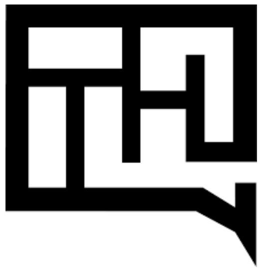

AZETS

THE TREASURY HUB
Markets Bulletin

Q2 2024 Review

Disclaimer:

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1. Executive Summary

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1.1 Introduction

Welcome to the 2024 second quarter review of THE TREASURY HUB Markets Bulletin.

As you are aware, these bulletins cover quite a wide range of topics and are a comprehensive review of all the various interest rate, foreign exchange, commodity and stock markets. Table 1 across sets out the year-to-date movement in a number of key metrics. What is notable is both the continuing increase in value of various asset classes and the increase in longer-term interest rates in response to the slower than expected fall in inflation.

The focus of markets in the second quarter continued to be on inflation and its impact on the expected timing of interest rate cuts. We predicted at the start of the year that the first ECB rate cut would be in June and not March as many believed then. Precisely because we believed that inflation would be slower than others expected in falling.

- 3-month euribor remained in a tight range around 3.90% until the markets finally accepted that the rate cut would come in June at which point 3-month euribor started to ease towards 3.75% or so
- EUR, UK and US yield curves continue to be inverted (i.e. rates decline after 1 year) with UK interest rates easing back slightly in the aftermath of the election result
- Oil prices rose again in Q1 but eased back in Q2 before rising by $10 again in the month of June
- Gold has had a record run to new heights over Q1 and has held at these levels for the most part in Q2.

1.2 Markets in a Table: what's up and what's down?

Table 1. Key Metric Movements: 2024

Heading	Metric	YTD move	From	To
Interest	3-m euribor	-0.22%	3.93%	3.71%
Interest	EUR 3-year	0.51%	2.55%	3.06%
Interest	GBP 3-year	0.58%	3.92%	4.50%
Interest	USD 3-year	0.58%	4.01%	4.59%
FX	EUR/GBP	-2.37%	0.8672	0.8471
FX	EUR/USD	-3.07%	1.1042	1.0713
Equities	ISEQ	6.37%	8760	9318
Equities	FTSE 100	5.57%	7733	8164
Equities	Nasdaq	18.09%	16667	19682
Commodities	Brent Crude	11.66%	77.39	86.41
Commodities	Carbon	-15.24%	78	66.13
Commodities	Gold	11.94%	2077	2325
Inflation	EU Core	-0.20%	3.30%	3.10%
Gilts	IE 10-yr	0.56%	2.41%	2.97%
Gilts	GB 10-yr	0.58%	3.60%	4.18%
Gilts	US 10-yr	0.32%	4.02%	4.34%

Please note that the % moves are in green if the metric has moved upwards and in red if it has moved downwards. It is NOT a statement as to whether this is a positive or negative move as one could be a borrower or depositor, a seller or buyer of currency, etc. Also, the % move for interest rates is in absolute terms while for currency and equities it is expressed in relative terms. **PLEASE NOTE THAT INTEREST RATE TRENDS ARE FROM A DEPOSITOR PERSPECTIVE.**

- Stock markets continued to drive higher in 2024 with the UK in particular showing gains after two fairly static years in 2022 and 2023. Nasdaq is being driven by a small number of stocks, especially Nvidia which is up 266% in 2024 alone
- Government borrowing (gilt) rates have actually risen since year-end on the back of less optimistic outlook for rate cuts in 2024
- Both USD and GBP continue to trade in a tight range against EUR although EUR/GBP has broken through the EUR/GBP0.8500 level. JPY is the currency under pressure, 11% weaker since the start of the year
- We still believe that US politics will be a more material factor as the year goes on.

1.2 Forward-looking Indices

Forward-looking indictors known as Purchasing Manager Indices or PMIs are useful to monitor the economic outlook for Ireland and the UK. Readings above 50 indicate expansion while below 50 denote contraction.

- Two of the three ROI indicators remain negative since year-end with only Services bucking the trend. Construction has fallen sharply over the past 2 months due to a fall in commercial activity. Manufacturing has been below 50 for every month bar one since September 2023
- In the UK, all three readings remain in positive territory with both Manufacturing and Construction generally trending upwards over the past few months.

