CENTRALNA BANKA
CRNE GORE

Financial and Banking Operations Department

- International Reserves Management Division -

International Financial Market Report

(24 – 28 July 2023)

Podgorica, 2 August 2023

FX NEWS

EUR/USD

Early this week, the **EUR/USD exchange rate** depreciated slightly, lasting until Tuesday's end. The depreciation in the mentioned period came after announcing that the composite PMI of the euro area fell to a 9-month low, suggesting that macroeconomic conditions in the euro area were worsening. On the other hand, the USD was supported by the publication of good data on consumer confidence in the USA. In the middle of the week, the exchange rate appreciated slightly despite the Fed increasing the interest rate by 25 basis points at its regular meeting. The exchange rate's appreciation continued until Thursday and the regular ECB meeting, when the exchange rate depreciated sharply after the meeting. It depreciated as the ECB President was much less sure about further interest rate hikes at a press conference, saying that a pause and an additional hike were possible in September. At earlier meetings, the ECB President strongly signalled interest rates increase. On Friday, the EUR/USD exchange rate recovered slightly as one of the key components for measuring US inflation showed signs of weakening, reducing pressure on the Fed to continue raising interest rates. The index measuring employee wages and benefits increased by 1% in Q2, the lowest growth rate since 2001.

EUR/GBP

The **EUR/GBP exchange rate** depreciated in this reporting week. The euro depreciated at the beginning of the week due to the published weaker-than-expected economic data. Preliminary data showed lower-than-expected manufacturing, services and composite PMI indices for the euro area for July, and the same was announced for Germany. In addition, the German IFO business climate index was also lower than expected for July. On the other hand, the sterling appreciated, as the IMF stated in its latest report that cheaper energy, better relations with the EU and calmer financial markets improved the UK's prospects since the beginning of 2023. The IMF has confirmed its May forecasts, and the British GDP is expected to grow by 0.4% this year and by 1.0% in 2024. In the middle of the week, the exchange rate did not show significant changes, and it fluctuated within a limited interval during the last two days. The reasons for this trend were the ECB meeting, which generally supported the euro. In contrast, the European Commission's report, which showed that the economic confidence of the euro area fell in June, harmed the euro. There were no significant data from Great Britain. On Friday, the BoE announced that Ben Bernanke, the former Fed Chair, would lead a review of the forecasting process at the BoE after criticism for failing to forecast inflation growth and its persistence.

EUR/JPY

During the first three days of this week, the **EUR/JPY exchange rate** slightly depreciated. The exchange rate depreciated until the regular ECB meeting, after which it experienced a sharp depreciation. The depreciation came after the ECB President said at a press conference that the Governing Council was "open minded" and could raise rates but also keep them at their current levels at the September meeting. The BoJ's announcement that it will adjust the return curve control programme by allowing the 10-year bond target to fluctuate 50 basis points above or below the target level also impacted the yen's appreciation. On Friday, the exchange rate recovered some of its losses during the week.

Table 1 - Exchange rates of the most important currencies

	24.07.2023[1]	28.07.2023[2]	% Change
EUR/USD	1.1124	1.1016	-0.97
EUR/GBP	0.86562	0.85739	-0.95
EUR/JPY	157.68	155.42	-1.43
EUR/AUD	1.65301	1.65624	0.20
EUR/CHF	0.96320	0.95841	-0.50
USD/JPY	141.73	141.16	-0.40
GBP/USD	1.2854	1.2851	-0.02

Table 2 - Overview of the leading central banks' interest rates

Central Bank	Reference interest rate	Reference interest rate level	Next meeting
European Central Bank (ECB)	ECB main refinancing rate	4.25%	14 September 2023
Federal Reserves (Fed)	Federal Funds Target Rate	5.50%	20 September 2023
Bank of Japan (BoJ)	Overnight Call Rate	-0.10%	22 September 2023
Bank of England (BoE)	Official Bank Rate	5.00%	3 August 2023
Swiss National Bank (SNB)	Libor Target Rate	1.75%	21 September 2023
Bank of Canada (BoC)	Target Overnight Rate	5.00%	6 September 2023
Reserve Bank of Australia (RBA)	Cash Rate Target	4.10%	1 August 2023

Fed, ECB and BoJ held monetary meetings last week.
Fed increased interest rates by 25 basis points each, in line with expectations. The statement after the meeting was almost the same as in June, and the only change concerned the tone when talking about economic activity, where instead of "modest", it was now described as "moderate". President Powell confirmed the inflation target of 2% and emphasised that the effects of previous increases still needed to be present, especially in the labour market, which has remained resilient. He reiterated that the Fed would continue with a "data-driven" approach, meaning that any future decision would depend on the state of the economy, so both a pause and a hike are possible in September.
As expected, the ECB increased interest rates by 25 basis points each. President Lagarde sounded less sure about further increases at the press conference, saying that a pause and an additional rise were possible in September, which would depend on published data, emphasising inflation reports. The ECB reduced the reserve requirement fee to 0%, which is lower than the current deposit rate. Analysts believe this would have a minimal impact because banks must hold a minimum amount of reserves, but they estimate that this move will save the ECB 6 billion euros.
At the BoJ meeting, the interest rate was not changed. Still, the adjustment of the return curve control programme was announced, i.e. taking a more flexible approach to controlling the return curve on 10-year bonds, allowing them to exceed the limit of 0.5%.

