MARKET RECAP
WEEKLY

Oct 31, 2022

MARKET REVIEW

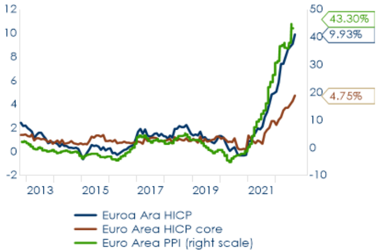
ECB TIGHTENING INTO RECESSION

- ECB hiked rates for third time in a row.
- With high inflationary pressures, tighter credit conditions and a robust labor market, ECB painted a more pessimistic economic outlook, with downside risks to growth and upside risks to inflation.
- ECB is concerned about a likely excessive wage increases, which could result in a wage-price spiral.

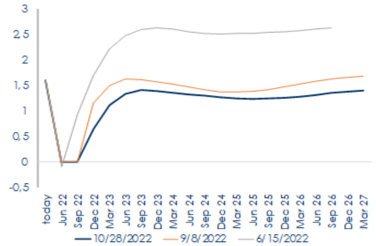
At its October monetary policy meeting, the ECB, as expected, raised all three official rates by 75 basis points. In the press release, the ECB stated that it 'has made substantial progress in draining monetary policy accommodation', and now the Governing Council 'expects to raise interest rates further' at future meetings. Any future decisions will be made 'meeting by meeting' and will remain data dependent. Furthermore, in the Q&A session, President Lagarde said upcoming ECB decisions would be based on three factors: 1) **the inflation outlook** "taking into account the evolution of the economy including the higher likelihood of a recession", 2) **the "measures we have taken so far" including 200bp of tightening to date**, and 3) **the "time lag" with monetary policy impacts the economy. This might suggest a 50 bp hike at the mid-December meeting.**

C. Lagarde painted a significantly more pessimistic scenario than in September, characterized by a weakening economic activity until Q1 2023. During the press conference, C. Lagarde tried to build a bridge between the now overly optimistic forecasts published in September and those to be published in December, emphasizing that the significant Euro Area slowdown risks sliding into a recession. Growth risks remain tilted to the downside, whereas those to inflation remain tilted to the upside.

Euro Area Inflation



Market Expected ECB Rate Trajectory



This likely demand slowdown has been interpreted by the markets as suggesting that the ECB will soon have to slow down hike path.

Lagarde also suggested that there were some indications that wage increases "may be picking up". These comments speak to the risk of second round effects becoming entrenched. Notwithstanding the slowing economic activity and tightening credit conditions, the labor market is strong and companies' hiring intentions are consistent with further employment growth. In Q2, negotiated wages growth moderated to 2.5% y/y. For Q3, more timely national data points to an increase in the range of 2.5%-2.8% y/y.

Despite this solid increase, with inflation averaging 9.3% in Q3, real incomes are being squeezed. The picture is similar across major eurozone countries. And while pay growth has caught up to pre-pandemic levels, increases are modest. Indeed, even the highest growth rate, the 3.7% y/y seen in the Netherlands, results in a squeeze to households' real incomes.

WEEKLY RECAP

EQUITY MARKETS

Newsflow on CBs and earning season led the Equity market performance in the week. The former more supportive, the latter more mixed.

Indeed, a WSJ article published last week reported a few Fed members willing to slow down with the rate hikes path; moreover, the Australian Central Bank and the Canadian Central Bank surprised with lower-than-expected rate hikes. Following that news, ECB used a more dovish language that referred to **"substantial progress" in fighting inflation and dropped the reference to raising rates "at upcoming meetings" effectively hinting to the market that it was open to a change of pace, at least the direction.**

Reporting continued with 43% and 40% of American and European companies, respectively, publishing quarterly reports. 73% of U.S. companies beat EPS expectations with a surprise around 2% and a y/y decline of 3%; good y/y growth for Energy, Industrials and Discretionary; negative growth, on the other hand, for Materials, Financials and Communication Services; revenues grew 9% y/y with a surprise of 2%. Positive reporting in particular for General Motors, Coca cola (with upward guidance revision) and UPS; for Apple numbers in line.

Challenging week instead for some mega caps especially in tech sector: Alphabet -9% on results with revenue and earnings misses; Microsoft -8% with beat in both revenue and earnings, but disappointing growth in cloud platform; Texas Instrument with soft outlook on current quarter and comments on weakness in personal electronics/industrial sectors; Amazon -12% in after hour for weakness in cloud and guidance cut; Meta -25% for disappointing guidance on 2023 and much higher than expected capex. In Europe, 60% of companies beat expectations, with y/y growth of +5% and EPS surprise almost zero (+4% ex financials and RE); also in Europe Energy and Industrials reported good y/y growth levels, negative growth for Communication Services, Financials and IT; revenues up 20% y/y with positive surprise of 1%.

EQUITY MARKETS	LEVEL		Δ WEEK
MSCI World AC	2 561,04	▲	4,0%
S&P 500	3 901,06	▲	4,0%
NASDAQ Composite	11 102,45	▲	2,2%
SX5E	3 613,02	▲	3,9%
DAX	13 243,33	▲	4,0%
CAC 40	6 273,05	▲	3,9%
FTSEMIB	22 529,20	▲	4,5%
IBEX 35	7 916,50	▲	4,9%
FTSE 100	7 532,95	▲	1,1%
MSCI Emerging	845,58	▼	-2,2%
CSI 300	3 541,33	▼	-5,4%

VOLATILITY	LEVEL		Δ WEEK
VIX (S&P 500)	25,75%	▼	-13,3%
V2X (SX5E)	24,89%	▼	-10,6%

Source : Bloomberg, as of 2022.10.31

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GOVERNMENT AND CORPORATE BOND MARKETS

Following the RBA's dovish hike at the beginning of October, the BoC also surprised on the dovish side, signaling a slow-down in the tightening pace. This is arguably a more meaningful signal given that the BoC remains the only G7 central bank to have hiked by 100 bps in one step. Neither central bank is currently signaling that they are close to stopping, but it is clear that concerns about the cumulative amount of hikes are rising, contributing to the rally in global bond markets.

