

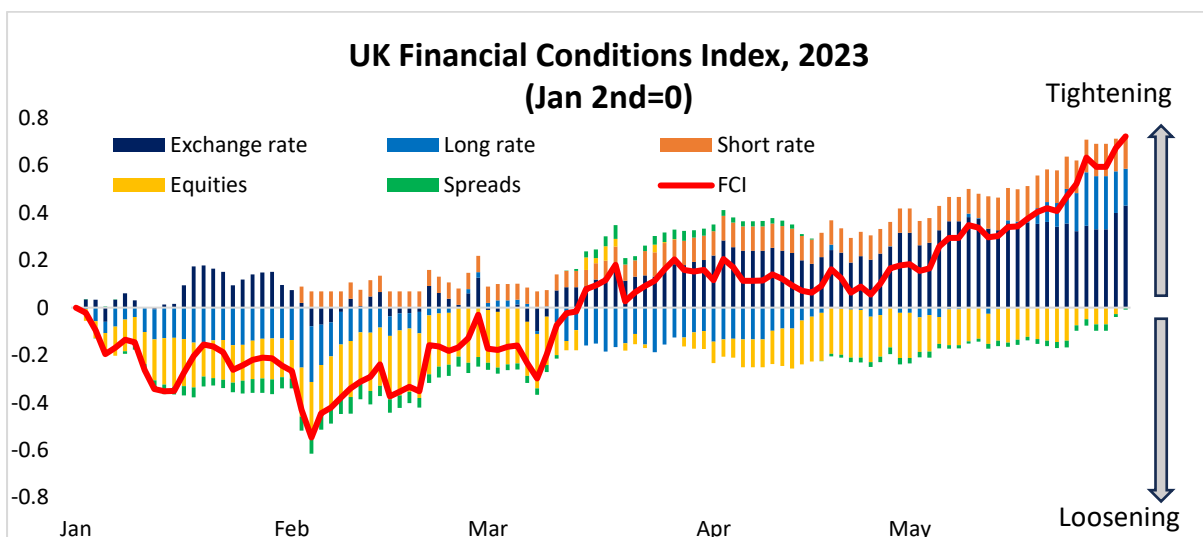
# Financial Markets Monitoring

June 2023

**Financial conditions have tightened rapidly over the past month. The Bank of England raised its key policy rate to 4.5% early in May, but later in the month, gilt yields ticked up sharply and equity prices slipped as higher-than-anticipated inflation data spooked investors. Meanwhile, global financial conditions have remained volatile as investors reacted to the news-flow on US debt-limit talks and another regional US bank fell victim to the sharp rise in US interest rates.**

Having stabilised during April, financial conditions tightened steadily from early May as generally better-than-expected economic data dispelled any doubts that the Bank of England would raise interest rates further on 11<sup>th</sup> May (which it duly [did](#)). Expectations for further monetary tightening in the months ahead strengthened later in the month, with the release of a higher than anticipated [CPI](#) figure of 8.7% for April (economists had expected 8.2%).

In the inflation data for April, core inflation (which excludes more volatile components like food and energy) rose to 6.2% and food inflation remained close to its 45-year highs at 19%, suggesting price pressures are proving more persistent than expected. The release of this data prompted a re-pricing of financial assets: gilt yields rose sharply; and UK equities dropped, with the FTSE 100 falling nearly 2% in the first hour of trading on 24<sup>th</sup> May. The broader FTSE all-share index has now lost all its year-to-date gains. As of end-May, Overnight Index Swap figures suggested that market expectations for the Bank of England's key rate 12-months ahead stood at 5.1%, up from 4.7% on May 2. For further information on the latest inflation data, read our update [here](#).



*Note: The Financial Conditions Index above is a weighted average of changes in a variety of indices designed to capture broad movements across financial markets. It was constructed by the CBI, but based on research by Goldman Sachs.*

Sources: CBI; Goldman Sachs; Macrobond.

The impacts of these shifts in asset prices can be seen in a composite Financial Conditions Index (see chart), which shows that credit conditions have tightened further relative to earlier in the year. Despite some loosening over the first quarter due to rising equities and falling gilt yields, recent increases in interest rates by the Bank of England, an upwards tick in gilt yields and an appreciation of the pound against a basket of other currencies (including the US dollar, euro and yen) since March have left credit conditions significantly tighter than on Monday, 2<sup>nd</sup> January.

Meanwhile, developments in the US have been dominating the global financial news in recent weeks. Investors received some good news in late May as President Biden and the House Speaker Kevin McCarthy reached an agreement to suspend the US debt ceiling until January 2025. News of this agreement triggered a mini market rally as the chances (already low) risk of an imminent debt default evaporated.

In less welcome news, the US banking crisis continued into May. On 1<sup>st</sup> May, US regulators took possession of First Republic and later passed all of the struggling bank's assets onto JP Morgan. This was the third failure of an American bank since March and the largest bank failure since 2008. First Republic was yet another victim of the uncertainty that has gripped US regional banks following the collapse of Silicon Valley Bank and Signature Bank (alongside major Swiss bank Credit Suisse). However, the swift response from authorities as well as financial regulations put in place following the 2008/09 banking crisis mean a systematic failure of the international banking system remains unlikely.

If you'd like to know more about what the recent banking stress means for your business, you can read more about the turmoil [here](#).

## Further details

*The bullets below summarise developments over the month of May, since the opening of currency markets on Monday 1<sup>st</sup> May and of UK equity and gilt markets on Tuesday 2<sup>nd</sup> May, to the close of markets on Wednesday 31<sup>st</sup> May.*

### **The pound depreciated against the dollar, but gained strength against the euro.**

- May saw the pound lose strength against the dollar, with sterling depreciating 1.2% from \$1.26 on May 1<sup>st</sup> to \$1.24 on 31<sup>st</sup> May. Meanwhile, the pound stood at €1.16 on 31<sup>st</sup> May up from €1.14 on 1<sup>st</sup> May.

