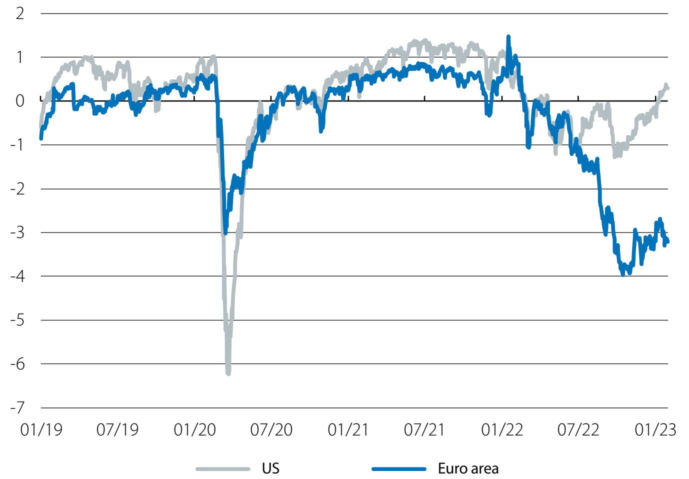
A good start to the year in the financial markets

Respite in the tightening of global financial conditions. Investors welcomed the new year with a heightened appetite for risk, reducing the losses registered during a tumultuous 2022. Among the main reasons behind the optimism is the increased confidence among investors that the worst of the inflationary shock is probably behind us, mainly due to the improvement in the global bottlenecks and the stabilisation in the energy markets. These factors have materialised in a moderation in headline inflation in the major economies, despite greater persistence in the core components. In this context, investors are betting that the central banks will likely be able to complete their cycle of official rate hikes in the coming months and that, in turn, the process of monetary tightening will not lead to a global economic recession – or if it does, it would at least be a short and mild one. This optimism has been reflected in widespread gains in the fixed-income and equity markets, paving the way for a significant easing in the financial conditions indices and a some containment in the volatility metrics.

The central banks are keeping their course, with the ECB at the helm. The enthusiasm seen in the markets contrasts with the messages of the central banks, which have been firm in their rhetoric of continuing to tighten monetary policy. In this regard, at its meeting in early February the ECB once again announced a rise in official rates of 50 bps (placing the depo rate at 2.50% and the refi rate at 3.0%), while also indicating its intention to increase them at the same pace in March. It also confirmed the plan already announced in December for the gradual reduction in the bond portfolio under its asset purchase programme (APP) beginning in March (at an initial rate of €15 billion per month). The Federal Reserve, meanwhile, approved a 25-bp rise, placing rates in the 4.50%-4.75% range, and reiterated that additional adjustments will be needed, although it also signalled that the end of the cycle of rate hikes was in sight. In the money markets, investors are expecting both the ECB and the Fed to reach the peak in rates in the coming months, with cumulative increases of around 100 bps up to 3.5% in the euro area and of 25 bps up to the 4.75%-5.00% range in the US. Rate cuts are expected to begin this year in the case of the Fed and in early 2024 for the ECB.

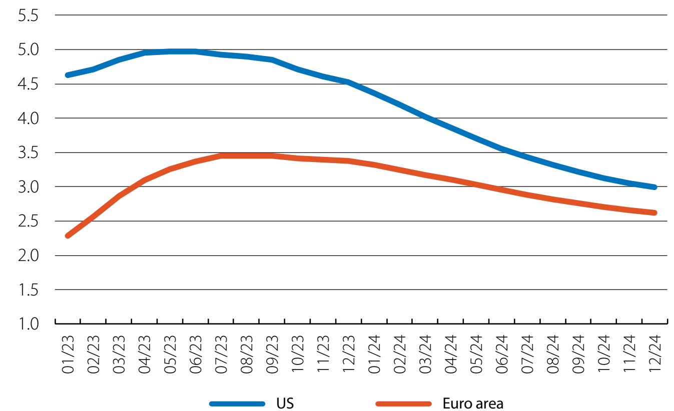
The euro consolidates its position against the dollar. Other central banks also approved a new round of rate hikes, including the Bank of England (+50 bps up to 4.0%) and the Bank of Canada (+25 bps up to 4.5%). The latter surprised the markets by indicating that, in the absence of further shocks, it would not implement any further increases. The Bank of Japan, meanwhile, kept both official rates and the parameters of its yield curve control policy unchanged – announcements which contributed to a depreciation of the yen and a fall in sovereign debt yields. Meanwhile, in the context of a tightening of the hawkish narrative previously noted by the ECB, the euro consolidated its rally against the dollar

