Looking back on 2023: markets rallied on the back of lower inflation with limited impact on growth

Resilient economic activity, easing inflation and expectations of a pivot in monetary policy enabled the main asset classes to end the year on a particularly favourable note.

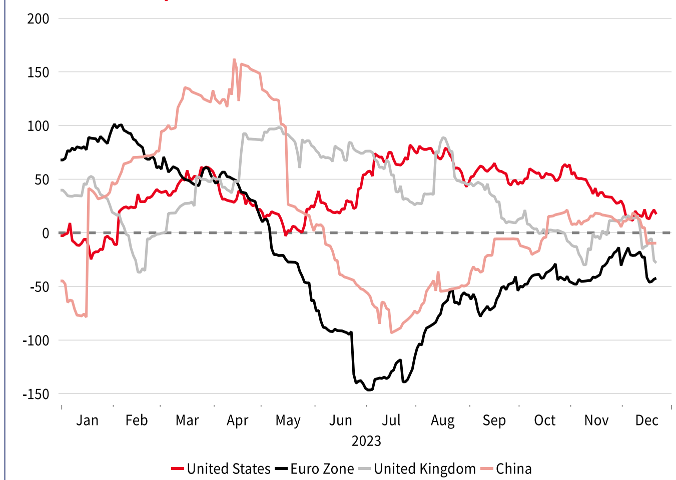
Resilient developed economies – especially the United States. Analysts were surprised by how well growth held up in 2023. In fact, despite continued monetary tightening and banking-sector turbulence in the first quarter, the major economies posted positive growth for the year. Activity in the United States proved especially solid thanks to robust consumer spending and a return to accommodating fiscal policy. Europe held firm as well but struggled more, posting muted growth for the year, boosted by Spain and Italy but hobbled by Germany. The United Kingdom was also more resilient than expected by the consensus, which predicted a recession in response to tension caused by higher interest rates. Meanwhile, China's recovery continued to lag, with weak consumption after three years of pandemic restrictions and a still sluggish real estate market.

Inflation continued to normalise. Inflation declined substantially in most major economies. Lower energy prices and the normalisation in durable goods prices played a part in the sharp drop in inflation, particularly in the second half of the year. Core inflation (ex-energy and food) was also down but remained well above the central banks' 2% target, specifically due to persistently high services prices. In response, monetary authorities continued the tightening cycle they began in 2022, before pausing in recent months: the Federal Reserve (Fed) last hiked in late July, the Bank of England (BoE) in early August and the European Central Bank (ECB) in September. While the Bank of Japan (BoJ) did soften the terms of its yield curve control policy, it stood apart for having kept its key rates unchanged. Overall, the positive surprise of 2023 was the decline in inflation with no major impact on growth or the job markets.

Financial markets finished on a high note. The year was characterised by elevated volatility in equity and bond markets. The equity markets had quite a positive start to the year in Europe and China against a backdrop of higher energy prices and stronger growth forecasts. While March's banking crises curbed their ascent, the equity markets quickly recovered, driven by the first conclusive results from the US artificial intelligence sector and the outlook for reflation in Japan. Most equity indices are ending the year with double-digit growth thanks to resilient corporate earnings (like 2023's economic growth) and the outlook for 2024 of a soft landing and rate cuts. The latter two factors also explain the bond markets' strong recovery at year's end, enabling them to finish in the green after a very volatile year. Overall, the key takeaway from the markets in 2023 is that financial assets can perform well despite high real rates, as long as growth stays on track against a backdrop of expectations of AI-led productivity gains.

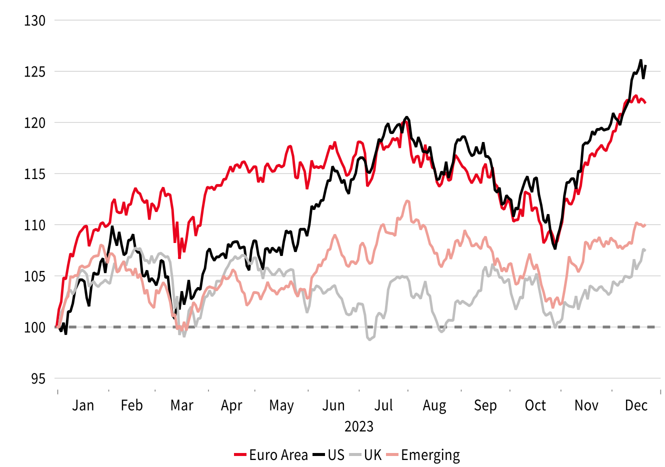
Our preference for US equities and highly-rated corporate bonds remains unchanged. For 2024, we expect a soft landing in the US and continued weak growth in Europe. We are therefore maintaining our overweight on US equity markets. We are also counting on a gradual fall in inflation and modest central banks rate cuts. This scenario remains favourable for bond markets, especially corporate bonds, particularly in terms of crystallizing current yields. In addition, the default rate of highly-rated companies is likely to remain moderate, thanks to healthy balance sheets.

Economic surprises indexes



Sources: SGPB, Macrobond, Citi 21/12/2023

Equity Market Performances (100=01/01/2023)



Sources: SGPB, Macrobond, MSCI 21/12/2023

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OUR MACRO COMMENTS

Events of the week

UK inflation surprised on the downside in November, reaching 3.9% year-on-year against expectations of 4.4%, the lowest since September 2021. The biggest contribution to this easing came from transport (petrol and car prices). All other components also softened in November. Core inflation was lower than expected, at 5.1% vs. 5.7%. This easing of inflation led to a 30bp drop in 10-year yields and a marked equity market outperformance this week.

