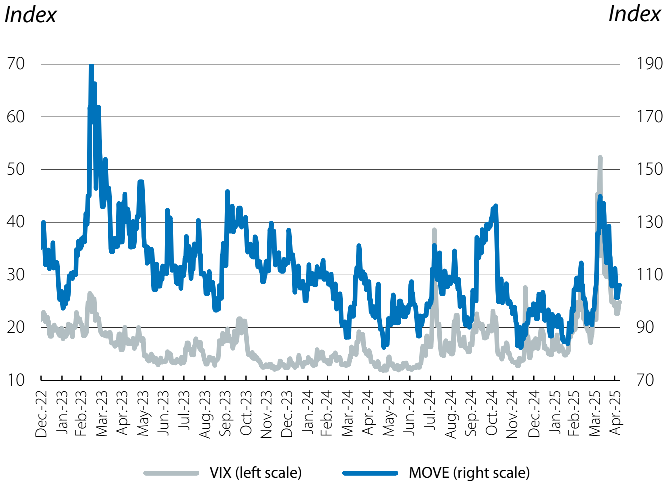
Financial markets embrace the tariff pause

Following the spike in volatility at the start of April, risk appetite recovers. President Trump's announcement of «reciprocal» tariffs on 2 April triggered an episode of high volatility in which uncertainty and concerns surrounding global growth, especially in the US, dominated the narrative in the markets. Global stock markets accumulated losses in excess of 10% in the space of just a few sessions, the dollar depreciated and even commodity prices suffered, particularly energy commodities and industrial metals. However, the 90-day pause on the tariffs announced by Trump, together with macroeconomic data suggesting that the global economy is holding up, at least for now, led to an easing of volatility in the markets. Risk appetite partially recovered and stock markets regained almost all of the lost ground. The dollar has managed to stabilise and commodities (with the exception of oil) recorded gains in the month. On the other hand, the declines in sovereign yields, particularly in the short end of the curves, have persisted amid expectations that central banks will continue to ease monetary policy.

Central banks' strategies diverge. The Fed finds itself in a delicate position in which its two mandates (price stability and full employment) are in tension. In this situation, and faced with a heightened risk of stagflation due to tariffs and the significant uncertainty of the current economic context, it has opted to put any decisions on hold until there is further clarity on the impact the tariffs will have on the real data. At its meeting in early May it kept the fed funds rate unchanged in the 4.25%-4.50% range for the third consecutive time. In contrast, with the risks clearly skewed towards weaker growth, other central banks have managed to continue easing policy. The ECB lowered interest rates by 25 bps at its April meeting, setting the marginal deposit facility rate at 2.25%, and it prepared to respond quickly to the impact of the tariffs, leaving the door open to future changes but without committing itself to any particular course of action. The Bank of England also cut rates by 25 bps at the beginning of May, placing the official rate at 4.25%, and highlighted the risks tariffs pose to economic activity. Looking ahead to the medium term, markets expect these three central banks will cut rates at least three more times by the end of the year, but the Fed has much less margin for manoeuvre, and in cumulative terms the ECB will have lowered interest rates the most in this cycle.

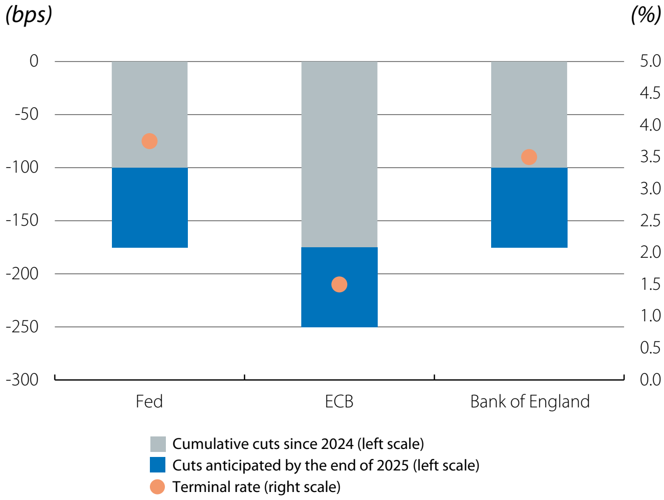
Sovereign yields fall back, in general terms, to the levels of March. In the US, the initial reaction to tariffs was a widespread spike in sovereign yields, but they have since fallen back down in the shorter section of the curve amid expectations that the Fed will cut interest rates this year. Yields in the longer sections, in contrast, have remained higher given the growing doubts surrounding the strength

Volatility indices



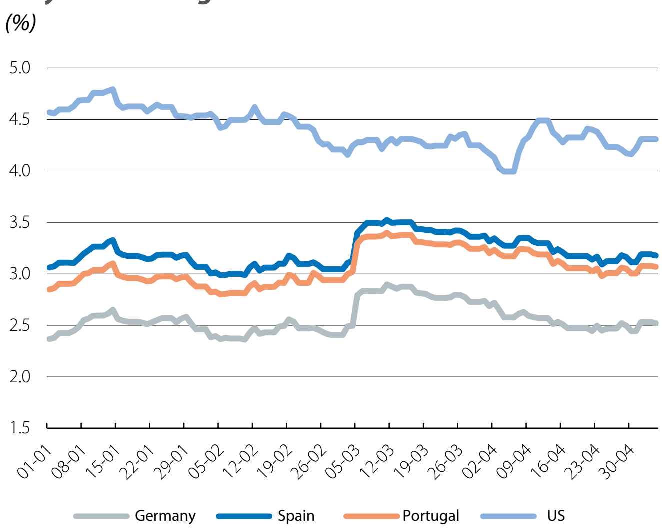
Note: *The VIX index measures the volatility of the S&P 500. The MOVE index measures the volatility of US debt markets.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Interest rate expectations



