

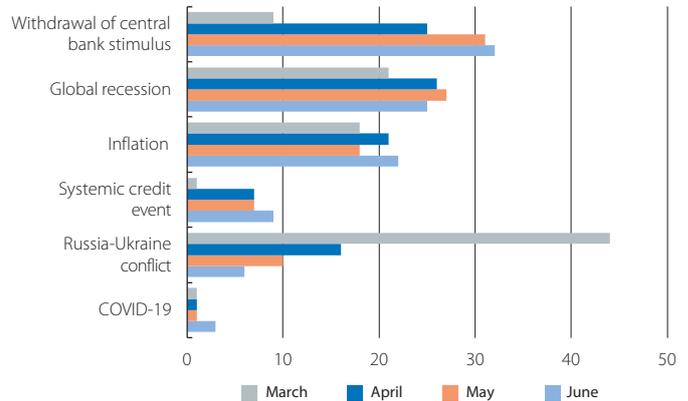
Fear of recession impacts the financial markets

Uncertainty and volatility, a damaging combination for the markets. The deterioration in investor sentiment continued throughout June and early July. The fear of a possible economic recession, aroused by the direction of monetary policy and the persistence of the inflationary pressures, remained one of the main concerns among investors. Pessimism gained ground as the disappointing tone of some macroeconomic data in the major advanced economies contrasted with the determination of monetary policymakers to persist with the withdrawal of the monetary stimulus, and relatively rapidly in the case of the Fed. Positive aspects such as the recovery of economic activity in China, following the strict lockdown imposed in several regions during April and May, did little to stop the narrative of an impending economic recession from spreading to the financial markets and materialising in the form of a new episode of risk aversion. As a result, the global financial markets ended Q2 with their worst performance since March 2020.

The Fed remains steadfast in its battle against inflation. At its June meeting, the monetary authority decided to raise interest rates by 75 bps up to the 1.50%-1.75% range, marking the biggest adjustment since 1994. Although several Fed members had revealed the central bank's plans to raise rates by 50 bps, the CPI rise in May (8.6% year-on-year) and the increase in inflation expectations justified the bigger hike in the fed funds rate. Looking at the dot plot, it appears that the members would consider similar increases appropriate for upcoming meetings, with the aim of placing the official rate above 3% by the end of 2022 and above 4% by 2023. However, in the weeks that followed, Jerome Powell's defence before US Congress of the need to further tighten financial conditions in order to defuse inflation, despite the perceived weakness in some economic indicators, fuelled investors' fears of an economic recession in the coming months. This shift in expectations led to the yield on the 10-year bond falling below 3% and a reduction in the slope of the treasury yield curve.

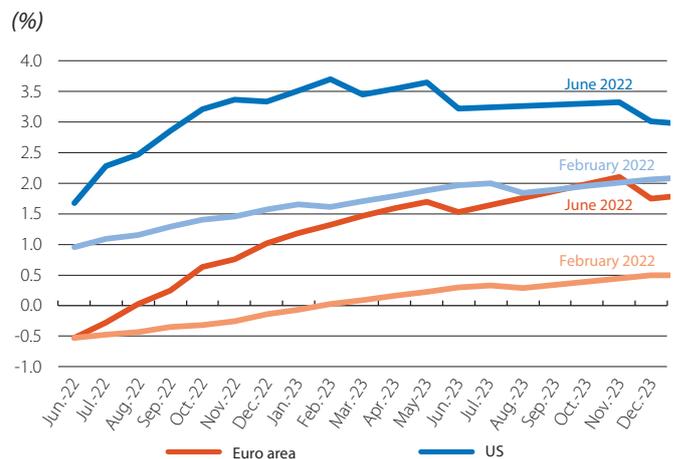
The ECB is joining the monetary normalisation process, but at a different pace. At its June meeting, although it left interest rates unchanged, the ECB adopted several changes to its monetary policy tools. On the one hand, it clarified its forward guidance for the coming months. It committed to raising rates by 25 bps at its July meeting, and possibly by a further 25 bps in September if the medium-term inflation outlook remains high, while it also stated it would pursue a gradual but sustained pattern of rate hikes over the coming quarters. On the other hand, the entity confirmed it would bring net purchases under the APP to an end from 1 July, the

Survey: what do you consider the biggest downside risk to the financial markets?
(% of total respondents)



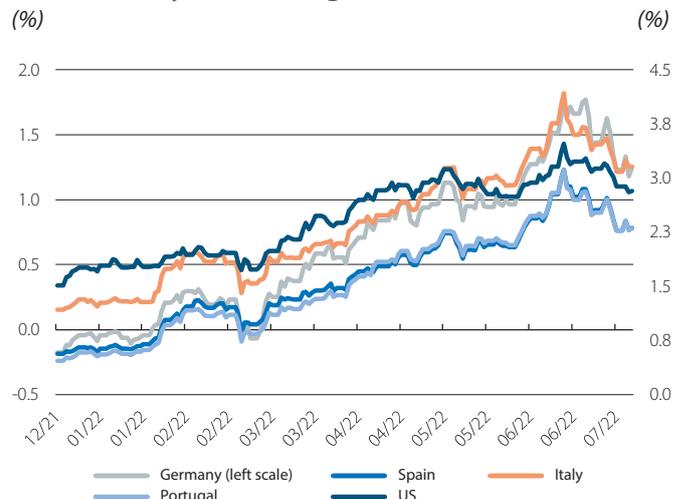
Note: Survey of 288 asset managers in different countries in the first weeks of the month in question.
Source: CaixaBank Research, based on data from the Bank of America Global Fund Manager Survey.

