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# TAPER TANTRUM IN 2021-22: BEWARE OF THE TUCKANS

## 04 October 2021

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# EXECUTIVE SUMMARY



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- **The Fed will start to normalize its monetary policy rather sooner than later.** With the recent USD1.9trn fiscal stimulus package and a new USD2.3trn infrastructure program (our estimate of what could represent the amount of the Build Back Better program), US GDP growth is likely to reach +6.1% in 2021 and +4.1% in 2022. As a consequence, tightening labor market conditions along with higher commodity prices should also lift consumer price inflation to 4.1% in 2021 and 2.2% in 2022. We now believe that the US Fed will consider tapering its bond purchases starting in December 2021, after an announcement in November, and increasing the Fed Funds Target rate mid-2023. Because monetary tightening in the US will certainly generate financial pressures worldwide, we think that the Fed will communicate on its future moves better than it did in 2013, when its announcements surprised markets and caused a taper tantrum. Nevertheless, our pattern recognition model confirms that the risk of Emerging Markets facing another taper tantrum cannot be entirely ruled out.
- **Emerging Market initial conditions are more favorable than in 2013, with exceptions.** Current account deficits are lower today, credit growth is at more sustainable levels and we expect inflation to remain under control, by and large. EM currencies are likely to remain volatile but we do not forecast a broad-based repeat of the substantial depreciations experienced in 2013-2014, also because real effective exchange rates are currently less strained as currencies already took large hits in 2020. Moreover, monetary policy is currently ultra-loose in many EMs and it should remain accommodative overall in the near future even though a moderate tightening has begun in several countries where inflation exceeds the central banks' target ranges. Increases in inflation expectations could put pressure on central banks as the need to adapt monetary policy clashes with the need to support the Covid-19 recovery.
- **However, external financing requirements and the steady rise in sovereign debt reveal some weak spots.** In six countries, the external debt payments falling due in the next 12 months significantly exceed the level of official foreign exchange reserves (Turkey, Argentina, Ukraine, South Africa, Romania, Chile). Moreover, the steady rise in sovereign debt over the past decade poses a significant risk, in particular for those EMs where the share of non-residents' holdings of public debt has increased over the last seven years.
- **Overall we identify seven EMs particularly vulnerable to the eventual Fed tapering, especially if it is not well communicated, the TUCKANS: Turkey, Ukraine, Chile, Kenya, Argentina, Nigeria, South Africa.** A stabilization of the money flows after a complicated 2020 would be crucial, but a pattern of relatively steady inflows into EMs is not yet visible, at least not in a generalized way.
- **EMs, in particular some of the TUCKANS, have already experienced increases in the yields of their local currency bonds.** This was something to expect considering the rate hikes and the inflation expectations, but if the trend continues, it could pose severe threats to debt sustainability, which was already an issue for some of the countries before. At the same time, the movements in the hard currency environment have been larger in Latin America and some of the TUCKANS, which reinforces our assessment of the countries at risk.

*This report was first published in April 2021 and updated in October 2021.*



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**Emerging Markets particularly vulnerable to an eventual tapering of monetary policy by the US Fed.**

# COULD THE FED'S UPCOMING TAPERING UNSETTLE FINANCIAL MARKETS?

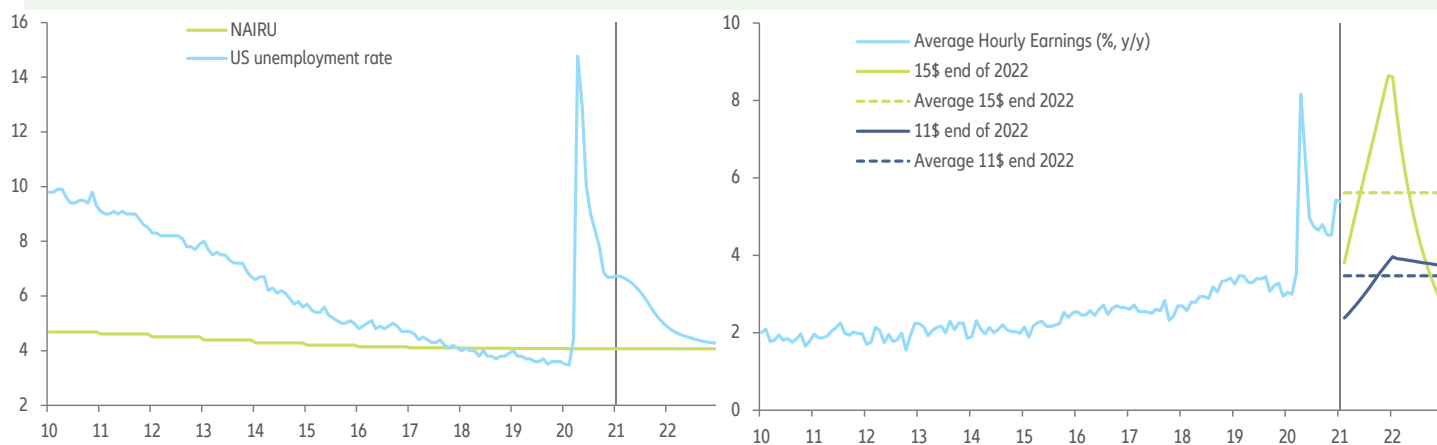
The interdependence of financial markets, and the predominant position of the US and the USD, make the rest of the world – especially Emerging Markets (EMs) – sensitive to any financial event that takes place in the US, not to mention any changes in the Federal Reserve's monetary policy. This was last seen in 2013, when just the announcement of future tapering by the Fed governor unchained a generalized spike in US sovereign yields, the appreciation of the USD and capital outflows from fragile EMs.

Taking into account President Joe Biden's USD1.9trn fiscal package and an estimated USD2.3trn Build Back Better plan, we now expect US GDP to grow by +6.1% y/y in 2021 and +4.1% y/y in 2022. As a result, the level of slack of the US job market in particular will

diminish more rapidly than expected before (full employment end-2022). We expect the US unemployment rate to hit 4.3% at the end of 2022 compared with 6.2% in February 2021. Fiscal incentives to increase the minimum wage (we integrate a scenario leading us to USD11 per hour by end-2022 compared with USD7.25 today) will add further inflationary pressures alongside the rapid diminution of the US job market's degree of slack. As a result of these upcoming tightening job market conditions and the positive pass-through of recent energy and commodity prices (the impacts of which are already visible at the level of input prices), we have revised on the upside our US CPI inflation scenario, with 4.1% y/y expected in 2021, 2% in 2022 and 2.1% y/y in 2023.

