CENTRALNA BANKA CRNE GORE

Financial and Banking Operations Department

- International Reserves Management Division -

International Financial Market Report

(29 July – 2 August 2024)

Podgorica, 7 August 2024

Weekly overview of short news

- Economic growth in France in Q2 was above expectations, indicating the resilience of the economy before the political events in this country. GDP grew by 0.3% on a quarterly basis, compared to the expected 0.2%, while it increased by 1.1% on an annual basis compared to the expected 0.7%. Growth rates for Q1 were simultaneously revised upwards, to 0.3% and 1.5%, respectively.

- Despite the unexpected reduction in the volume of the economy in Germany, the euro area economy grew more than expected in Q2. Euro area gross domestic product was 0.3% higher during the mentioned period, maintaining the same pace as at the beginning of the year and exceeding the forecast of 0.2% This growth was supported by the economies of France and Spain, whose growth exceeded estimates, as well as continued growth in Italy, which offset in total the 0.1% decline that occurred in Germany.

- The consumer price index in Germany reached 0.3% on a monthly basis in July, more than in the previous month, which was 0.1% according to preliminary data. On an annual level, the index was 2.3% in July, also higher than the previous month, when it amounted to 2.2%.

- The Bank of Japan decided to raise interest rates from 0.10% to 0.25% at the end of a two-day monetary policy meeting and unveiled a detailed plan to scale back its massive bond-buying programme. The Bank of Japan said it will slow down the pace of its bond purchases by 400 billion yen per quarter to reach a monthly pace of about 2.9 trillion yen in Q1 2026. The consensus was that the pace would be reduced to 5 trillion yen from the current 6 trillion yen starting next month. The Bank emphasized that it will be flexible in this plan and will conduct an interim assessment of the plan to reduce bond purchases at its June 2025 meeting.

- According to estimates, the annual rate of total inflation in the euro area recorded an increase from 2.5% to 2.6% in July, and it was expected to remain at the June level. On a monthly level, the inflation rate is 0%, whereas the expected drop was 0.1%. The rate of core inflation, which excludes energy, food products, alcohol and cigarettes, amounted to 2.9% in July, the same as in June, while a drop to 2.8% was expected, according to preliminary data. The service inflation rate fell slightly, from 4.1% to 4%, but it is still high, which may cause discomfort to the European Central Bank. Since August 2022, with the exception of April this year, the service inflation rate has not been below 4%.

- At the Fed meeting, the interest rate was, as expected, kept at the current level (5.25%-5.50%). The Fed President Powell sent a clear signal at the conference that followed the meeting that if the economic data move in line with the expectations, the interest rate could be reduced in September.

- The BoE's Monetary Policy Committee voted 5 out of 4 to cut interest rates by 25bp to 5%. Although such move was predicted by most economists, market prices implied the likelihood of a cut was akin to a "coin toss" given the uncertainty of how officials would interpret various economic data and what decision would be made based on it. Officials announced a cautious stance regarding further interest rate cuts. The Bank of England Governor Andrew Bailey said the bank must be careful not to cut rates too quickly or by too many basis points, as he expressed uncertainty about whether ongoing inflation is in line with the bank's 2% target. He warned that service price inflation could rise slightly in August before easing for the rest of the year. Markets expect the rate cut next year.

FX NEWS

EUR/USD

The EUR/USD exchange rate appreciated in this reporting week. Although it was down for most of the week, its increase on Friday led to a weekly gain. The exchange rate weakened at the beginning of the week in response to data on inflation in the euro area, and the Fed meeting for fresher inputs regarding the timing of the first interest rate cut in the U.S. The exchange rate had a downward trend due to the weakening of the euro as a result of release of weaker than expected data on the GDP of Germany, although the GDP of the euro area was above expectations, which prevented a greater fall of this currency. The exchange rate recovered on Wednesday, as preliminary data showed that inflation in the euro area was higher than expected in July, therefore the euro showed signs of growth. At the Fed meeting, which ended on the same day, the interest rate was kept at the existing level but President Powell but at the press conference hinted at a possible reduction in September, provided that the economic data published by then are in line with the Fed's expectations. The exchange rate continued to weaken the following day to the level of 1.0778 (minimum this week), due to the drop in share prices on the European stock exchanges, and the rise in the euro area unemployment rate in June. However, the exchange rate rose sharply on Friday, over 1.0900. The rise in the exchange rate was caused by the weakening of the dollar due to the release of disappointing data from the U.S. labour market, which increased concerns about the slowdown of this economy and fuelled expectations regarding a larger reduction in the Fed's interest rate compared to earlier estimates.

