GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

FRIDAY, MARCH 5, 2021

- **US payrolls data stronger than expected** (link)
- **Growing disconnect between Fed and futures markets worries investors** (link)
- **China sets conservative growth target of 6%** (link)
- **Italy withholds vaccine exports to Australia** (link)
- **Mortgage backed security hedging could worsen Treasury selloff** (link)
- **Dovish remarks from BOJ governor reassure bond market** (link)

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Testing the Fed

The market was looking for more aggressive rhetoric from Fed Chair Powell, but while his remarks were dovish, he did not discuss any immediate plans for doing more to keep interest rates in check. The game of cat and mouse continued as the market reacted by pushing bond yields higher again, and today the 10-year yield is back at 1.61%, the highest in a year. Futures markets are pricing earlier and more aggressive rate hikes compared to current FOMC estimates as markets continue to test the Fed's resolve. With the large impending new supply of Treasury bonds as the latest stimulus bill comes closer to passing, the odds appear to favor even higher Treasury yields if the Fed does not step in. Meanwhile, oil prices surged over the past two days as OPEC+ kept production cuts in place, setting up the most bullish expectations for oil in recent months. US equity futures are higher, and most European markets are marginally lower. The strong US payrolls report gave a boost to sentiment this morning.

Key Global Financial Indicators

Last updated:	Level		Change from Market Close				
3/5/21 7:58 AM	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		3768	-1.3	-2	-3	25	0
Eurostoxx 50		3690	-0.4	1	1	10	4
Nikkei 225		28864	-0.2	0	0	35	5
MSCI EM		53	-2.3	-2	-5	30	3
Yields and Spreads					bps		
US 10y Yield		1.57	0.6	16	41	66	66
Germany 10y Yield		-0.30	1.3	-4	15	39	27
EMBIG Sovereign Spread		351	-2	5	8	-4	1
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		56.2	-0.3	-1	-2	-3	-3
Dollar index, (+) = $ appreciation		91.9	0.3	1	1	-5	2
Brent Crude Oil ($/barrel)		68.5	2.6	4	15	37	32
VIX Index (%, change in pp)		27.6	-1.0	0	7	-12	5

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

United States

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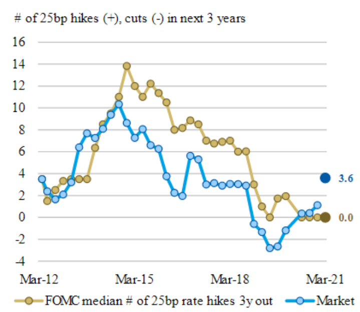
This morning's US payroll data came in well ahead of expectations, and January's jobless numbers saw a substantial upward revision. Labor force participation remained unchanged at 61.4%, underlining the positive tone of the report. Treasury yields moved sharply higher and equity index futures posted further gains in the immediate aftermath of the report.

US February Payrolls Report 8.30 am

Data Release	Consensus Forecast	Actual Data
Change in Nonfarm Payrolls	200K	379K, Jan. revised to 166K from 49K
Unemployment Rate	6.3%	6.2%
Average Hourly Earnings mom	0.2%	0.2%
Average Hourly Earnings yoy	5.3%	5.3%
Source: Bloomberg.		

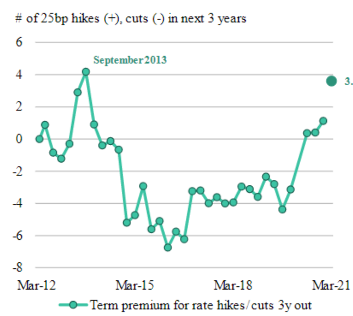
With the Treasury market back in the spotlight with the renewed uptick in interest rates, market participants are growing worried about the increasing disconnect between the Fed's forecast of policy rates in the years ahead and the interest rate futures market. The FOMC dot plot forecasts no rate hikes through 2024, while futures markets expect three rate hikes. How will this disconnect be resolved? Either the Fed will have to take aggressive action to change market expectations, or the markets will be proved right as inflation expectations continue to rise, and the entire interest rate complex will reprice higher. The latter could spark a substantial bout of volatility for risk assets. Fed Chair Powell's highly dovish remarks at a Wall Street Journal conference yesterday failed to convince markets, as interest rates resumed their upward climb and sent stocks to another day of losses. All the eyes are on the 1.61% yield level for the benchmark 10-year Treasury, the one-year high set on February 25. A major breakout above that level would be a red flag for markets. **Meanwhile, the Senate appears close to voting along party lines to pass President Biden's stimulus package, with key support measures from previous bills set to expire on March 14.**