### **Short and long term-dated government bond yields jumped up in May in response to a higher-than-expected inflation reading.**

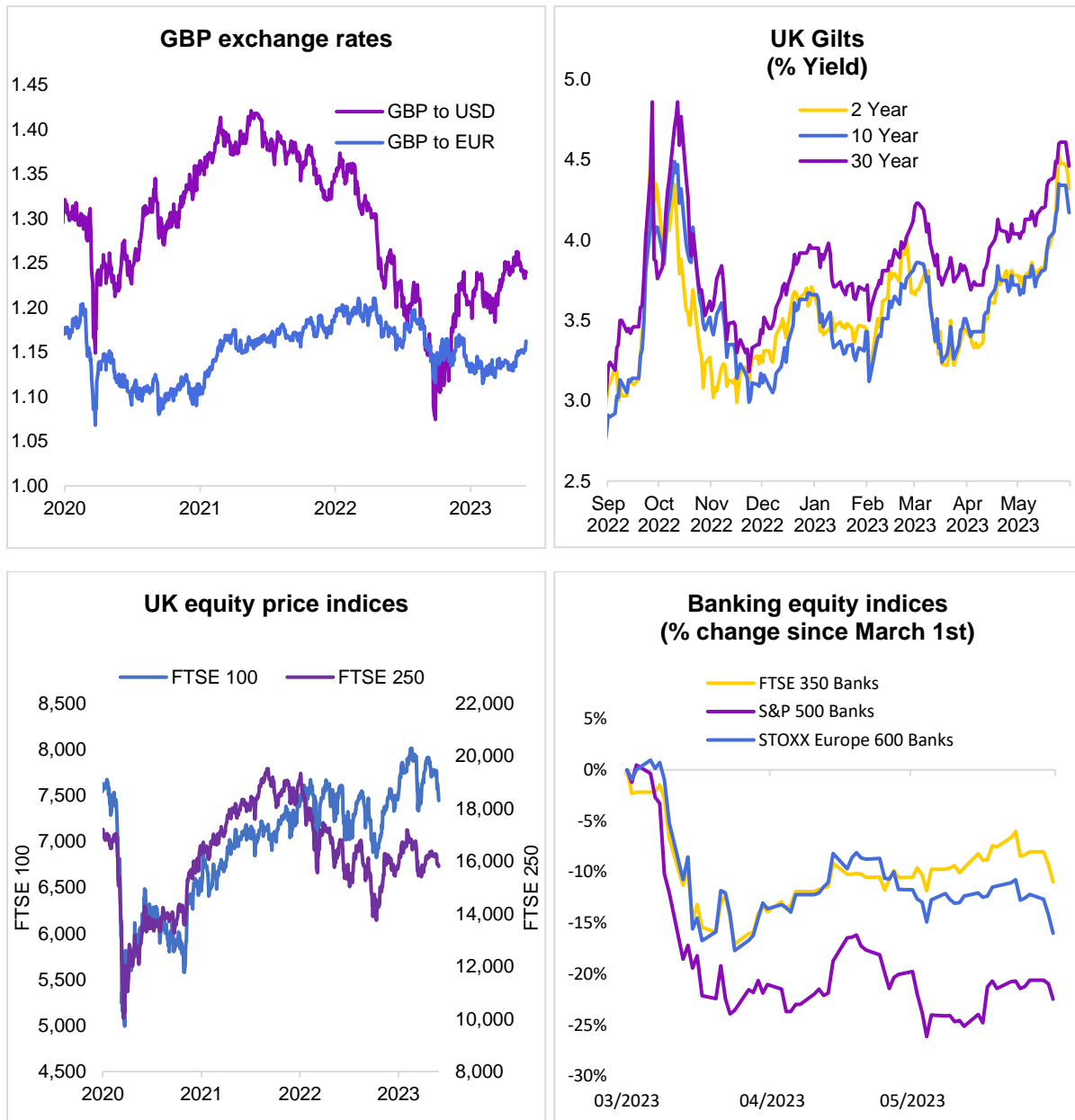
- The 2-year gilt yield stood at 4.3% as of 31<sup>st</sup> May, a considerable jump from 3.7% on 1<sup>st</sup> May.
- Yields on long-dated 10-year and 30-year gilts also rose, though at a slower pace – to 3.5% (from 3.7%) and 3.8% (from 4.1%), respectively. This leaves long-dated gilts close to the highs seen in the aftermath of the “mini”-Budget in October 2022.

### **UK equity markets struggled, pulled down by an above consensus inflation reading on Wednesday, 24<sup>th</sup> May**

- UK equity markets fell in May, primarily due to a higher-than-expected inflation, which raised prospects of interest rates rising above 5%. The FTSE 100 lost 5.4% of its

value through the month, erasing all of its year-to-date gains. The more domestically focused FTSE 250 lost 3.6%.

- The headline European index (STOXX Europe 600) also lost value (-3.3%), whereas the US S&P 500 gained 0.3%.
- Banking stocks continued their weak performance as SVB and Credit Suisse were joined in bankruptcy by First Republic (the biggest bank failure since the 2008 financial crisis). The FTSE 350 banking index has lost 11% of its value since the beginning of March when SVB collapsed, while European and American banking indices have fallen 16% and 22.5%, respectively.



Sources: CBI; Macrobond.

**If you have any feedback on this article or would like to share any insights into the trading conditions currently facing your business, please contact us at:**

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