



## Weekly round up (Week 22)

Our weekly view of key developments in financial markets and economies examines the reasons for a lacklustre end to the month for risk assets.

After investors spent the first half of the month in risk-on mode, the last two weeks have been more representative of the old market adage "sell in May and go away", at least in Europe. Rates rose and equities seemed to run out of steam, with most major indices in negative territory.

We enter June with German and UK 10-year government bond yields close to their highest levels since last November, with UK gilts hovering around 4.4% and German bunds at 2.66%.

In May, European yields caught up with US yields, which had notably underperformed in March and April. The German 10-year yield closed the month 8 basis points (bps) higher, while the US 10-year yield was 18 bps lower.

### Continued theme of improvement in Europe and disappointment in the US

The scenario that the European Central Bank (ECB) will cut its key rates ahead of the US Federal Reserve at its June 6 meeting remains intact, but expectations of further cuts have been pushed back and economic data has been better than expected.

Eurozone unemployment fell in April to a new low of 6.4%, while the economic sentiment indicator - a measure of business confidence across all sectors - rose by 0.3 points to 96.5.

Meanwhile, US data failed to meet expectations, as shown by the US Citi Economic Surprise Index, a measure of how economic data compares with analysts' forecasts. As of May 30, the index remains negative, meaning that recently released data have fallen short of expectations.

According to the latest estimates from the Bureau of Economic Analysis, US real GDP will grow at an annualized rate of 1.3% in the first quarter, below the 1.6% initially forecast, and well below the 3.4% increase in the fourth quarter of last year.

The release of half-hearted data prevented US rates from rising in May. We can see this clearly in our "chart of the week", which shows the evolution of US and German 10-year yields this year.

The divergence in April occurred when expectations of a Fed rate cut were pushed back, while ECB officials supported expectations of a June cut. This movement was completely reversed in May.

This past week, we had several rate hike factors in the US and Europe, but those in Europe seemed to have more influence. Comments by Neel Kashkari, President of the Federal Reserve Bank of Minneapolis, that the Fed's next move could be higher rather than lower were not unusual, and if the Treasury auctions generated less interest than expected, this was probably due in part to the fact that they took place over the Memorial Day weekend and to the high volume of auctions this week. Our economic forecast does exclude a rate hike. But, as written previously, higher for longer is the mantra.



The improvement in the consumer confidence index for the first time since January was welcomed, although the index remains weak compared with what it has been for most of the post-COVID period.

In Europe, harmonized inflation was higher than expected in Germany, France, Spain and Italy. Annualized headline inflation in the Eurozone is expected to rise from 2.4% in April to 2.6% in May, driven by the services sector, where inflation is expected to rise from 3.7% to 4.1%. These forecasts follow last week's publication of a higher-than-expected consumer price index in the UK and a general improvement in purchasing managers' indices across Europe.

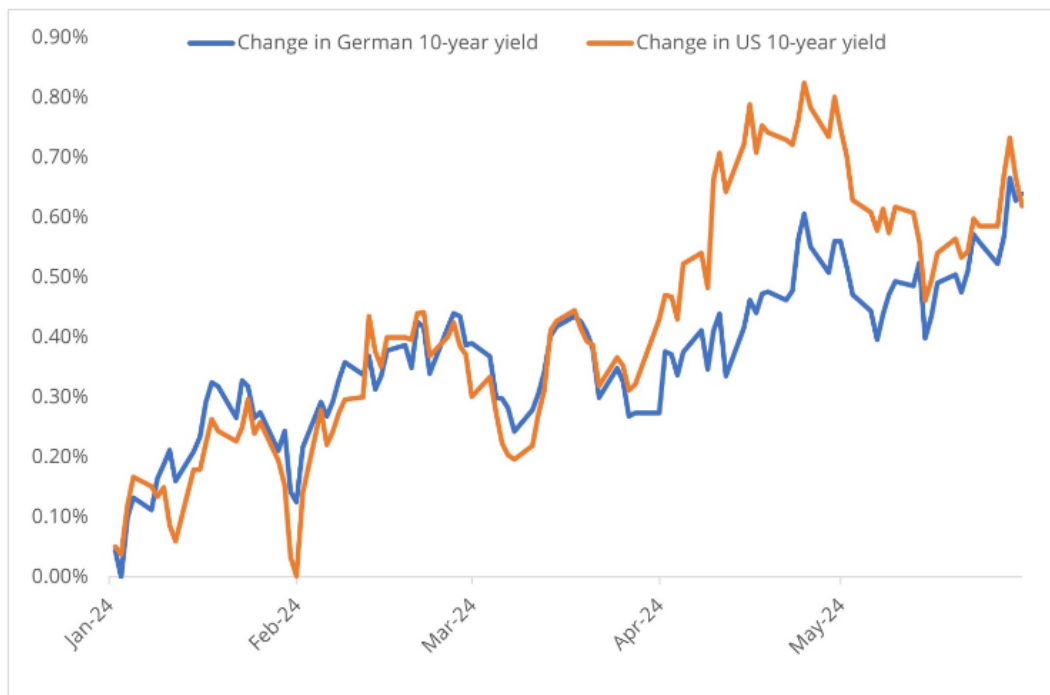
### **ECB stays on course for June rate cut.**

Inflation rigidity offers a plausible explanation for the fact that ECB rate cuts after June may not be as frequent as expected at the start of the year.

Although we still expect the ECB to confirm its easing trend with a first rate cut of 25 basis points on June 6, the central bank's commentary may have a somewhat hawkish - or at least neutral - bias given the strength of recent data. The ECB may oppose any fixed pace of rate cuts, repeating comments from previous press conferences that it will take a data-dependent approach to key rates.

We believe this is positive for European spreads in the short term, but could put pressure on longer-term spreads, a recent trend exacerbated by the increase in long-term euro issuance.

### **Chart of the week: Year-to-date trend in 10-year government bond yields**



Source: Bloomberg, as of May 31, 2024



- [1] Eurostat, as of May 30, 2024
- [2] Directorate General for Economic and Financial Affairs, as of May 30, 2024
- [3] MacroMicro, as of May 30, 2024
- [4] Bloomberg, 'ECB's Villeroy Says Probability of June Rate Cut 'Significant'', as of May 16, 2024
- [5] Bloomberg, 'Fed's Kashkari Says Interest-Rate Hikes Not Entirely Ruled Out', as of May 28, 2024
- [6] CNBC, '10-year Treasury yield rises above 4.5% following weak auction', as of May 28, 2024
- [7] The Conference Board, as of May 28, 2024

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