EUR/GBP

The EUR/USD exchange rate appreciated in this reporting week. The exchange rate fluctuated during most of the week within the interval 0.84109 - 0.84600, and its significant growth occurred after the Bank of England meeting. Speculation about a BoE interest rate cut ahead of Thursday's meeting caused sterling to weaken. On the other hand, sterling was supported by announcements regarding the improvement of British finances. In her first speech in the parliament, the U.K. Finance Minister announced that the budget presentation, scheduled for 30 October, will contain tough decisions on taxes, spending and social benefits, with the aim of improving "unsustainable finances". According to preliminary data, the inflation rate of the euro area was above expectations in July, which supported the euro in mid-week, but expectations regarding two more reductions in the ECB's interest rate by the end of the year did not change significantly. However, after the Bank of England, by the votes of the Monetary Policy Committee members 5 to 4, decided to reduce the interest rate, sterling began to weaken, thus the exchange rate had an upward trend until the end of the reporting week.

EUR/JPY

The EUR/JPY exchange rate was quite stable for the first two days of the week, with a slight upward trend, but it started to fall as of Tuesday afternoon, which caused its decline at the weekly level as well. Although expectations were growing that the Bank of Japan would increase the interest rate, the euro was supported at the beginning of the week by better-than-expected data on the economic growth of Spain and France, which encouraged economic growth at the level of the euro area as well. The subsequent fall in the exchange rate was caused by the strengthening of the yen due to the Bank of Japan's decision to increase the interest rate by 15bp, and the announcement of plans to reduce bond purchases. The yen was supported by the growth in demand for safe assets due to the situation in the Middle East, but also by expectations regarding the global development of interest rates. Namely, investors expect that the BoJ will continue to increase the interest rate, and that the ECB will cut the interest rate at least twice this year, while the disappointing data from the U.S. labour market triggered speculations about the Fed's interest rate cut by more than 25bp.

Table 1 - Exchange rates of the most important currencies

	29-Jul-2024[1]	2-Aug-2024[2]	% Change
EUR/USD	1.0856	1.0911	0.51
EUR/GBP	0.84373	0.85210	0.99
EUR/JPY	166.93	159.91	-4.21
EUR/AUD	1.65813	1.67590	1.07
EUR/CHF	0.95940	0.93598	-2.44
USD/JPY	153.76	146.53	-4.70
GBP/USD	1.2867	1.2801	-0.51

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%	12-Sep-2024
Federal Reserves (Fed)	Federal Funds Target Rate	5.50%	18-Sep-2024
Bank of Japan (BoJ)	Overnight Call Rate	0.25%	20-Sep-2024
Bank of England (BoE)	Official Bank Rate	5.25%	19-Sep-2024
Swiss National Bank (SNB)	Libor Target Rate	1.25%	26-Sep-2024
Bank of Canada (BoC)	Target Overnight Rate	4.50%	4-Sep-2024
Reserve Bank of Australia (RBA)	Cash Rate Target	4.35%	6-Aug-2024

Table 3 - ESTR and Euribor

	29-Jul-2024[3]	2-Aug-2024[4]	Change in basis points
ESTR	3.663	3.6640	0.10
Euribor 1W	3.642	3.645	0.30
Euribor 1M	3.621	3.611	-1.00
Euribor 3M	3.655	3.623	-3.20
Euribor 6M	3.591	3.553	-3.80
Euribor 12M	3.426	3.320	-10.60

[1] Opening market value on Monday

[2] Closing market value on Friday

[3] Opening market value on Monday

[4] Closing market value on Friday

Table 4 - Economic indicators (29 July – 2 August 2024)

