GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, NOVEMBER 2, 2021

- **Global bond yields surge as central banks get hawkish** (link)
- **Derivatives markets are pricing faster Fed rate hikes** (link)
- **Australia abandons yield curve target** (link)
- **Natural gas prices decline in Europe** (link)
- **Wheat futures close at highest price since 2012** (link)
- **Rising dollar hedging costs could deter foreign investors in US market** (link)
- **Special Feature: ESG Monitor (attached)**

Mature Markets | Emerging Markets | Market Tables

Global markets near record highs despite hawkish central banks

Markets hit new record highs in the US, Europe, and other countries yesterday, although they have pulled back slightly in early morning trading today. The rally has come in the face of a shift to more hawkish policies by central banks around the world, suggesting that markets are comfortable with a moderately higher level of interest rates. However, inflation remains a major concern, with food inflation being a particular focus for emerging markets. If inflation gets out of control, central banks may have to act more aggressively and markets would face greater challenges. Meanwhile, trading conditions remain fairly quiet ahead of the FOMC meeting tomorrow and the Bank of England meeting (BOE) on Thursday. The Fed is expected to announce tapering and there is a distinct chance that the BOE could be on the move. Interest rate volatility is trending upwards as central banks get more aggressive, but equity volatility remains subdued.

Key Global Financial Indicators

Last updated: 11/2/21 8:04 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities					%		%
S&P 500		4614	0.2	1	6	39	23
Eurostoxx 50		4283	0.1	1	6	42	21
Nikkei 225		29521	-0.4	1	3	27	8
MSCI EM		51	0.8	-2	2	13	-1
Yields and Spreads					bps		
US 10y Yield		1.55	-0.3	-6	9	71	64
Germany 10y Yield		-0.14	-4.1	-3	8	50	43
EMBIG Sovereign Spread		357	0	1	-5	-63	6
FX / Commodities / Volatility					%		
EM FX vs. USD, (+) = appreciation		54.7	0.1	-1	-2	1	-6
Dollar index, (+) = $ appreciation		93.9	0.1	0	0	0	4
Brent Crude Oil ($/barrel)		84.3	-0.5	-2	6	846	63
VIX Index (%, change in pp)		16.5	0.1	0	-5	-21	-6

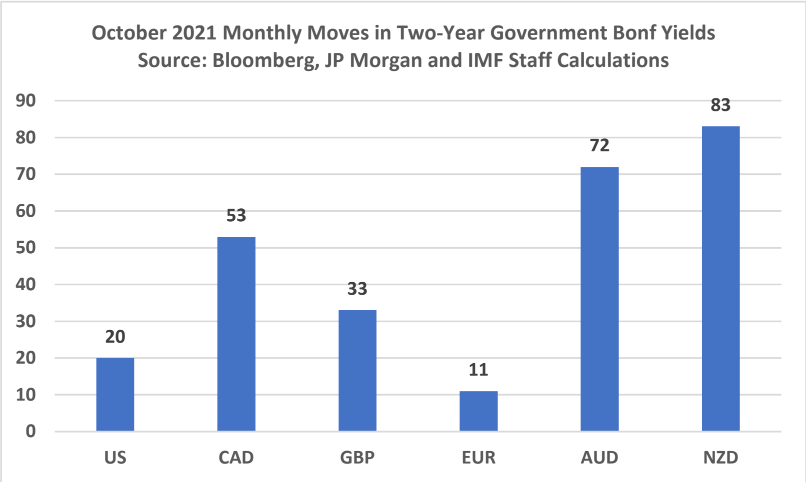
Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

