

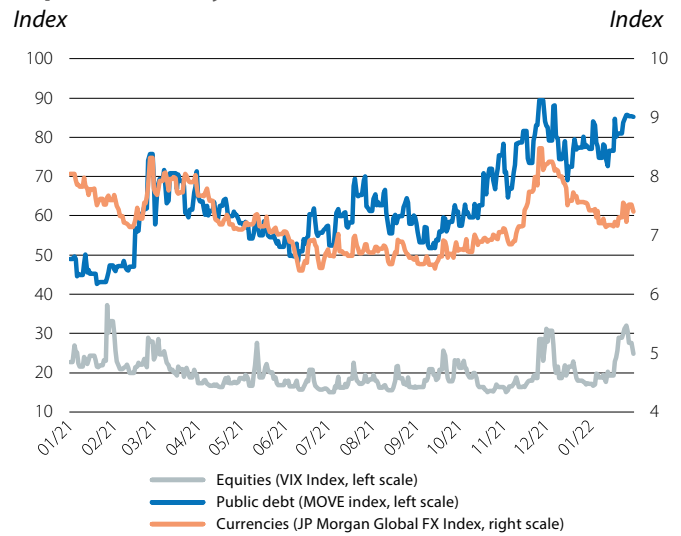
A tumultuous start of the year in the financial markets

Monetary policy normalization regains focus against Omicron. The start of the year has been marked by a realignment of risk factors among investors. On the one hand, fears about the possible impact of Omicron have diminished, and on the other hand, the debate about the persistence of the inflationary pressures and, above all, the withdrawal of monetary stimuli has gained traction. The risk of geopolitical confrontation in Ukraine has also increased. The result has been a widespread increase in financing costs and volatility, reflected in rising sovereign interest rates and a tightening of financial conditions. The international stock markets, meanwhile, have zigzagged in a downward trend, and currencies considered safe havens have tended to appreciate, while energy prices have risen. The tumultuous month of January sets the tone for what looks set to be a year of sharp movements in the markets, as the course of monetary policy accelerates its adjustment towards the new normal.

The Fed prepares the ground to begin the cycle of rate hikes. At its early meeting on 25-26 January, the Fed maintained the benchmark interest rate in the 0.00-0.25% range, but it made it very clear that, in the absence of surprises, it will implement the first rate hike in March. Having declared the goal of reaching full employment achieved, and in a context of rising inflation risk, the Fed chair Jerome Powell did not rule out the possibility of the rate hike cycle being more aggressive than previously announced, while outlining the initial guidelines on the strategy for the gradual reduction of the size of the balance sheet, the next step in the Fed's roadmap. Accordingly, the implicit rates in the money markets closed the month reflecting expectations of up to five 25-bp rate hikes this year, in contrast with the three hikes that were expected in December. The yield on US treasuries rose significantly (+28 bps to 1.79% for the 10-year bond) under a pattern marked by a flattening of the yield curve. The dollar also strengthened against the major currencies; against the euro, it closed the month trading at its lowest level since mid-2020.

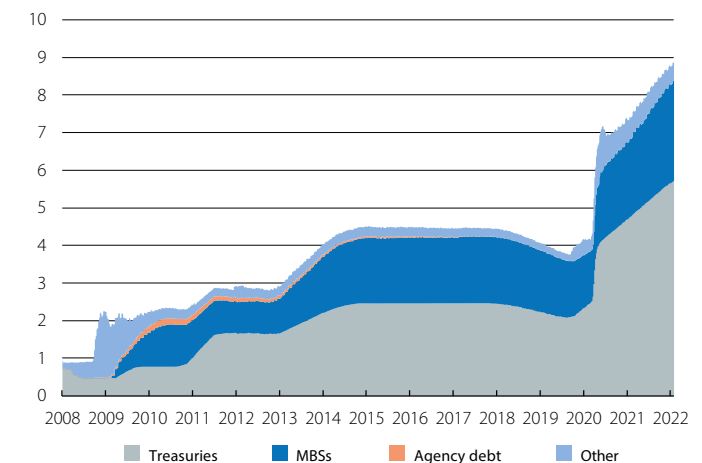
The ECB is also more concerned about inflation. With regard to the ECB, the rebound in inflation in recent months, and above all the potential risk of it persisting for longer than expected, is beginning to concern the more hawkish wing of the Governing Council. This divergence was reflected in the minutes of the December meeting, when several members expressed their reservations about some of the measures adopted, such as the decision to extend the reinvestment of assets under the PEPP until 2024, or even the decision to increase net purchases under the APP this year. However, no major changes are expected in the coming months. In an interview, the institution's president, Christine Lagarde, categorically rejected the possibility of early official rate hikes.