Country	Indicator	Period	Expected value	Current value	Previous value
Euro area	**GDP S.A.** It measures the value of products and services produced in the country. GDP is the most comprehensive measure of economic output and provides a key insight into an economy's main drivers.	Q2 Preliminary QoQ% YoY%	 0.2% 0.5%	 0.3% 0.6%	 0.3% 0.5%
	Consumer price index (CPI estimate) Early assessment of the Consumer Price Index The consumer price index measures changes in the cost of living, tracking price changes in a basket of goods and services used by an average household, and is therefore a key measure of inflation.	July YoY%	 2.5%	 2.6%	 2.5%
	Unemployment Rate The percentage of individuals on the labour market and unemployed, but actively looking for a job.	June	6.4%	6.5%	6.4%
Germany	**GDP S.A.** It measures the value of products and services produced inside the country. GDP is the most comprehensive measure of economic output and provides a key insight into an economy's main drivers.	Q2 preliminary data QoQ%	 0.1%	 -0.1%	 0.2%
USA	**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	99.7	100.3	97.8
	ADP Employment Change This indicator measures the monthly change in the number of employees on the private sector payroll.	July			
	Initial Jobless Claims It measures the number of people filing for unemployment benefits for the first time.	K=1,000	150 K	122 K	155K
	ISM Manufacturing This indicator assesses the state of U.S. industry by questioning executors about their expectations in terms of production, new orders, employment, raw materials deliveries and inventory.	27 July K=1,000 July	236K 48.8	249K 46.8	235K 48.5
	Change in nonfarm payrolls The report shows the total number of newly employed workers on a monthly basis by economy industries. It does not include employees in farms, some government agencies, self-employed individuals and non-profit organisations. It serves as the basis for tailoring economic policy and forecasting future economic trends.	July K=1,000	175K	114K	179K
	Unemployment Rate It shows the number of unemployed persons as a percentage of the total labour force.	July	4.1%	4.3%	4.1%
Japan	**Unemployment Rate** It shows the number of unemployed persons as a percentage of the total labour force.	June	2.6%	2.5%	2.6%

EUROPEAN GOVERNMENT BONDS MARKET

The return on 10-year German government bonds fell on the weekly level as well. The yield did not record major changes in the first two days of the week and averaged at 2.35%. The yield weakened first due to the announcement that the inflation rate in Spain in July slowed down compared to the previous month, and later due to market expectations that the ECB will cut interest rates next year, even if data showed that inflation in Germany accelerated in July. The yield also weakened ahead of the Fed and the Bank of England meetings, as well as due to increased expectations regarding a global reduction in interest rates, despite an unexpected rise in inflation in the euro area. The yield fell at the very end of the week, as weak U.S. economic data increased concerns about global economic growth. In addition, the demand for safe assets grew as a result of the fall in share prices in Japan and the USA. The yield on German 10-year government bonds was at the level of 2.40% at the beginning of the week, being 2.17% at the end of the week.

U.S. GOVERNMENT BONDS MARKET

The yield on 10-year U.S. government bonds fell in this reporting week and followed a similar trend as the yield on 10-year German government bonds. The yield was stable and averaged 4.17% for first two days of the week. The yield on 10-year bonds fell on Wednesday as the Fed hinted at a September interest rate cut at its meeting. The next day, weaker than expected data on U.S. production as well as jobless claims helped boost demand for safe assets. The yield on 10-year U.S. government bonds had a downward trend at the very end of the week, as weaker than expected data from the U.S. labour market fuelled speculation that the Fed could start a cycle of aggressive interest rate cuts to prevent a slowdown in the economy, but also as the fall in share prices caused an increase in demand for safe assets. The yield on U.S. 10-year government bonds stood at 4.19% at the beginning of the week, reaching 3.79% at the end of the week.

GOLD

The gold price mainly rose in this reporting week. The price was at the level of $2,388.04 per ounce at the beginning of the week, being $2,443.78 per ounce at the end of the week. The price recorded a slight decline on Monday, due to the strengthening of the dollar and anticipation of the Fed meeting, which could lay the foundation for an interest rate cut in September. The killing of Ismail Haniyeh (Hezbollah commander), which occurred in an Israeli airstrike on Iran, incited the search for safe assets the next day. The price of gold gained in value during the rest of the week as the Fed president hinted that there could be a reduction in the interest rate at the September meeting, and geopolitical tensions in the Middle East intensified. The price of this precious metal rose at the very end of the week due to the weakening of the dollar and the growing demand for safe assets, approaching a record high level. Despite this, the price fell in the late afternoon, probably as investors sold the precious metal to take advantage of previously reached levels or cover losses in other asset classes (Friday saw a drop in stock prices once the U.S. labour market report fuelled concerns about the U.S. economy slowdown).

OIL

The price of oil was at the level of $81.37 per barrel at the beginning of the week, reaching $77.70 per barrel at the end of the week. This price weakened at the very beginning of the week, as the prevailing factor in this market was concern about oil imports from China. In addition, Israeli officials, referring to a deadly rocket attack that took place over the weekend in the Golan Heights area, occupied by Israel, announced that they do not want to drag the Middle East into an all-out war, which somewhat eased the tensions in the market. The price of oil fell on Tuesday, as prospects for demand for this energy generating product in China remained "bleak", and traders also focused on the release of key data. The price of oil rose the following day due to the escalation of geopolitical tensions in the Middle East. The price of oil fell again on the last day as concerns about the demand of the world's two largest economies, the USA and China, had a greater impact on development than geopolitical risks, given that the events in the Middle East still do not significantly affect the global supply of this energy generating product.