Exhibit 7: FOMC dot plot-implied # of 25bp rate hikes three years ahead vs. market-implied # of hikes



Source: Federal Reserve, Morgan Stanley Research

Exhibit 8: Market-implied pricing vs. FOMC dot-plot: Three-year-ahead term premium



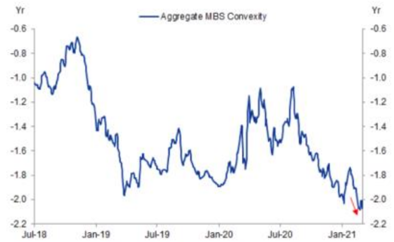
Source: Federal Reserve, Morgan Stanley Research

Convexity hedging in the mortgage backed securities (MBS) market likely contributed to the upward pressure on Treasury yields, according to Goldman. MBS exhibit negative convexity, i.e. their prices fall faster when rates rise, and rise slower when rates go down by the equivalent amount. "Normal" bonds without embedded options exhibit positive convexity, with their prices rising more quickly when rates go down and falling more slowly when rates go up. Negative convexity forces some MBS holders to sell Treasuries as rates go up in order to hedge the interest rate risk (a.k.a. duration risk) embedded in the MBS (the Fed is a major exception as it does not hedge its MBS portfolio, and Fannie Mae and Freddie Mac do much less convexity hedging than they did in the pre-GFC era). Goldman's analysis finds that an increase in mortgage duration of one year tends to be followed by a 10 bps increase in the 10-year term premium. The analysts conclude that MBS convexity hedging played an important role in the Treasury selloff, although it was not the proximate cause. Moreover, the MBS market has become even more negatively convex due to the higher level of rates, implying that convexity hedging could kick in again if rates keep going up.

Exhibit 3 : Changes in mortgage duration tend to lead to an increase in Treasury yields in the subsequent month
Month-over-month change in 10-year Treasury bond term premium vs. 1-month lagging month-over-month change in MBS duration, 1/2010-2/2021

Source: Bloomberg, Federal Reserve Bank of New York, Goldman Sachs Global Investment Research

Exhibit 4 : The mortgage market is still negatively convex: further moves up in Treasury yields will lead to additional MBS extension
Convexity, Bloomberg-Barclays agency MBS index



Source: Bloomberg, Goldman Sachs Global Investment Research

Europe

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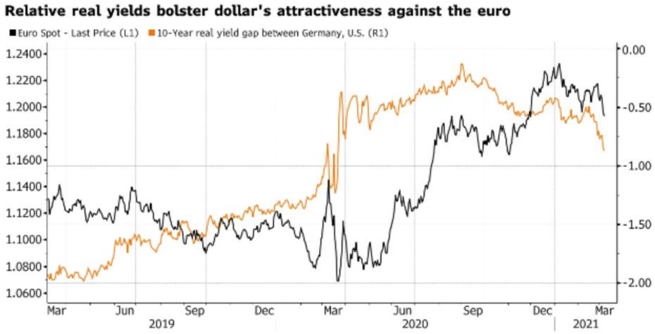
European equities opened about 1% lower but managed to regain ground with the STOXX 600 benchmark down just fractionally%. Energy shares were outperforming (+1.7%) benefiting from higher oil prices.

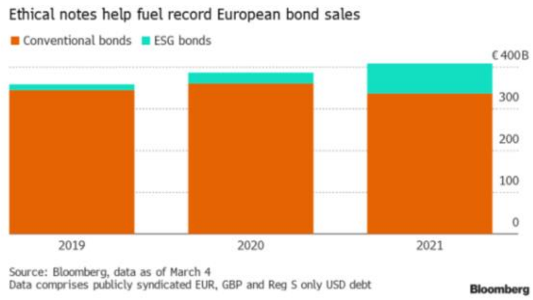
European sovereign bond yields increased by 2 bps with Southern European spreads mostly unchanged. **The increase in the U.S. bond yields is feeding into currency markets** with the euro (-0.4%) and the sterling (-0.7%) depreciating on broader dollar strength through growing real-yield differentials.

