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- US Treasuries stage major rally as real yields sink ([link](#))
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Markets confront new hawkish reality

The Bank of Canada's unexpected switch to earlier than expected rate hikes and an end to bond purchases was only the latest indication that rising inflation could compel a much more hawkish policy stance from global central banks. The major global government bond markets are holding steady this morning, but yesterday saw a significant flattening of yield curves as markets repriced towards faster central bank rate hikes across multiple economies. Inflation is getting to be a particular challenge for emerging markets, especially in Latin America. Emerging market stocks are down almost across the board today, although US equity futures are slightly higher and European stocks were mixed. With many markets close to record highs, a mood of caution prevails as investors confront the new hawkish reality.

Key Global Financial Indicators

Last updated: 10/28/21 8:00 AM	Level		Change from Market Close				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		4552	-0.5	0	5	39	21
Eurostoxx 50		4234	0.3	2	4	43	19
Nikkei 225		28820	-1.0	0	-2	24	5
MSCI EM		52	-0.8	-2	2	15	0
Yields and Spreads			bps				
US 10y Yield		1.54	0.5	-15	1	78	63
Germany 10y Yield		-0.16	2.6	-5	5	47	42
EMBIG Sovereign Spread		358	2	3	5	-61	8
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		55.1	-0.1	0	-1	1	-5
Dollar index, (+) = \$ appreciation		93.8	0.0	0	0	0	4
Brent Crude Oil (\$/barrel)		83.1	-1.7	-2	5	112	60
VIX Index (% change in pp)		16.6	-0.3	2	-7	-24	-6

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

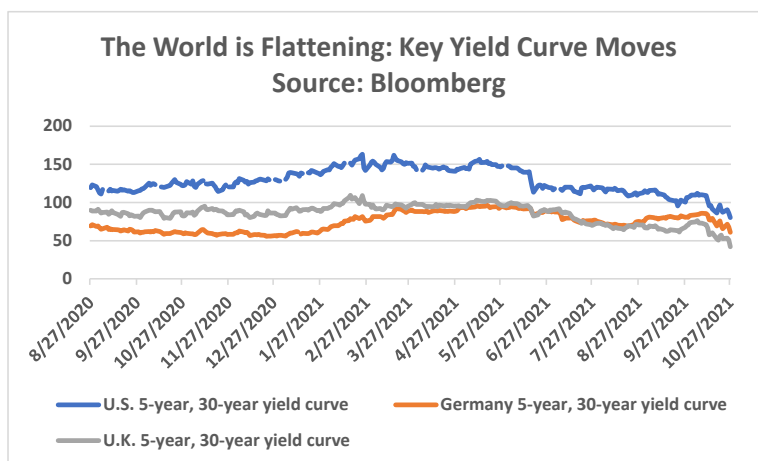
This morning's US economic data were mixed. The first estimate for Q3 GDP came in much lower than expected, while initial jobless claims and continuing claims were better than forecasts. Jobless claims have fallen to a new post-pandemic low. Markets had little reaction to the data.

US Economic Data 8.30 am

Source: Bloomberg

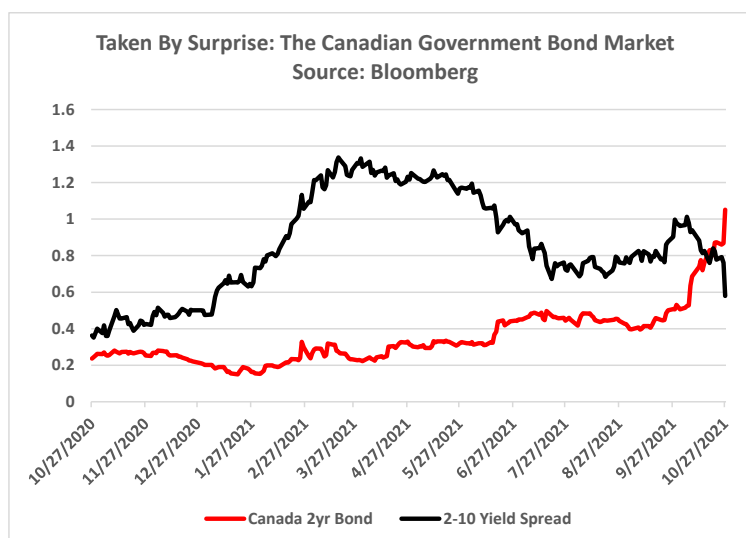
Data Release	Consensus Forecast	Actual Data
Q3 GDP annualized qoq	2.6%	2.0%
Initial Jobless Claims	288K	281K
Continuing Claims	2420K	2243K
Q3 Core PCE qoq	4.5%	4.5%