Mature Markets

back to top

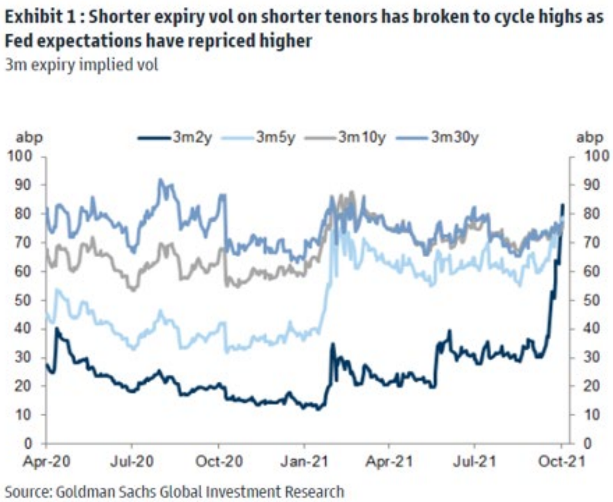
Global bond markets

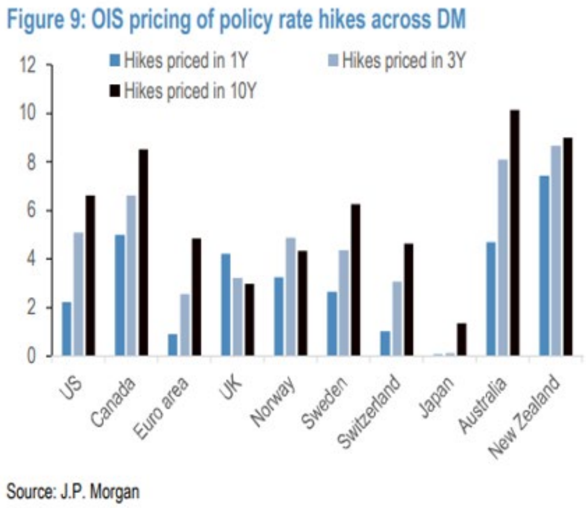
Bond markets in advanced economies are seeing a surge in short term rates and flatter yield curves. Investors are positioning for hawkish central bank policy, as inflation pressures are expected to force policymakers to act. New Zealand has already hiked, Canada ended asset purchases and indicated that it may hike by April, while there is a distinct chance that the Bank of England could move on Thursday. The Fed is expected to announce tapering this week. Even euro area markets are pricing a10 bps of rate hike in Q3 of 2022.



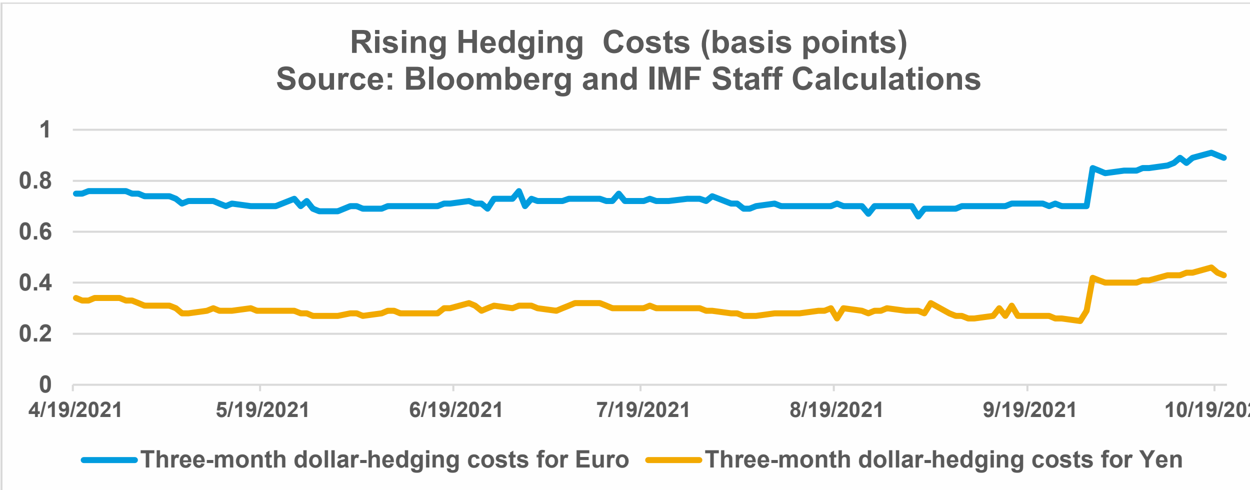
United States

Derivatives markets are pricing a faster pace for Fed rate hikes. In the market for swaptions, which are options to enter into interest rate swaps, the volatilities for shorter maturity options has gone up sharply, while volatilities for longer maturity options has held relatively steady. This implies that markets expect Fed rate hikes to come earlier than originally expected, but the hiking cycle is expected to be relatively brief. The markets are now looking for a July liftoff, with nearly 2 ½ rate hikes priced by the end of 2022. Based on pricing in the overnight index swap (OIS) market, only five Fed rate hikes are expected over the next three years.





