32	-55	30
Romania		4.1	-0.4	-1.3	0	6	-2		2.7	5.0	7	40	-94	-2
Russia		73.6	0.5	1.5	3	-10	1		6.3	-7.2	1	33	37	62
South Africa		15.0	0.5	0.0	0	2	-2		9.9	5.3	14	45	38	21
Turkey		7.43	0.4	-1.1	-4	-18	0		13.7	10.8	21	27	218	56
US (DXY; 5y UST)		91	0.3	1.2	0	-6	1		0.72	-1.1	-10	26	-6	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	1 Day	7 Days	30 Days	12 M	YTD
								basis points						
China		5281	-3.1	-3	-4	28	1		199	0	-2	-9	30	-9
Indonesia		6291	-1.3	0	3	11	5		158	0	-9	-25	-5	-29
India		50846	-1.2	0	0	32	6		156	-3	4	0	-21	5
Philippines		6882	-0.9	2	0	0	-4		83	0	-9	-17	13	-22
Malaysia		1581	-0.5	0	0	6	-3		113	0	-2	-3	9	3
Argentina		47325	-1.7	-5	-7	27	-8		1459	0	19	8	-570	91
Brazil		111184	-0.3	-1	-7	4	-7		253	0	0	-16	58	3
Chile		4758	1.4	4	8	9	14		126	0	-6	-16	-14	-18
Colombia		1347	-0.2	1	-1	-13	-6		207	0	-4	-15	44	2
Mexico		46377	1.5	3	5	7	5		348	0	-9	-34	55	-12
Peru		22872	0.0	-1	6	21	10		133	0	-4	-3	22	1
Hungary		42849	-1.7	-3	-3	-1	2		65	0	-6	-15	-42	-31
Poland		57497	-0.7	0	1	11	1		-22	0	-4	-11	-54	-21
Romania		10317	0.7	0	-2	6	5		200	-2	-3	6	-41	-3
Russia		3389	-0.8	-1	1	20	3		159	0	-5	-3	19	-7
South Africa		67849	-0.7	1	6	28	14		357	0	-4	-35	25	-23
Turkey		1537	0.4	3	0	39	4		421	0	-5	-47	34	-24
Ukraine		525	0.0	1	1	-2	5		479	0	12	-21	127	-12
EM total		55	-1.1	-2	-2	30	6		421	0	17	-10	97	128

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

back to top