CENTRALNA BANKA CRNE GORE

Financial and Banking Operations Department

- International Reserves Management Division -

International Financial Market Report

(8 – 12 July 2024)

Podgorica, 17 July 2024

Weekly overview of short news

- The second round of parliamentary elections in France, held on 7 July, with a turnout of around 67%, brought several surprises. No political party received an absolute majority (289 seats in parliament). The left-wing coalition "New People's Front" finished in first place (182 seats), Macron's party and allies took second position (163 seats), while the far-right "National Assembly" ended up third (143 seats). After the elections, President Macron called on the main political parties to form a "solid" majority coalition, and in a letter published in several regional newspapers, he stated that he will appoint a new prime minister after the completion of this process. After the election results, Gabriel Attal announced he would resign as prime minister, but Macron initially rejected his resignation, before accepting on it on 16 July, with Attal serving as prime minister until a new government is appointed.
- The U.S. inflation rate slowed down in June and is at its lowest level since 2021. Total inflation at the monthly level amounted to -0.1%, being 3% on the annual level, which is below expectations (0.1%, 3.1%) and the May level (0.0%, 3.3%). Core inflation amounts to 0.1% on a monthly basis, or 3.3% on an annual basis, and it is expected to remain at May levels (0.2%, 3.4%). The long-awaited reduction in housing costs stands in the background of this trend. These data send the strongest signal yet that the Fed may cut interest rates soon. However, the producer price index recorded an increase in June, which indicates that price pressures are still present. The PPI recorded an annual growth of 2.6% in June, which is above expectations (2.3%) and the May level (2.4%).
- Investors' expectations that the ECB will reduce the interest rate one or two more times this year are reasonable as long as inflation and economic growth develop according to expectations, said Klass Knot, the ECB Governing Council member. If quarterly data on wages, profits and productivity are in line with the ECB's latest projections, "I am perfectly fine with our policy stance and with current market expectations of future rate cuts" Knott said in an interview with Germany's Handelsblat. He believes that disinflation is ongoing and well entrenched, and will be 2% by end-2025, but officials must also be cautious as inflationary risks remain, primarily rapid wage growth and the ability of businesses to absorb higher working costs.
- The ECB Governing Council member, Fabio Panetta, stated that the ECB can continue to reduce rates gradually without the risk of an immediate drop in inflation, all in line with macroeconomic trends and the ECB's expectations. In June, the ECB reduced interest rates from record high levels, without an explicit commitment that the same move would follow at the next meeting. He reduced concerns about high prices in the services sector and predicted moderate wage growth, while pointing out that previous interest rate increase continues to reduce demand, output and inflation.
- Joachim Nagel believes that core inflation is still high, warning that a cautious approach is needed in pursuing monetary policy, and stressed that the ECB does not cut rates automatically. He eased concerns about persistently high inflation in the services sector, adding that an analysis of available data has tended to reduce concerns about potential earnings growth. According to his projections, inflation could reach 2% by end-2025 at the latest.
- During a two-day presentation to Congress, the Fed Chairman Jerome Powell said the Fed needs more evidence of cooling inflation, and he agrees with current market expectations for interest rate cuts this year. He added that the labour market is completely balanced and that monetary policy makers are aware of the risks related to both too early and too late rate cuts. Powell stressed the importance of the Fed's independence in promoting price stability, and said political factors such as election cycles are not considered in decision-making, and the bank will make interest rate decisions "when and if" needed.
- The former U.S. President, Donald Trump, was injured in a shooting at his political rally in Pennsylvania on Saturday. The perpetrator was shot dead by the Secret Service. After the incident, Trump said he could not allow the assassination attempt to disrupt his plans to attend the Republican National Convention. Now it is being investigated whether Trump had adequate protection, and Biden, condemning the violence in comments from the White House, ordered a review of all security measures of the Secret Service and an independent audit of Saturday's rally.

FX NEWS

EUR/USD

The EUR/USD exchange rate appreciated during this reporting week. During the first three days of the week, the exchange rate was relatively stable, fluctuating between 1.0802 and 1.0842. The period of the exchange rate sharp growth begins as of Thursday as it was announced that inflation in the U.S. slowed down in June and fell to the lowest level since 2021. Such information increase expectations that the Fed will cut interest rates this year, which leads to a weakening of the dollar against the euro and other currencies. The exchange rate continued to rise on Friday as it was announced that the consumer confidence index released by the University of Michigan was revised downwards to 66.0, from an initial estimate of 68.2.