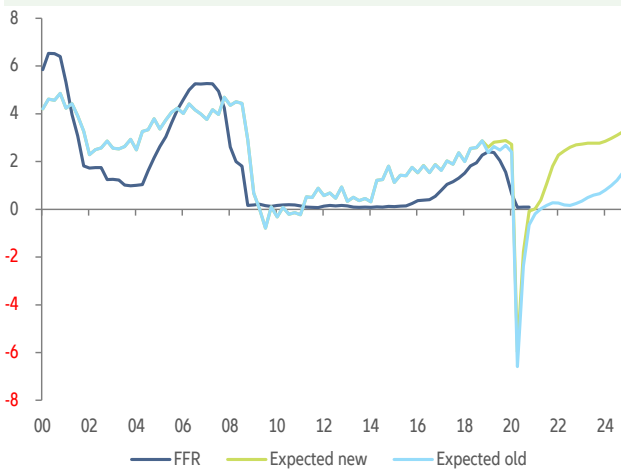
Our Fed reaction function, estimated in function of the spread of inflation between observed data and the target of 2%, and in function of the NAIRU gap, confirms that the US central bank could be tempted to normalize monetary policy much earlier. The Fed will consider tapering before year-end, while 50% of FOMC members see a rate hike as being conceivable in 2022. In line with Fed's recent communication and our view on a rapid convergence toward a situation of maximum employment, we now expect the tapering to start in December 2021 and finish in November 2022. In such circumstances, we need to anticipate the consequences of another potential taper tantrum.

**Figures 1 and 2:** Job market conditions in the US



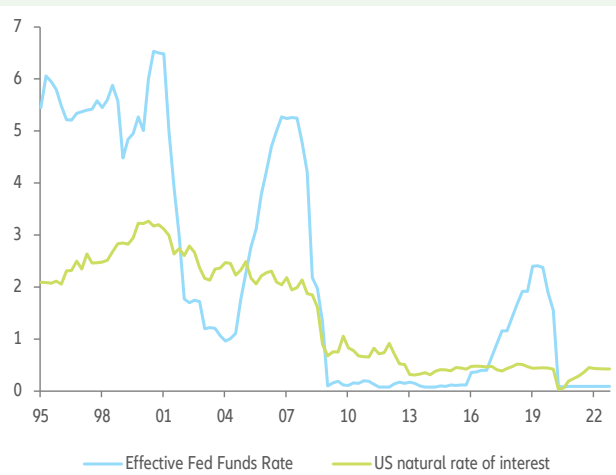
Sources: National statistics, IMF, Allianz Research forecasts

**Figure 3: Fed's theoretical reaction function**



Sources: National statistics, IMF, Allianz Research forecasts

**Figure 4: Fed Funds target rate (%)**



Sources: National statistics, IMF, Allianz Research

**What do the markets tell us about the proximity to a taper tantrum-like situation?**

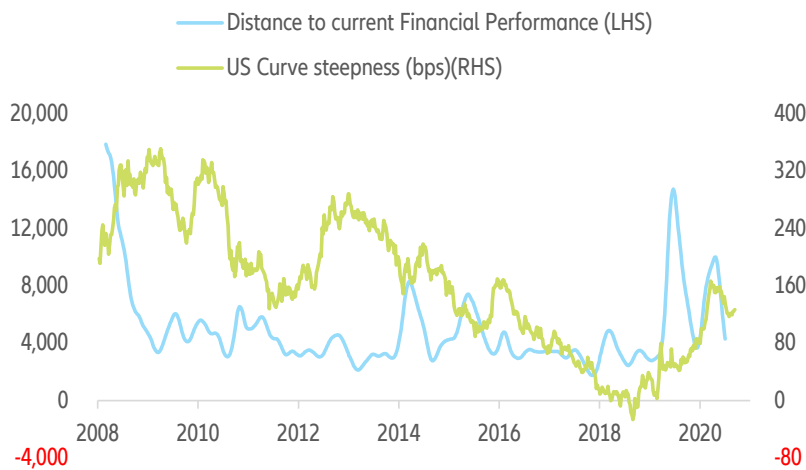
One year after Covid-19 shook up the financial markets, the waters are calmer but volatility and risks remain, translating into some market movements, including in the US yield curve<sup>2</sup> and commodities markets<sup>3</sup>, both of which EMs are very sensitive to. In order to analyze the global situation of financial markets, and how close we are to the taper tantrum situation seen in 2013, we use a pattern recognition framework to identify whether there are simi-

larities between the current situation and our pattern of interest (early 2013).

In our case, we use a very large sample of ETFs – cross asset classes and cross geographies – and measure their relative strength against the MSCI World, our benchmark. By doing that, we do not limit ourselves to a particular market or asset but aim to capture the general trend. After comparing today's strength with the weekly positioning since late 2008 by ETFs, we aggregate the square of the differences and the results are shown in Figure 5.

These results show that the current situation is more similar to relatively calm moments than to severe crisis-like situations. However, as experienced sailors know, it is important to distinguish real calm from apparent calm. Compared to 2013, the framework of today's situation is not very different (nor the closest) so some kind of taper tantrum is not something that can be excluded.

**Figure 5: Pattern recognition – relative strength of financial indicators against the MSCI World**



Sources: Bloomberg, Refinitiv, BofA, Allianz Research.