As they are due to be reactivated on January 1, 2024, EU members have agreed on a reform of the European budgetary rules. Once officially adopted, these rules may prove more country-specific as the focus will be debt sustainability assessment. They should also encourage a less pro-cyclical fiscal policy. Nevertheless, "safeguard" measures to force member states to reduce their deficits could lead to drastic austerity policies for the most indebted countries.

Following numerous attacks on merchant ships, several companies have decided to stop using the Suez Canal for the transit of their goods. This poses a risk to world trade, which is already under stress due to the drought in the Panama Canal (around 12% of world trade passes through the Suez Canal). This situation could fuel inflation concerns, especially as much of the world's oil and gas transits through the Suez Canal. Although there has been no impact on oil prices or markets for the time being, this is something to keep an eye on for 2024.

Figures of the week

	Actual	Forecast	Last
Inflation (November, YoY)	3.9% ↓*	4.4%	4.6%
Core Inflation (November, YoY)	5.1% ↓	5.6%	5.7%
Retail Sales (November, YoY)	0.1% ↑	-1.3%	-2.5%
Inflation (November, YoY)	2.8% ↓	2.6%	3.3%
Core Inflation (November, YoY)	2.5% →	2.5%	2.9%
Business Confidence (December)	100 ↑	98	99
Consumer Confidence (December)	89 ↑	88	88
Ifo Business Climate (December)	86.4 ↓	87.8	87.2

Sources : Macrobond, December 22th 2023.
*Arrows represent variation from consensus

The week ahead

Tuesday

Unemployment rate (November)

Wednesday

BoJ Summary of Opinions

Thursday

Industrial Production (November)
Retail Sales (November)

Friday

Inflation (December)

Chicago PMI (December)

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MARKET PERFORMANCES

Interbank rates	Last.	-1W	-3M	YTD	-12M
€STER O/N	3,90	3,91	3,90	1,91	1,90
USD SOFR O/N	5,31	5,31	5,30	4,30	4,30
JPY TONAR O/N	-0,01	-0,01	-0,06	-0,02	-0,07
GBP SONIA O/N	5,19	5,19	5,18	3,43	3,43
CHF O/N	1,68	1,66	1,88	0,80	0,80

Long term sov. rates	Last.	-1W	-3M	YTD	-12M
10Y OAT	2,48	2,71	3,24	2,98	2,83
10Y Bund	1,97	2,17	2,70	2,44	2,30
10Y BTP	3,56	3,88	4,46	4,55	4,42
10Y JGB	0,64	0,74	0,71	0,41	0,47
10Y Bonos	2,92	3,17	3,75	3,51	3,37
10Y Swiss	0,62	0,66	1,10	1,57	1,43
10Y Gilt	3,61	3,91	4,24	3,66	3,56
10Y USTnote	3,86	4,04	4,35	3,88	3,68

Credit & EM	Last.	-1W	-3M	YTD	-12M
EUR Corporate Aaa	2,70	2,92	3,59	3,12	2,95
EUR Corporate Baa	3,79	4,06	4,66	4,65	4,46
GBP Corporate Baa	4,30	4,65	5,14	4,59	4,54
USD Corporate Aaa	4,46	4,56	5,03	4,62	4,46
USD Corporate Baa	5,36	5,49	6,11	5,70	5,54
USD EM aggregate	7,07	7,35	7,79	7,52	7,41

Commodities	Last.	-1W	-3M	YTD	-12M
Brent, USD/BL	79,11	6,1%	-15,0%	-8,0%	-3,8%
Or, USD/oz	2 031	0,2%	5,2%	11,2%	11,9%
Copper, USD/metric ton	8 567	3,2%	2,8%	2,0%	2,6%
Platinium, USD/oz	954	2,5%	1,0%	-10,4%	-4,5%
Palladium, USD/oz	1 200	23,0%	-6,0%	-32,9%	-29,7%
Silver, USD/oz	23,97	5,5%	3,0%	0,1%	0,3%

FX rates	Last.	-1W	-3M	YTD	-12M
EUR/USD	1,09	1,5%	2,3%	2,4%	2,9%
EUR/CHF	0,94	-0,1%	-1,5%	-4,2%	-3,9%
USD/GBP	0,79	-1,1%	-2,2%	-4,9%	-4,4%
USD/JPY	143,70	-1,0%	-2,7%	9,9%	8,9%
USD/BRL	4,88	-1,6%	0,7%	-8,6%	-6,2%
USD/CNY	7,14	-0,5%	-2,1%	3,4%	2,2%
USD/RUB	90,62	0,6%	-6,0%	24,1%	26,6%

Equity indices	-1W	-3M	YTD	-12M
Developped markets	0,6%	3,0%	6,2%	6,2%
Euro area	0,1%	6,0%	17,6%	17,1%
Germany	-0,2%	6,0%	18,9%	18,7%
France	0,7%	3,4%	15,0%	15,2%
United Kingdom	2,2%	-0,2%	3,5%	2,9%
Switzerland	-0,4%	-0,1%	3,9%	2,8%
United States	-0,2%	6,7%	22,4%	21,1%
Japan	-0,2%	-2,4%	24,2%	24,1%
Brazil	1,0%	10,2%	23,0%	21,8%
Hong Kong	2,4%	-7,1%	-16,0%	-13,3%
India	1,3%	5,5%	15,3%	15,5%
China	-2,1%	-11,0%	-14,8%	-13,9%

Source: Bloomberg, on December 21th, 2023.
-1W = 1-week change, -3M = 3-month change, -12M = 12-month change, YTD = year-to-date change. Equities; total return in local currency. Government bonds = 10-year returns. Figures are rounded.

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