Markets also interpreted the ECB as dovish, with lower terminal rates, a bull steepening of the curve, tighter peripheral spreads and a weaker EU, especially as there seemed to be no firm commitment to start discussions on balance sheet reduction. This week the focus will be on the Federal Reserve meeting, which is expected to deliver another 75bp rate hike. Attention will turn to J. Powell's words, which may offer a slightly stronger hint that it is reasonable to expect lower rate hikes at subsequent meetings.

US government bond yields rose and the curve flattened on expectations of next week's meeting. The Fed signaled it would discuss reducing the pace of hikes at the November FOMC and the Bank of Canada surprised with a lower-than-expected hike. Financial conditions eased in response: 10-year real rates fell 25bps, equities rose 4%, and the US dollar weakened about 2%. The market strongly desires a turnaround; we suggest caution: slower does not mean lower.

Credit markets recorded a positive week with activity levels picking up and renewed real money side buying flows. The markets' attention was focused on the Central Banks' meetings, first Bank of Canada on Wednesday and then ECB on Thursday, which while raising rates (by 50 and 75bp respectively) shifted the focus at the margin away from fighting inflation by inserting some nods to slowing growth. **The message picked up by the markets was of a pivot by the Central Banks that may not be far off and that much of the monetary tightening path can be considered done.** The reaction of risky assets and credit in particular has therefore been positive and also supported by the reporting season from which positive aggregate data and guidance are coming out that do not signal the slowdown that was seen in the anticipatory macro data.

GOV'T BONDS	LEVEL		Δ WEEK
US 10-year Yield	4,01%	▼	-20,4 bp
GER 10-year Yield	2,10%	▼	-31,4 bp
FRA 10-year Yield	2,61%	▼	-35,7 bp
ITA 10-year Yield	4,18%	▼	-57,2 bp

CORP BONDS	LEVEL YTW		Δ WEEK
USD Invest. Grade	5,87%	▲	1,97%
EUR Invest. Grade	2,60%	▲	1,59%
USD High Yield	8,99%	▲	2,44%
EUR High Yield	5,96%	▲	2,12%
Emerging Local ccy	4,52%	▲	1,03%
Emerging Hard ccy	8,14%	▲	2,16%

BOND SPREADS	LEVEL		Δ WEEK
Itraxx Main	112,07	▼	-13,1 bp
Itraxx Xover	547,576	▼	-54,7 bp
Itraxx Sub Fin.	216,86	▼	-27,6 bp
CDX North Am. IG	87,525	▼	-6,7 bp
CDX North Am. HY	500,51	▼	-41,6 bp

Source : Bloomberg, as of 2022.10.31

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COMMODITIES

The gas price shows a modest increase and is back above €110 per Megawatt-hour. The EU energy ministers are expected to meet on 24 November to decide whether to cap the gas price.

Oil price rises influenced by Bloomberg's news that the US and EU will settle for a tighter and higher oil price cap than previously expected, due to investor scepticism. The latter and the lack of adherence by China, India, Brazil and other trading partners could mean that the price ceiling is higher than the proposed $60 per barrel and will not have as big an impact on Russia's safe as expected. Even the World Bank is cautious, suggesting that the oil price ceiling is an untested mechanism and that for it to work properly it would require the participation of the major economies.

COMMODITIES	LEVEL		Δ WEEK
Gold	1 645	▼	-0,8%
Silver	19,26	▼	-0,8%
WTI	87,90	▲	3,4%
Brent	95,77	▲	2,4%
Copper	342,90	▼	-1,3%
Iron Ore	93,01	▼	-2,0%
Baltic Dry Index	15,32	▲	5,9%

Source : Bloomberg, as of 2022.10.31

EXCHANGE RATES

The main event of the week was the meeting of the ECB. The Central Bank was expected to hike rates by 75 bps (the second time in a row) and to modify one or both of the tools used to support Eurozone economy during the crisis, the TLTRO3 and the APP. The ECB didn't fall short of the expectations and delivered the hike and a change in the terms of the TLTRO3 in order to reduce the excess liquidity in the system. **The euro remained supported during the week in anticipation of this meeting, but after hearing from Mrs Lagarde that the growth outlook is now part of the reaction function of the Bank, the common currency depreciated somewhat and closed the week below parity.**

All the other G10 currencies appreciated against the Dollar: the best one was the Pound, supported by the change at the helm of the government: Mrs Truss resigned and Mr. Sunak (former finance minister during Boris Johnson premiership) become the new prime minister. This event allowed the pound to reduce the losses registered during the brief tenure of Mrs Truss.

EXCHANGE RATES	LEVEL		Δ WEEK
Dollar Index	110,75	▼	-1,1%
EUR/USD	0,9965	▲	1,0%
GBP/USD	1,1615	▲	2,8%
EUR/GBP	0,8581	▼	-1,7%
EUR/CHF	0,9924	▲	0,9%
USD/JPY	147,60	▼	0,0%
Bitcoin/USD	20 636	▲	7,6%

Source : Bloomberg, as of 2022.10.31

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