US Treasuries staged a major rally on Wednesday, especially at the long end where the 10-year yield fell by 8 bps and the 30-year yield fell by 9 bps, large moves by recent standards. In addition, the yield curve flattened significantly, in keeping with the yield curves in Germany and the UK. Meanwhile, five and ten-year real yields were also down sharply and are approaching the all-time lows seen back in August. With inflation on the rise across the globe, central banks are getting more hawkish, leading some analysts to speculate that markets are positioning for both rate hikes and the global slowdown that could ensue in their wake. The day's five-year Treasury auction saw heavy demand in the rallying market, closing 2.5 bps below the pre-auction level.

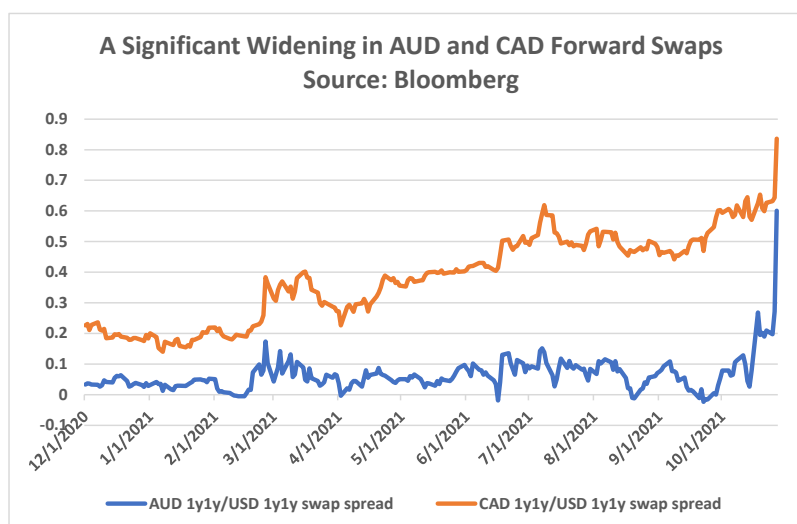


Canada

The Bank of Canada delivered a hawkish surprise by announcing that rate hikes could begin as early as April 2022. In addition, the central bank ended its asset purchase program and will now move into the reinvestment phase. The market response was immediate and emphatic, with two-year yields soaring by nearly 20 bps and the Canadian dollar surging over 0.5%. The 10-year yield also shot up by 10 bps, but came down very quickly and was actually lower in the day, in step with the rally in US Treasuries. With the 10-year yield holding steady, the 2-year/10-year yield spread flattened dramatically. The impact of supply constraints on inflationary forces was among the reasons cited for this unexpected change in policy. Markets are now pricing in four rate hikes in 2022. The July and September BOC statements had indicated that rate hikes would begin in the second half of next year. The BOC's hawkish turn was made despite the fact that it downgraded its GDP forecasts from 6% to 5.1% for 2021 and 4.3% from 4.6% for 2022. The bank also upgraded its inflation forecast for 2022 from 2.4% to 3.4%.