EUR/GBP

The EUR/GBP exchange rate fluctuated during the first two days of the week, averaging at 0.84513. The fluctuation of the exchange rate was caused by developments in the French political scene and political stability in the U.K. following the last week's elections (the euro weakened), while reduced fiscal concerns, arising from a potential victory of the far right or the left, supported the euro. The strengthening of the euro also occurred when the German central bank governor emphasized that core inflation is still very high and warned that a cautious approach is needed in pursuing monetary policy. The exchange rate had a downward trend as of Wednesday until the weekend. The EUR/GBP exchange rate fell, as traders withdrawn expectations of an interest rate cut by the BoE, following the comments by Huw Pill, the Chief Economist, that inflation remains persistent in the U.K. Pill said the timing of interest rate cuts remains an "open question" and noted that easing monetary policy is a matter of "when, not if." He expressed concern about persistent inflation, despite other policymakers signalling a willingness to cut rates. Investors interpreted his comments as a reluctance to cut interest rates. The exchange rate weakened on Thursday due to the generally faster recovery of the British economy than expected (GDP grew by 0.4%). The euro fell at the very end of the week, as traders compared the political stability in Britain with its neighbour, France. The data showing that inflation in the U.S. is slowing also had impact on the pound recovery, which suggested that the world's largest economy could cut interest rates before the U.K., which made the pound a more attractive currency.

EUR/JPY

The EUR/JPY exchange rate had a slight upward trend during the first three days of this week. The slight rise in the exchange rate came as investors positioned themselves ahead of the Bank of Japan's regular meeting later this month. The EUR/JPY exchange rate continued to rise until mid-day on Thursday, when it recorded a sharp decline, from 175.43 to 171.52. Traders attribute such a large drop in the exchange rate to the intervention of Japanese officials, and a similar drop in the exchange rate occurred earlier this year when the Ministry of Finance of Japan intervened in the market to stop excessive weakening of the yen against other currencies. Japan's currency chief, Masato Kanda, said he was not in a position to say whether the drop was a result of intervention. The yen continued to strengthen against the euro over the last day of the week.

Table 1 - Exchange rates of the most important currencies

	8-Jul-2024[1]	12-Jul-2024[2]	% Change
EUR/USD	1.0840	1.0907	0.62
EUR/GBP	0.84580	0.83973	-0.72
EUR/JPY	174.21	172.16	-1.18
EUR/AUD	1.60611	1.60777	0.10
EUR/CHF	0.97093	0.97544	0.46
USD/JPY	160.75	157.83	-1.82
GBP/USD	1.2815	1.2988	1.35

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%	18-Jul-2024
Federal Reserves (Fed)	Federal Funds Target Rate	5.50%	31-Jul-2024
Bank of Japan (BoJ)	Overnight Call Rate	0.00%	31-Jul-2024
Bank of England (BoE)	Official Bank Rate	5.25%	1-Aug-2024
Swiss National Bank (SNB)	Libor Target Rate	1.25%	26-Sep-2024
Bank of Canada (BoC)	Target Overnight Rate	4.75%	24-Jul-2024
Reserve Bank of Australia (RBA)	Cash Rate Target	4.35%	6-Aug-2024

Table 3 - ESTR and Euribor

	8-Jul-2024.[1]	12-Jul-2024.[2]	Change in basis points
ESTR	3.663	3.661	-0.20
Euribor 1W	3.607	3.610	0.30
Euribor 1M	3.635	3.625	-1.00
Euribor 3M	3.712	3.664	-4.80
Euribor 6M	3.678	3.662	-1.60
Euribor 12M	3.588	3.564	-2.40

[1] Opening market value on Monday

[2] Closing market value on Friday

Table 4 - Economic indicators (8 - 12 July 2024)