The flatter yield curve US credit markets could face headwinds as the yield curve flattens. Foreign investors have been heavy buyers of investment grade (IG) US corporate bonds, due to higher yields and low hedging costs. However, flatter yield curves raise the hedging costs for non-US investors, and if the trend continues, they might pull back. Costs are already higher in the past few days. Another potential threat is that a flatter yield curve makes longer maturity bonds less attractive. The market is vulnerable because valuations are very expensive, with the Bloomberg IG US corporate bond index spread currently at 85 bps, close to the all-time tight level of 80 bps seen back in June.

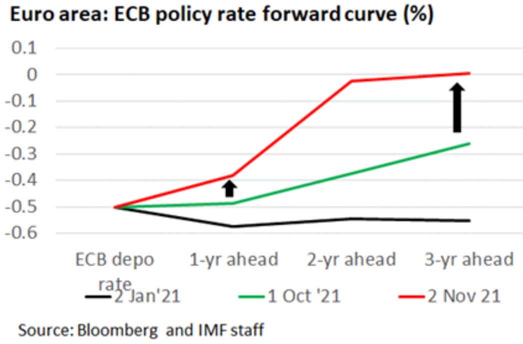


Euro area

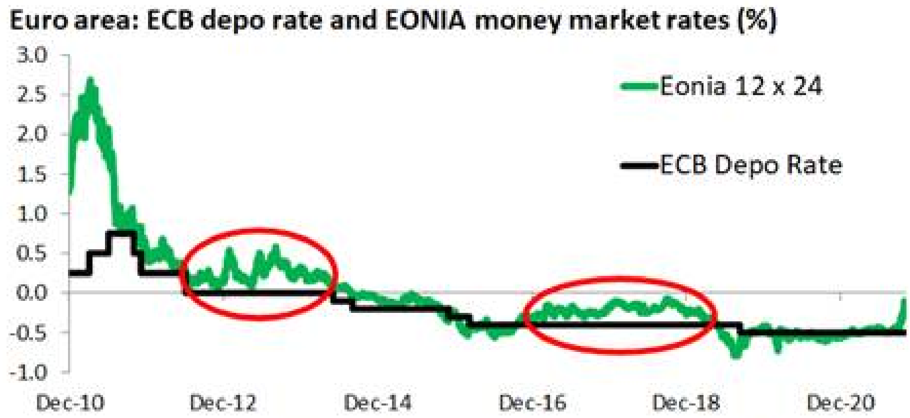
Yields traded sharply lower, and spreads tightened as the euro area reported slightly softer final October manufacturing PMI readings. German 10-yr bund yields fell 5 bps (to -0.15%). Italian 10-yr spreads are 6 bps lower at 126 bps and 10-yr Greek spreads fell 3 bps to 140 bps. **Equities (+0.2%) edged higher.**

Bank equities (-0.9%) fell as the chair of ECB's supervisory board Enria said that costs as a share of revenue at European banks are "depressingly stuck" at 65% on average. Mr. Enria also warned that European banks may be a bit optimistic given that all banks are expecting a continued decrease in gross non-performing loans (NPLs) until at least the end of 2022.

Euro area money markets are pricing in a first hike of 10 bps in the year ahead but have reversed 10 bps of additional tightening priced in after last week's meeting. Contacts generally argue that the ECB is unlikely to hike next year as wage pressures have remained contained. In addition, ECB forward guidance specifies that net asset purchases will end shortly before the ECB starts raising interest rates so a hike in 2022 would mean an end to net asset purchases before, which contacts believe could put substantial upward pressure on Southern European spreads.

