CENTRALNA BANKA CRNE GORE

Financial and Banking Operations Department

- International Reserves Management Division -

International Financial Market Report

(27 – 31 May 2024)

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Weekly overview of short news

- The inflation rate of the euro area has accelerated more than estimated, which "blurs" the outlook for the further ECB's interest rates trend after the planned June reduction. The consumer price index in April amounted to 2.4%, while consumer prices rose by 2.6% in May compared to the same period of the previous year, Eurostat's preliminary data showed, and it is expected that it will amount to 2.5%. The core consumer price index, which excludes volatile components, also overcame expectations, accelerating to 2.9% (being 2.7% in April, and 2.8% was expected in May). The service inflation rate rose from 3.7% to 4.1%. As for individual European economies, national reports released during this reporting period showed a relatively uniform acceleration in the region's leading economies, with faster-than-expected inflation growth in Germany, France and Spain, while inflation rose at a more moderate pace in Italy.
- The ECB Chief Economist, Philip R. Lane, said the full impact of the ECB's unprecedented monetary tightening campaign was yet to be felt - even as officials prepared to cut borrowing costs in June. He added that while the impact of the tightening cycle on economic activity may have peaked at the turn of this year, model-based analyses suggest that most of the impact on inflation is relatively lagging, with a significant portion of the effects expected to be carried over to the coming period. Lane added that the ECB is on track to start cutting interest rates, but will have to keep policy in restrictive territory through 2024.
- Some officials, including the Bundesbank President, do not see the need for a reduction in the interest rate in June, while the Central Bank of France Governor argues that such a scenario should not be ruled out. The Governor of the Central Bank of Italy said that even with several cuts in key interest rates, the ECB's monetary policy position will remain "firm". He added that the ECB should not delay the reduction of interest rates because this can only lead to more drastic action at a later stage - when defining the way of interest rate reduction, it should be borne in mind that quick and gradual action "limits" macroeconomic volatility better than late and hasty approach.
- Cleveland Fed President Loretta Mester said the Fed should consider ways to better communicate with the public. At the Bank of Japan conference, Mester recommended that the Fed's post-meeting statements use more words to describe the current assessment of the economy, how it affects the outlook and the risks to that outlook, and she added that scenario analysis should be a standard part of the Fed's communication. By the way, Mester is retiring at end-June, and Beth Hammack, the former Goldman Sachs CEO and a long-time leader in the financial industry, will take her place on 21 August. Hamak has more than three decades of experience in finances, capital markets and risk management, and she was a member of several Ministry of Finance advisory groups. She recently held the position of co-chair of global finance of this investment bank, and was appointed partner in 2010.
- The credit agency S&P announced on Friday it has cut down France's long-term credit rating from AA to AA-, with stable outlook. The change occurred due to the new S&P projection that the share of government debt in the gross domestic product will increase, which is the result of a larger than expected budget deficit for the period 2023-2027.
- The GDP growth in the U.S. for Q1 was revised downwards in relation to the initial data, from 1.6% to 1.3%, which is the lowest growth rate in the last almost two years.
- The personal spending expenditure deflator in the U.S. in April increased by 0.3% compared to March, and when volatile components are excluded, the personal spending expenditure deflator recorded a growth of 0.2%, which is the lowest growth this year.

FX NEWS

EUR/USD

EUR/USD exchange rate rose slightly on Monday as trading volume was reduced due to the holiday in the USA. Once the market opened, the exchange rate fell as expectations grew that the Fed would not cut interest rates until this year, and it was also announced that consumer confidence unexpectedly improved in the U.S. in May (the index rose from 97 to 102), which went in favour of the dollar. The EUR/USD exchange rate first rose on Wednesday due to data on inflation and consumer confidence in Germany, which were better than expected, but the exchange rate weakened in the second part of the day due to the release of the Fed Richmond production index (the index rose from -7 to 0). The EUR/USD exchange rate recorded growth on the last day of the week as the euro strengthened once euro area inflation data in May caused lower expectations for the ECB interest rate cut following June's cut. The euro strengthened against the dollar and as the latest data from the U.S. pointed to a slowdown in economic growth and inflation. The PCE core inflation deflator did not meet expectations last month, fuelling expectations that the Fed will cut interest rates by the end of the year.