<sup>2</sup> To understand the tensions at the short-end of the curve, refer to [U.S. Yield curve: Let's twist again?](#)

<sup>3</sup> Find our latest analysis on commodities [Higher demand, supply bottlenecks, but no speculation \(yet\).](#)

# EMERGING MARKET INITIAL CONDITIONS ARE MORE FAVORABLE THAN IN 2013, WITH EXCEPTIONS

Higher yields in the US and Europe create competition for capital and can make financing EM imbalances more difficult. Previous EM crises have showed that a slow policy response to rising imbalances can indeed lead to a sharp deterioration in market confidence. The key indicators that identify EM vulnerabilities and also differentiate between economies are the current account balance, credit growth, inflation, currencies, policy interest rates, foreign exchange reserves, sovereign debt and bonds. In the following

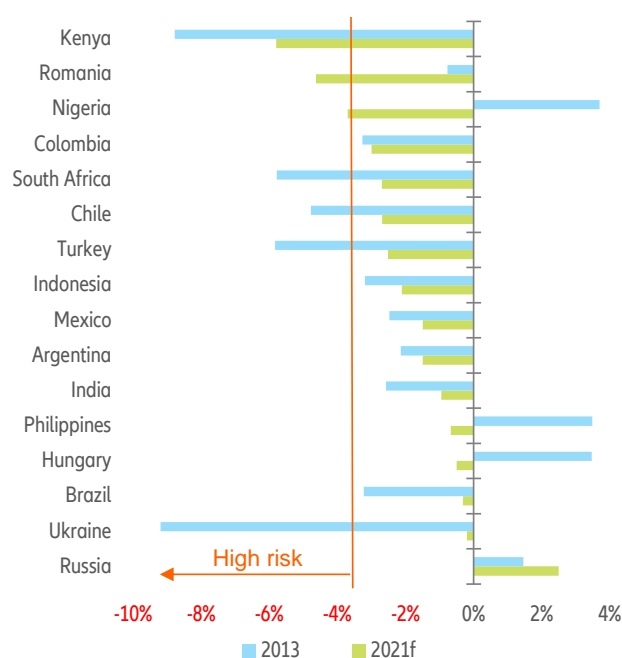
section, we compare the current situation to that of 2013 for 16 selected comparatively fragile EMs, the Fragile 16<sup>4</sup>, with a focus on these key risk indicators.

## Current account deficits have significantly declined

The external balances of major EMs are currently more favorable than back in 2013. Most of the 16 EMs in our sample are forecast to record a smaller current account deficit in 2021 than

eight years ago, including the large economies of India, Brazil, Mexico, Turkey and South Africa. Only two countries, Kenya and Romania, are projected to post shortfalls of more than -4% of GDP in 2021, a value often used as the threshold between critical and adequate deficits (see Figure 6). In 2013, five out of the Fragile 16 exceeded this threshold. This suggests that these EMs are currently overall less dependent on foreign capital inflows than in 2013 – at least for now – boding well for the eventual Fed tapering.

**Figure 6:** Current account balances (% of GDP) of selected EMs



Sources: National statistics, IMF, Allianz Research forecasts

<sup>4</sup> The 16 selected “comparatively fragile EMs” – the Fragile 16 – comprise the 10 EMs we identified as fragile in 2013 and the 13 most fragile EMs we have identified in early 2021, both out of a larger group of 28 economies. There is an overlap of seven countries between these samples from 2013 and 2021.

## Credit growth is more sustainable

Also positive from a risk point of view, credit growth to the private sector was more moderate in our sample of EMs in 2020 than it was in 2013, despite the massive monetary easing that was implemented to mitigate the impact of the Covid-19 pandemic on economies. This may reflect less demand for credit amid the crisis and will reduce growth prospects in the near term but it also indicates lower liquidity risk than during the taper tantrum period in 2013-2014. This is particularly the case for Brazil, Colombia, Russia, India, the Philippines and Indonesia, countries where credit growth was at or above our 15% threshold in 2013, indicating elevated risk<sup>5</sup>. However, rapid credit growth still flashes warning signals in Turkey, Argentina and Nigeria, where it rose by well above 20% y/y on average in 2020, as well as in Hungary (17% y/y, see Figure 7). At the time of writing, a clear downward trend in credit expansion was only visible in Argentina. Meanwhile, the expected transmission of sharp interest rate hikes in Q4 in Turkey into slower credit growth has yet to materialize. In fact, this may not happen at all after the dismissal in mid-March 2021 of Central Bank governor Agbal who had been in office for just four months and was responsible for the appropriate rate hikes. Markets now fear that Turkey will revert to its known unorthodox

monetary policy style, including lowering interest rates to levels that will increase rather than decrease economic imbalances.

## Inflation to remain in check in most Ems

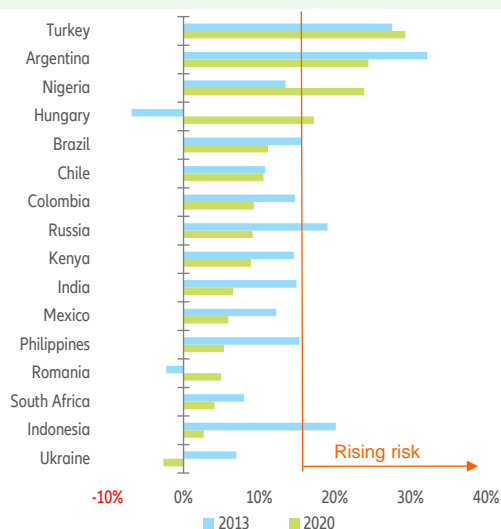
A view on consumer price inflation rates provides a more differentiated picture. In 2013, Argentina was the only country with double-digit inflation (10.6%) in our sample of 16 EMs. In 2021, we forecast Argentina, Nigeria and Turkey to post average annual inflation rates well above 10% (43% in the case of Argentina), which will also be clearly higher than the rates recorded eight years ago. Ukraine (9% forecast in 2021 vs. -0.3% in 2013) should also post significantly higher inflation this year than eight years ago, with the projected rate to well exceed the central bank's 5% ± 1pp inflation target range. Hungary, Romania, the Philippines, Mexico, Chile and Colombia are also expected to record higher inflation in 2021 compared to 2013, but the price changes should be kept in check, i.e. remain below 5%, and within or only slightly above the central banks' respective target ranges. In Russia, average annual inflation is forecast to increase from 3.4% in 2020 to 5.9% in 2021, thus exceeding the 4% inflation target, but it will be lower than the 6.8% posted in 2013. India, Brazil, Kenya and Indonesia are expected to experience inflation

below the 6% mark and within the individual target ranges of their national central banks in 2021, which is an improvement compared to 2013 (see Figure 8).

