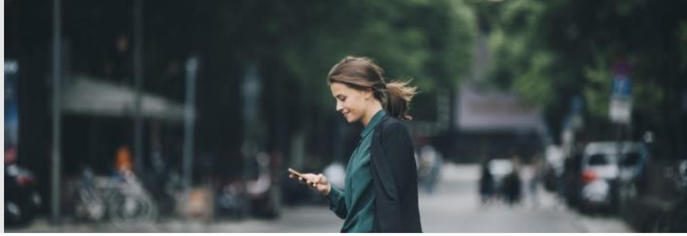
WEEKLY UPDATE

Why it matters that debt markets get monetary policy right



Leading central banks go into a round of crunch meetings in mid-December, rounding off a historic year for policy tightening. Bond markets are a key lever for transmitting monetary policy to the real economy and the big fluctuations of recent weeks have complicated the situation.

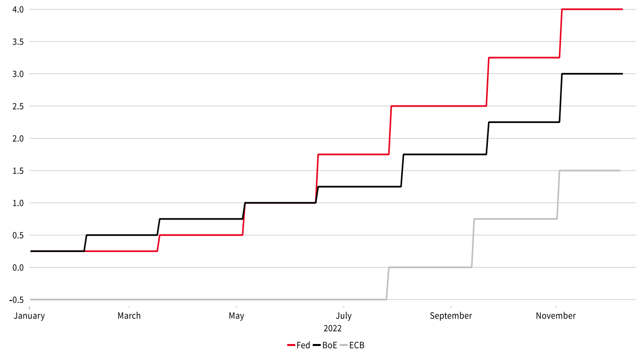
Historic tightening of monetary policy. 2022 will be remembered for a radical policy shift by central banks to cope with a succession of serial inflation shocks: the Federal Reserve (Fed) hiked rates by 400 bp, the Bank of England (BoE) by 300 bp and the European Central Bank (ECB) by 200 bp. All three also tweaked their balance sheet policies: the Fed and BoE both began quantitative tightening, slimming down their balance sheets by either selling off securities or not reinvesting proceeds as they mature, while the ECB halted its asset purchase programmes and encouraged banks to early redeem TLTRO borrowings. True, inflation may well now have peaked on both shores of the Atlantic, but underlying pressures persist and will continue to make monetary policy forecasting an uncertain business in 2023.

The importance of market expectations. Debt markets are a major channel for transmitting monetary policy. They translate movements in central bank policy rates into the interest rates demanded at different maturities and between different counterparties (governments, financial intermediaries, companies). In this way they help turn tighter monetary policy into more expensive financing terms for consumers and businesses in the real economy. This squeezes demand (consumption and investment) and so eases pressure on inflation. However, debt markets base their movements on expectations for monetary policy and growth, and if their expectations go wrong so does the transmission of monetary policy. For monetary policy to work properly, debt markets have to price in the right levels of current and future policy tightening. And for some weeks now, market forecasts have been up and down like a yo-yo based on the latest inflation and economic news. As it stands, markets still expect the screws to keep tightening into early 2023, but have heavily scaled back their forecasts for central bank rates in the medium term. This substantially more dovish outlook has left real rates - stripped of expected inflation - once again converging towards zero, which means the current rate tightening will have less of a real world impact. Raising the risk that central banks will have to push rates higher and harder to bend the economy to their will.

What will December meetings bring? The mid-December meetings by central banks (Fed on the 14th and ECB and BoE on the 15th) will be crucial in getting the message through to debt markets. At the moment, it looks highly likely the three banks will hike rates by 50 bp apiece. Any messaging on terminal target rates or tightening of balance sheet policies could force bond markets to sharply revise their forecasts, in the direction central banks intend.

The 2022 monetary tightening was one of the fastest since the 1970s.

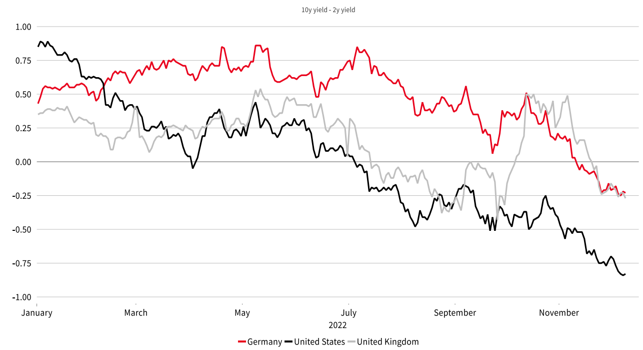
Key central bank interest rates



Sources: SGPB, Macrobond, Fed, BoE, ECB, 09/12/2022

Sovereign yield curves reversed during the year, the usual signal of impending recession

Slope of the sovereign yield curve



Sources : SGPB, Macrobond, U.S. Department of Treasury, 09/12/2022

OUR MACRO COMMENTS

Events of the week

The price of oil has corrected significantly downwards, crossing the $80 threshold, its lowest level of the year, against a backdrop of slowing global economic activity. While European PMI indices had already caused downward pressure, the stronger-than-expected contraction in Chinese exports in November also weighed. On Sunday, OPEC members maintained the course of reducing production by 2 million barrels per day until the end of 2023.