Note: *Rate cuts anticipated according to the futures curves for the EFFR, the STR OIS and the GBP OIS.*
Source: *CaixaBank Research, based on data from the ECB, the Fed, the Bank of England and Bloomberg.*

10-year sovereign interest rates



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

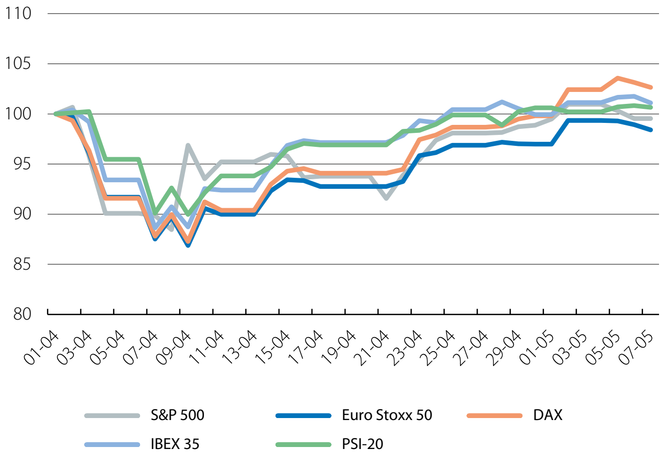
of US economic activity and the potential fiscal deterioration. Sovereign yields in the euro area, meanwhile, have returned to the levels they were at in late March, along the whole curve, even falling below those levels and wiping out all the gains accumulated with the announcements of fiscal expansion and defence spending. The expectation of a dovish ECB has been the main catalyst behind the rally in European sovereign bonds of recent weeks.

The stock markets recover some ground. The main global indices managed to recover the losses suffered at the start of the month and are now back at, or very close to, the level of the day prior to the tariffs announcement. The S&P 500 racked up nine consecutive sessions of gains at the end of April, the longest streak in two decades, driven by strong employment data and a good earnings season for tech firms. In the euro area, the German and Spanish stock markets led the gains amid better-than-expected economic activity data. Global sentiment also steadily gained traction on the back of the Trump administration's negotiation annoucements and as conversations with some trading partners got underway.

The dollar stabilises, but remains weak. Despite its traditional role as a safe-haven asset, the dollar suffered a sharp deterioration (of over 4%) against its main counterparts after tariffs were imposed and amid the surge in volatility in the financial markets. Moreover, this weakness was widespread: both against developed-economy currencies such as the euro, pound sterling and yen, and against those of emerging markets such as the Mexican peso. However, the dollar appears to have hit a floor, for now. Against the yen it has stabilised at around 142 and 143 dollars per yen, against the euro at 1.13, and against the pound sterling at 1.33. Similarly, against the Mexican peso, the dollar has been trading at around 19.6 dollars per peso for the past two weeks.

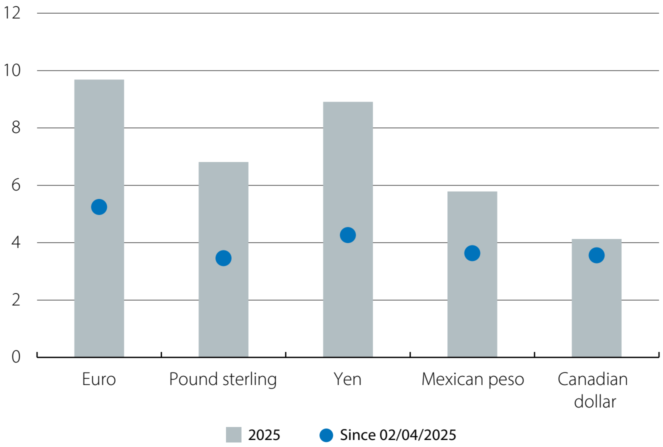
Energy prices feel the effects of the global uncertainty. The focus of commodity markets has been primarily on energy. The price of Brent fell more than 15% during the month of April, reaching around 60 dollars/barrel, its lowest level in four years. This is due, firstly, to expectations of lower global activity growth, which would stifle demand for crude oil. Secondly, it is because OPEC and its partners announced a production increase of 411,000 barrels a day beginning in June. Moreover, Saudi Arabia warned other members of the organisation that it would increase its production even more if they do not meet their quotas. On the other hand, gold has performed particularly well, amassing gains of over 25% in the year to date due to its role as a safe-haven asset (see the Focus «Gold: the shiniest asset» in this same *Monthly Report*).

Performance of stock market indices
Index (100 = 01/04/2025)



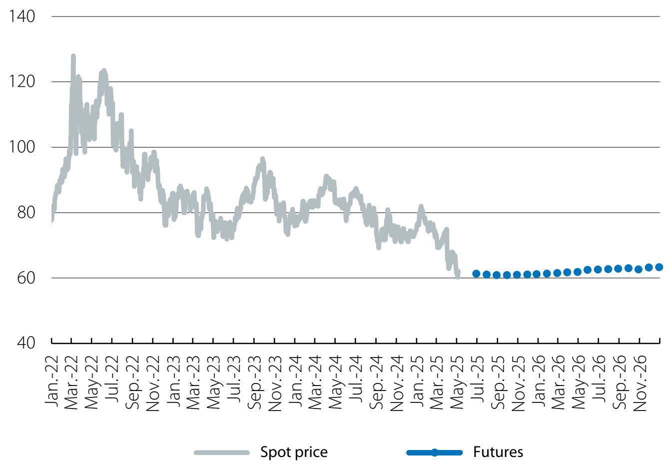
Source: *CaixaBank Research, based on data from Bloomberg.*

Performance of currencies against the dollar
(%)



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

Brent oil prices
(Dollars/barrel)



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