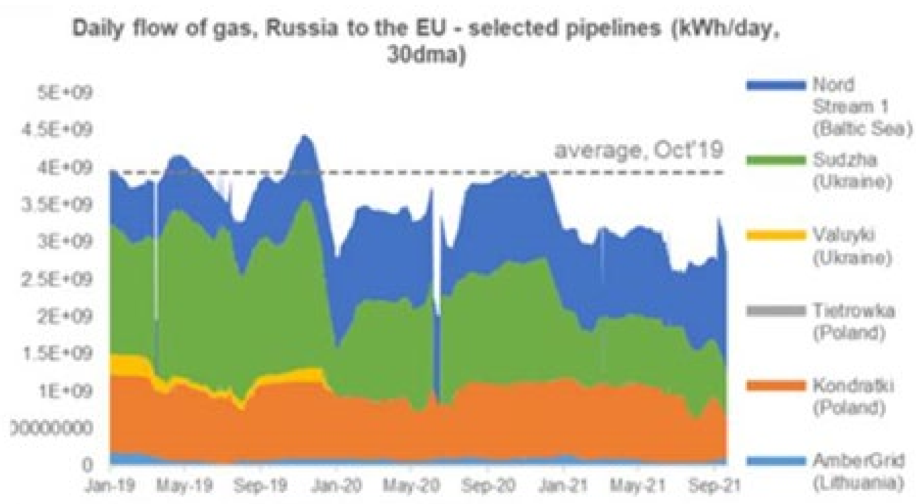


Traders had previously expected the ECB to hike rates in 2013 and in 2017, only for the ECB to ultimately cut rates.



Note: A 12x24 contract fixes a rate for the period starting at the end of month 12 and ending at month 24.
Source: Bloomberg and IMF staff

Spot natural gas prices in the Netherlands fell 2% to €65/MWh, significantly below October's panic levels of to €118/MWh but they remain elevated from a historic perspective. Analysts at BNP Paribas do not expect natural gas prices to return to historic levels before Nord Stream 2 starts operating, which is unlikely before 2022Q1. **Gas supplies to the EU through Eastern Europe fell recently, only slightly offset by inflows through Nord Stream 1.**



Gaps = N/A data. Sources: ENTSOG, Gazprom, BNP Paribas.

Australia

The Reserve Bank of Australia (RBA) abandoned the bond yield target at today's meeting. The move comes after the central bank allowed April 2024 bond yields to surge well above its 0.1% target last week. The statement noted that the effectiveness of the yield target in holding down the general structure of interest rates has diminished, and cited improvement in the economy and earlier-than-expected progress toward the inflation target as reasons to discontinue the yield target. RBA Governor Lowe stated that the bank is unlikely to adopt yield targeting again. Other policy settings remained unchanged with the cash rate set at 10bps and weekly purchases of government securities amounting to 4 bn Australian dollars at least until February 2022. Also, the central bank reiterated it will not increase the cash rate until actual inflation is sustainably between 2-3%, with underlying inflation forecast to be no higher than 2.5% by end-2023.

Commodities

Wheat closed at the highest level since 2012 as food inflation fears grow. According to Bloomberg, benchmark wheat in Chicago climbed above $8 a bushel for the first time in almost nine years as importers boosted purchases amid adverse weather conditions and surging fertilizer prices that risk denting next year's harvests. For other food commodities, corn rose for a fifth straight session on Monday, closing 2% higher at $5.79 in Chicago for the highest settlement since July 2. Soybeans ended little changed at $12.49.

