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Special: ECB cautiously loosens the monetary policy reins

Analysts: Christian Lips, Chief Economist // Valentin Jansen

ECB set to start rate-cut cycle at the June Council meeting, thereafter navigation by sight

As ECB Governing Council member François Villeroy stressed in the week before the June meeting, only major surprises could dissuade the central bankers in Frankfurt from an initial easing of monetary policy. A lot of work has been invested in this line of communication, especially since the April meeting. Along with the latest data on wage settlements in Q1, the data for the new projections are also available. ECB President Lagarde recently expressed strong optimism: "The forecast that we have for next year and the year after that is really getting very, very close to target. I'm really confident that we have inflation under control."

From the camp of monetary policy hawks, Bundesbank President Joachim Nagel pointed out the lagging nature of the rather mixed wage data for the first quarter of 2024. Should the updated projections corroborate the Governing Council's current assessment, Nagel sees no obstacles to an initial easing in June. He added that the ECB would be well advised not to make any key-rate adjustment at the following meeting after the initiation of the rate reduction cycle, and to wait until the September meeting at the earliest to discuss the next easing against the background of fresh projections and a broader data basis. A predefined rate-cut path could not be derived in the event of a positive vote at the June meeting – a view that also chimes with statements by ECB Vice-President Luis de Guindos. As regards the extent of a rate cut in June, de Guindos specifically favours a reduction of 25 basis points.

From the camp of monetary policy doves, Piero Cipollone and Fabio Panetta expressed vehement support for a rate cut in June, but also emphasized the necessity of maintaining a data-dependent approach with regard to the second half of the year. Overall, it is particularly striking that in the run-up to the June meeting the central bankers are keeping a very low profile as regards the future interest rate path. Only Isabel Schnabel and Joachim Nagel are right now in favour of a wait-and-watch approach in July against the background of the high ongoing uncertainties and still unchecked inflation risks. Robert Holzmann emphasizes the risk entailed in premature easing, and also warns against implementing interest rate cuts at an overly rapid or aggressive pace.

ECB Chief Economist Philip Lane, too, favours a data-based decision-making from meeting to meeting, and gives the green light for the June meeting "to remove the top level of restriction". In view of the further inflation trend in the eurozone, however, this should by no means be seen as a declaration of victory, he adds. Rather, the debate in the Governing Council on further monetary easing steps must be conducted at all times throughout the course of the year against the background that, as a result of the "still significant amount of cost pressure", in particular from rapid wage growth, the ECB's policy needs to remain restrictive. "Within the zone of restrictiveness we can move down somewhat."

Without further incidents, therefore, it would basically no longer be possible to justify holding the key interest rates unchanged in June. In addition to the fresh projections, which should shed more light on the further timetable, the focus is therefore primarily on the accompanying communication.

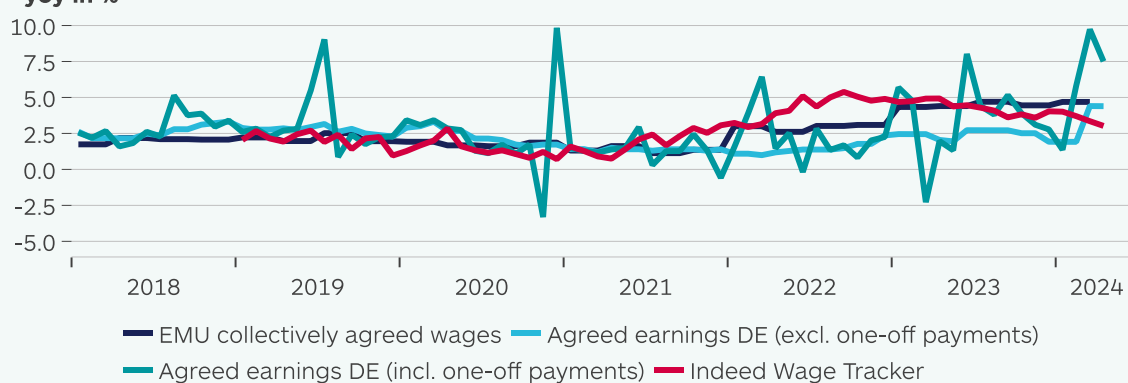
Latest macroeconomic data warn ECB to proceed with caution

The ECB had postponed the initial rate cut for a long time, justifying this with the fact that important further wage data had to be awaited first. The data on the development of collective wage rates in the euro area for the first quarter are now available, according to which there was actually a slight acceleration in wage growth again at the beginning of the year, from 4.5% to m 4.7% yoy. This is attributable on the one hand to quite high one-off or special payments, this effect being particularly pronounced in

Germany (see chart). On the other hand, there are also good reasons for the momentum to remain elevated for some time to come, as the employee side is looking to attain the greatest possible compensation for the cost increases in recent years. Declining unemployment despite cyclical weakness (6.4% in April) together with the structural shortage of skilled workers are factors strengthening the trade unions' bargaining power.

The wage increases and the latest inflation data, too, serve as a warning that a cautious approach is called for, but ought not to be overly alarming to the central bankers. The companies themselves still have potential to compensate for wage cost increases, and recent surveys indicated that they are planning extremely modest increases in the prices of consumer goods. Moreover, leading indicators – such as the Indeed Wage Tracker – are signalling a potential slowdown in wage growth over time.