Another traditional indicator for inflation expectations are inflation-linked bonds, both in terms of the amount issued and in terms of breakeven inflation. Although these bonds are not available for all the countries in our sample, for the countries that do have them, the picture is very similar to our forecasts in terms of countries at risk of higher inflation (see Figure 9). Among the countries in the selection, Turkey has been one of the most volatile, with break-even inflation above 15%. However, the situation has improved after the turmoil that came with the hike in March and the subsequent changes in the central bank. Apart from Turkey, the hikes have been generalized across Latin America and Eastern Europe. These moves confirm that some Emerging Economies are already fighting inflation.

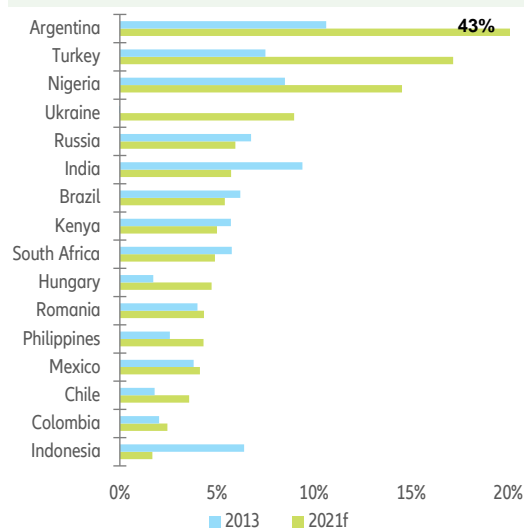
To summarize, we expect inflation to remain under control across major EMs in 2021, excluding a few vulnerable economies that already experienced crises prior to the Covid-19 pandemic. This offers room for central banks to provide support to their domestic economies, and perhaps governments, in the event that foreign credit dries up.

**Figure 7: Private sector credit growth (%) of selected EMs**



Sources: National statistics, IMF, Allianz Research

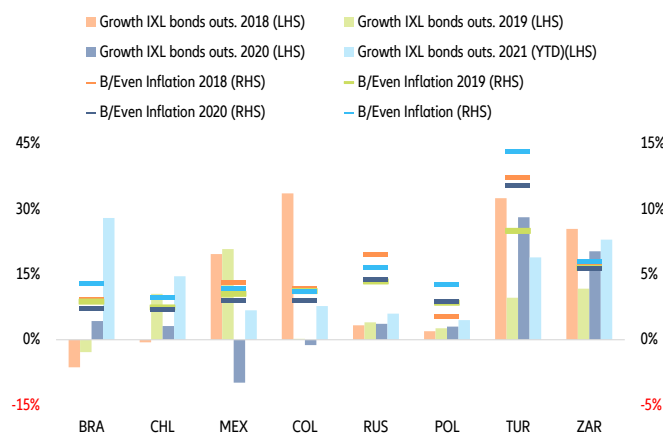
**Figure 8: Average annual inflation (%) in selected EMs**



Sources: National statistics, IMF, Allianz Research forecasts

<sup>5</sup> The threshold is given as 150% of the long-term average of the monthly medians (of private sector credit growth) of approximately 160 EMs.

<sup>6</sup> Here it is calculated as the difference between the nominal bonds yield and the inflation-linked bond yield. It is the level of inflation that would provide equal real yield in both type of bonds.

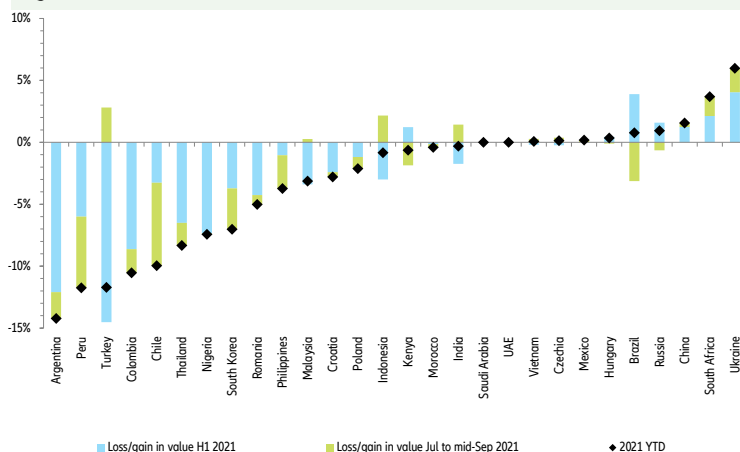
**Figure 9: Inflation-linked bonds across selected EMs**

Sources: Refinitiv, BofA, Allianz Research

### Currencies to remain volatile but no broad-based repeat of the deep slides in 2020

When looking at the evolution of currencies, 2020 was a year of generalized depreciations of EM currencies, if we exclude some strong Asian economies (China, South Korea and Malaysia), Chile and the Eastern European currencies highly correlated with the euro. There were different intensities, ranging from the small movements of the rest of the APAC currencies such as the Thai baht (almost flat) or the Indonesian rupiah (-1.2%) to the strong depreciations in Brazil (-29%) or Argentina (-40%).

During the first three quarters of 2021 we saw a further strengthening of the USD, which besides deepening the depreciations in Latin America, has also reached Eastern Europe and Asia, mainly against the euro-centric Eastern Europe and APAC currencies. Meanwhile, the Turkish lira slumped at the end of March after the firing of the central bank governor Agbal who had calmed financial markets prior through appropriate monetary tightening during his short term in office. Although the lira has regained some ground in Q3, markets continue to be concerned that Turkey may begin monetary loosening too quickly, which could maneuver the economy once again close to the next currency crisis. Meanwhile, as other main currencies such as the euro or the Japanese yen are losing ground against the USD as well, the impact on those exchange rates is lessened. Figure 10 shows the largest movements

**Figure 10: Exchange rates of selected EMs**

Sources: IHS Markit, Allianz Research

in the FX Market since the end of 2020.

Looking ahead, our internal calculations show that some currencies may have depreciated too much and there could be room for some reversal, although still not enough to reach 2019 levels. On the other hand we have China, where the authorities have attempted to halt the appreciating trend of the CNY via foreign exchange reserve requirements. The Argentinian peso and the Turkish lira seem to position themselves as the most volatile currencies among the selection. However, the pace of the post-Covid-19 recovery, the high risk of policy mistakes – as idiosyncratic features – and the evolution of the US economy and global financial markets – as systemic risks – could dramatically change the outlook.