Table 2. Irish and UK PMI readings

	Ireland	UK
Manufacturing PMI	**49.4**	**50.9**
Services PMI	**54.2**	**52.1**
Construction PMI	**47.5**	**52.2**

1.3 Inflation

Table 3. Selected Inflation Rates

	CPI/Core Inflation
ROI	**3.47%**
EUROZONE	**2.9%**
UK	**3.5%**
US	**3.4%**

Note: Core figures exclude energy, mortgages and food.

Irish core rate continued on its downward trend over the course of 2024 although it was largely unchanged in May compared to the previous month. CPI was also flat at 2.6% in May for the second month in a row. Food prices continue to fall but transportation prices are increasing by 6.7%. **Prices element of the PMI data suggest that both input and output prices are on the rise again.**

Eurozone core inflation which peaked at 5.7% in March 2023 has been static since March 2024 around 2.9% which gives further weight to the argument that ECB won't cut interest rates at the July meeting. Inflation is back up to 2.5% as it seems to have hit a floor around these levels.

UK core inflation at 3.5% is at its lowest level since January 2022 having been as high as 7.1% last May. Headline inflation has fallen even further – now at 2.0% compared to 11.1% in October 2022. UK inflation trends, in general, look good.

Finally US core inflation rate declined slowly since September 2023. But the headline figure rose in Q1 before easing back again**. See Section 3 for further comment.**

2. Foreign Exchange, Oil & Carbon

2.1 EUR/USD

- Graph 1 looks at the EUR/USD rate trend over the past 12 months
- The high/low range in 2024 to date is 4.22% which is narrow by historic standards
- The trend, if anything, appears to be downwards i.e. strengthening USD
- While some of the recent decline may have been attributable to EUR weakness as a result of uncertainty surrounding the result of the French election, one has to ask the question at what point does uncertainty over the US election (including selection of candidates) begin to impact negatively on USD?
- In addition, as we have referenced before, markets continue to ignore the huge US government deficit which we think must become a factor at some stage.
- But for now, USD seems to have support.

Graph 1. EUR/USD: 12-month trend

2.2 EUR/GBP

- Similar trend for EUR/GBP: the high/low range for 2024 being only 3.42%, although the average rate for 2024 is 1.5p lower at EUR/GBP0.8549 versus a 2023 average of EUR/GBP0.8703
- GBP continues to be supported by relatively high interest rates, generally positive inflation and PMI trends and an outcome to the general election that was largely anticipated
- The trading range from a technical analysis perspective is narrowing (see yellow lines on Graph 2 overleaf).

- Although the rate briefly dropped out of the range, it returned quite quickly and so remains in that range that has a floor at approximately EUR/GBP0.8430
- We have previously mentioned that the average rate for the past 7 years has remained in the EUR/GBP0.8527 to EUR/GBP0.8896 range which is quite narrow. The current year average rate is just about within that range but exporters to the UK have had opportunities to sell GBP (BRIEFLY) below EUR/GBP0.8400. Exporters should consider leaving orders at lower levels in case the market drops however briefly.

Graph 2. EUR/GBP: 2-year trend

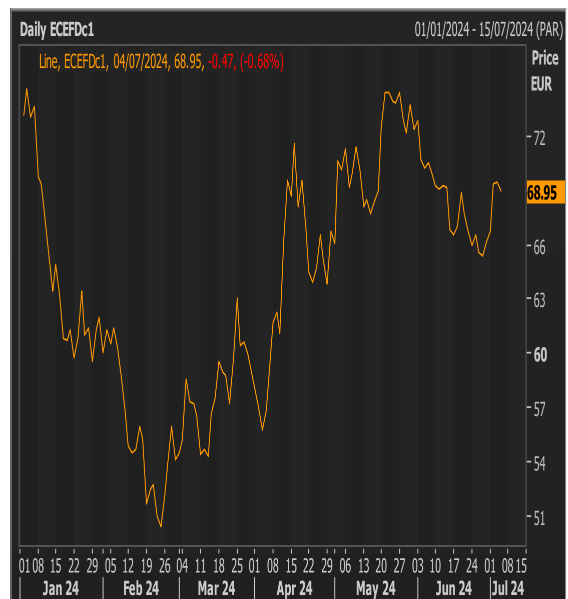
2.3 OIL & CARBON

Brent Crude had moved upwards and downward quite a bit in 2024. An average price of $80Bbl was expected by the markets (OPEC) but the price has bounced around and currently sits at just under $87Bbl. This will continue to be influenced by both OPEC actions on supply and the economic outlook globally – worsening outlook reduces demand for oil which reduces price.