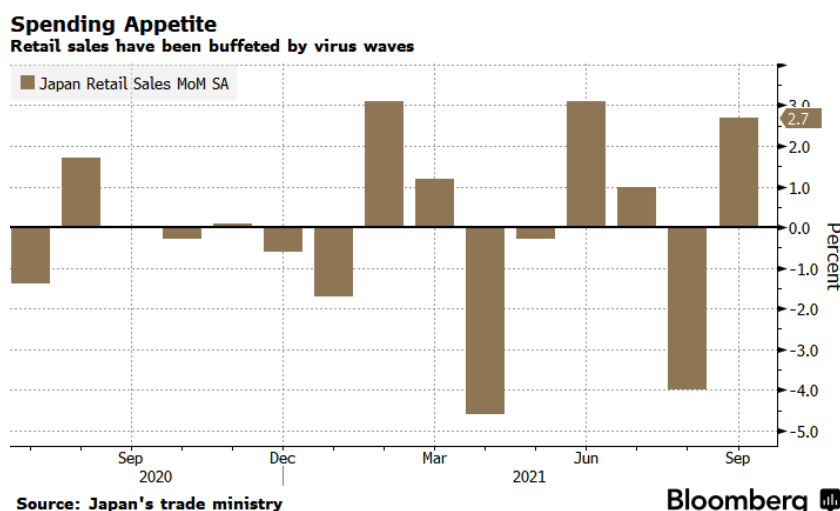


With the Reserve Bank of New Zealand already in hiking mode and strong recent inflation data in Australia, it looks like Canada and its fellow members of the bloc of commodity exporters could see tightening financial conditions. CAD and AUD forward swap spreads have move sharply higher in anticipation. Higher commodity prices could turn from being a tailwind to a headwind for these countries if inflation keeps rising and central banks raise their policy rates significantly higher.



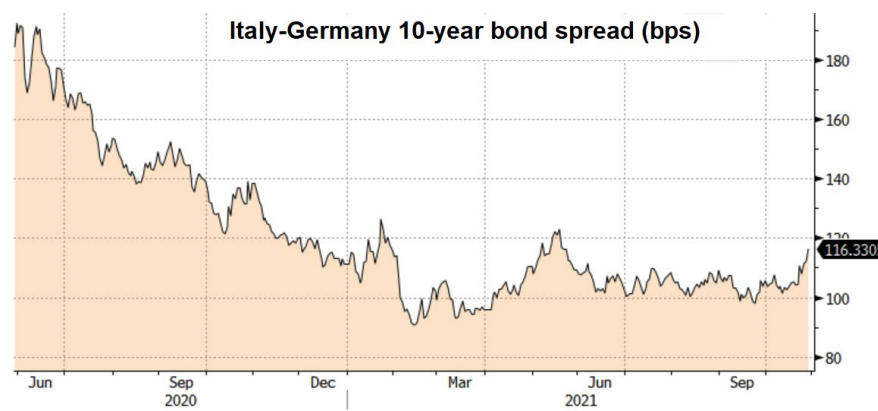
Japan

The Bank of Japan (BOJ) kept policy rates unchanged as expected. Both the (short-end) policy balance rate and the 10-year bond yield target were kept at -0.1% and zero, respectively. There was a dissenter in an 8-1 vote to keep the yield-curve settings unchanged. The BOJ also maintained its forward guidance, aiming for 2% inflation with its current policy framework as long as necessary. The BOJ appeared more bearish about the macro outlook for this fiscal year, revising inflation down to 0% (from 0.6%) and growth down to 3.4% (from 3.8%). Meanwhile, inflation projections were kept unchanged at 0.9% for the next fiscal year, while growth was revised up to 2.9% (from 2.7%). Governor Kuroda said that a slower pickup in Japan's inflation was due to a delayed demand recovery, less wage pressure from re-hiring, and firms' reluctance to pass on costs to consumers. **Retail sales increased 2.7% m/m in September, stronger than expected** (consensus +1.5%), supported by more spending on clothing, accessories, and general merchandise. Analysts commented that the rebound in retail sales may suggest that households felt more comfortable with spending as COVID-19 infection fell from August's peak.