Implicit volatility in the financial markets



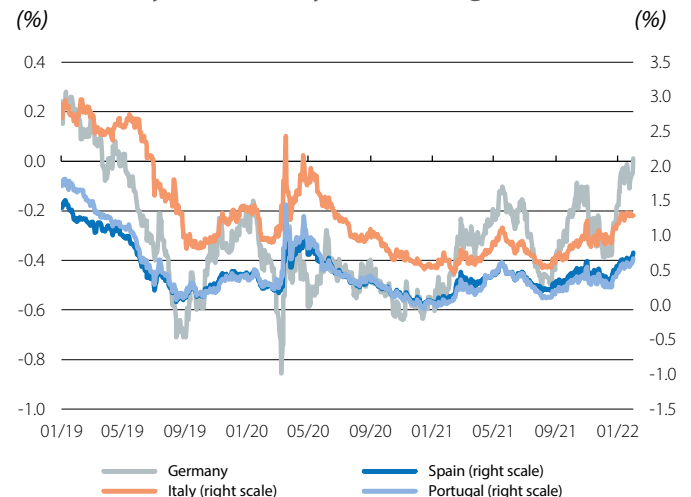
Source: CaixaBank Research, based on data from Bloomberg.

Composition of the Federal Reserve balance sheet (USD trillions)



Source: CaixaBank Research, based on data from Bloomberg and the Federal Reserve.

Euro area: yields on 10-year sovereign debt



Source: CaixaBank Research, based on data from Bloomberg.

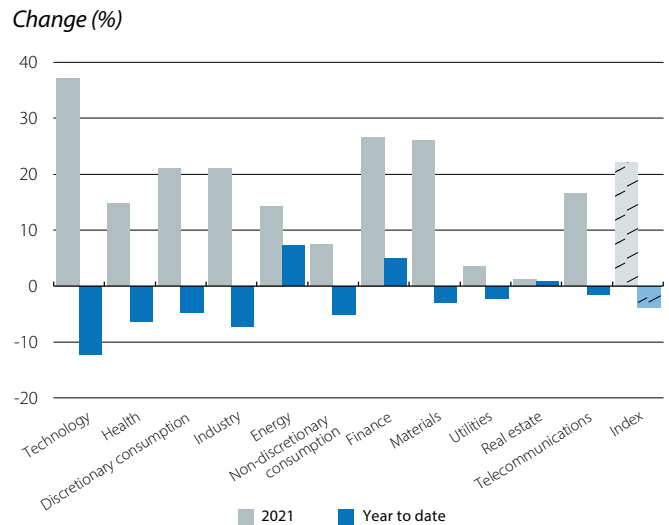
According to implicit rates in the money markets, meanwhile, investors are anticipating a 25-bp rise in the deposit facility rate within a year. Yields on sovereign debt, meanwhile, followed the pattern set by the US, with the 10-year German *bund* trading in positive territory for the first time in the last three years. Debt premiums in the southern countries were stable, even in Italy, despite uncertainty about the president's re-election process.

A month of ups and downs in the international stock markets. For equities, the realignment among investors of the risk factors has led to a shift in favour of the sectors most exposed to the business cycle and to the detriment of those with a high growth profile. This latter group most notably includes the tech sector, which plummeted, generating widespread risk aversion that ended up affecting the good performance of other sectors. Thus, in the year to date, the stock market indices have registered sharp declines, especially in the US. Another important factor has been the beginning of the business earnings season. While somewhat better than the analyst consensus expectations, the earnings reported to date are no match for those of the previous quarters, which far exceeded predictions. The outlook for this year is that the international stock markets will continue to perform well, albeit most likely at rates below those of 2021 (see the Focus «What goes up... must come down? The outlook for equities» in this same *Monthly Report*).