This week, the Chinese government announced measures to relax its health policy following the publication of new signals of deterioration in economic activity. These announcements also follow unprecedented protests in China in opposition to the measures in place. These decisions, although minor at the moment, demonstrate the change of direction of the Chinese executive.

Figures of the week

	Current		Forecast	Previous
ISM services PMI (October)	56,5	↑	53.1	54.4
Trade balance (October)	$-78.2B	↑	$-79.1B	$-73.28B
Retail sales (YoY, October)	-2.7%	↓	-2.6%	0%
Trade balance (November)	$69.8B	↓	$78.1B	$85.15B
Inflation (YoY, November)	1.6%	↓	1.6%	2,1%
Policy interest rate decision	3.1%	↑	3.1%	2.85%

The week ahead

Monday
Industrial production, Trade balance (October)
Tuesday
Inflation (November)
Economic sentiment (December)
Wednesday
Inflation (November)
Industrial Production (October)
Industrial Production (October)
Monetary policy decision
Thursday
Monetary policy decision
Monetary policy decision

Sources : Macrobond, 9 December 2022.

MARKET PERFORMANCES

Interbank rates	Last.	-1W	-3M	YTD	-12M
€STER O/N	1,40	1,39	-0,08	-0,59	-0,58
USD SOFR O/N	3,80	3,82	2,28	0,05	0,05
JPY TONAR O/N	-0,08	-0,08	-0,04	-0,02	-0,02
GBP SONIA O/N	2,93	2,93	1,69	0,19	0,05
CHF O/N	0,80	0,80	0,36	-0,71	-0,74

Long term sov. rates	Last.	-1W	-3M	YTD	-12M
10Y OAT	2,24	2,41	2,14	0,20	0,04
10Y Bund	1,78	1,94	1,58	-0,21	-0,38
10Y BTP	3,60	3,87	3,86	1,17	1,03
10Y JGB	0,25	0,25	0,24	0,07	0,05
10Y Bonos	2,76	2,94	2,73	0,56	0,41
10Y Swiss	0,98	1,06	0,88	-0,13	-0,29
10Y Gilt	3,05	3,17	3,02	1,02	0,76
10Y USTnote	3,42	3,68	3,27	1,52	1,52

Credit & EM	Last.	-1W	-3M	YTD	-12M
EUR Corporate Aaa	2,58	2,77	2,52	0,33	0,27
EUR Corporate Baa	3,99	4,22	3,73	0,66	0,58
GBP Corporate Baa	4,17	4,29	4,15	1,52	1,24
USD Corporate Aaa	4,21	4,43	4,19	2,13	2,18
USD Corporate Baa	5,36	5,60	5,26	2,60	2,64
USD EM aggregate	7,37	7,59	7,15	4,33	4,52

Commodities	Last.	-1W	-3M	YTD	-12M
Brent, USD/BL	77,31	-10,7%	-11,9%	-2,2%	1,8%
Or, USD/oz	1 786	1,0%	3,9%	-2,3%	0,2%
Copper, USD/metric ton	8 370	2,1%	9,5%	-13,5%	-12,4%
Platinium, USD/oz	983	-2,8%	14,4%	1,7%	2,1%
Palladium, USD/oz	1 848	-1,8%	-7,7%	-6,6%	0,2%
Silver, USD/oz	22,39	3,8%	23,2%	-3,0%	-0,2%

FX rates	Last.	-1W	-3M	YTD	-12M
EUR/USD	1,05	1,5%	6,5%	-7,0%	-6,8%
EUR/CHF	0,99	0,5%	1,0%	-4,8%	-5,7%
USD/GBP	0,82	-2,3%	-6,0%	11,1%	8,4%
USD/JPY	136,69	-2,0%	-5,4%	18,7%	20,0%
USD/BRL	5,22	-0,8%	-0,6%	-6,4%	-6,0%
USD/CNY	6,97	-1,7%	0,1%	9,7%	9,9%
USD/RUB	62,89	3,3%	3,3%	-16,1%	-14,6%

Equity indices	Last.	-1W	-3M	YTD	-12M
MSCI AC World (USD)	1 064	-2,1%	5,3%	-8,3%	-6,0%
Eurostoxx 50	3 921	-1,1%	12,0%	-8,8%	-7,4%
Dax 40	14 261	-0,9%	10,4%	-10,2%	-9,1%
CAC 40	6 661	-1,2%	9,1%	-6,9%	-5,0%
FTSE 100	7 489	-1,1%	3,5%	1,4%	2,1%
SMI	11 010	-1,1%	1,9%	-14,5%	-12,6%
SP500	3 934	-3,6%	-1,2%	-17,5%	-16,3%
TOPIX	1 948	-1,9%	1,7%	-2,2%	-2,7%
iBovespa	109 069	-3,0%	-0,6%	4,1%	0,9%
Hang Seng	18 815	1,2%	-1,2%	-19,6%	-21,6%
Sensex 30	62 411	-1,1%	5,7%	7,1%	6,4%
CSI 300	3 958	2,7%	-2,4%	-19,9%	-20,8%

Source: Bloomberg, on 9 December 2022.
-1W = 1-week change, -3M = 3-month change, -12M = 12-month change, YTD = year-to-date change. Equities; total return in local currency. Government bonds = 10-year returns. Figures are rounded.

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