Chart: Q1 with an uptick in wage dynamics due to special payments
yoy in %



Sources: ECB, German Federal Statistical Office, Indeed Hiring Lab, Macrobond, NORD/LB Macro Research

ECB to remain restrictive this year, with rate cuts of just 25 basis points per quarter

With wage growth in the first quarter having already been somewhat stronger than expected due to high one-off payments, the accelerated pace of inflation in May, especially in services, is additional grist to the mill for the hawks on the ECB Governing Council. This all points to an intensive monetary policy discussion among the central bankers at their meeting in June, though the firmly planned initial rate cut of 0.25 percentage points will certainly not be overturned on the home stretch.

Rather, the focus will be on the further interest rate path. The latest macroeconomic data are not likely to have changed the way the Council members see the situation. This will also be reflected in the fact that merely marginal changes are likely to be made to the projections this time. For the hawks on the Governing Council, however, the May inflation figures provide sound arguments in favour of maintaining a cautious stance after an initial rate cut in June. Indeed, the Council's members could conceivably decide clearly or even explicitly against a rate cut in July.

In our view, however, the lower inflation figures to be expected in late summer will increase the pressure to take action again. This means that, for reasons of caution, the next rate cut is not to be expected until September. Moreover, the monetary policy meetings with updates to the projections are likely to be prioritized for further interest rate adjustments – which provides good reason to expect an interest rate path of 25 basis points per quarter. With this pace of adjustment in mind, however, we expect a further key-rate cut of the same level in December as well. Only then will the central bankers (have to) focus their attention more on the actions of the Federal Reserve, on which they are not looking to make themselves dependent – but will certainly also want to avoid any marked divergence between the respective interest rate policies.

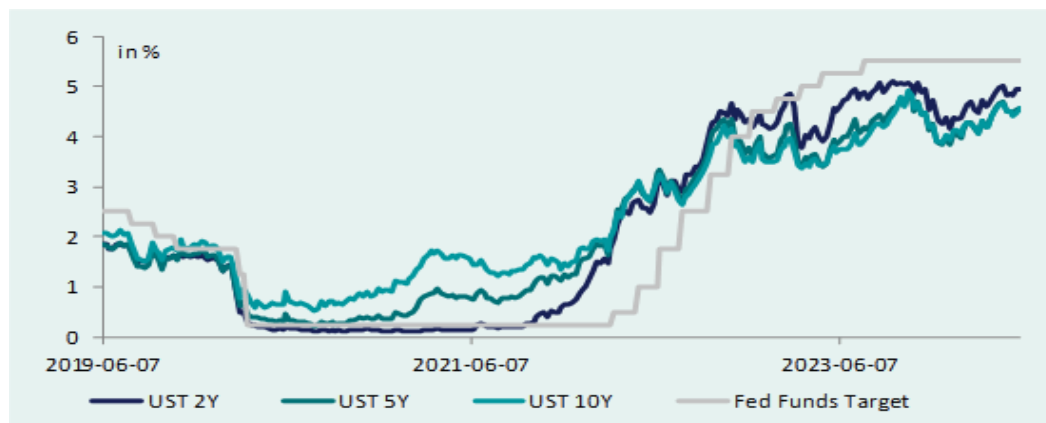
USA: 2nd half of the year to see the Fed able to take action

Analysts: Tobias Basse // Constantin Lüer

Consumers remain in focus

The first revision of the GDP figures for Q1/2024 produced no "newsflow" of any real note for market participants. With the annualized rate of change revised to 1.3 percent, the signs of a slowdown in the US economy at the start of the new year are now even clearer; this was also to be expected. As anticipated, private consumption's growth contribution was not quite as strong as originally reported. The conclusion thus to be drawn is that the US economy doesn't appear to have got off to quite such a good start into 2024. Q2 will probably see a pick-up in growth, though within limits and not at the pace of recent quarters. The latest published data on the development of retail sales came as rather a surprise on the downside for the majority of interested observers, with this time series merely revealing a month-on-month rate of change of 0.0 percent in April; indeed, the control group – which is of core relevance for the GDP survey – registered a decline of 0.3 percent mom. This means household demand is no longer providing the economy in the land of unlimited opportunity with any great positive stimulus. With a certain deterioration in the situation on the labour market to be feared and interest rates remaining high, this trend is likely to intensify in the future, although there will of course also be "countermovements" here and there – the time series of the monthly rate of change in retail sales is, after all, subject to the phenomenon of "mean reversion".

Chart: Interest rates in the USA



Sources: Macrobond, NORD/LB Macro Research

Interest rates weighing on the mood in the real estate market

The latest figures on the development of real estate prices indicate certain tendencies towards a deceleration of the upward trend in the corresponding time series. For example, the Case-Shiller HPIs in the 20 major US metropolitan regions recently rose by just 0.3 percent mom, though this was pretty much in line with market expectations. Moreover, the monthly FHFA House Price Index recently disappointed with an increase of just 0.1 percent mom. These reports come as no great surprise. The high yield levels and the prospect of merely very cautious interest rate cuts by the Federal Reserve have put quite a lasting strain on sentiment in the US construction industry of late. The NAHB index, a reliable leading indicator for the development of house prices in the United States, has recently plummeted and is now back below the "magical" 50-points mark. This is certainly not a good omen for the US real estate market. At any rate, a very close eye now needs to be kept on the time series that is computed by the NAHB.