### Monetary policy to remain accommodative overall despite an expected moderate tightening

Monetary policy interest rates are currently lower for most EMs than in 2013, except for countries that have suffered from the aftermath of a recent crisis, such as Argentina, Mexico, Turkey and Nigeria (see Figure 11). In most cases, policy rates were already on a downward path prior to 2020 as a result of easing inflationary pressures and were cut further during the pandemic in order to mitigate the impact of the crisis. Although several central banks in Emerging Europe and Latin America have raised policy rates since March 2021 in response to above-target inflation (Ukraine, Turkey, Russia, Hungary, Bra-

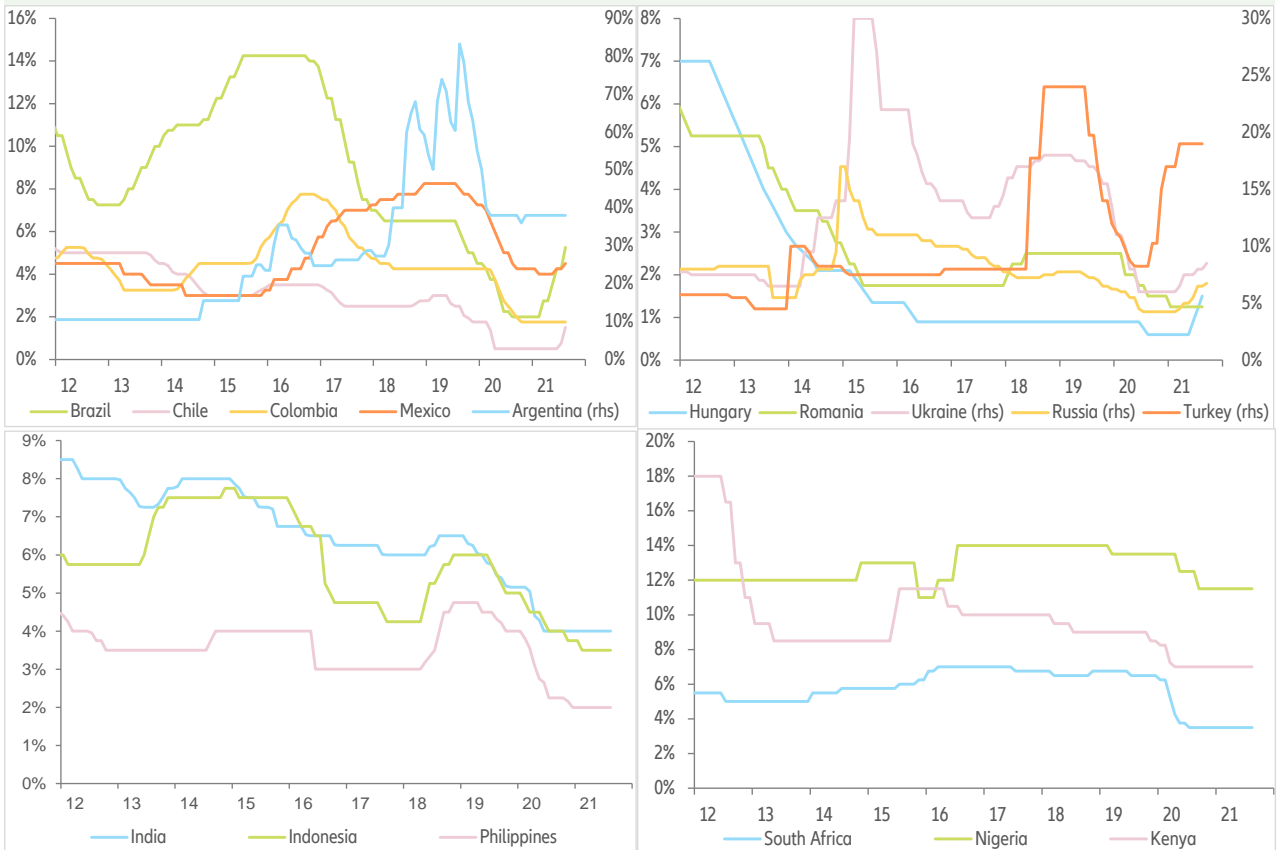
zil, Mexico, Chile), interest rates should remain low in the EM world, by and large, and continue to support the recovery in 2021-2022. And even if rates are hiked further in these economies and in a few other countries over the next 12 months, as will likely be the case, we expect the overall monetary policy stance in EMs to remain loose. This should continue to provide space for alleviating any impact of the eventual Fed tapering on EMs without putting the recovery path at risk.

### External financing requirement reveals weak spots

With regard to the foreign exchange (FX) reserves coverage of maturing short-term external debt, the situation has worsened since 2013. In six countries, the external debt payments falling due in the next 12 months significantly exceed the level of official FX reserves held at the respective central banks, notably in Turkey where the debt is more than four times higher than reserves (see Figure 12). Four of the six countries (Turkey, Argentina, South Africa, Chile) have been through one or several crises over the past few years. As a result, the economies experienced net capital outflows and currency pressures. Mostly unsuccessful FX interventions by the respective central banks to mitigate the financial turbulence have led to a drawdown of FX reserves. On the other hand, a majority of EMs including India, Brazil, Russia and Mexico have ample reserves, which strengthen their central banks' policy options in the event of external shocks.

