CENTRALNA BANKA CRNE GORE

Financial and Banking Operations Department

- International Reserves Management Division -

International Financial Market Report

(18 - 22 July 2022)

Podgorica, 27 July 2022

FX NEWS

EUR/USD

Source: *Bloomberg LP*

The **EUR/USD exchange rate** had appreciated at the beginning of the week as traders lowered expectations regarding the speed at which the Fed would increase the interest rate. (At the next meeting, the Fed is expected to increase the interest rate by 75 instead of 100 basis points). Announcements that the ECB will increase the interest rate at the upcoming meeting by 25 basis points or 50 basis points influenced the euro to appreciate against the USD for the rest of the week. The USD retreated further on relief that Europe could avoid the worst fears of energy shortages (Russian gas flows via the Nord Stream 1 pipeline will restart later this week after scheduled maintenance) and the prospect of a more aggressive ECB interest rate increase. On Wednesday, the EUR/USD exchange rate depreciated due to uncertainty regarding Italy and whether Mario Draghi will resign, i.e. whether the country's Government is on the verge of collapse since the three political pariahs who are part of the coalition did not vote. The exchange rate appreciated to almost 1.0280 the next day as the ECB rate increased by 50 basis points and depreciated to 1.0233 at the end of the day. The exchange rate depreciated due to the lack of details regarding the ECB's further moves regarding the interest rate increase and the new instrument. The exchange rate did not register significant changes on Friday and hovered around 1.020.

EUR/GBP

Source: *Bloomberg LP*

The **EUR/GBP exchange rate** fell at the beginning of the week as expectations grew that the BoE could increase the interest rate at the August meeting by 50 basis points instead of the expected 25 basis points. The sterling depreciated on Tuesday amid political instability as Britain faces fierce competition to replace ousted Prime Minister Boris Johnson. Strong data from the UK labour market recovered sterling (296 new jobs were created in the past three months, much more than expected (170 thousand), while the unemployment rate remained at 3.8% in May, as expected). The EUR/GBP exchange rate fell on Wednesday after announcing that the inflation rate reached its peak value in 40 years in June, raising expectations that the BoE would raise interest rates by 50 basis points at its next meeting. On Thursday, the exchange rate rose as the sterling depreciated on the announcement that interest payments on British government bonds reached a record high in June due to rising inflation. At the very end of the week, the sterling was slightly stronger against the euro after announcing that monthly retail sales in June fell less than expected, while the manufacturing index rose in July to 52.2.

EUR/JPY

Source: *Bloomberg LP*

In the first half of the week, the **EUR/JPY exchange rate** mostly appreciated. According to a Reuters survey, Japan's economic growth will be slower than previous estimates as risks from a global economic slowdown and supply woes plague Japanese exporters. Central banks worldwide are increasing the interest rate significantly, which will soon happen at the ECB meeting, unlike the BoJ, which firmly sticks to an expansionary monetary policy. In the middle of the week, the EUR/JPY depreciated as the Japanese Government appointed a new member to the Board of the BoJ, which could potentially lead to a change and gradual withdrawal of the ultra-loose monetary policy implemented by the central bank. Namely, the BoJ appointed Hajime Takata to be a BoJ Board member, and he is known as an economist who warned about the adverse effects of monetary easing. After the ECB decided to increase the interest rate, the EUR/JPY exchange rate depreciated. The EUR/JPY exchange rate continued to depreciate on Friday as concerns about the global economic recovery renewed. Some sources point out that the Japanese authorities are expected to reduce their GDP forecast for 2022 to 2%, instead of the previously forecasted 3.2%, due to the significant uncertainty prevailing in the global market.