Financial conditions
Index (0 = historical average)



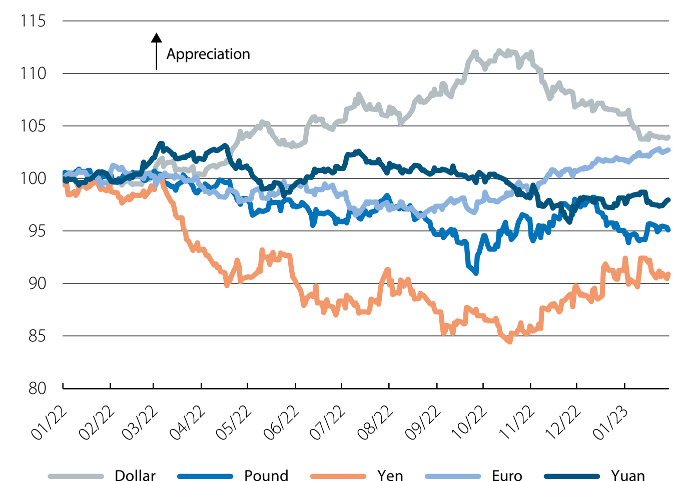
Source: *CaixaBank Research, based on data from Bloomberg.*

Expectations for Fed and ECB reference interest rates
(%)



Note: *Forwards on the EFFR and the OIS of the euro area derived using market yield curves as of 31 January 2023.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Currencies: effective nominal exchange rates
Index (100 = January 2022)



Source: *CaixaBank Research, based on data from Bloomberg.*

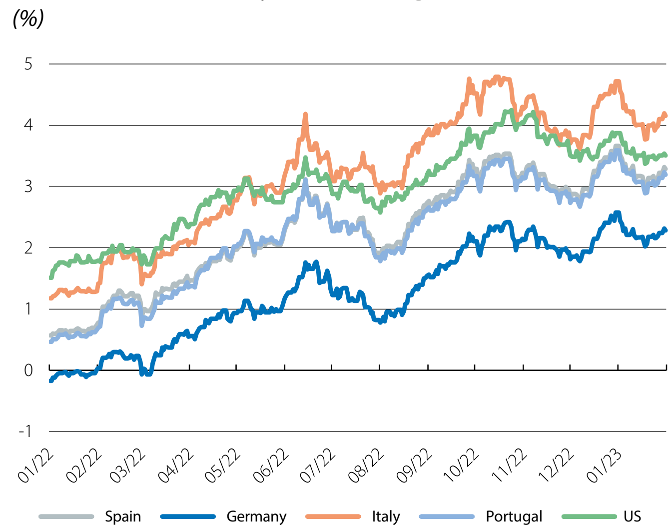
and traded near 1.10, the highest level since the spring of 2020. In contrast, the dollar weakened against most currencies, including those of both other advanced countries and the major emerging markets; in January, the dollar's nominal effective exchange rate weakened by 1%, following the depreciation of 9% already accumulated during Q4 2022.

The price of government paper also begins the year in the green. In the government bond market, sovereign yields declined in January by around 30 bps, both in Europe (the German 10-year bond stood at 2.3%) and in the US (3.5% in the case of the 10-year bond). However, sovereign yield curves have remained inverted in several sections in the main benchmark countries, serving as a warning of the risk of a possible recession. The risk premiums of the euro area periphery countries, meanwhile, went down (compared to Germany, by –10 bps in both Spain and Portugal) and for the time being they do not seem to reflect any substantial impact of the Quantitative Tightening plan announced by the ECB. Also, risk premiums have found support in the possibility of an agreement in the EU for the creation of a mechanism financed with EU debt to respond to the subsidies planned in the US (under the Inflation Reduction Act). Meanwhile, US Secretary of the Treasury Janet Yellen told Congress that the debt ceiling was reached on 19 January and, although there has been little reaction in the markets, warned that exceptional measures, some of which have already been put in place, could maintain the funding capacity until June.