The price of Carbon fell dramatically in the first two months of 2024 but has since staged a strong recovery. Current level is well below the highs of 2022/2023.

Graph 3. Brent Crude: 2024 trend

Graph 4. Carbon: 2024 trend



3. Interest and Economic Review

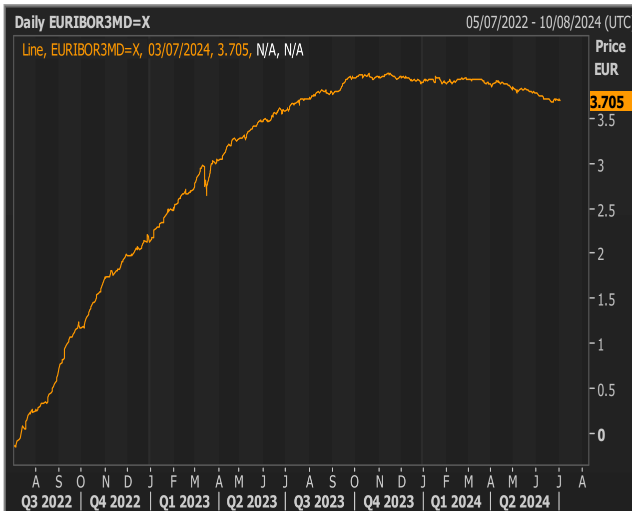
3.1 EUR Short-term Rates

Interest rates, have been the "topic du jour" over 2023 and 2024 after almost 15 years of no movement. The Euribor rate that we monitor for the purposes of this bulletin (as it is the most relevant one for variable rate debt) is the 3-month rate.

Key Observations

- Although the top of the interest rate cycle was reached last year, the 3-month Euribor rate plateaued over the course of Q1 2024 and into Q2 2024
- 3-month Euribor tracks the ECB Base Deposit Rate very tightly and in advance of the ECB first rate cut in June, it gradually eased back to 3.70% (the ECB cut the deposit rate from 4.00% to 3.75%)
- This rate will continue to ease downwards as ECB implements further rate cuts – the market doesn't expect a rate cut in July hence why the 3-month Euribor rate has stayed around 3.70%
- We expect two further at most by the ECB over the remaining three meetings from September to December.

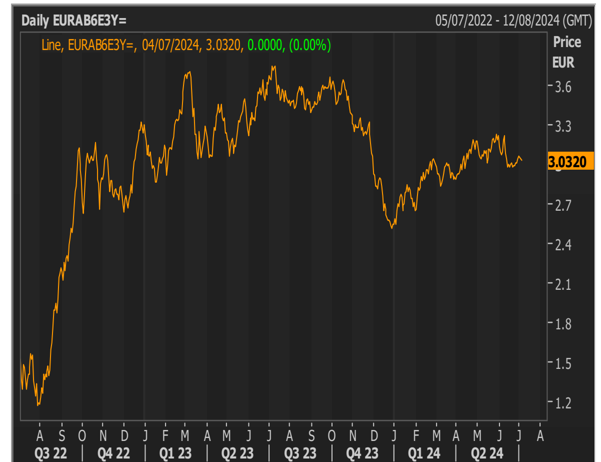
Graph 5. 3-month Euribor: 24-month trend



3.2 EUR medium-term Rates

- We always look at 3-year swap rates as they are a better indicator of the future direction of interest rates
- The EUR fixed rate curve (before margin) eased quite significantly over Q4 2023 (see Graph 6) but as the financial markets have re-evaluated the likely pace of rate cutting by the ECB i.e. less cuts, this rate has climbed again.

Graph 6. EUR 3-year swaps: 24-month trend



3.3 Summary

- As the ECB starting cutting rates in June, the markets are now focused on how many cuts there will be and when
- ECB meet in July, September, October and December this year
- No cut is expected in July as inflation seems to be sticky around current levels. Waiting until September allows the ECB time to assess further data
- Therefore, that leaves time for 3 more cuts at most
- We think that they will only cut twice at most and there is a growing number that think there may only be one further cut in 2024
- The interest rate curve remains inverted with 1-year, 3-year and 5-year rates (ex margin) at 3.55%, 3.06% and 2.91% respectively.