Table 1 - Exchange rates of the most important currencies

	18.07.2022[1]	22.07.2022[2]	% Change
EUR/USD	1.0080	1.0213	1.32
EUR/GBP	0.85015	0.85093	0.09
EUR/JPY	139.630	139.000	-0.45
EUR/AUD	1.48364	1.47427	-0.63
EUR/CHF	0.98465	0.98324	-0.14
USD/JPY	138.570	136.120	-1.77
GBP/USD	1.18550	1.19990	1.21

Table 2 - Overview of the reference interest of the leading central banks

Central Bank	Reference interest rate name	Reference interest rate level	Next meeting
European Central Bank	ECB main refinancing rate	0.50%	8 September 2022
Federal Reserves	Federal Funds Target Rate	1.75%	27 July 2022
Bank of Japan	Overnight Call Rate	-0.10%	22 September 2022
Bank of England	Official Bank Rate	1.25%	4 August 2022
Swiss National Bank	Libor Target Rate	-0.25%	22 September 2022
Bank of Canada	Target Overnight Rate	2.50%	7 September 2022
Reserve Bank of Australia	Cash Rate Target	1.35%	2 August 2022

To the surprise of many, the ECB increased interest rates by 50 basis points, so the reference interest rate is now 0.50%, the interest rate on deposit facilities 0.00% and the interest rate on credit facilities 0.75%. The ECB has abandoned its previous "forward guidance" approach and adopted a new "meeting-to-meeting" approach to interest rate decision-making, meaning that upcoming decisions will depend on monthly data. The next ECB meeting is scheduled for September when further interest rate hikes are expected.
In line with expectations, the BoJ has not changed its monetary policy. The BoJ increased inflation forecasts more than expected, to 2.3% for the year ending in March.

Table 3 – ESTR and Euribor

	18.07.2022[1]	22.07.2022[2]	Change in basis points
ESTR	-0.582	-0.582	0.00
Euribor 1W	-0.565	-0.421	14.40
Euribor 1M	-0.317	-0.170	14.70
Euribor 3M	0.072	0.200	12.80
Euribor 6M	0.532	0.706	17.40
Euribor 12M	1.057	1.200	14.30

[1] Opening market value on Monday
[2] Closing market value on Friday

EUROPEAN GOVERNMENT BONDS MARKET

Source: *Bloomberg LP*

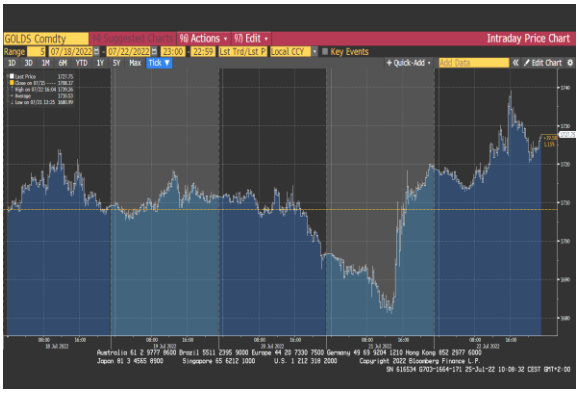
During most of this reporting week, the return on 10-year German government bonds trended up to 1.378% to fall sharply after the ECB meeting, resulting in a weekly decline. The rise in stock prices primarily caused the return rise after announcing that Russia would continue to deliver gas as planned, albeit in a reduced volume, which led to a decreased demand for safe assets. In addition, as the ECB meeting approached, expectations for an interest rate hike grew. The initial return reaction to the ECB's surprise 50 basis points rate hike was a return jump, but they were soon corrected. The return fell as traders lowered expectations for future interest rate hikes after the ECB meeting due to the release of weaker-than-expected economic data from the euro area, which fuelled recession concerns. (PMI fell to a 17-month low in July at the level that indicates a contraction), so on Thursday afternoon and the following day, the 2-year yield experienced the most significant drop since 2008 (by 31 basis points to 0.37%). The return on 10-year German government bonds fell to a 7-week low on Friday (slightly below 1%), amounting to 1.031% at market close and 1.144% at the start of the week. The return on Italian 10-year government bonds remained almost unchanged this week. However, they ranged from 3.16% to 3.66% during the week amid the uncertain political situation in Italy and the news that Prime Minister Draghi resigned the morning before the ECB meeting.