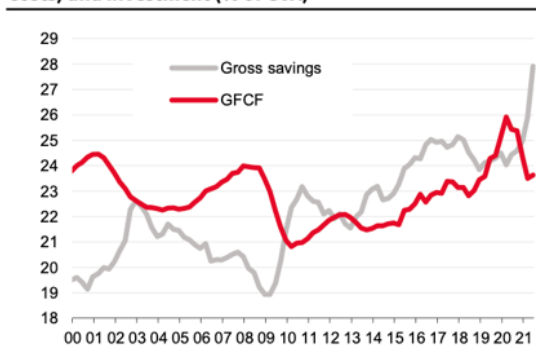


Euro Area

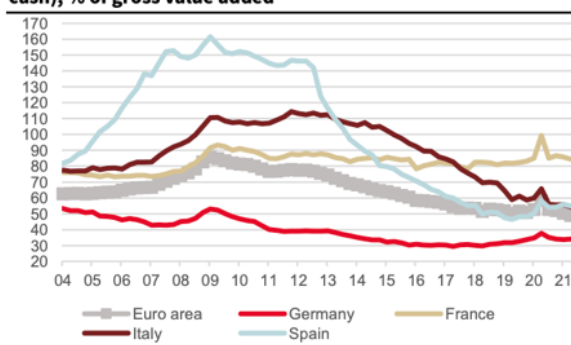
There were no major changes in the ECB policy statement, as expected. The pandemic emergency purchases program is expected to run at least until the end of March 2022 with favorable financing condition maintained at a moderately lower pace than in the second and third quarters this year. European bonds and the euro were little changed, while the euro 1-year forward 1-year rate fell 2 bps following the release. Money markets are now pricing about 20 bps of hikes by the end of 2022. On the data front, **Spain's preliminary October inflation came with a large upside surprise** increasing to 5.5% yoy against 4.5% consensus, the largest rise in three decades. According to the press release, electricity and gas prices were the main drivers. Italian bonds were underperforming in recent trading.



Analysts note that signs of corporate credit demand revival may create room for capex-led growth surprise. After a steep downward trend over the last few months, non-financial corporations (NFC) loan growth picked up to 2.1% yoy in September from 1.5% in August with ECB's survey also noting a growth in loan demand. Analysts at Societe Generale argue NFC financial situation looks healthy as net debt ratios remain low with gross saving reaching historical highs in Q2 this year, setting the necessary condition for net investment recovery.

Chart 5: NFC gross savings (profits net of taxes and financial costs) and investment (% of GVA)

Source: Eurostat, Refinitiv, SG Cross Asset Research/Economics

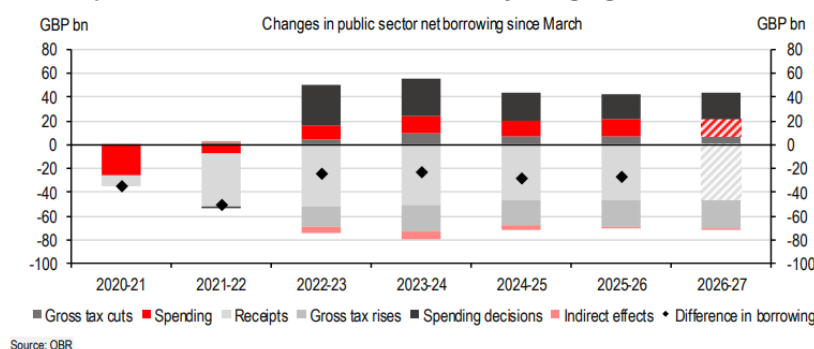
Chart 1: Non-financial corporations, net debt ratios (gross debt-cash), % of gross value added

Source: Eurostat, ECB, SG Cross Asset Research/Economics

United Kingdom

The UK's autumn budget update brought a lower deficit and higher spending. The bulk of the deficit forecast reduction came from an upgrade in the GDP growth forecast through a lower estimate of post-pandemic scarring. The pre-announced tax changes also contributed positively but were offset by a surprise increase in budget spending. The debt-to-GDP is now expected to be 13 percentage points lower at 90% of GDP in 2025, although analysts note that optimistic growth projections and potential tax cuts pose an upside risk to the projections. Analyst also noted that the increase in spending is hawkish from Bank of England's policy perspective. **Given the lower deficit, the debt management office announced a £57.8 bn cut to gilt sales for 2021/22, which was nearly double analysts' consensus of £33 bn.** The borrowing projection for the following years was reduced by £78 bn. The 10-year gilt yield fell 8 bps after the budget announcement and closed about 12 bps lower on the day, the biggest one-day drop since March 2020.

2. The improvement in the deficit forecasts is driven by stronger growth and tax rises



Source: OBR

Emerging Markets

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Most emerging markets are in negative territory today on weakening global risk sentiment. Latin American markets followed US stocks lower yesterday, and their dollar bond curves flattened in step with the pronounced flattening in the US yield curve. Brazil hiked by 150 bps as expected. Colombia's new green bond was priced 17 bps below its closest conventional peer. Asian equities were also down across the board along with most bourses in eastern Europe, the Middle East and Africa. India saw its biggest decline in six months as the central bank announced it would withdraw liquidity and Morgan Stanley issued a downgrade for the market.