2nd half of the year to see the Fed able to take action

The latest figures on US consumer prices do not yet provide any clear impetus pointing in the direction of near-term interest rate cuts by the FOMC. The time series increased by 0.3 percent mom in April, making for an annual rate of 3.4 percent. It could have been worse – but “real” signs of easing on the macroeconomic price front look different. The core rate of consumer prices likewise rose by 0.3 percent mom, thus making for an annual rate of 3.6 percent. The important shelter segment remains in focus. April saw prices rise at mom and yoy rates of 0.4 and 4.5 percent respectively. We are nevertheless maintaining our view that the FOMC will be able to cautiously lower the key interest rate level in the course of the 2nd half of 2024. The inflation data should certainly justify appropriate changes to the central bank's highly restrictive monetary policy in Q3. Given the Fed's objectives, somewhat less encouraging figures from the labour market should likewise help towards a decision in favour of lowering interest rates. The Fed's third objective must not be lost sight of either – namely to ensure an appropriate level of interest rates. In terms of government funding, lower yields could be very helpful in the meantime.

Fundamental forecasts, USA

	2023	2024	2025
GDP	2.5	2.2	1.7
Private consumption	2.2	2.1	1.5
Govt. consumption	2.7	2.5	1.1
Fixed investment	2.0	2.5	2.6
Exports	2.6	1.9	2.6
Imports	-1.7	2.5	2.2
Inflation	4.1	3.2	2.3
Unemployment rate ¹	3.6	3.9	4.2
Budget balance ²	-6.5	-5.9	-6.1
Current acct. balance ²	-3.0	-3.1	-3.0

Change vs previous year as percentage; ¹ as percentage of the labour force; ² as percentage of GDP

Sources: Feri, NORD/LB Macro Research

Quarterly forecasts, USA

	III/23	IV/23	I/24	II/24	III/24
GDP qoq ann.	7.0	3.4	1.6	1.2	1.3
GDP yoy	2.9	3.1	3.0	1.5	0.9
Inflation yoy	3.5	3.2	3.2	3.4	3.1

Change as percentage

Sources: Feri, NORD/LB Macro Research

Interest and exchange rates, USA

	30.05.	3M	6M	12M
Fed funds target rate	5.50	5.25	5.00	4.25
3M rate	5.35	5.00	4.70	4.10
10Y Treasuries	4.55	4.00	3.70	3.50
Spread 10Y Bund	189	170	150	120
EUR in USD	1.08	1.07	1.09	1.09

Sources: Bloomberg, NORD/LB Macro Research

Euroland: Green light for an initial ECB rate cut

Analysts: Christian Lips, Chief Economist // Christian Reuter

Eurozone bounces back from technical recession with robust GDP growth in Q1

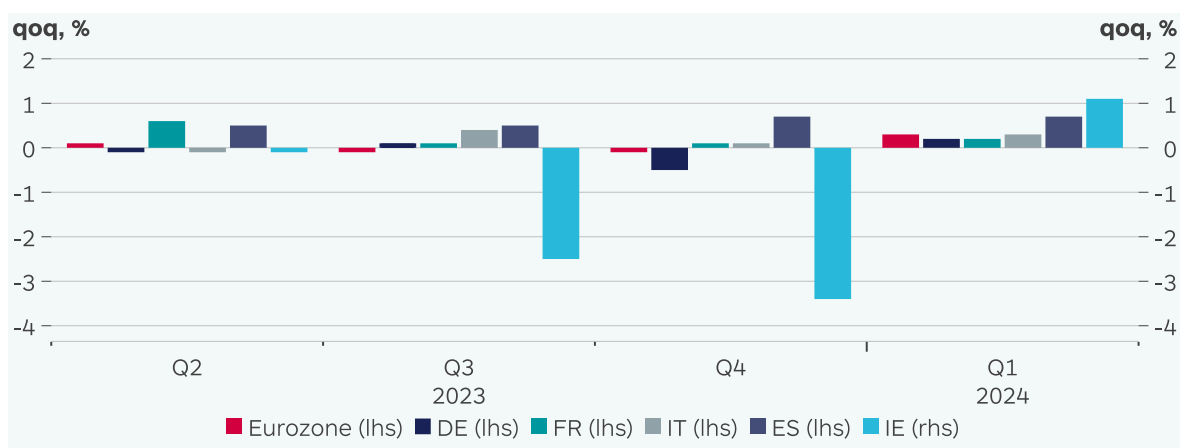
The European economy started into 2024 slightly more dynamically than expected, bouncing back from its mild technical recession. Q1 saw price and seasonally-adjusted GDP rise by 0.3 percent qoq and the annual rate by 0.4 percent yoy. All member states registered growth in economic output at the start of the year and, relative to the consensus estimates, the major economies surpassed expectations without exception.