Emerging Markets

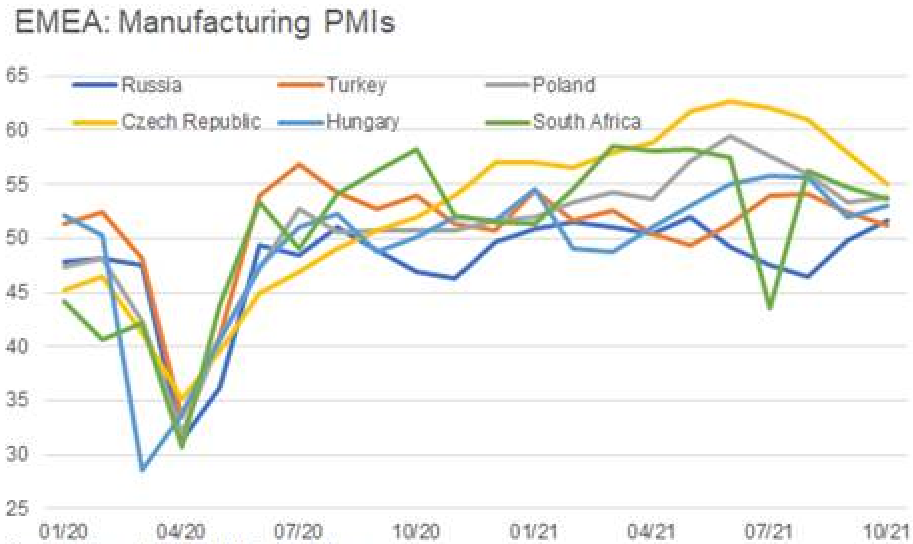
back to top

EMEA equities were mostly higher and currencies were stronger. Asian stocks were mixed but generally lower. In South Korea, consumer price inflation surged to 3.2% yoy in October, further above the Bank of Korea (BOK) target of 2%. Analysts see another policy rate hike later this month. Separately, Korea's finance ministry announced 2tn won ($1.7bn) of bond buybacks in a bid to ease bond market volatility. Latin American markets were mixed. The Mexican peso (-1.4%) fell for a fifth straight day, the longest losing streak since Sept 30. The currency has tumbled 3.3% in the past five days.

EMEA manufacturing

PMIs were mixed. Poland's manufacturing PMI surprised on the upside, increasing to 53.8 (consensus 53.0 from 53.4). In Hungary, manufacturing PMI surprised on the upside and increased to 53.1 (consensus 52.5 from 52.1). In contrast, manufacturing PMI disappointed in South Africa at 53.6 (compared to 55. 8

expected). PMI manufacturing also disappointed in the Czech Republic, falling to an 11-month low (55.1) in October (consensus 56.8 from 58.0) as production and new orders declined amid supply-side issues. The survey also flagged an accelerated rate of input costs in October.



Source: Bloomberg and IMF calculations

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Global Financial Indicators

Last updated: 11/2/21 8:07 AM	Level Last 12m	Level Latest	Change 1 Day	Change 7 Days	Change 30 Days	Change 12 M	YTD
Equities					%		%
United States		4609	0.2	1	6	39	23
Europe		4283	0.1	1	6	42	21
Japan		29521	-0.4	1	3	27	8
China		3506	-1.1	-3	-2	7	1
Asia Ex Japan		87	0.8	-2	3	9	-3
Emerging Markets		51	0.8	-2	2	13	-1
Interest Rates					basis points		
US 10y Yield		1.55	-0.3	-6	9	71	64
Germany 10y Yield		-0.14	-4.1	-3	8	50	43
Japan 10y Yield		0.08	-1.8	-3	2	3	6
UK 10y Yield		1.05	-1.7	-7	4	83	85
Credit Spreads					basis points		
US Investment Grade		88	1.2	3	2	-39	-7
US High Yield		320	2.4	3	-2	-209	-60
Europe IG		51	0.0	2	0	-12	3
Europe HY		261	-1.3	6	2	-97	19
Exchange Rates					%		
USD/Majors		93.94	0.1	0	0	0	4
EUR/USD		1.16	0.0	0	0	0	-5
USD/JPY		113.7	-0.3	0	2	9	10
EM/USD		54.7	0.1	-1	-2	1	-6
Commodities					%		
Brent Crude Oil ($/barrel)		84	-0.5	-2	6	846	63
Industrials Metals (index)		165	-1.0	-4	3	37	25
Agriculture (index)		60	0.4	3	4	46	25
Implied Volatility					%		
VIX Index (%, change in pp)		16.5	0.1	0.5	-4.7	-20.7	-6.3
US 10y Swaption Volatility		77.3	0.3	6.0	4.5	-0.4	17.1
Global FX Volatility		7.1	0.0	0.1	0.4	-1.9	-0.9
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		139	-4.4	23	31	-18	19
Italy		124	-7.4	13	20	-15	13
Portugal		60	-5.1	7	6	-13	0
Spain		69	-4.1	5	4	-7	8