The oil price rises to its highest level since 2014. Following the upswing already seen in December, the price of a barrel of Brent continued on its upward trajectory in January, registering a cumulative increase of 17%. This rally is driven by factors on both the supply side, such as reports of breakdowns in certain regions and doubts among investors about the capacity of some countries to increase their production, as well as on the demand side, in the face of signs that the impact of Omicron will be lower than originally anticipated. However, the futures markets continue to indicate that the price will peak this quarter before gradually moderating during the course of the year, a pattern also expected for the price of gas. To a large extent, these projections will depend, among other factors, on the conflict surrounding Ukraine. An increase in tensions would result in a sharp rise in energy prices and, with it, further stress in global inflationary pressures.

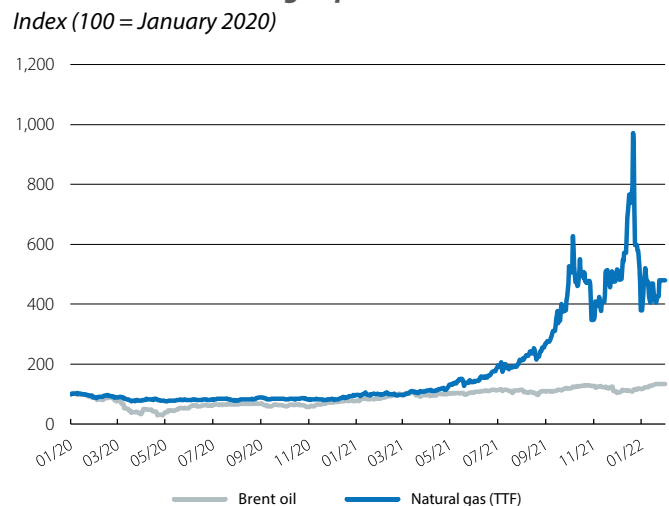
In emerging markets, China relaxes its monetary policy. In contrast with other emerging-market central banks, the People's Bank of China announced a further reduction in some of its benchmark interest rates, including a 10-bp cut in the rate applied to the medium-term lending facility, the first such reduction since April 2020. The measures come in response to the slowdown in growth, with the real estate sector hitting the brakes and due to the restrictive policies adopted to combat the health emergency. In Russia, the heightened geopolitical risk was reflected in a 4% depreciation in the rouble against the dollar, a 6% drop in the stock market, and a 102-bp increase in 10-year sovereign debt yields.

Sectors of the Eurostoxx 600



Source: CaixaBank Research, based on data from Bloomberg.

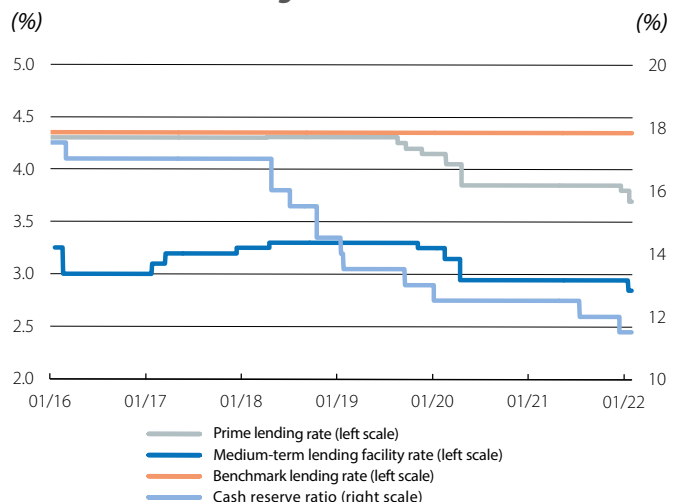
Brent oil and natural gas prices



Note: TTF natural gas is the benchmark gas price used in Europe.

Source: CaixaBank Research, based on data from Bloomberg.

China: main interest rates and reserve ratio for wholesale banking



Source: CaixaBank Research, based on data from Bloomberg.