Expectations for ECB and Fed reference interest rates



Note: Forwards on the EFRR and the OIS of the euro area derived using market yield curves.
Source: CaixaBank Research, based on data from Bloomberg.

Yields on 10-year sovereign debt



Notes: US, Spain, Italy and Portugal, right-hand scale. Data as of 6 July 2022.
Source: CaixaBank Research, based on data from Bloomberg.

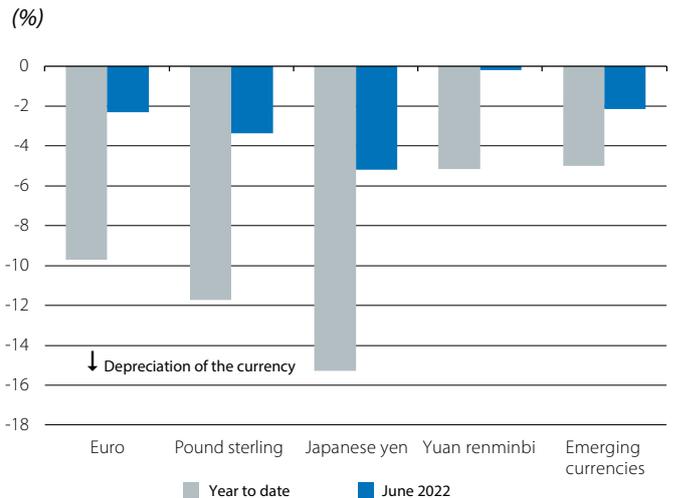
earliest date allowed by the statements made at previous meetings. Christine Lagarde’s hawkish tone, combined with the lack of details regarding possible tools for preventing the euro area’s financial fragmentation, prompted a rise in yields on the region’s sovereign bonds, particularly in the case of the periphery countries. In the face of the surge in risk premiums in these countries, the monetary authority called an urgent meeting to discuss the possibility of introducing an «anti-fragmentation» tool to safeguard financial stability. Investors welcomed the ECB’s response and debt spreads narrowed, despite the lack of details from the institution and the incipient deterioration in euro area growth expectations.

Fear of recession plunges the euro to a 20-year low. The increased restrictions in the flows of Russian natural gas to Europe in the closing weeks of June exacerbated investor fears regarding the risk of economic recession in the euro area. This, the weakness observed in the region’s economic activity surveys, as well as the difference in the pace of monetary normalisation between the euro area and the US favoured the depreciation of the euro against the dollar, bringing it to 1.02 on 6 July, the lowest level since 2002. Furthermore, the dollar’s position as a safe-haven asset accentuated its strength against the rest of the G10 and emerging currencies.

Energy prices remain in the spotlight. The risk of recession and the uncertainty associated with developments in the war in Ukraine continued to drive the evolution of European oil and gas prices. Investors’ concerns regarding the impact of an economic recession on global demand for oil overpowered the current supply-side tensions (most notably OPEC’s production limits and the Western sanctions on Russian crude oil), driving down the price of a barrel of Brent to 100 dollars on 6 July. However, in the case of natural gas, the 40% reduction in the flow of Russian gas to Germany during the stockpiling season, coupled with the doubts surrounding the flows over the winter, drove up the price of TTF natural gas by more than 100% between 14 June and 6 July.

Risk aversion weighs heavily on the stock markets. The context of uncertainty and volatility had a negative impact on the major stock market indices, with the S&P 500 registering its worst half since 1970, having accumulated a 20% decline between the beginning of the year and 6 July. The rotation of portfolios towards more defensive stocks was not enough to prevent the EuroStoxx 50 from ending June down nearly 9%. The weakening of the economic indicators, the hawkish rhetoric of the central banks and the persistent high commodity prices prompted many listed companies to issue warnings of a possible deterioration in their margins over the coming quarters. In fact, the analyst consensus has begun to revise down its earnings forecasts for the coming quarters, which will also weigh on investor sentiment.

Currencies against the US dollar



Note: The «year to date» figures cover the period up to 5 July 2022. Source: CaixaBank Research, based on data from Bloomberg.

Commodity prices

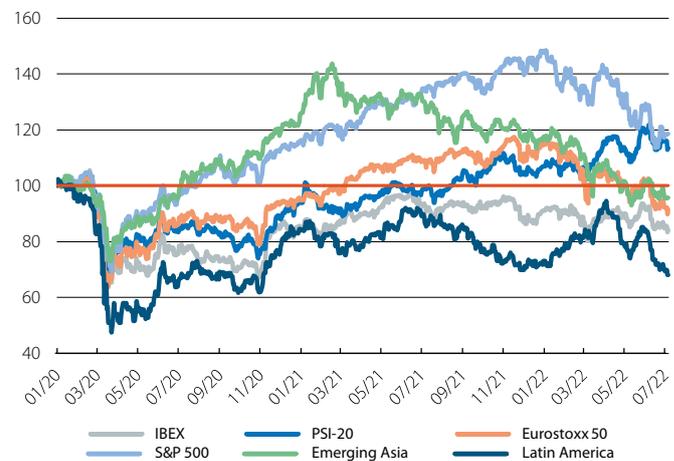
Index (100 = January 2021)



Note: Data as of 6 July 2022. Source: CaixaBank Research, based on data from Bloomberg.

Major international stock markets

Index (100 = January 2020)



Note: Data as of 6 July 2022. Fuente: CaixaBank Research, based on data from Bloomberg.