3.4 UK and US Interest Rates

- **Graph 7 below shows that the UK 3-year rate has behaved in a similar fashion to EUR interest rates in that it started to rise again in 2024 as the number of expected rate cuts was revised downwards due to stubborn inflation.**

Graph 7. GBP 3-year swaps: 12-month trend

Graph 8. USD 3-year swap rates: 12-month trend

- US rates followed the same trend as the other major currencies with a rapid fall off in Q4 2023 as markets anticipated rate cuts (at one stage last December markets were calling 7-8 cuts in the US in 2024) only to see the rate rise again as the number of cuts was continually revised downwards
- US GDP is forecast to grow by 2.7% in 2024 compared to an average of 1.7% for advanced economies. However, it is hard to see this continuing as the main driver is consumption and this, in turn, has been greatly aided by fiscal stimulus by the Government and direct transfer to households. Therefore, we would expect to see a fall off in US GDP growth in the second half of the year
- Unemployment rose to 4.1% in June
- We will look at macroeconomic indicators in more detail in Section 5.

3.5 Summary

- **Fixed interest rates (which are a better indictor of the future direction of rates) have all increased in 2024**
- **The result of all of this is that markets have revised downwards the number of interest rate cuts in all main economies and also have adjusted upwards where rates are likely to bottom out**
- **Current forward/forward annual rates show this level as 2.66% in Eurozone, 3.85% in the UK and 4% in the US**
- **Some now think that there may be only one more rate cut in the Eurozone this year**
- **UK looks like their first rate is soon**
- **US outlook is more complicated as stubborn inflation and growing debt levels would keep upward pressure on interest rates while a slowing economy requires falling rates**
- **What is clear everywhere is that the zero/negative rates seen for almost 15 years are not likely to be seen again so borrowers must get used to a higher cost of debt for the foreseeable future**
- **In addition to all of the above, the geo-political outlook remains volatile.**

4. Wealth Management

4.1 Gold

Graph 9. Gold prices: 2024 trend

- Gold been rising in value since 2019 – it was just under USD1,300 in May 2019 but hit USD2,000 by August 2020
- As previously noted there has been a drive by Chinese asset holders to liquidate some of their holding of US Government Bonds and switch such holdings into Gold which has driven the price higher as it constitutes an asset switch but in USD therefore protecting the value of their currency.

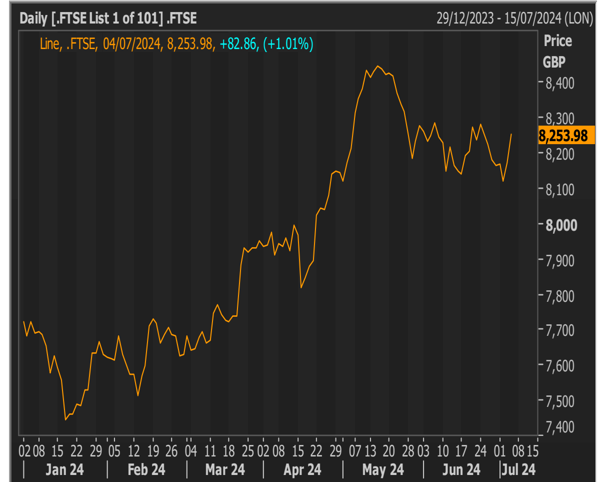
4.3 Equity Markets

Equity markets have had a very solid start to 2024:

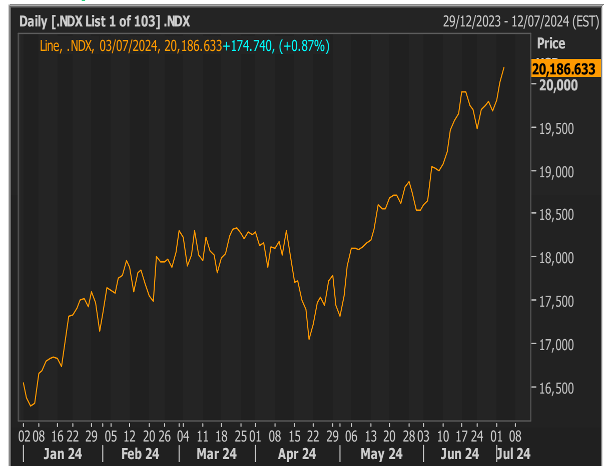
- ISEQ up 6.4%
- FTSE up 5.6%
- NASDAQ up 18%.