Relative real yields bolster dollar's attractiveness against the euro

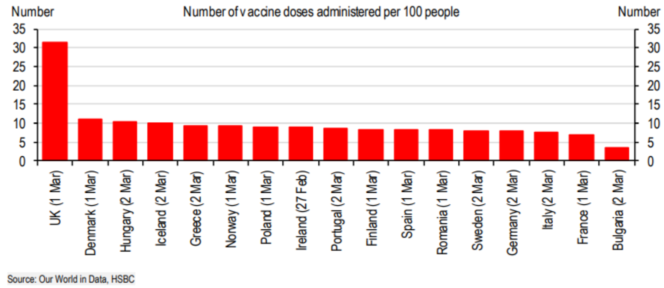


German January industrial orders delivered an upside surprise, increasing 1.4% mom (0.5% expected). The slump in domestic orders was more than offset by foreign demand both from the Eurozone and rest of the world. Analysts note that the incoming data continues to suggest that the industrial sector should provide a major cushion for the German economy amid broader lockdown extension.

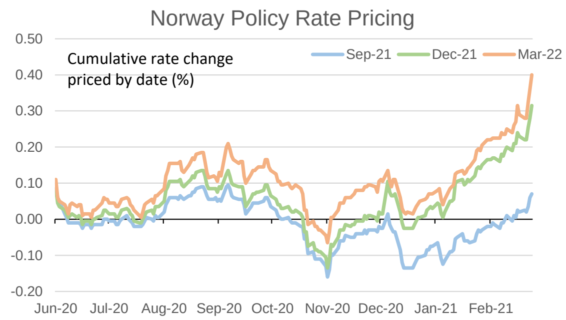
The year-to-date issuance in European primary bond markets remains at record high, boosted by ESG bond placements. ESG issuance stands at 17% of total placement as compared to 7% in 2020. After a successful placement by Italy, German car manufacture Daimler issued €1 bn of green bonds yesterday amid €2.8 bn of demand. The ESG bond market is expected to get another major boost from the EU recovery fund related green bond issuance in the second half of this year.



Italy withheld AstraZeneca vaccine exports to Australia. According to press reports, the EC did not oppose Italy's decision to block the export of 250 000 vaccines as it was in line with the Commission's legislation on export restrictions introduced in January. Vaccinations in the European Union continues to lag both the UK and the U.S.



Analysts expect Norway to be the first in the G-10 to lift its policy rate. Markets are now pricing in the first rate hike in September, with two rates hikes to be delivered this year. According to analyst reports, the outlook is supported by faster than expected vaccinations, higher oil prices and rapid house price growth. This contrasts to Norges Bank December monetary policy report, which projected the first rate increase in 2022.



Other Mature Markets

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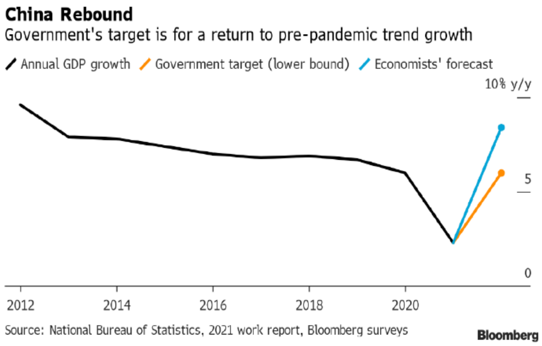
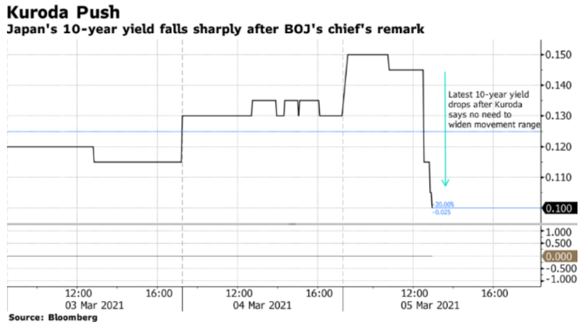
Japan