Ireland recorded the highest growth rate among the member states, with a quarter-on-quarter figure of +1.1 percent, though all major economies in fact registered growth in real economic output. There was unexpectedly strong GDP growth in Spain and Portugal (+0.7% qoq). GDP growth was somewhat more moderate in Italy (+0.3 percent), France and Germany (both +0.2 percent, see chart).

May as month under review saw the leading indicators in the eurozone again register improvement, pointing to a continuation of the economic recovery there. The Economic Sentiment Indicator rose slightly to 96.0 points, though remaining slightly below the long-term average. The PMIs are in the meantime giving particularly clear indication of growth. Though the Industry PMI is still below the expansion threshold of 50 points, at 47.4 points, the PMI services is well inside the growth zone at a level of 53.3 points. In May, the sentix Economic Index registered its highest level since February 2022 with a figure of -3.6 points.

Against this background we have adjusted our growth forecast for 2024 slightly upwards to +0.7 percent, and expect to see the ECB likewise raise its projections for GDP development in the current year at its monetary policy meeting on 6 June.

Chart: Eurozone's economic growth surprises on the upside in Q1



Sources: Eurostat, Macrobond, NORD/LB Macro Research

Special effects make for inflation rebound in May

As expected, the inflation rate rose again in May, though, according to Eurostat's flash estimate, remaining within reach of the ECB's medium-term stability target of 2 percent with a level of 2.6 percent yoy. Compared to the previous month, this equates to an increase in the harmonized consumer price index (HICP) of 0.2 percent mom. The core rate (excluding energy, food, alcohol and tobacco) likewise rose by two decimal places, and currently stands at 2.9 percent yoy.

The major euro countries Germany, France, Italy and Spain each registered an uptick of 0.2 percent in their respective HICPs. The annual rates there range from 0.8 percent yoy in Italy to 3.8 percent yoy in Spain. Portugal registered a sharp increase to 3.9 percent yoy. Belgium's consumers are currently experiencing the highest price pressure, with a year-on-year inflation rate of 4.9 percent.

Inflation was driven up throughout the eurozone by slightly higher energy prices (+0.3 percent yoy) on the one hand and, on the other, a significant but not unexpected rise on the services front to 4.1 percent yoy. The latter is the highest level since October 2023. However, a rebound was to be expected in May, due to the normalization of package holiday prices and the pronounced base effect in Germany.

ECB: Focus on possible signals for its path after June rate cut

June is virtually certain to see the ECB's initial rate cut, seeing as the central bankers' preparations for this move have been too intensive and long for this not to be the case. All the same, the rebound in the inflation rate reported shortly before the week of the next meeting, along with the higher-than-expected wage dynamics in Q1, together make for a set of data that, at least in the short term, is grist to the mill of the hawks on the ECB Governing Council (see our Special).

While the latest macroeconomic data will not suffice to overturn the June rate cut decision in the final stages, those members do urge caution in the pace of the further cuts. The ECB will for the time being be looking to proceed very cautiously with a strictly data-dependent approach. Indeed, the central bankers could even already decide quite clearly and explicitly against a further rate reduction at the following meeting in July. We, at any rate, do not expect the next key-rate cut before September after the first one in June.

Interest rate expectations continue to fluctuate sharply in the markets. However, it could be that some of the market participants reacted too hastily to the visually uninspiring May inflation figures. As soon as inflation nears or even falls below the 2 percent mark again, however, the expectations regarding the key rate path will likely normalize again as well.

Fundamental forecasts, Euroland

	2023	2024	2025
GDP	0.5	0.7	1.4
Private consumption	0.6	0.9	1.6
Govt. consumption	0.8	1.5	0.7
Fixed investment	1.4	2.1	2.6
Net exports ¹	0.2	-0.4	-0.1
Inflation	5.4	2.3	2.0
Unemployment rate ²	6.6	6.4	6.3
Budget balance ³	-3.6	-2.8	-2.6
Current account balance ³	1.7	2.1	1.7

Change vs previous year as percentage, ¹ as contribution to GDP growth; ² as percentage of the labour force; ³ as percentage of GDP

Sources: Feri, NORD/LB Macro Research

Quarterly forecasts, Euroland

	III/23	IV/23	I/24	II/24	III/24
GDP sa qoq	-0.1	-0.1	0.3	0.3	0.3
GDP sa yoy	0.1	0.1	0.4	0.5	0.8
Inflation yoy	5.0	2.7	2.6	2.4	2.1

Change as percentage

Sources: Feri, NORD/LB Macro Research

Interest rates, Euroland

	30.05.	3M	6M	12M
Repo rate ECB	4.50	4.25	3.65	3.15
3M rate	3.79	3.60	3.30	2.90
10Y Bund	2.65	2.30	2.20	2.30