China

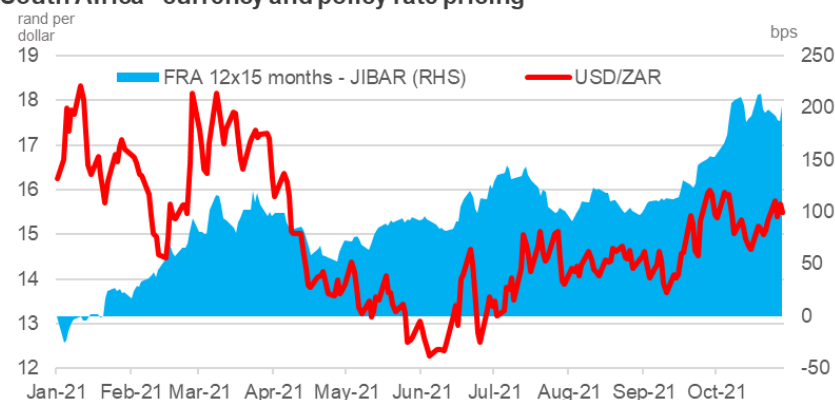
China will launch a pilot program with an aim to eliminate hidden local government debt. Guangzhou province, as well Beijing and Shanghai, will join the pilot. State-owned banks were reportedly purchasing a

large amount of the US dollar. The People's Bank has set the daily RMB fixing weaker than market expectations many days in the past three weeks (11 pips on average; 8 pips today). **Equities declined (CSI 300: -0.7%)**, led by energy firms (-5.8%). Chinese coal miners tanked while power generators rose as Beijing plans to limit the selling price of thermal coal to ease a power crunch. **Moody's commented that China's property sector is caught in a negative cycle.** Tighter financing conditions pushed property developers to reduce spending on land and construction to preserve cash flow for debt repayment, leading to a further decline in sales. Rising default risk also increases risk aversion from investors and lenders, which further exacerbates refinancing risk, particularly for small and financially weak property developers.

South Africa

The rand depreciated (-0.3%) after producer price inflation in September (7.8% y/y) surprised on the upside (consensus 7.3% y/y, up from 7.2% in August). The increase was mainly driven by coal, petroleum, and food products. The rand has been under pressure ahead of the local elections on Monday with analysts noting that outcomes are difficult to predict given internal turmoil in all major parties. Moreover, scheduled electricity cuts have increased following further breakdowns at the power utility's coal-driven power stations. Consumer prices have been increasing (5% y/y in September, up from 4.9%) and analyst estimate that household food prices increased by 10.2% y/y in October. **The market is pricing in a 25 bps hike at the November monetary policy committee meeting, with roughly 200 bps of hikes in the next year.** The governor last week commented that the current monetary policy stance is appropriate given the outlook for prices but flagged that policy would adjust if higher inflation is persistent.

South Africa - currency and policy rate pricing



Source: Bloomberg and IMF 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: 10/28/21 8:05 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		4563	-0.5	0	5	39	21
Europe		4234	0.3	2	4	43	19
Japan		28820	-1.0	0	-2	24	5
China		3518	-1.2	-2	-1	8	1
Asia Ex Japan		87	-0.8	-2	2	11	-3
Emerging Markets		52	-0.8	-2	2	15	0
Interest Rates			basis points				
US 10y Yield		1.54	0.5	-15	1	78	63
Germany 10y Yield		-0.16	2.6	-5	5	47	42
Japan 10y Yield		0.09	-0.7	0	1	7	7
UK 10y Yield		1.00	1.3	-20	1	79	80
Credit Spreads			basis points				
US Investment Grade		84	-1.8	-6	0	-39	-11
US High Yield		317	1.1	1	9	-198	-62
Europe IG		50	0.5	-1	0	-15	2
Europe HY		256	1.7	-1	7	-114	15
Exchange Rates			%				
USD/Majors		93.77	0.0	0	0	0	4
EUR/USD		1.16	-0.1	0	-1	-1	-5
USD/JPY		113.6	-0.2	0	2	9	10
EM/USD		55.1	-0.1	0	-1	1	-5
Commodities			%				
Brent Crude Oil (\$/barrel)		83	-1.7	-2	5	112	60
Industrials Metals (index)		168	1.3	-3	2	40	26
Agriculture (index)		58	0.0	2	3	41	22
Implied Volatility			%				
VIX Index (% change in pp)		16.6	-0.3	1.7	-6.6	-23.6	-6.1
US 10y Swaption Volatility		72.0	0.8	-4.2	-2.1	-0.6	11.9
Global FX Volatility		7.0	0.0	0.1	0.2	-2.1	-1.1
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		121	0.5	8	15	-49	1
Italy		117	5.0	13	12	-22	6
Portugal		57	1.3	5	2	-21	-3
Spain		66	0.9	3	2	-15	4