Long-end JGB yields declined (10-year: -4 bps; 30-year: -4.1 bps) following Bank of Japan (BOJ) dovish rhetoric from Governor Kuroda. He made it clear that a widening of the movement range around the BOJ's 10-year JGB yield target is off the table for the policy review. He also said that the BOJ wants to keep the whole yield curve low to support the economic recovery, easing market concerns about the recent rise in yields. **The state of emergency will be extended by two weeks for Tokyo and three adjacent prefectures** to contain the spread of the virus.





Emerging Markets

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Markets were mixed. Russian 10-yr local bond yields (+14 bps to 6.68%) rose sharply after reports that the U.K. and U.S. are considering additional sanctions but Russian equities (+0.6%) are modestly higher. Most Asian markets were mostly lower while Latin America was more mixed, with Brazil posting solid gains.

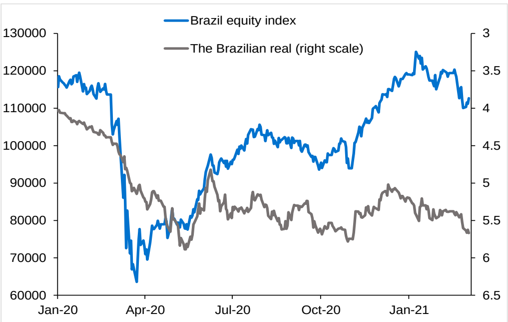
Key Emerging Market Financial Indicators

Last updated:	Level		Change				
3/5/21 8:00 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks				%			%
MSCI EM Equities		53.25	-0.5	-2	-5	30	3
MSCI Frontier Equities		28.84	-0.9	0	-3	5	2
EMBIG Sovereign Spread (in bps)		351	-2	5	8	-4	1
EM FX vs. USD		56.24	-0.3	-1	-2	-3	-3
Major EM FX vs. USD				%, (+) = EM currency appreciation			
China Renminbi		6.49	-0.3	0	0	7	1
Indonesian Rupiah		14300	-0.2	0	-2	-1	-2
Indian Rupee		73.03	-0.3	1	0	0	0
Argentine Peso		90.29	0.0	-1	-3	-31	-7
Brazil Real		5.70	-0.5	-2	-6	-19	-9
Mexican Peso		21.23	-0.5	-2	-5	-7	-6
Russian Ruble		74.45	0.2	0	0	-9	-1
South African Rand		15.29	0.1	-1	-3	2	-4
Turkish Lira		7.50	0.3	-1	-6	-19	-1
EM FX volatility		10.23	0.0	-0.5	0.3	2.1	-0.5

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

Brazil

Brazil's Senate backed a $7.8 bn emergency bill to mitigate the impact of the second wave of the pandemic. The bill will revive the government's cash handout program from last year. Senators approved the bill in two rounds of voting on Wednesday night and Thursday, allowing the government to finance four monthly payments of BRL $250 to 40 million citizens at a total cost of BRL $44 bn (around $7.8 bn). The Lower House may vote on it as early as March 10. Stocks surged on the news and FX volatility declined.



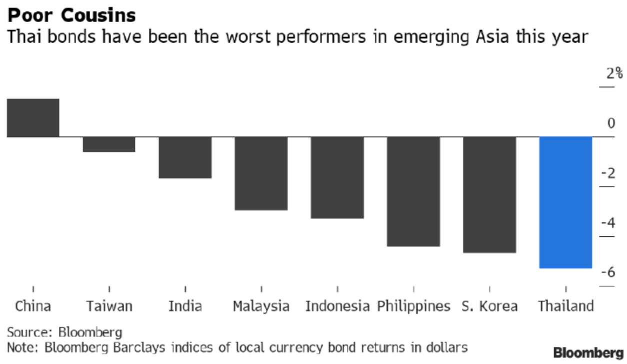
Source: Bloomberg.