EUR/GBP

The EUR/GBP exchange rate fell on Monday as the euro weakened against sterling following the comments from the ECB Governing Council member Francois Villeroy that the ECB should not rule out another interest rate cut in July. The EUR/GBP exchange rate initially weakened on Tuesday, as speculation grew that the Bank of England would keep interest rates at a higher level longer than other central banks. However, the EUR/GBP exchange rate recovered slightly in the second part of the day as it was announced that retail inflation in Great Britain slowed down in May (the index fell from 0.8% to 0.6%). The exchange rate fluctuated slightly on Wednesday and Thursday. The exchange rate rose first on the last day of the week, as it was announced that consumer loans in Britain grew less than predicted in the previous month as well (loans increased by 700 million pounds in April, which is significantly less compared to the 1.4 billion pounds that they increased in March). In the second part of the day, the exchange rate fell slightly, because the real estate market in Britain remained stable in April, which indicated resilient consumer confidence, and which consequently strengthened the British pound.

EUR/JPY

The EUR/JPY exchange rate fluctuated slightly on Monday, to rise the following day due to increased speculation that the ECB will lower interest rates more slowly than expected, as inflation is still high. The EUR/JPY exchange rate fell on the daily level on Thursday. It was expected that the Ministry of Finance of Japan will publish monthly data on FX intervention operations and that this report will confirm that the Bank of Japan intervened in the currency market on 29 April 29 and 1 May. Inflation in Tokyo rose 1.9% in May and was in line with the expectations. The yen weakened against most major currencies on Friday despite reports that the core consumer price index rose in line with expectations in Tokyo and retail sales data suggested that the economic recovery was underway.

Table 1 - Exchange rates of the most important currencies

	27-May-2024[1]	31-May-2024[2]	% Change
EUR/USD	1.0847	1.0848	0.01
EUR/GBP	0.85157	0.85149	-0.01
EUR/JPY	170.23	170.62	0.23
EUR/AUD	1.63638	1.63085	-0.34
EUR/CHF	0.99224	0.97889	-1.35
USD/JPY	156.99	157.31	0.20
GBP/USD	1.2737	1.2742	0.04

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	4.50%	6 June 2024
Federal Reserves (Fed)	Federal Funds Target Rate	5.50%	12 June 2024
Bank of Japan (BoJ)	Overnight Call Rate	0.00%	14 June 2024
Bank of England (BoE)	Official Bank Rate	5.25%	20 June 2024
Swiss National Bank (SNB)	Libor Target Rate	1.50%	20 June 2024
Bank of Canada (BoC)	Target Overnight Rate	5.00%	5 June 2024
Reserve Bank of Australia (RBA)	Cash Rate Target	4.35%	18 June 2024

Table 3 - ESTR and Euribor

	27-May-2024[1]	31-May-2024.[2]	Change in basis points
ESTR	3.9010	3.892	-0.90
Euribor 1W	3.881	3.889	0.80
Euribor 1M	3.792	3.717	-7.50
Euribor 3M	3.808	3.785	-2.30
Euribor 6M	3.780	3.745	-3.50
Euribor 12M	3.729	3.711	-1.80

[1] Opening market value on Monday

[2] Closing market value on Friday

Table 4 - Economic indicators (27 - 31 May 2024)

Country	Indicator	Period	Expected value	Current value	Previous value
Great Britain	**Net Consumer Credit** The high value of the indicator points to the "overheating" of the economy when consumers take more credit than necessary for a normal living standard.	April b=bill.	1.4b	0.7b	1.4b
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.	May Preliminary data MoM% YoY%	 0.2% 2.4%	 0.1% 2.4%	 0.5% 2.2%
	GfK Consumer Confident This index measures the level of households' confidence in terms of economic performance.	June	-22.5	-20.9	-24.2
	IFO Business climate It refers to the examination of German companies about the current conditions (state) of business, as well as their expectations for the next six months.	May	90.4	89.3	89.4
Euro area	**Consumer price index (CPI Core)** Core inflation represents the long-term trend of price levels. In measuring long-term inflation, transient price changes should be excluded, and the only way is to exclude items subject to frequent price changes, such as food and energy.	May Preliminary data	2.7%	2.9%	2.7%
	Consumer price index (CPI estimate) This index uses available data comparable to a historical trend to anticipate changes in consumer prices. Positive CPI points to price increase.	May	2.5%	2.6%	2.4%
	Unemployment Rate The percentage of individuals on the labour market and unemployed, but actively looking for a job. In general, higher unemployment rate weakens the economy and results in lower personal spending.	April	6.5%	6.4%	6.5%
USA	**Initial Jobless Claims** It measures the number of people first time applying for receiving compensation.	May 25 K=1,000	217 K	219 K	215 K
	PCE Core Deflator An economic indicator measures inflation by tracking changes in the prices of goods and services purchased by U.S. consumers, excluding food and energy costs.	April MoM% YoY%	 0.2% 2.8%	 0.2% 2.8%	 0.3% 2.8%
	GDP Annualized GDP measures the annual change in the inflation-adjusted value of all goods and services produced by the economy. It is the broadest measure of economic activity and the primary indicator of the economy's health.	Q1 QoQ%	 1.3%	 1.3%	 1.6%
Japan	**Retail Sales** This indicator shows changes in sales. The statistics covers universal shops and supermarkets. It shows the level of consumer shocks and consumer demand.	April MoM%	0.6%	1.2%	-1.2%