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

Last updated: 10/28/2021 8:08 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	-0.1	-0.1	1	5	2		3.1	-2	10	-20	-16	
Indonesia		14173	0.0	-0.4	1	3	-1		6.2	-4	-4	-47	9	
India		75	0.1	-0.1	-1	-1	-2		6.4	-2	12	45	50	
Philippines		51	0.0	0.2	1	-5	-5		4.4	9	18	87	78	
Thailand		33	0.1	0.4	2	-6	-10		2.0	-5	17	53	70	
Malaysia		4.15	0.1	0.2	1	0	-3		3.7	-1	22	116	112	
Argentina		100	-0.1	-0.3	-1	-21	-16		50.1	88	93	149	-604	
Brazil		5.59	-0.8	1.4	-3	3	-7		11.8	66	154	542	621	
Chile		805	0.0	1.6	0	-4	-12		6.1	-17	86	347	336	
Colombia		3760	0.3	0.2	2	1	-9		7.7	31	42	243	268	
Mexico		20.36	-0.3	-0.3	0	5	-2		7.6	7	30	150	197	
Peru		4.0	0.3	-0.8	4	-9	-9		6.1	5	-39	196	247	
Uruguay		44	-0.3	0.3	-2	-2	-3		8.1	12	23	78	89	
Hungary		313	-0.1	0.0	-2	0	-5		3.4	0	59	164	182	
Poland		3.98	0.0	-0.6	0	-1	-6		2.3	9	87	169	165	
Romania		4.3	-0.1	-0.3	-1	-3	-7		4.4	-3	82	123	169	
Russia		70.4	0.5	1.0	3	12	5		7.9	46	70	224	220	
South Africa		15.1	-0.4	-3.0	0	8	-3		10.2	14	19	5	53	
Turkey		9.61	-1.1	-1.0	-8	-14	-23		18.6	-4	74	459	553	
US (DXY; 5y UST)		94	0.1	0.1	0	1	4		1.19	-5	17	86	83	

	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		4864	-0.7	-1	1	2	-7		206	-2	-2	-33	-23	
Indonesia		6524	-1.2	-2	6	27	9		181	9	8	-49	-19	
India		59985	-1.9	-2	1	51	26		136	-7	-9	-71	-15	
Philippines		7158	-1.0	-2	3	15	0		118	9	10	-18	6	
Malaysia		1567	-1.0	-2	1	5	-4		127	-2	-2	-45	-8	
Argentina		85353	-4.0	-2	13	96	67		1655	34	41	205	299	
Brazil		106363	-0.1	-4	-3	12	-11		319	10	21	2	60	
Chile		4116	0.0	2	-5	13	-1		157	-3	10	-26	1	
Colombia		1404	-0.7	0	4	25	-2		292	7	-2	40	77	
Mexico		51715	-0.9	-1	2	38	17		349	3	-4	-114	-8	
Peru		20886	-0.6	0	13	18	0		164	5	-4	4	35	
Hungary		54077	-1.3	-2	5	68	29		122	10	-6	-25	-27	
Poland		73279	#VALUE!	-1	6	63	29		47	13	24	23	19	
Romania		12788	0.3	0	2	48	30		205	8	13	-35	2	
Russia		4173	-1.3	-1	3	55	27		160	8	2	-56	-19	
South Africa		67941	0.7	3	7	30	14		359	8	0	-127	-25	
Turkey		1522	0.2	5	10	35	3		501	-1	-7	-128	54	
Ukraine		526	0.0	0	0	5	5		504	19	-2	-209	11	
EM total		52	-0.7	-2	2	15	0		376	7	5	-28	37	

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

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