China

China set a conservative growth target at 6% for 2021 while adopting larger-than-expected fiscal measures. The National People's Congress (NPC) started today. Premier LI Keqiang delivered the Government Work Report, which outlines key economic targets and policies for this year. The modest growth target is well below consensus forecasts, signaling the government's intention to focus on longer-term priorities. The fiscal deficit target is set at 3.2% of GDP (vs. 3.6% last year), and the quota for local government special bond issuance at 3.65 tn yuan ($564 bn). Both targets are higher than market expectations, suggesting a slower pace of policy normalization. Some analysts think Beijing may intend to guide local government special bond issuance to reduce off-balance sheet financing and alleviate hidden debt risks. China also plans to reduce its CO_2 emission intensity by 18% by 2025.

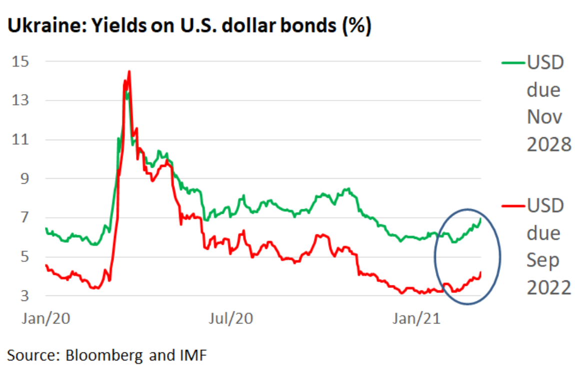
Thailand

Headline CPI declined -1.2% y/y In February, driving up real bond yields amid the global bond sell-off. The decline was much larger than the consensus of -0.2%. Core CPI remained flat yoy. The data drove up real 10-year government bond yield to 3.0% and the real policy rate to 1.7%, placing Thailand among the emerging markets with highest real interest rates. Long-end government bond yields have increased by 65 bps year-to-date, broadly similar to the rise in U.S. treasury yields. Markets were weaker on the day.



Ukraine

Yesterday, the National Bank of Ukraine unexpectedly increased its policy rate to 6.5% (from 6%) given the "balance of risks and the significant rise in fundamental inflationary pressures." Central bank deputy governor Sologub said another hike is possible in April depending on inflation developments, Covid-19 developments, delays in the IMF program and volatility on global markets. Headline inflation rose to 6.1% yoy and core inflation to 5% yoy in January. The hryvnia has appreciated 2% YTD against the dollar after depreciating almost 20% last year but yields on Eurobonds are up 100 bps in 2021.



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Global Financial Indicators

Last updated: 3/5/21 8:00 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		3768	-1.3	-2	-3	25	0
Europe		3690	-0.4	1	1	10	4
Japan		28864	-0.2	0	0	35	5
China		3502	0.0	0	0	14	1
Asia Ex Japan		93	-2.3	-3	-5	35	4
Emerging Markets		53	-2.3	-2	-5	30	3
Interest Rates					basis points		
US 10y Yield		1.57	0.6	16	41	66	66
Germany 10y Yield		-0.30	1.3	-4	15	39	27
Japan 10y Yield		0.10	-3.6	-7	4	21	8
UK 10y Yield		0.77	3.8	-5	29	44	57
Credit Spreads					basis points		
US Investment Grade		92	0.9	-1	1	-38	-3
US High Yield		347	-0.2	3	-9	-172	-33
Europe IG		50	1.2	-1	2	-18	2
Europe HY		256	5.2	-9	14	-62	15
Exchange Rates					%		
USD/Majors		91.93	0.3	1	1	-5	2
EUR/USD		1.19	-0.3	-1	-1	6	-2
USD/JPY		108.3	0.3	2	3	2	5
EM/USD		56.2	-0.3	-1	-2	-3	-3
Commodities					%		
Brent Crude Oil ($/barrel)		68	2.6	4	15	37	32
Industrials Metals (index)		143	1.5	-2	5	37	8
Agriculture (index)		52	0.2	-1	3	34	8
Implied Volatility					%		
VIX Index (%, change in pp)		27.6	-1.0	-0.4	6.7	-12.0	4.8
US 10y Swaption Volatility		84.7	1.3	-4.4	22.3	-9.8	24.6
Global FX Volatility		7.8	0.0	-0.5	0.5	0.5	-0.3
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		126	-1.4	-11	5	-71	6
Italy		106	1.2	4	8	-69	-5
Portugal		59	0.6	2	9	-39	-1
Spain		70	0.9	2	13	-20	8