Sources: Bloomberg, NORD/LB Macro Research

Germany: Growing signs of recovery

Analysts: Christian Lips, Chief Economist // Valentin Jansen

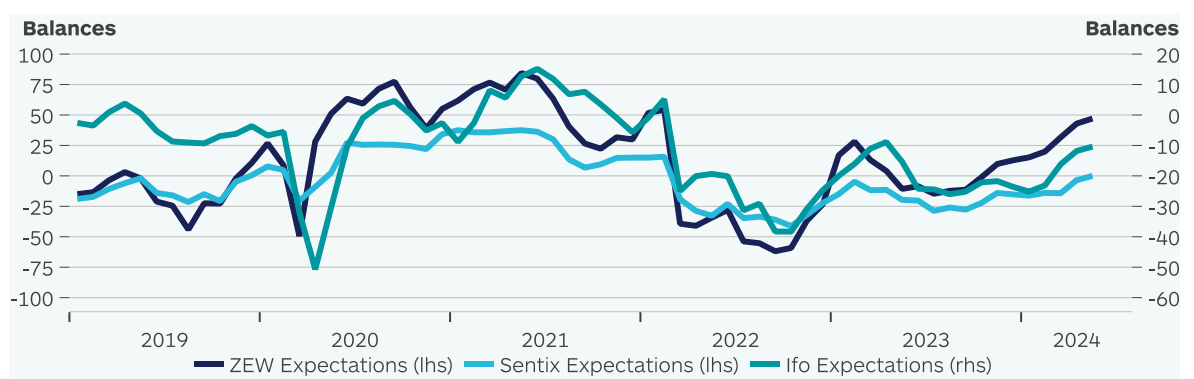
German economy starts the year with a slight GDP uptick – consumption (still) weak

The German economy got off to a far better start to 2024 than feared, avoiding a technical recession thanks to price and seasonally-adjusted GDP growth of 0.2 percent, quarter on quarter. The annual rate remained in the slightly negative zone, at -0.2 percent yoy. That said, the annual rate in terms of non-calendar-adjusted GDP was quite a bit lower (-0.9 percent yoy) than in Q1, despite the leap year effect, with, mathematically speaking, 1.6 fewer working days than in the same period one year back.

Construction investment registered particularly strong expansion in Q1 (+2.7 percent qoq). At first glance, this news comes as a surprise in light of the ongoing negative impacts of rising interest rates and costs. The upturn is primarily due to the favourable weather conditions, however, with February unusually warm and with very few frost days. The early onset of the spring economic revival has thus spurred growth in Q1. This growth momentum that normally occurs in the spring will now be lacking, however, thereby restricting the potential for growth in Q2. Like construction investment, net exports made a strong contribution to GDP growth since, at 1.1 percent qoq, the rate of expansion in exports was significantly higher than that of imports (+0.6 percent qoq).

Private consumption, on the other hand, shrank again in price-adjusted terms (-0.4 percent qoq), thus preventing even stronger GDP expansion. However, real wages are already rising strongly again due to the marked downward inflation trend and relatively high nominal wage increases. Indeed, Q1 saw real wages surge by 3.8 percent yoy – their strongest rate of growth since this time series was first surveyed in 2008. Real disposable income rose accordingly, by 1.4 percent qoq. This initially drove just the savings rate, pushing it to 12.4 percent and thus the highest level since mid-2021. Even though consumer sentiment is still at a low level, the massive reduction in consumers' savings plans suggest an imminent real wage-driven turnaround in private consumption, however.

Chart: Economic and business expectations in upward trend



Sources: ZEW, sentix, ifo, Macrobond, NORD/LB Macro Research

ifo climate stagnates in May – majority of indicators suggest economic recovery

The ifo Business Climate Index failed to continue its upward trend in May, remaining at 89.3 points.

While business expectations were again seen in a far more optimistic light, the current business situation surprised on the downside with a significant decline. Sentiment in the service sector deteriorated in contrast to the positive trend in the other sectors.

However, too much significance ought not to be placed on the overall index's stagnation. Indeed, the signs of a gradual economic stabilization in Germany remain clearly in the majority. The weak data of the ifo index also came as such a surprise on the downside because a whole series of leading indicators

had previously delivered positive signals. In May, for example, financial market experts were more optimistic about both the current macroeconomic situation and economic prospects in the ZEW Business Survey, similar to the sentix survey published earlier. Moreover, the PMIs had also shown marked improvement, with the composite index's level of 52.2 points signalling unquestionably positive growth after a prolonged dry spell. In light of the bounceback in construction investment then to be expected, we expect no perceptible upturn in economic momentum until the second half of the year, however, and are sticking to our GDP growth forecast of 0.2 percent for 2024 as a whole.

Expected inflation bounceback in May – but disinflationary trend to remain intact

The inflation rate as measured by the national consumer price index (CPI) rose to 2.4 percent yoy in May (previous month: 2.2 percent yoy). The stronger uptick in inflation feared by some economists thus failed to materialize. The likewise published core rate remained unchanged at 3.0 percent yoy according to the flash estimate. In contrast, the CPI rose by just 0.1 percent month on month.

Though more granular details are not available as yet, the data from the federal states already indicate that, as expected, a pronounced base effect was responsible for the slight rebound in the annual rate. A year ago, the introduction of the “49-euro ticket” entitling holders to unlimited use of public transport throughout the country led to a sharp fall in the 'transport' price component, but the influence of this effect on the annual rate has now faded. This also explains a good part of the at least visually unpleasant uptrend in service prices, with the annual rate surging from 3.3 to 3.9 percent in May as month under review while goods prices again had a marked dampening effect (+1.0 percent yoy).