Table 3 – ESTR and Euribor

	24.07.2023[1]	28.07.2023[2]	Change in basis points
ESTR	3.3849	3.4040	0.00
Euribor 1W	3.394	3.465	7.10
Euribor 1M	3.502	3.585	8.30
Euribor 3M	3.721	3.725	0.40
Euribor 6M	3.972	3.958	-1.40
Euribor 12M	4.162	4.111	-5.10

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

EUROPEAN GOVERNMENT BONDS MARKET

The return on 10-year German government bonds fell at the beginning of the week as the production indices for Germany and the euro area were weaker than expected, indicating a possible reduction in economic activity in the coming period. The return also weakened due to the IMF's prediction that the volume of the German economy would decrease by 0.3% this year, instead of the previously predicted 0.1%, due to weakened production activity and the contraction that occurred in Q1. Weak IFO data from Germany put additional pressure on the return. After the ECB meeting on Thursday, the return first weakened due to Lagarde's statement that the next ECB meeting would depend on the data released by then and that the council was "open" to all options in September. However, by the end of the day, there was a recovery in demand for risky assets due to the stock price rise and the announcement that the US GDP in Q2 was better than expected. At the end of the week, the return fell as the July data showed that inflation in Germany was slowing down (the consumer price index fell 6.2% year-on-year vs. 6.4% in June). Muller from the ECB said that the subsequent political decisions were not obvious, while Vasle, also an ECB representative, said that a break in September was possible.

US GOVERNMENT BONDS MARKET

The return on 10-year US government bonds weakened on Monday morning following the announcement of weak data from the euro area, to recover in the afternoon awaiting the Fed meeting. The return rose on Tuesday as the IMF upgraded its forecasts for US GDP in 2023 and rising stock prices. The return weakened the next day as the Fed raised interest rates in line with expectations. Chairman Powell said further hikes would depend on upcoming data, raising market expectations that a September rate hike would be skipped. At the end of the week, the return on 10-year US government bonds rose on the back of encouraging US GDP data. Moreover, labour and real estate market data contributed to the increase in the return on the bonds mentioned above, which fuelled expectations that the Fed would continue to fight inflation by raising rates. US bond prices also rebounded on Friday on US economic data (personal income fell vs expectations in June; personal spending rose vs expectations; employee cost index, which includes wages, bonuses/benefits, social benefits, training costs, medical care, taxes, etc. were lower in Q2 compared to expectations (1% vs 1.1%).

GOLD

On Monday, the gold price did not change significantly, but it trended up from Tuesday until the middle of Thursday. The gold price's strengthening in this period occurred as the USD depreciated compared to a basket of currencies, and the return on American bonds declined. At the same time, awaiting the Fed's regular meeting and the signals it would give after the meeting influenced the growth of the gold price. On Thursday, the gold price experienced a sharp drop as strong economic data on the USA was published (the GDP of the USA increased in Q2 this year, initial jobless claims fell, and real estate sales increased). The gold priced recovered slightly on Friday.

OIL

The oil price trended up this week, with the most significant jump at the daily level in the oil price trend occurring right at the beginning of the reporting week. On Monday, the oil price rose as China signalled that it would introduce additional measures to boost economic growth, while on the other hand, OPEC+ members started cutting global production. During the rest of the week, the oil price rose after announcing that oil stocks in the US fell by 600,000 barrels last week. In addition, the increase in the oil price was influenced by the improved macroeconomic outlook of the USA and the optimism of investors regarding the fact that the strong demand for oil and cuts in production would keep oil at elevated levels in the coming period.

Table 4 - Economic indicators (24 – 28 July 2023)

Country	Indicator	Period	Expected value	Current value	Previous value
Euro area	**HCOB Eurozone Manufacturing, Services, Composite PMI** PMI surveys tracks opinion among procurement managers at manufacturing, construction and/or services firms. The index was obtained from the results of questionnaires related to production, orders, stocks, employment, prices, etc.	June Preliminary data	43.5 51.6 49.6	42.7 51.1 48.9	43.4 52.0 49.9
	Economic Confidence This indicator tracks confidence in the economy. The results are obtained by conducting surveys of households and companies.	July	95.0	94.5	95.3
Germany	**HCOB Germany Manufacturing, Services, Composite PMI** PMI surveys tracks opinion among procurement managers at manufacturing, construction and/or services firms. The index was obtained from the results of questionnaires related to production, orders, stocks, employment, prices, etc.	July Preliminary data	41.0 53.1 49.8	38.8 52.0 48.3	40.6 54.1 50.6
	IFO Business climate Monthly survey of companies in Germany (in production, construction, wholesale and retail), in terms of the current business climate and expectations for the next 6 months.	July	88.0	87.3	88.6
USA	**S&P Global US Manufacturing, Services, Composite PMI** PMI surveys tracks opinion among procurement managers at manufacturing, construction and/or services firms. The index was obtained from the results of questionnaires related to production, orders, stocks, employment, prices, etc.	July Preliminary data	46.2 54.0 53.0	49.0 52.4 52.0	46.3 54.4 53.2
	Conference Board Consumer Confidence This index tracks confidence among households or consumers. The results are obtained by conducting surveys on a random sample of households.	July	112.0	117.0	110.1
	New Home Sales The indicator shows the sale of newly built properties in the United States.	June MoM%	-5.0%	-2.5%	6.6%
	Gross domestic product (GDP) It measures the final market value of all products and services produced within the country.	Q2 QoQ%	1.8%	2.4%	2.0%
	Initial Jobless Claims It measures the number of people first time applying for receiving compensation.	22 July K=1,000	235k	221K	228K
	PCE Core Deflator This indicator tracks changes in personal consumption expenditures excluding food products and energy.	June YoY%	4.2%	4.1%	4.6%
Japan	**Consumer price index (CPI)** It estimates the changes in the cost of living, by measuring changes in the price level of market basket of consumer goods and services purchased by households.	July YoY%	2.9%	3.2%	3.2%