



Monthly Newsletter – May 2024



In the first week of June the ECB decided to cut interest rates, the first time in 5 years, from 4% to 3.75% and the question is why? Inflation is above their 2% target and their projections for 2024 and 2025 are 2.5% and 2.2% respectively. But in my Nov 2021 newsletter I quoted the ECB projecting inflation in 2022 at 1.7% however by August 2022 it was 9.1%. Not even close! I suspect they can see high interest rates risk a deep recession in Europe.

The Bank Of England is under pressure to cut rates and there are calls in the USA for the Federal Reserve to cut as well. On 12 June they left the rates unchanged at 5.25% based on inflation fears. The annual rate is 3.1% but the month on month rate is 0% so some believe the looking backwards nature of the Fed is going to be too late to act. Also the employment data for the month of May was much higher than expected and since central banks believe in the Philip's curve (see newsletter Oct 2023) which claims a link between employment and inflation. (Higher unemployment means lower inflation it is claimed) So rates were held fast. But have they forgotten stagflation of the 1970s when there was high unemployment AND high inflation?

The bond markets have been predicting lower rates from central banks. The 10 year German government bonds offers 2.5% which is lower than the ECB overnight rate. The US 10 year bond offers 4.3% which is lower than the overnight rate of 5.25%. Why buy a long term bond offering a lower rate than the overnight rate? Because investors, pension funds, insurance companies etc. see rates falling much further and want to lock in the rates now. Also as interest rates fall the capital value of a bond rises. The very opposite of 2022 when rates rose and the bond values tumbled.

There is a growing feeling that the global economy is tipping into recession due to central bank policy. This will upset the politicians who face elections this year. The EU elections on 9 June saw support for Macron in France collapse and he has called a general election. The governing coalition in Germany saw its combined vote fall to 31% with the party of the chancellor falling to just 14%. The UK election is on 4 July and on 5th November is the US presidential election. Most interesting will be the first Biden/Trump television debate on 27 June. No politician like higher rates.

Best wishes

Tim

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