Graph 10. ISEQ: 2024 trend

Graph 11. FTSE: 2024 trend



Graph 12. NASDAQ: 2024 trend



Three US companies now have a market cap of over $3 trillion: Apple, Microsoft and Nvidia. Amazon and Google are in the $2 trillion range implying that these five alone account for 32% of the S&P 500 and have a combined value of $14.5 trillion. For comparative purposes, total market cap of all US quoted companies after the dot.com bubble burst was $11.1trillion!

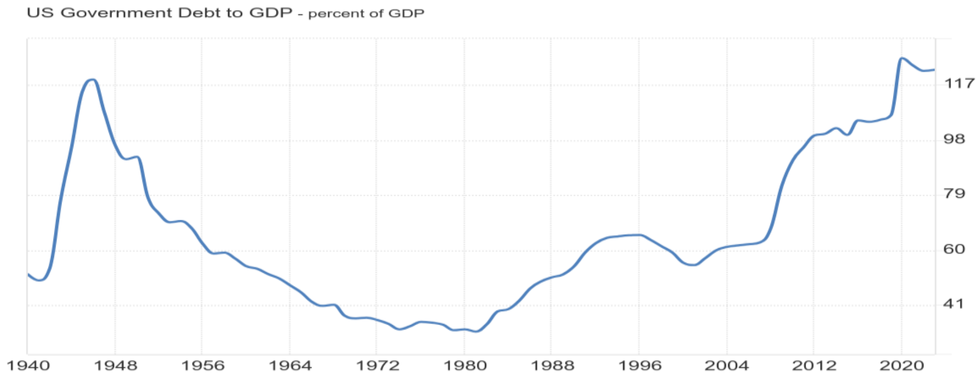
5. Macroeconomic Outlook

We have been worried about the prospects for the US economy for some time so have decided to look in more detail at their data.

5.1 Government Debt:GDP

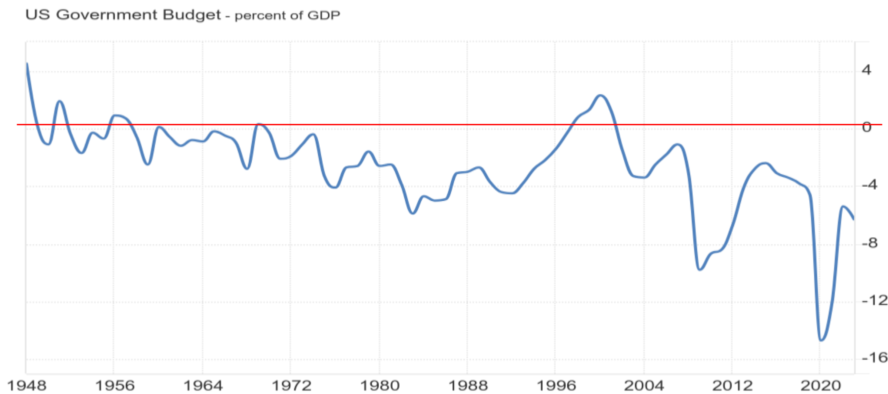
This is a figure that markets seem to be ignoring – the US is running up deficits even though GDP is ok. The basic theory in this space was that governments ran surpluses when the economy was strong so that they had capacity to run deficits when the economy slowed down. Surpluses are also required to repay debt. However, the US is continually running deficits/increasing debt:GDP since the Clinton era. The following graph is quiet telling. All-time low was 31.8% in 1981, all-time high was 126.30% in 2020. For comparative purposes, Eurozone equivalent is 88.6%, UK 97.6%, Germany 63.6%, Sweden 31.2%, China 77.1%, India 86.5%.

Graph 13. US Government Debt:GDP (source: tradingeconomics.com)



This borne out by the Budget deficit history – the last surplus was in 2000. Red line below is no surplus/no deficit.