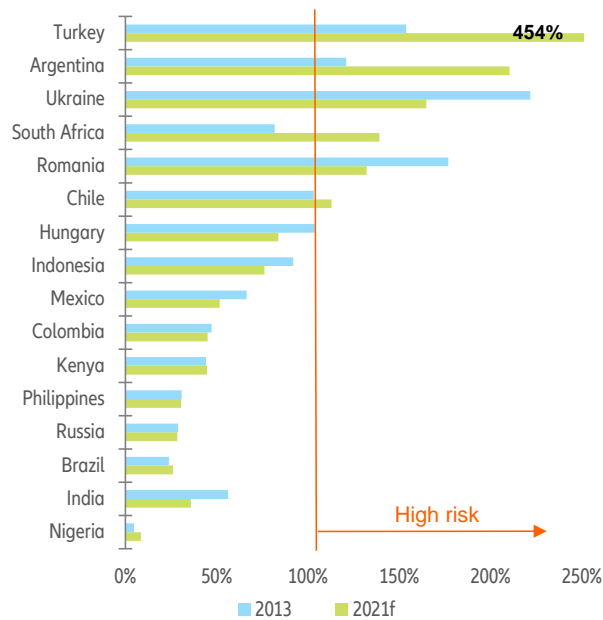


**Figure 11: Key monetary policy interest rates in selected EMs**



Sources: National statistics, IHS Markit, Allianz Research

**Figure 12: Maturing external debt over the next year in relation to FX reserves (%) in selected EMs**



Sources: National statistics, IMF, Allianz Research forecasts

### Risks with regard to sovereign debt

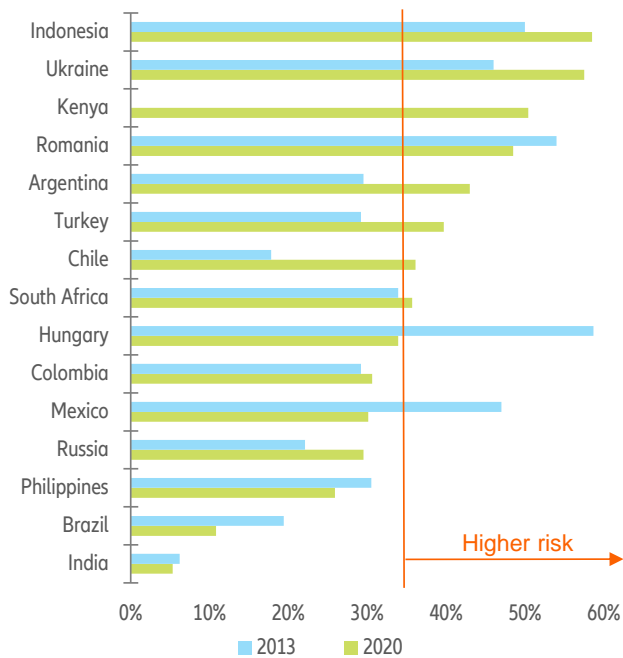
On a negative note, the share of non-residents' holdings of public debt has increased in many EMs over the last seven years. In Indonesia, Ukraine, Kenya, Romania, Argentina, Turkey, Chile and South Africa, it currently exceeds 35% of total public debt (see Figure 13). This increases the risk of a sudden capital reallocation from EMs to the US and financial market turbulence in EMs in the event that the Fed tapers and hikes rates earlier than currently announced and without appropriate advance communication. This will make financing more expensive for EMs, also for the private sector (notably corporates), so that payment behavior could deteriorate and insolvencies may increase.

On the other hand, this risk has declined since 2013 in Hungary, Mexico, the Philippines and Brazil because the share of nonresident holdings of public debt has markedly fallen in these markets.

Meanwhile, the spreads of hard currency sovereign bonds present two different trends. The main EMs in Asia and Central and Eastern Europe now have narrower spreads than they did in April 2013, so in case of a future spike the starting point is lower. The opposite situation is visible in Turkey and the main Latin American and African economies in our sample (see Figure 14).

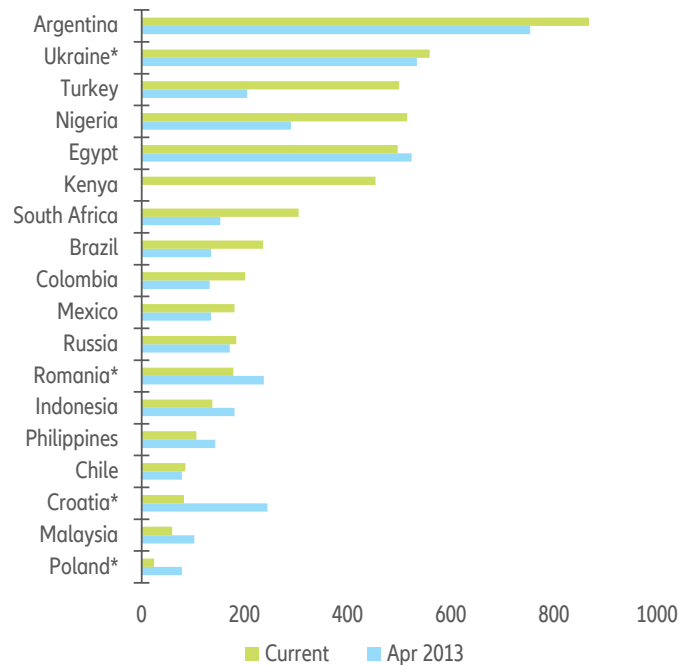
We conclude from this analysis of crucial vulnerability indicators that, by and large, major EMs are in a better position to withstand the impact of eventual US Fed tapering than they were in 2013. Yet, the risk of widespread financial market turmoil is not negligible, especially if the Fed tapering is badly communicated. Moreover, a few markets are currently more vulnerable than others, mostly due to macroeconomic imbalances or a lack of economic policy leeway to counter cyclical weaknesses. In the next section we will identify the weak spots by combining the advanced indicators for financial tensions in EMs in a scoring model.

**Figure 13:** Non-resident holding of total public debt (%)



Sources: IIF, IHS Markit, Allianz Research estimates

**Figure 14:** EM hard currency sovereign bond spreads (bps)



Note: \* indicates that the hard currency is EUR, otherwise USD.

Sources: Refinitiv, BofA, Allianz Research

# WHICH COUNTRIES ARE MOST AT RISK?

Even if we expect this time to be different from 2013 with regard to the US Fed policy announcements, financial market reactions and the pre-conditions in many major EMs, there will be some among the latter that are more vulnerable than others to a taper tantrum, especially if the Fed's actions are not well communicated.