EUROPEAN GOVERNMENT BONDS MARKET

The yield on 10-year German government bonds increased by some 10bp in this reporting week, amounting to 2.664% at the very end of the week. Although the yield fell on Monday, following the ECB Governing Council member statement, Villeroy, that one should not rule out a reduction in borrowing costs in both June and July, it started to go up the next day. Growth was present until Wednesday, as preliminary data on German inflation in May fuelled expectations that the ECB would ease monetary policy at a slower pace. Despite the data that indicated the growth of inflation in Spain as well, the yields weakened the next day, mainly following the developments in the American bonds market. The yield had a rising trend at the beginning of the day on Friday, due to the release of data on inflation in the euro area, only to decline by the end of the day, as a result of developments in the USA again.

U.S. GOVERNMENT BONDS MARKET

The U.S. government bonds market was closed for the Memorial Day on Monday, but from Tuesday on to the end of the week the yield rose by about 5bp, amounting to almost 4.50% at the end of the day on Friday. The yield trended higher on Tuesday and Wednesday, following the release of better-than-expected U.S. consumer confidence data and Fed official Kashkari's statement that the FOMC had not completely ruled out further interest rate increase, but the probability that this will happen is "very small". The rise in yields was also caused by weak demand at the auction of 7-year U.S. bonds. In the last two days of the week, a downward trend prevailed in this market, as weaker economic data reduced risk appetite. Specifically, the U.S. GDP for Q1 was revised downwards, and it was announced that the personal spending expenditure deflator (PCE deflator) in the USA increased at a monthly rate of 0.3% in April (third month in a row), whereas the basic PCE the deflator rose 0.2%, which is the lowest growth rate this year. In addition, it was announced that personal spending unexpectedly decreased by 0.1% in April.

GOLD

The gold price fell in this reporting week. The price was mostly trending upwards in the first two days of the week, as easing inflationary expectations of American consumers reinforced expectations that the Federal Reserve may have space to cut interest rates this year. Growth was also present due to increased demand for this precious metal due to investors' concerns regarding geopolitical risks. Wednesday saw a larger price drop as the dollar strengthened and traders awaited U.S. inflation data. The day after it was announced that U.S. GDP for Q1 was revised downwards, the price of gold rose. A sharp drop of gold price came on Friday. Although the total PCE deflator in the U.S. in April was in line with expectations and at the level of March, and the core PCE deflator, which is the basic measure of inflation for the Fed, amounting to 0.2% in April compared to 0.3% in March, expectations were rising that the Fed will need additional evidence of a slowdown in inflation before there is a change in the interest rate, which is what caused the price of this precious metal to fall.

OIL

The price of oil had an upward trend in the first two days of the week. At the beginning of the week, investors were focused on the upcoming OPEC+ meeting, scheduled for 2 June, where the production policy for H2 2024 will be discussed. Most analysts were of the opinion that OPEC+ members would continue with a voluntary reduction of 2.2 million barrels of oil per day. The increase in price is caused by investors' expectations that the demand for oil will increase during the summer season in the USA, but also by increased tensions in the Middle East after the death of an Egyptian soldier during a conflict with Israeli troops. However, the second half of the week was marked by a drop in the price of this energy generating product, which resulted in its drop at the weekly level as well. Despite the U.S. Government's data that showed the highest drop in oil stocks in the U.S. in the last five weeks, and the fall in stocks was announced by the American Petroleum Institute, the market was dominated by concerns about the existence of excess oil and the slowdown in Chinese demand. The price weakened at the very end of the week as a result of increasing expectations that the Gaza conflict will come to an end.