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

back to top

Last updated: 11/2/2021 8:09 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	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.				
China		6.40	0.0	-0.2	1	5	2		3.1	-4	7	-25	-19
Indonesia		14251	0.2	-0.7	0	3	-1		6.2	2	-3	-41	14
India		75	0.3	0.4	0	0	-2		6.5	3	13	47	54
Philippines		50	0.3	0.8	1	-4	-5		4.5	-2	19	89	83
Thailand		33	0.2	-0.1	2	-6	-10		2.1	3	21	60	75
Malaysia		4.15	0.1	-0.1	1	0	-3		3.7	4	23	125	117
Argentina		100	-0.1	-0.3	-1	-21	-16		51.3	134	157	93	-482
Brazil		5.68	-0.9	-2.3	-6	1	-9		12.6	84	237	611	702
Chile		813	-0.2	-1.1	-1	-6	-13		6.0	-12	45	331	328
Colombia		3760	0.2	0.1	1	3	-9		7.8	16	49	239	270
Mexico		20.80	0.2	-2.8	-1	3	-4		7.6	7	27	144	205
Peru		4.0	0.0	-0.5	3	-9	-9		6.0	-2	-45	184	236
Uruguay		44	0.0	-0.8	-3	-3	-4		8.3	22	42	74	106
Hungary		310	0.4	1.7	-1	2	-4		3.5	5	51	168	192
Poland		3.97	0.1	0.0	-1	-1	-6		2.4	3	81	176	174
Romania		4.3	0.0	0.0	0	-2	-7		4.5	11	68	148	180
Russia		71.7	-0.1	-3.0	1	12	3		8.2	31	93	240	248
South Africa		15.4	0.1	-3.7	-2	5	-5		10.2	1	23	0	59
Turkey		9.54	0.0	0.1	-7	-12	-22		18.4	-48	64	412	529
US (DXY; 5y UST)		94	0.0	0.0	0	0	4		1.16	-1	23	79	80

	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		4840	-1.0	-2	-1	1	-7		195	-12	-18	-38	-34
Indonesia		6493	-0.9	-2	4	26	9		174	5	-7	-54	-26
India		60029	-0.2	-2	2	49	26		132	-10	-16	-77	-19
Philippines		7106	0.7	-1	3	12	0		108	0	-12	-22	-4
Malaysia		1538	0.4	-3	1	5	-6		121	-7	-13	-52	-14
Argentina		87460	4.7	-2	13	84	71		1714	63	121	243	358
Brazil		105551	2.0	-3	-7	12	-11		339	19	29	22	80
Chile		4092	0.0	-2	-5	16	-2		162	4	4	-23	6
Colombia		1394	-1.0	-1	2	23	-3		303	14	0	50	88
Mexico		51653	0.7	0	1	40	17		352	4	-4	-119	-5
Peru		20738	-1.1	-2	13	17	0		177	21	-4	17	48
Hungary		54531	0.6	-1	2	69	30		119	5	0	-22	-30
Poland		73914	0.4	0	4	68	30		46	1	17	21	18
Romania		12742	0.2	0	1	49	30		198	0	-9	-42	-4
Russia		4211	-0.3	-1	3	54	28		158	4	-8	-58	-21
South Africa		67854	0.6	1	7	31	14		361	6	-13	-117	-23
Turkey		1531	-0.3	3	9	35	4		497	-20	-12	-141	50
Ukraine		522	0.0	-1	-1	4	4		516	12	-14	-176	23
EM total		51	-0.7	-2	2	13	-1		381	7	2	-23	43

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

back to top