Graph 14. US Federal Government Budget (source: tradingeconomics.com)



The implication of this, along with rising interest rates, is that the interest bill of the US Government in both $ and % of expenditure terms is growing meaning there is less money available to provide other services as the debt has to be serviced. As of May 2024, the annual cost of servicing the debt is $728 billion (16% of total 2024 federal spending). The debt pile has an average cost of 2.97% compared to 1.61% in 2021 and with interest rates rising, maturing debt will have to be refinanced at higher rates driving this figure up in the coming years.

5. Macroeconomic Outlook

Aside from the government, the largest driver of US economic growth is the consumer. However, the picture is not much better as evidenced by the following graphs:

Graph 15. Personal Savings

Personal savings all-time low was in 2005 (1.40%), the current level is 3.2%.

Graph 16. Credit Card Debt

This reached an all-time high of $1.13 trillion in Q4 2023, easing back slightly in Q1 2024. Similarly, the number of credit card accounts reached an all-time high of 596.6 million in Q1 2024 having fallen post financial crisis from 496 million in 2008 to 378 million in 2010.

When one considers that auto loans total a further $1.6 trillion, student debt is $1.6 trillion and that's before mortgage balances of €12.44 trillion, the average American is quite indebted – household debt is put at €104k per household or 73% of GDP versus Eurozone average of 54%.

The problem with data like this in general is that averages can hide distortions in sub-segments of the economy. We believe this to be case given the general perception of a growing inequality gap.

5. Macroeconomic Outlook

US Banking

In addition, US banks resisted pressure to allocate more capital against certain activities while they continue with their dividend payment and share buyback programmes. We have seen three small to mid-sized banks fail in March 2023 with Silicon Valley Bank running into trouble as it had to recognize losses on long-term bonds held to maturity once they sold a small portion of such bonds portfolio for liquidity purposes. The view in certain quarters is that a lot of similar-sized banks are sitting on losses of this nature hoping that they won't have to realize the bonds due to a liquidity squeeze thereby forcing them to recognize the losses. However, the principle supposed to be adopted after the 2008 financial crisis was that no bank could be "too big to fail" going forward. Its highly questionable that this is the case in 2024.

US Politics

The confirmation of a Democratic candidate is the first key decision but, for now, a choice between a 78 year old and an 81 year old as next President for the largest economy in the world is not confidence inspiring. Throw into the mix the recent Supreme Court ruling whereby the President has immunity for official acts taken while in office, and the lack of accountability could be a huge risk in the wrong hands!

Where does this leave Ireland?

Ireland's fortunes have been transformed since the Celtic Tiger era. Our savings rate is a steady 10.1%, consumer credit at €12.5 billion is less than half the peak of €28.9 billion in 2009. Borrowings by Irish companies are also a fraction of the 2008/09 peak with most recent data showing €34.3 billion outstanding versus a peak in 2009 of €174 billion.

And the Irish banks are also in a very strong and liquid position (AIB deposits exceeded loans made by €37.8bn at the end of 2023)

And yet a lot of sectors appear to be under pressure, infrastructure is not good enough and we have to start spending more on climate change and will incur more cost as a result of an ageing population.

Summary

Countries have had to incur higher debts/borrowings due to the financial crisis in 2008 and then Covid in 2019. Outside of those events, deficits are still common and government borrowing increasing. Where countries run deficits, they can only "repay" maturing bonds by issuing new bonds i.e. rolling over debt. The key question is: how long is this sustainable? It wouldn't be possible to run a household or a company like that in the medium-term. The view that the US government can continue to print money indefinitely because everyone will accept dollars has held up so far…but for how long?

We don't put ourselves forward as wealth management experts but we think that the above merits consideration in the context of what would one do to protect portfolio values if the markets eventually reacted poorly to constant US debt issuance and/or to another problem in the US banking sector.

And one final point - notwithstanding the push towards climate change investment and adoption of ESG principles in investing, the topic seems to be cooling off a little from an investor perspective. It would appear that addressing climate change might be worthwhile from a long-term societal perspective but asset managers want return this year. And commodities have been providing that in recent times.

There is a touch of St. Augustine about it… "Oh Lord make me pure…but not yet".

All of this points to a macroeconomic outlook that is likely to be benign at best for the coming years with a risk of a major US event either politically or in banking/financial markets having a material negative impact on global economic growth.