Though some base effects will tend to provide some alleviation in the months ahead, the weighty base effects related to energy prices will eventually come to an end. Furthermore, the inflation in services (wage development!) is proving relatively persistent. The further course of the inflation rate will thus be bumpy, on the one hand, and on the other the disinflationary trend will progress significantly more slowly than in the past twelve months. Overall, however, the latest data on consumer price developments in Germany remain consistent with our scenario that the inflation rate is gradually nearing the ECB's target of 2 percent.

Fundamental forecasts, Germany

	2023	2024	2025
GDP	-0.2	0.2	1.1
Private consumption	-0.7	0.8	1.8
Govt. consumption	-1.0	1.0	1.2
Fixed investment	-0.7	-1.0	2.4
Exports	-0.7	1.8	3.8
Imports	-2.4	1.0	5.2
Net exports ¹	0.8	0.4	-0.4
Inflation ²	6.0	2.4	2.1
Unemployment rate ³	5.7	5.9	5.7
Budget balance ⁴	-2.5	-1.7	-1.0
Current account balance ⁴	6.1	6.8	6.3

Change vs previous year as percentage, ¹as contribution to GDP growth; ²HICP; ³as percentage of the civil labour force (Federal Employment Office definition); ⁴as percentage of GDP

Sources: Feri, NORD/LB Macro Research

Quarterly forecasts, Germany

	III/23	IV/23	I/24	II/24	III/24
GDP sa qoq	0.1	-0.5	0.2	0.2	0.3
GDP nsa yoy	-0.5	-0.4	-0.9	0.6	0.6
Inflation yoy	5.7	3.0	2.7	2.5	1.9

Change as percentage

Sources: Feri, NORD/LB Macro Research

Switzerland: Industry in a more optimistic frame of mind

Analyst: Christian Reuter

Looking ahead: Setbacks in Q1/2024 not to be blown out of proportion

Q1/2024 saw Swiss GDP develop less dynamically than expected, with year-on-year growth of 0.4 percent in real terms, adjusted for calendar, seasonal and sporting event effects. This is, as before, attributable to an industrial sector that has barely been able to make progress, largely due to the weak economic environment. The service sector, on the other hand, once again delivered a solid growth contribution, driven by unexpectedly solid private consumption. In the early stages of Q2, it looks like the Swiss economy is beginning to recover from this scenario. The results of the KOF business survey in April at any rate point in this direction, with the surveyed companies in the manufacturing sector showing themselves to be in a more optimistic frame of mind, citing diminishing inflation concerns. Moreover, lower wage increases and an improved earnings situation are expected. In the manufacturing sector, hopes are also being fuelled by an upturn in foreign trade, besides which the Swiss franc's depreciation since the beginning of the year will likely also have helped boost optimism. The situation in the hospitality industry appears to be calming further, now that the catch-up effects from the COVID crisis are no longer in evidence there. Although companies in this sector are seeing a certain erosion of their previously increased pricing power, this is not necessarily bad news for the economy as a whole as it reduces inflationary pressure. On balance, the KOF Economic Barometer and KOF Business Situation indicator remain in the recovery quadrant, similar to the ifo Economic Clock for Germany, albeit at a low level, which indicates a slow recovery of the Swiss economy.

Inflation slightly up but not making for any obstacle to a key-rate cut

The figures published in early May on April's inflation probably only came as no surprise to the SNB, which in its conditional forecast also recently assumed that the monthly rate could also reach 2 percent yoy at some point. Though not going quite that far, inflation climbed from the previous month's 1.1 to 1.4 percent yoy – its highest level since December 2023. In particular package holidays abroad and air travel became more expensive. Imported goods continued to dampen inflation while the upward domestic price trend accelerated quite markedly with, for example, core inflation excluding fresh and seasonal products, energy and fuels surging to 1.2 percent yoy (previous month: 0.4 percent). Inflation can thus be said to be persistent in Switzerland as well. Isolated voices promptly called into question an interest rate cut by the SNB in June, after the Swiss central bankers had already cut their policy rate by 25bp in March. We are not among those voices, however, and draw attention to the aforementioned favourable KOF survey results from the hospitality industry, which indicate decreasing inflation in the service sector and ought to dampen domestic price pressure in the foreseeable future. Hence, from this perspective there is little standing in the way of the SNB lowering the policy rate again in June.

Fundamental forecasts*, Switzerland

	2023	2024	2025
GDP	1.2	1.2	1.8
Inflation (CPI)	2.1	1.2	1.1
Unemployment rate ¹	2.0	2.3	2.2
Budget balance ²	0.5	0.6	0.5
Current account bal. ²	7.6	8.0	7.5

Interest and exchange rates, Switzerland

	30.05.	3M	6M	12M
SNB policy rate	1.50	1.25	1.00	1.00
3M rate	1.38	0.90	0.90	0.90
10Y	0.88	0.70	0.70	0.90
Spread 10Y Bund	-177	-160	-150	-140
EUR in CHF	0.98	0.97	0.97	0.97

* Change vs previous year as percentage; ¹ as percentage of the labour force, ² as percentage of GDP

