



Weekly round up (Week 24)

The weekly take on key developments in financial markets and economies looks at Emmanuel Macron's reaction to a big bet and the latest meeting of the US Federal Open Market Committee.

You know what they say: investors don't like surprises. As a rule, this amounts to an undervaluation of risk premiums, and asset prices react accordingly. Safe-haven assets are doing better, with government bonds such as German Bunds and US government bonds among the main beneficiaries, along with the US dollar and gold. Conversely, the epicenter of concern is generally moving below average.

Last week, French President Emmanuel Macron and the US Federal Reserve (Fed) sprang a surprise.

After the disappointing results of Macron's Renaissance party in the European Parliament elections and the strong scores of the far-right Rassemblement National led by Marine Le Pen, Macron sprang a surprise by dissolving the National Assembly (French parliament) on June 9 and calling early legislative elections, to be held in two rounds on June 30 and July 7, just before the opening of the Olympic Games in Paris. To obtain a majority, 289 seats out of 577 are required.

Macron's game of chance

In an interview with *Le Figaro*, Macron stressed that the result would have no impact on his position and that he would remain president come what may. Early polls indicate, however, that this risky strategy of bolstering support for his Renaissance party could backfire: the Rassemblement National is expected to win, but not gain an absolute majority. And after the Greens, the Socialists, the Communists and the far-left France Unbowed party announced that they would contest the elections as a single group, the polls currently put them in second place.

If the mood of voters doesn't change, this could lead to many Renaissance candidates failing to even qualify for the second round, and to a cohabitation government in which the Prime Minister and President are from different parties.

France has already experienced three cohabitation governments, the last one dating from 1997-2002. With no party having a clear mandate, it could be extremely difficult for France to implement the austerity measures needed to comply with the European Union's budgetary framework, which requires member states to put in place plans to reduce the deficit to 3% of GDP and public debt to 60% of GDP. According to a recent publication by Insee, France's public deficit will reach 5.5% of GDP by the end of 2023, while public debt will stand at 110.6% of GDP.

On May 31, S&P Global downgraded France's long-term credit rating from AA to AA-, citing concerns over the country's deteriorating fiscal situation.

In a generally bad week for European equities, France's flagship CAC 40 index fared the worst, falling by over 6%. Meanwhile, French 10-year government bond yields rose by 7 basis points (bps), while German Bunds followed suit and fell by 13 bps.



Losing the plot (period)

The next surprise came from the Fed's Federal Open Market Committee (FOMC) meeting on June 12, which noted that with economic activity continuing to grow at a steady pace, there was only "modest progress" towards the Committee's 2% inflation target. This comment contradicted what the data showed.

The FOMC's median dot plot now shows only one 25bp interest rate cut this year (4 members favor no cut, 7 favor one cut and 8 favor two cuts). This contrasts sharply with the three cuts planned by the FOMC in March, and is below the market consensus of two cuts.

The unemployment rate is expected to end the year at the current level of 4%, a level we see as conducive to a change in Fed policy if we take into account the other less encouraging employment data released recently. In the week ending June 8, initial jobless claims, a measure we follow closely, rose by 13,000 on the previous week to 242,000, the highest level of the year.

The FOMC left its growth forecast for 2024 unchanged at 2.1%. With first-quarter growth set at 1.3%, this means that the economy will grow at 2.4% in each of the remaining three quarters. However, the Bloomberg consensus for GDP growth is 2.1% for Q2, 1.7% for Q3 and 1.6% for Q4.

At the same time, the FOMC raised its 2024 inflation forecast for core personal consumption expenditure (PCE) from 2.6% to 2.8%. This reflects the seasonal inflationary impulse observed in the first quarter. The core PCE index may rise by 0.185% month-on-month over the rest of the year to reach the Fed's estimate. After weaker-than-expected consumer price inflation and a surprising 0.2% month-on-month drop in producer prices, the consensus for May's PCE index figures is a very modest 0.1% increase.

The Federal Reserve's mandate is to "effectively promote the goals of maximum employment, stable prices and moderate long-term interest rates". With weaker employment data and inflation under control, investors could be forgiven for wondering whether the FOMC's dotted chart looks backward-looking.

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