Country	Indicator	Period	Expected value	Current value	Previous value
Euro area	**Sentix Investor Confidence** Sentix Investor Confidence is a monthly survey that shows the market's opinion on the current economic situation and expectations for the next semester. Above 0.0 indicates optimism, whereas below 0.0 indicates pessimism. Usually, a higher reading is considered positive for the Euro area.	July	-0.5	-7.3	0.3
Germany	**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 an average household.	June- Final data MoM% YoY%	0.1% 2.2%	0.1% 2.2%	0.1% 2.2%
France	**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 an average household.	June- Final data MoM% YoY%	0.1% 2.1%	0.1% 2.2%	0.1% 2.1%
Spain	**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 an average household.	June- Final data MoM% YoY%	0.3% 3.4%	0.4% 3.4%	0.3% 3.4%
Great Britain	**BRC shop Price Index** The British Retail Consortium (BRC) retail price index measures price changes in BRC member retail stores in the U.K. A higher-than-expected reading should be taken as positive for the pound, while a lower-than-expected reading should be taken as negative for the pound. **Monthly GDP** It measures the final market value of all products and services produced within the country on a monthly basis.	June May	0.8% 0.2%	-0.5% 0.4%	0.4% 0.0%
USA	**Initial Jobless Claims** Number of inhabitants receiving unemployment benefits. **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 an average household.	6 July K=1,000 June MoM% YoY%	235 K 0.1% 3.1%	222 K -0.1% 3.0%	238 K 0.0% 3.3%
Japan	**Producer Price Index (PPI)** The index measures the average price change domestic producers receive for their production.	June MoM% YoY%	0.4% 2.9%	0.2% 2.9%	0.7% 2.4%

EUROPEAN GOVERNMENT BONDS MARKET

The yields on 10-year German government bonds fell for some 6bp, from 2.555% to 2.496% in this reporting week. From Monday to Thursday, the yield ranged from 2.51% to 2.59% (maximum for this week). This market alternated between downward and upward trends in the mentioned period. Apart from the statements of the ECB individual officials and the speech by the Fed president, there were no significant causes of this trend. A larger change in yields, more precisely a drop of around 10bp, took place on Thursday following a release of the U.S. inflation data. A surprising drop in the inflation rate caused yields to fall to 2.46% (the lowest level this week), as European bonds usually react to U.S. price data as they give a picture of inflation and because analysts say the ECB is not too keen on diverges in policy from the Fed. The yields fluctuated on the last day of this reporting week. Traders were satisfied with the outcome of the French election at the beginning of the week, without an absolute majority from the extreme right or extreme left, so the spread between the 10-year French and German bonds narrowed, amounting to 65bp at the end of the week.

U.S. GOVERNMENT BONDS MARKET

During this reporting week, the return on 10-year U.S. government bonds dropped from 4.286% to 4.183%. The yield fluctuated most of the week from 4.263% to 4.327%, as the presentation of the Fed Chairman in Congress and the June data on U.S. inflation were expected. The Fed President stated in his address to the Congress that the reduction of the interest rate is not justified until the Fed gains "greater confidence" that inflation is heading towards the level of 2%. During the second day of testimony, he said that the Fed will make decisions on interest rates "when and if" they are needed, regardless of political cycles in the U.S., and he also pointed to the risks to which the economy is exposed by pursuing a constantly restrictive monetary policy. However, on Thursday, following the release of surprising U.S. inflation data, the yield fell by around 13bp to 4,166% (lowest weekly level). The weaker-than-expected data brought the Fed closer to cutting interest rates, which caused yields to fall. Although the yield recovered towards the end of the day, the downward trend continued on Friday. Despite the data on the growth of producer prices in the U.S., investors raised expectations regarding the Fed's interest rate cut, as a survey by the University of Michigan indicated less optimistic consumers.

GOLD

The price of gold fell during the first day of this week, as the Fed President's speech and the release of U.S. inflation data were expected. The price of gold did not change significantly the next day, and from Wednesday on the price of gold began to rise. The highest increase in the price of gold happened on Thursday, when the price jumped from $2380 to $2424 per ounce. The increase in the price of gold in the mentioned period was caused by the release of the U.S. inflation data, which support the growth of expectations that the Fed will reduce the interest rate during this year. The price of gold rose on Friday as the data on consumer confidence measured by the University of Michigan was revised downwards. The price of gold rose from $2392.16 to $2411.43 per ounce in this reporting week.

OIL

The price of oil weakened during the first two days of this week. The price drop came on news that damage to oil production facilities was less than initially estimated after Hurricane Beryl hit the Texas area. The price of oil recovered in mid-week as the U.S. government report showed that after the demand for oil products was on an increase after 4 July (oil stocks in the U.S. fell by 3.4 million barrels in the previous week). Alongside daily fluctuations, the price of oil rose the next day as expectations increased that the demand for oil would also increase due to the summer travel season. There was a slight drop in the price of oil on Friday as Kuwait announced that it had found large oil and gas reserves in an offshore field east of Failaka Island. The price of oil was $87.46 per barrel at the beginning of the week, being $86.07 at the end of the week.