Widespread gains in the international stock markets. Stock indices kick-started the year with cumulative gains in January of 6% in the US (S&P 500), 10% in Europe (Euro Stoxx 50) and 8% in the case of Emerging economies on aggregate. This is the best start to the year for the international stock markets since 2019, according to the global MSCI aggregate; in Europe, the advance is the most pronounced in a month of January in the last 40 years. The weak tone in corporate earnings forecasts during the Q4 2022 earnings season has been offset by the positive outlook for the global economy, the reopening process in China and the improvement in economic sentiment, most notably in Europe. In emerging markets, the advance in the stock markets also reflects the improvement in capital flows to these economies, as well as the aforementioned weakening of the dollar.

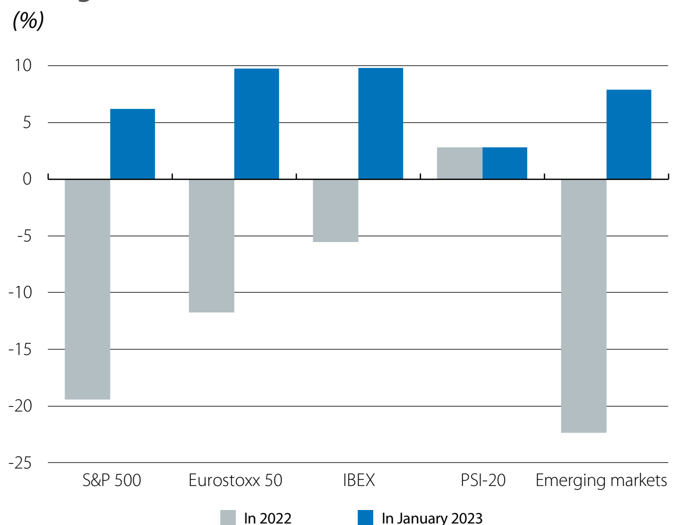
Stabilisation in commodity prices, except metals. In the commodity markets, the big surprise has been the correction in gas prices which, despite remaining at historically high levels, have stabilised at their lowest levels since Russia's invasion of Ukraine, dispelling the risks of a rationing of supplies (see the Focus «Energy: with 2022 behind us, will 2023 be as turbulent?» in this same report). The price of Brent oil, meanwhile, has fluctuated at around 85 dollars a barrel against a backdrop of upward revisions in the forecasts for demand, on the one hand, and a greater accumulation of reserves in the US, on the other. OPEC+ has also signalled that it is not planning any production cuts in the short term, in anticipation of the reopening process in China. This latter factor, however, has exerted upward pressure on industrial metal prices, while food prices have remained high.

Interest rates on 10-year sovereign debt
(%)



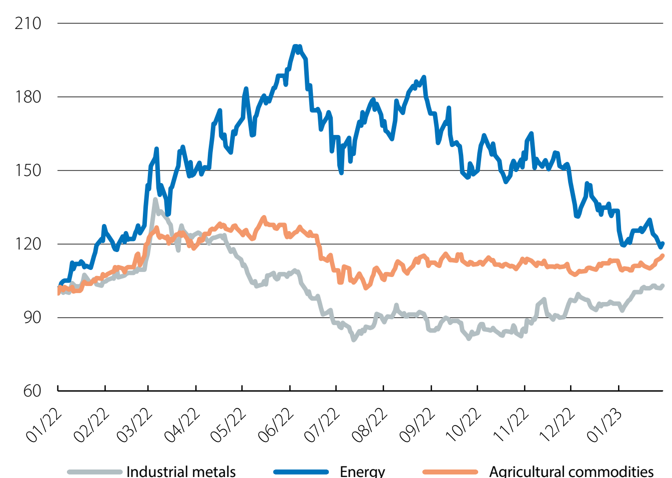
Source: *CaixaBank Research, based on data from Bloomberg.*

Change in the main stock market indices
(%)



Source: *CaixaBank Research, based on data from Bloomberg.*

Commodity prices
Index (100 = January 2022)



Source: *CaixaBank Research, based on data from Bloomberg.*