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

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Emerging Market Financial Indicators

Last updated: 3/5/2021 8:03 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		6.49	-0.3	-0.3	0	7	1		3.4	0.7	-1	2	56	8
Indonesia		14300	-0.2	-0.5	-2	-1	-2		6.6	3.8	0	43	-6	54
India		73	-0.3	0.6	0	0	0		6.4	-1.3	2	23	-1	48
Philippines		49	0.1	0.0	-1	4	-1		3.5	1.4	3	3	-64	-15
Thailand		31	-0.3	-0.2	-2	4	-2		1.9	2.2	11	50	77	59
Malaysia		4.07	-0.4	-0.6	0	2	-1		3.0	4.3	11	35	26	49
Argentina		90	0.0	-0.5	-3	-31	-7		43.0	19.9	150	-673	-566	-1310
Brazil		5.70	-0.5	-1.7	-6	-19	-9		7.3	-49.0	11	96	171	170
Chile		732	-0.8	-0.9	1	12	-3		3.1	3.5	1	40	-14	39
Colombia		3654	-0.2	-0.2	-3	-3	-6		5.8	-2.8	22	70	40	75
Mexico		21.23	-0.5	-1.8	-5	-7	-6		6.1	11.1	3	51	-26	56
Peru		3.7	-0.3	-1.0	-1	-7	-2		4.6	14.0	39	80	58	105
Uruguay		44	0.2	-1.7	-3	-9	-4		7.0	1.1	0	-12	-329	-23
Hungary		307	-0.7	-2.3	-3	-2	-3		2.0	-0.6	-8	37	60	48
Poland		3.83	-0.5	-2.3	-3	0	-3		0.9	-1.8	3	29	-57	29
Romania		4.1	-0.3	-1.3	-1	5	-3		2.7	0.0	-7	43	-86	-2
Russia		74.4	0.2	0.2	0	-9	-1		6.3	-5.6	-13	29	42	57
South Africa		15.3	0.1	-1.1	-3	2	-4		9.9	5.6	9	51	52	27
Turkey		7.50	0.3	-0.9	-6	-19	-1		14.0	30.1	43	65	283	86
US (DXY; 5y UST)		92	0.3	1.1	1	-5	2		0.80	0.5	6	33	12	43

	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		5263	-0.3	-1	-4	25	1		199	0	-2	-9	30	-9
Indonesia		6259	-0.5	0	2	11	5		158	0	-9	-25	-5	-29
India		50405	-0.9	3	-1	31	6		155	-1	7	0	-17	4
Philippines		6881	0.0	1	-2	0	-4		83	0	-9	-17	13	-22
Malaysia		1600	1.2	1	1	7	-2		113	0	-2	-3	9	3
Argentina		47808	1.0	-2	-6	30	-7		1459	0	19	8	-570	91
Brazil		112690	1.4	2	-6	10	-5		253	0	0	-16	58	3
Chile		4709	-1.8	3	6	9	13		126	0	-6	-16	-14	-18
Colombia		1337	-0.7	-2	-2	-14	-7		207	0	-4	-15	44	2
Mexico		46004	-0.8	4	4	9	4		348	0	-9	-34	55	-12
Peru		22536	-1.5	-1	3	20	8		133	0	-4	-3	22	1
Hungary		43238	0.7	-1	-2	1	3		65	0	-6	-15	-42	-31
Poland		57693	-0.3	1	0	14	1		-22	0	-4	-11	-54	-21
Romania		10432	0.9	2	-2	9	6		193	-6	-4	-1	-33	-10
Russia		3421	0.7	2	1	21	4		159	0	-5	-3	19	-7
South Africa		68074	0.5	3	6	29	15		357	0	-4	-35	25	-23
Turkey		1543	0.3	5	1	38	4		421	0	-5	-47	34	-24
Ukraine		517	-1.5	-1	-1	-4	3		479	0	12	-21	127	-12
EM total		53	-0.5	-2	-5	30	3		421	0	17	-10	97	128

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

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