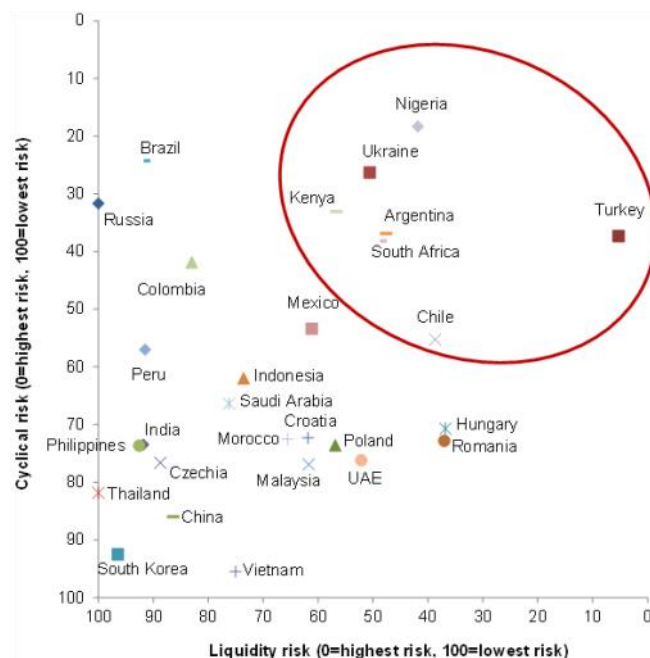
We have undertaken a reality check and identified the most fragile EMs with regard to:

- Liquidity risk (current account balance, short-term external debt due, import cover, private sector credit growth) and
- Cyclical risk (currency risk, inflation, commodity dependence, equities, bonds).

The result is summarized in Figure 15.

Seven EMs are particularly fragile to a potential repeat of the 2013 taper tantrum over the next two years or so according to our analysis, the TUCKANS: Turkey, Ukraine, Chile, Kenya, Argentina, Nigeria and South Africa. Less vulnerable but not fail-safe are Brazil, Mexico, Colombia, Hungary, Russia and Romania, which should thus also be monitored closely.

**Figure 15:** Advanced indicators for financial tensions in major EMs



Source: Allianz Research

# WHAT COULD THIS MEAN FOR MARKETS?

Irrespective of the exact timing of the Fed tapering, the effects of it will be felt in capital markets, specifically in the emerging economies as global liquidity is reduced and some capital flows go back to developed markets. Although tightening in the US will certainly generate pressures worldwide, the Fed claims to have learnt its lesson. Whether the announcements, the tapering and the hikes are somehow predictable and relatively structured will determine the impact and will prove whether the lesson was really understood.

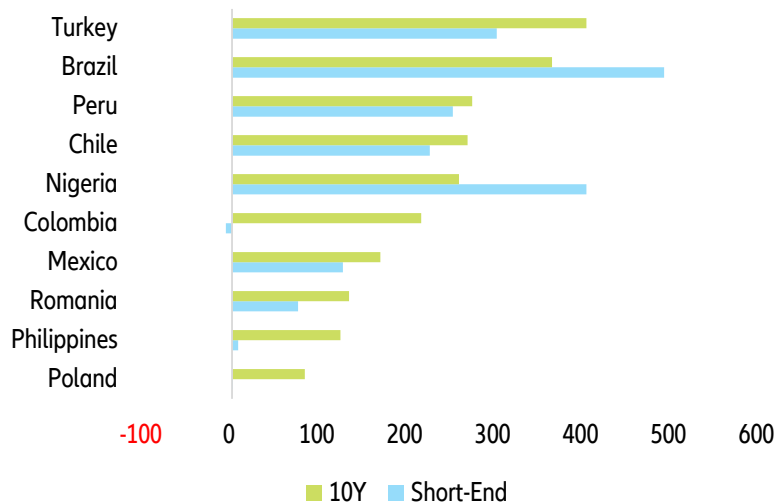
As we have seen lately, the movements in the US bond markets have had corresponding aftershocks in local currency bond yields in developing countries. In terms of hard currency bonds, the movements in the US bond market have not yet caused generalized

spread widening in EMs (with the exception of Turkey), which could have made things harder.

Figure 16 shows the latest volatility in sovereign bonds issued in local currency. In broad terms, the figure also corroborates the findings of the taper tantrum risk indicator: the largest moves so far took place in the TUCKANS. As mentioned in previous sections, the events at the Central Bank of Turkey have created turmoil in Turkish financial markets, which exacerbates the trend seen in other regions. In addition to the countries in Figure 16, Argentina and Ukraine deserve a special mention, with interest rates in the local currency bonds above 40% and 10%, respectively. Their curves have flattened in the last couple of months, with decreases in the long end (from 50.8% to 46.6% in the

Argentinian 7Y), and increases in the short end. In those two countries, the idiosyncratic pressures of both countries and the situation that they had already at the beginning of the year play an important role. The fact that movements in their bond markets may go in the opposite direction as the rest of EM countries is not necessarily a good signal.

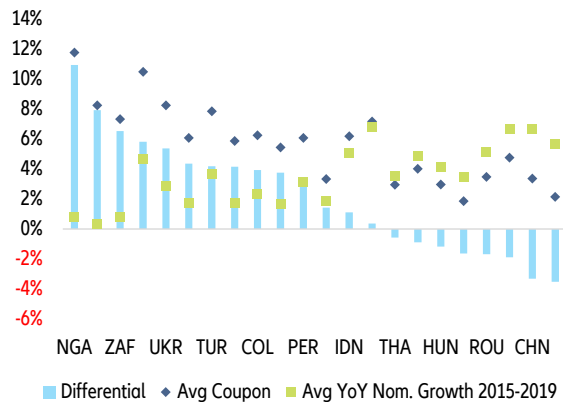
**Figure 16:** Changes in the LC sovereign yields since 01.02.2021 (in bps) – 1Y and 10Y



Note: The graph shows only a sample of the countries analyzed, that corresponds with the countries with the highest increases in the 10Y bonds.

Sources: Refinitiv, BofA, Allianz Research

**Figure 17: Differential between past economic growth and current cost of debt (measured as the average coupon of the sovereign debt)**



Note: Argentina's not shown as the picture would not contain the defaulted bonds in 2020.