Sources: Feri, Bloomberg, NORD/LB Macro Research

Japan: The Yen remains under pressure for now

Analyst: Tobias Basse

The Yen remains under pressure for now

The carry traders' activities are making for marked pressure on the Japanese currency. The weak yen is indeed a very double-edged sword for Japan's economy. Despite the positive impact of the currency's depreciation tendencies on the domestic export industry, there are growing concerns, particularly in the Ministry of Finance, because higher import prices could have a negative impact on household consumption. Basically, therefore, hardly anything has changed of late. That said, Finance Minister Shunichi Suzuki has very clearly underscored his concerns surrounding the yen's current weakness, thus making for fresh pressure on the Bank of Japan to take action. We can therefore expect a near-term raising of the key interest rate. The central bankers in Tokyo should try to reduce the need for fresh forex market interventions. The situation remains challenging in the short term. The yield on 10-year Japanese government bonds is already hovering just above the 1.00 percent mark at present; that on their "counterparts" from the USA stands in the range of 4.50 percent, however. However, the central bankers in Washington should still see opportunities for interest rate cuts in the course of the year. Consequently, a less weak yen is to be expected in the second half of the year due to the combination of slightly higher interest rates in Japan and slightly lower rates in the United States. The central bank in Tokyo will be inclined to take a cautious approach.

Cautious rate hikes on the horizon

Against this background the FX segment will likely force the Bank of Japan to raise interest rates. Though deflationary concerns have receded even further into the background of late, aggressive key-rate adjustments are by no means to be expected in Tokyo. BoJ Governor Kazuo Ueda now faces a challenging task. He must on no account appear overly dovish in light of the merely very cautious realignment of Japanese monetary policy probably planned. The slight rate hike likely to be consensually agreed among the central bankers in Tokyo would otherwise fail to have any great impact at all on the forex market. This is definitely not something they would want. In this respect, the BoJ Governor will probably prefer to present himself at present as a monetary policy "hawk".

Fears of deflationary tendencies fade into the background

The headline rate of consumer price inflation rose by 2.5 percent yoy in April, exactly in line with our expectations. Though the CPI core rate fell to just 2.2 percent yoy, it is important to note that the almost habitual deflation fears in Japan have faded more clearly into the background of late. Wage developments can be expected to consolidate this trend for the time being. As a result, the Japanese price data ought to give the central bankers in Tokyo some leeway for rate hikes – which they most probably then will also make cautious use of.

Fundamental forecasts*, Japan

	2023	2024	2025
GDP	1.9	0.2	1.5
Inflation	3.3	2.4	1.8
Unemployment rate ¹	2.6	2.5	2.4
Budget balance ²	-5.2	-4.2	-3.6
Current account bal. ²	3.6	3.7	3.5

* Change vs previous year as percentage;

¹ as percentage of the labour force; ² as percentage of GDP

Sources: Feri, Bloomberg, NORD/LB Macro Research

Interest and exchange rates, Japan

	30.05.	3M	6M	12M
Key rate	0.10	0.20	0.20	0.25
3M rate	0.29	0.25	0.30	0.35
10Y	0.66	1.00	1.10	1.20
Spread 10Y Bund	-265	-130	-110	-110
EUR in JPY	170	165	165	157
USD in JPY	157	154	151	144

China: Stuttering economy underlines need for reform

Analyst: Valentin Jansen

Official Manufacturing PMI unexpectedly back in the contraction zone

After April's still fairly encouraging data from the purchasing managers surveyed within the framework of the official Manufacturing PMI, as well as from the Caixin Manufacturing PMI largely aimed at private companies, the former unexpectedly interrupted its recovery streak in May and slipped back into the contraction zone. With a level of 49.5 points (April: 50.4), the CFLP Manufacturing PMI thus fell to a three-month low, while analysts and economists had actually expected a slight uptick. A closer look at the details reveals bad news in the order situation and overseas demand, with the subindex for export orders dropping unexpectedly sharply to 47.2 points (April: 50.6). Should these indications also be corroborated by the Caixin Manufacturing PMI's May data and, in addition, the hard data on Chinese industrial activity also point in this direction, the pressure on Beijing will likely increase further. While the current reform plans are indeed dynamic and quite certainly reflect political will, it will likely take some time before they have any perceptible effect.

National reform efforts and foreign trade relations move into focus

As a result of the Chinese economy's tedious and rather sectoral progress, the focus of China's stock markets has meanwhile shifted onto the developments in national support programmes and foreign trade relations. Against the backdrop of what was of late the worst house price trend in ten years and a stock of unsold new-builds at an eight-year high, the PBOC is relaxing national regulations on real estate loans in its most vehement support initiative yet. Beijing also stated that local governments and state-owned enterprises should purchase unsold residential homes at "reasonable" prices and convert them into "affordable housing". The skimming of the excess supply is to be accompanied by financing from state-owned banks. However, this stimulus has so far met with restraint on the stock markets – many market participants remain sceptical as to a near-term bottoming out of real estate prices. As regards foreign trade relations, new levels of escalation in punitive tariffs are particularly weighing on sentiment.

Interest rate cuts still on hold

Despite what are actually sound arguments in favour of key-rate cuts, the Chinese central bank held back for the ninth month in a row at its May meeting, leaving the important one-year key rate unchanged. Currency stability, which has come under significant pressure in the global interest rate environment, remains a key issue for the government. The PBOC's scope for monetary easing will likely remain limited until the two most important central banks on either side of the Atlantic start reversing their restrictive monetary policy. An initial rate cut by the ECB at mid-year will open a time window for the PBOC; rate adjustments of -15 basis points have been common practice so far.

