

MARKET COMMENTARY

KEY INFORMATION ON THE MACROECONOMIC SITUATION – A SUMMARY OF 2023

INTEREST RATES AND INFLATION

We entered the new year with the ongoing hot war in Ukraine caused by Russia, high inflation, tight monetary policy and concerns about the state and prospects of the global economy. The stabilizing and declining in the second half of 2023, industrial inflation rates (PPIs) began to impact consumer inflation (CPIs) and one of the first major signs of optimism was a reversal of the inflation trend and the entry of CPIs onto a downward path. These declines were faster in economies that did not apply anti-inflation shields. This gave rise to investor hopes that the cycle of rising interest rates was coming to an end. The decline in pessimism was relatively short, however, as parts of the US banking sector were hit by rising interest rates, a tightening of monetary policy and falling US bond prices. The US FED had no mechanism worked, which greatly improved sentiment. Since the middle of the year, sentiment started to improve, despite worsening real economic data in major global economies (except the US) and ongoing interest rate hikes by central banks. Such behaviour could be interpreted as anticipating a shift in monetary policy stance relatively soon and an upcoming phase of the economic cycle in the form of a disinflationary recovery. But there followed some desynchronisation between US economic growth and the performance of the rest of the world's major economies. While other economies experienced economic slowdowns, in the USA monthly and quarterly data improved. This had a positive impact **on the US stock market, which was a driving force for the rest of the world**, despite worse (but not very bad) data from other economies, where we had to do with a “soft landing”. Differences in the dynamics of the main economic data influenced inflation projections and growth projections and, consequently, central bank decisions. For example, in the Czech Republic and Poland, the central banks no longer increased interest rates, communicating a potential end to the cycle of increases and an inclination to start reductions, while the FED and the ECB continued to raise interest rates. Contrary to expectations, FED actions did not hamper the US economy, as monetary policy makers anticipated, which in the middle of the year, given the still very good US consumer situation, slowly dispelled investor expectations of an imminent end to the cycle of rises and of rapid interest rate cuts as a result. The rising expectations that interest rates would remain high in the US for a prolonged period of time dampened confidence since the beginning of August, which translated into declines in equity markets. In Poland, the most important third quarter event was the first interest rate reduction by 75 bps by the Monetary Policy Council in September, which came as a major surprise to the market. Initially, the market received this decision very negatively, regarding it as a harbinger of greater troubles in the Polish economy than expected. However, after the inflation data, especially compared to the projection and other economic figures, confidence improved. The beginning of the last quarter of 2023 in Poland was marked by another reduction in interest rates, this time by 25 bps, and by the parliamentary election after which the Polish stock exchange received a clear growth boost. At that time, however, geopolitical tensions came to the fore. Hamas attacked Israel and a war in the Middle East began. The response of the markets was negative as, in

the context of the Fed's fears of a repetition of the 1970s inflation scenario and the pressure of this new situation on the global economy, fears of a tighter monetary policy in the context of weak economic growth increased. The reversing factor was November's lower-than-expected reading of US inflation in October. The end of the year was very good for the stock market.

STOCK INDICES

Throughout 2023, the Polish broad equity WIG index increased by 36.54%. Both large companies and companies with smaller stock market capitalization contributed to this. Two sectors of the Polish stock exchange ended 2023 with negative returns, namely the WIG-CHEMIA chemistry index (-4.16%) and the WIG-SUROWCOWY commodity index (-6.45%). The best sectors were the WIG-BUDOWNICTWO construction index (86.88%) and the WIG-BANKI (76.94%) banking index, with other sectoral indices rising from 9.23% to 38.07%. At that time, all segments of the Polish market were still very strongly correlated with one another and returns were very close. The mWIG40 index performed relatively best (39.26%). The sWIG80 and WIG20 indices were at 30.91% and 30.75%, respectively.

The stabilization of inflation levels, good data from the US economy and the prospect of economic slowdown and of the FED reducing rates **facilitated valuations of selected segments of US equity**. The technology share segment was the best performer in the USA. The value of the NASDAQ COMPOSITE index increased by 43.42% and of the narrower NASDAQ 100 by 53.81%. The slightly broader S&P 500 GROWTH index increased by 28.35%. The S&P 500 VALUE index increased by 19.77%. Shares from major European stock exchanges also gave cause for satisfaction. Germany's DAX grew by 24.28% and CAC40 by 16.52%.

For **stock exchanges from the Emerging Markets** group, 2023 was a year of positive returns, but not as successful as for stock exchanges from developed countries. The MSCI Emerging Markets index was 7.04% higher at the end of 2023 than at the beginning of the year, with the best performance by the Latin American (MSCI Emerging Markets Latin America +25.11%) and European (MSCI Emerging Markets Europe +25.22%) stock exchanges. Asia was the worst performer, primarily due to China, with MSCI Emerging Markets Asia returning 5.57% (MSCI Emerging Markets China: - 13.31%).

BOND MARKET

In Poland last year was a year of falling inflation levels after the highest increases in a decade. CPI inflation reached 18.4% y/y in February and, according to preliminary data, it was 6.1% y/y at the end of December. This fostered expectations of a change to a less restrictive monetary policy and of the Monetary Policy Council being more likely to reduce interest rates. Such moments in the economic cycle have historically **promoted yield declines and bond price increases**. The first interest rate reduction, which surprised the market, as interest rates were cut by 75 bps, was in September, followed by 25 bps in October. As a result, interest rates fell from 6.75% to 5.75% throughout the year.