US GOVERNMENT BONDS MARKET

Source: *Bloomberg LP*

This week's return on 10-year US government bonds moved similarly to the German return. This return grew for most of the week, from 2.90% (Monday) to 3.08% (Thursday). However, the return fell sharply on Thursday and constantly weakened to stand at 2.73% at the market close on Friday. The rise in share prices on the stock exchanges caused an increase in the global appetite for risk, so the demand for safe assets decreased, which is why bond prices fell, and the return rose. The rise in the return also resulted from traders' expectations that the Fed will increase the interest rate by 75 basis points at this month's meeting but also awaiting the ECB meeting. On Thursday afternoon, after the mentioned meeting, the return on 10-year US government bonds began to fall sharply after publishing the Philadelphia Fed's survey of regional business activity in July was published with weaker than expected results (-12.3 vs 0.8). In addition, the composite PMI index, which includes both manufacturing and services, showed that business activity contracted for the first time since 2020, raising concerns about a US recession.

GOLD



Source: Bloomberg LP

The gold price was stable during the first two days of this week. The price dropped from Wednesday until the middle of Thursday. The drop came as the USD rose against most currencies. However, it recorded a sharp jump from Thursday noon, and the ECB increased the interest rate more than expected. On Friday, the gold price continued to rise due to concerns about global economic growth.

OIL

Source: Bloomberg LP

The oil price rose during the first two days of this reporting period. The oil price increase was caused by Saudi Arabia's refusal to commit to increasing oil production after the US President visited the country. During the rest of the week, the fuel price trended down due to the signal that this fuel's stocks increased in the USA. At the same time, the oil price drop also resulted from the worsening outlook regarding the demand for this energy because there are growing signals that the flywheel of economic growth in developed economies was lost.

Table 4 - Economic indicators (18 – 22 July 2022)

Current value	Indicator	Euro area	Expected value	Current value	Previous value
Euro area	**Consumer price index (CPI)** This indicator estimates the changes in the cost of living, measuring changes in the price level of the basket of consumer goods and services purchased by an average household. Therefore, it is a key measure of euro area inflation.	June MoM% (YoY%)	0.8% (8.6%)	0.8% (8.6%)	0.8% (8.6%)
	Consumer Confidence It measures consumer confidence in euro area countries. This figure is the result of a survey of euro area consumers in terms of their labour market finances, willingness to save, and expectations regarding the economy.	July	-24.9	-27.0	-23.6
Germany	**Producer Price Index (PPI)** This indicator measures the change in the price paid by domestic producers. The indicator rise is an early inflation indicator.	June MoM% (YoY%)	1.5% (33.7%)	0.6% (32.7%)	1.6% (33.6%)
Great Britain	**Retail Sales** This indicator measures changes in retail sales in the UK.	June MoM% (YoY%)	0.8% (11.8%)	0.9% (11.8%)	0.7% (11.7%)
	S&P Global/CIPS UK Services PMI The index was compiled based on responses to questionnaires sent as a panel to 650 companies from the service sector. Sectors covered include retail (except retail), transportation, information, communications, finance, insurance, real estate and business services. Data collection began in July 1996. Answers are collected in the second half of each month and indicate the direction of changes compared to the previous month. A score above 50 indicates that the services sector is generally expanding, while a score below 50 indicates its general decrease.	July	53.0	53.3	52.8
USA	**Initial Jobless Claims** It measures the number of people receiving unemployment allowances. Similar to the applicant, the growing number of jobs is accompanied by an economic expansion that could influence inflationary pressures.	16 July K=1.000	240 K	251 K	244 K
Japan	**Exports** Products and services produced in Japan, sold or pending for sale outside of Japan.	June YoY%	17.0%	19.4%	15.8%
	Imports Japan's demand for foreign products. The value of exports and imports is an important input in the calculations of the trade balance, current account and GDP.	June YoY%	46.3%	46.1%	48.9%

Source: Bloomberg