Sources: Refinitiv, national statistics, Allianz Research

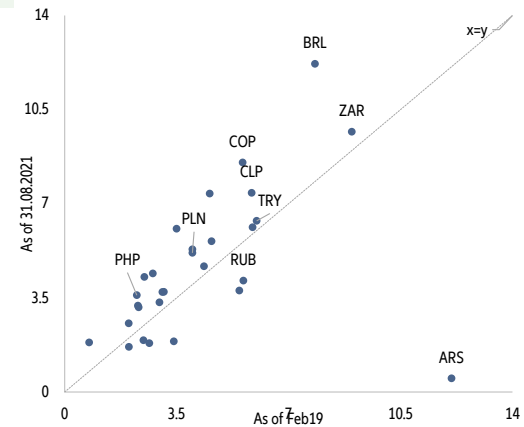
Although the concept of a taper tantrum is linked to volatility in the short term, should the increase in the interest rates remain; it could have harming effects on debt sustainability. Low interest rates are key for sustaining current levels of indebtedness, especially when the programs to fight Covid-19 and its lasting effects may require more financing.

To analyze that, in addition to the changes shown in Figure 16, we have performed an analysis of the differential between the interest rates and growth rates. This is a common measure of debt sustainability, as the cost of debt is compared with the returns it provides. For the calculation, we use the average coupon that EM countries are paying for their sovereign debt and the average nominal yearly growth between 2015-2019. The countries that in Figure 17 show a positive difference between average coupon and past economic growth could have problems in the coming years if they do not manage to change one or both variables. As the starting point of GDP in 2020 is low, the potential growth is higher. But will it be enough to offset the cost of debt? As of today, we have been observing some increases in the interest rates that could make it harder, a situation that could worsen in the event of a taper tantrum. Figure 17, read from left to right, shows the countries with the largest imbalances.

Most of the TUCKANS are again at risk when looking at the interest rate-growth differential: Nigeria, Ukraine, Turkey, Kenya and South Africa (Argentina as well, refer to the note on Figure 17). In addition, some of the countries that appeared in the second group regarding their taper tantrum risk (Brazil, Russia, Colombia) could face severe debt sustainability issues, given the already high differential between payable coupons and economic growth. In terms of maturity, among the countries more at risk, Turkey and Brazil are the ones with the shortest term, which adds more uncertainty as they would have more redemptions in 2021. On the opposite side, we find the Asian economies and Central and Eastern Europe (with the exception of Russia and Ukraine). Their reasons, however, are different: while the Eastern European countries are characterized by low interest rates and moderate economic growth, some of the Asian economies like India, Indonesia and Philippines are characterized by strong economic growth that makes up for interest rates above 5%.

In any case, the figure uses pre-crisis economic growth, so the perspectives could change for some countries, either because they are not able to go back to pre-crisis growth rates, or because they manage to recover quickly and strongly. In terms of how the interest rates could change in the future, there are some risks that indicate that they could

**Figure 18: Volatility in the FX market – selected currencies against the USD**



Sources: Refinitiv, Allianz Research

rise as well, including the potential taper tantrum.

Even if a proper taper tantrum does not finally materialize in generalized outflows from EMs and generalized spikes in sovereign yields and spreads, the struggle to overcome the Covid-19 crisis (both from sanitary and economic perspectives), rising inflation expectations and the eventual Fed tightening are elements that will increase volatility across EMs, at least to higher levels than seen in the period preceding the Covid-19 shock. In fact, since the trough of the oil crisis in 2015, and with the exception of local instabilities, EMs had performed relatively well.

Will higher volatility become the norm in the coming years? We cannot answer the question yet, but we have already seen how the volatility that came after Covid-19 has not fully disappeared. One example is the FX market.

To observe this, we compare moving standard deviations on exchange rate changes at different points in time. Instead of taking the values around the volatility peak in March 2020 – which could be considered one-offs – we take the situation one year before and one year after (current). We observe in Figure 18 how the volatility is generally higher.

Yet another proof of volatility, both in the US and in the EMs, is the flow of capital from/to these markets. After a 2020 of net outflows in most of the local bond markets, the flows in 2021 depict an erratic trajectory. In principle, we expect the cumulative balance to be positive – with net inflows to EMs in 2021, but at the same time with high volatility in both size and direction of the net flows – unless the tapering starts.

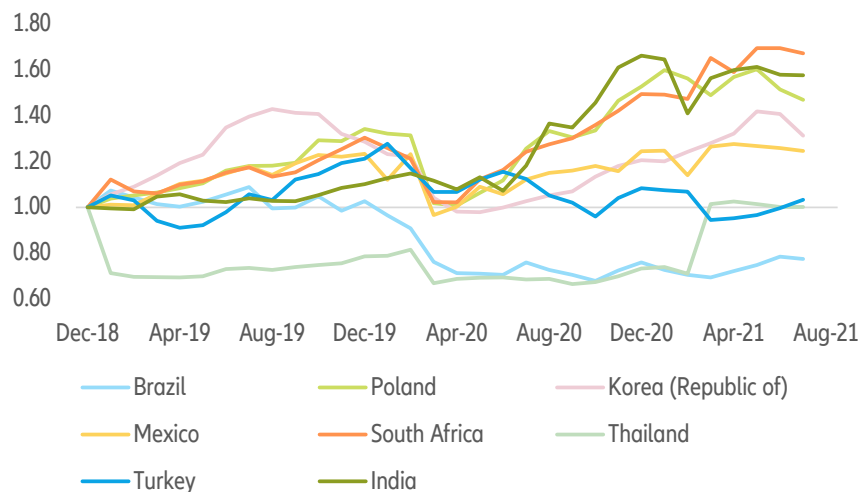
The situation differs considerably across countries. Figure 19 shows the standardized cumulative flows to local bond markets since 2018 in a selection of

countries. Although 2021 has meant a recovery for most of them, there are still some laggards.

At this point, it is important to note the interdependency of financial markets. One should not forget that central banks, by tampering the risk perception in their intent to contain idiosyncratic risks, have increased interdependence between different asset classes<sup>7</sup>. For the case of this paper, this means that in the case of negative developments, the improvements of a country's situation would not be enough to avoid the contagion, although it is always preferable to have low idiosyncratic pressures.

All in all, we expected a bumpy 2021, which by definition includes some volatility in expectations through the year. As of today, with the mentioned exceptions of particular countries, the current developments fit into the turbulence narrative. Whether the turbulence remains manageable will depend on many factors, one of them being the indirect effects of US tapering, but it is definitely not the only one.

**Figure 19:** Cumulative flows since 31.12.2018 in the local bond markets, standardized



Sources: Refinitiv, Allianz Research

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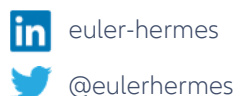
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