All this translated into positive reactions of market indicators:

- WIBOR 6M fell from 7.14% to 5.82%

- the two-year interest rate swap (IRS) rates, pending further interest rate cuts, fell from 6.92% to 4.25% in September to end the year at 4.92%.

The **government bond market responded very positively** to this development.

For **fixed coupon bonds**, yields fell along the entire length of the yield curve. As a result, the increase in value affected bonds with a wide spectrum of maturities. Due to the sensitivity of bond prices to changes in yields (the so-called modified duration), long-term bonds grew the most in value. The increase in the value of the Polish government bond index with maturity ranging from 1 to 3 years amounted to 8.63%, for 3-5-year bonds to 13.21% and for 7-10-year bonds it amounted to 20.68%.

The prices of **variable-rate government bonds** also increased as a result of, among other things, a decrease in the discount margin (i.e. the expected rate of return on a variable-rate security relative to the yield of its benchmark).

On the **domestic corporate bond market**, 2023 should also be regarded as a very successful year. The main factors supporting the market situation included: rapidly declining inflation and the resulting government bond yields, initially stabilization, and since September the first interest rate cuts, increasing inflows to debt funds, especially corporate bond funds, growing optimism among investors and consumers about the economic situation, and improved sentiment of foreign investors towards our region. As regards the situation in particular industries, it is worth mentioning the very good performance of banks benefiting from high interest rates and a clear recovery in the real estate market, especially after the introduction of the Safe Loan programme since July. In the context of increased demand, the activity of corporate bond buyers increased significantly, initially mainly in the aftermarket and, after summer holidays, also in the primary market. This led to a significant narrowing of credit margins, which combined with rising government bond prices and still high interest rates allowed corporate bond funds to achieve the highest returns over the years. The outlook for the next months is also positive – the economic situation has been improving markedly in recent months, interest rates remain relatively high and credit spreads, despite a strong decline last year, are still higher against historical values.

Accelerating disinflation impacted the global economy as a whole. However, yield and bond price dynamics were quite diverse and were more closely linked to monetary policy and concerns that the period of higher interest rates would last longer than originally assumed. Thus, for most of the time 2023 was a continuation of declines on the **bond markets in countries such as the US, the UK, Germany and Japan**. Yield growth peaked in late October and **bond prices began to rise rapidly** since then. By a toss of the belt, US 10-year government bonds ended the year with a positive return.

Higher interest rates, falling US bond prices (rising yields) and general volatility in the debt market also shaped the **emerging market bond market** trends. Their prices fluctuated significantly in 2023. The first half of the year was good, the third quarter was very poor and the end of the year was excellent. Profitability, on average, declined from 6.95% to 6.19% throughout the year. Bond prices were also affected by the impact of the fluctuating value of the US dollar on the values of local currencies. The Emerging Market Currency Index (EMCI) rose at the beginning of the year, decreased again in February and started to follow a lateral trend. On

the other hand, the end of the year was successful and the entire index ended the year at a level 4.85% higher as compared to the end of 2022. As a result, investors who had invested in emerging market bonds had reasons to be satisfied.

In the **USD and EUR bond** markets, two opposing trends clashed over the first 3 quarters of last year: on the one hand, government bond yields in the underlying markets rose due to the hawkish rhetoric of the major central banks (the Fed and the ECB) and, on the other hand, corporate bond credit spreads declined due to improved investor sentiment, especially in our region (CEE). This resulted in a relatively small but systematic **increase in valuations of Eurobonds** in fund portfolios. The situation improved significantly in the fourth quarter, as yields in the underlying markets fell sharply, which, with still narrowing credit spreads, significantly supported the pricing of corporate bonds. As a result, hard currency bonds may rank 2023 as a very successful year.

COMMODITIES

As in 2022, in 2023 commodity prices were affected by geopolitical events. Despite the ongoing war caused by Russia's aggression against Ukraine, the global supply chain tensions eased and the lower global demand and deteriorating situation in the manufacturing sector lowered the demand for commodities and, as a result, their prices decreased, with the Bloomberg Commodity Index very volatile. As a result, the primary fuel segment ended the year with a decrease of 25.59% (despite the tense situation in the Middle East), the agricultural goods segment with a decrease of 9.24% and the industrial metals segment with a decrease of 13.72%. The only positive return segment was precious metals, which accounted for 4.11%. As a whole, the Bloomberg Commodity Index ended the year with a return of -12.55%.

GOLD

After very volatile 2022, the value of gold continued to be highly volatile in 2023. After breaking the \$2,000/oz level in the second quarter of 2023, it fell again to \$1,800. The rise in geopolitical tensions in the third quarter of 2023, including the situation in the Middle East, and expectations of the FED reducing interest rates and of a weaker dollar, again positively impacted to the price of gold. At the end of October, the price again surpassed \$2,000 per ounce and the year ended at \$2,062.98/oz, which means an increase of 13.10%.

[Watch forecasts for 2024](#)

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