Fundamental forecasts*, China

	2023	2024	2025
GDP	5.2	4.8	4.5
Inflation	0.3	0.7	1.5
Unemployment rate ¹	5.5	5.2	5.2
Budget balance ²	-4.6	-4.8	-4.8
Current account bal. ²	1.4	1.8	1.3

* Change vs previous year as percentage;

¹ as percentage of the labour force; ² as percentage of GDP

Sources: Feri, Bloomberg, NORD/LB Macro Research

Interest and exchange rates, China

	30.05.	3M	6M	12M
Deposit rate	1.50	1.50	1.50	1.50
3M SHIBOR	1.96	2.00	2.00	2.00
10Y	2.31	2.30	2.30	2.30
Spread 10Y Bund	-34	0	10	0
EUR in CNY	7.83	7.76	7.85	7.79
USD in CNY	7.23	7.25	7.20	7.15

Britain: Upheavals could be on the horizon

Analyst: Constantin Lüer

Is a base effect positioning inflation on the home stretch?

If the inflation rate still to be published for May 2024 as month under review stands at no more than 0.4 percent, month on month, the Bank of England's target will have been achieved: price stability! This target rate is, as with the Fed and the ECB, 2.0 percent in the United Kingdom. The fact that inflation is so rapidly closing in on this threshold can continue being attributed to a base effect. The high inflation figures from spring 2023 are gradually losing their significance for the annual rate's calculation, which explains why April 2024 saw the Office for National Statistics report a level of just 2.3 percent yoy (0.3 percent mom). Although this would mark a crucial milestone, the MPC will nevertheless not necessarily be inclined to automatically reduce the Bank Rate. The BoE's policymakers would first wish to establish that the price trend will foreseeably stabilize at a sustainably low level, besides which the upside risks of a rebound in the inflation rate still don't appear to have been averted. The MPC has at all times stressed these two factors. Moreover, implications for the Bank of England's monetary policy could also come from 10 Downing Street in the near future, as the UK too is set to hold new elections this year.

Super election year 2024 – UK edition

The turbulent tenure of the Conservative Party ("Tories" for short) headed by current Prime Minister Rishi Sunak will soon either mark a significant milestone of its own or – more likely – come to an abrupt end. The government set July 4th as date for the general election, which leaves a narrow time frame of just six weeks between the announcement and the actual election day. Such short deadlines for elections are not uncommon in the UK, however. The latest opinion polls suggest there could well be an imminent change of government. Besides smaller parties, the party landscape in the United Kingdom is primarily focussed on the aforementioned Tories and the centre-left leaning Labour Party, currently in opposition, with its lead candidate Keir Starmer. The Tories have steadily lost popularity in recent years, with their approval rating currently hovering at around just 20 percent, with the party's frequent leadership changes, which attracted considerable attention from the media, likely having been a contributory factor. Above all, however, its failed Brexit policy and high inflation will likely prove major drawbacks for the party. Labour, on the other hand, has seen a surge in voter approval, consistently heading the opinion polls since late 2021 – the most recent of which puts the party at just short of 46 percent, making it by far the strongest political force. Reform UK, also known as the Brexit party, is causing some disruption, however, although it more likely appeals to the Tories' voter base. This would make re-election even more difficult for the governing party.

Fundamental forecasts*, Britain

	2023	2024	2025
GDP	0.1	0.5	1.2
Inflation (CPI)	7.3	2.9	2.2
Unemployment rate ¹	4.0	4.4	4.5
Budget balance ²	-5.0	-3.5	-3.0
Current account bal. ²	-3.3	-2.7	-2.8

* Change vs previous year as percentage

¹ as percentage of the labour force as per ILO concept,

² as percentage of GDP

Sources: Feri, Bloomberg, NORD/LB Macro Research

Interest and exchange rates, Britain

	30.05.	3M	6M	12M
Repo rate	5.25	5.00	4.75	4.25
3M rate	5.20	4.78	4.55	4.03
10Y	4.35	3.80	3.68	3.50
Spread 10Y Bund	170	150	148	120
EUR in GBP	0.85	0.86	0.86	0.86
GBP in USD	1.27	1.24	1.27	1.27

Portfolio strategies

Yield curve, Euroland

Yields and forecasts (Bunds/Swap)

	Yields (in %)	NORD/LB forecasts for horizons		
	30.05.2024	3M	6M	12M
3M	3.79	3.60	3.30	2.90
1Y	3.41	2.90	2.60	2.20
2Y	3.08	2.50	2.30	2.00
3Y	2.85	2.37	2.17	2.00
4Y	2.74	2.30	2.10	2.04
5Y	2.69	2.30	2.10	2.10
6Y	2.66	2.30	2.13	2.15
7Y	2.64	2.30	2.15	2.19
8Y	2.59	2.30	2.17	2.23
9Y	2.62	2.30	2.19	2.27
10Y	2.65	2.30	2.20	2.30
2Y (Swap)	3.38	2.85	2.65	2.40
5Y (Swap)	2.99	2.65	2.45	2.50
10Y (Swap)	2.88	2.65	2.55	2.70

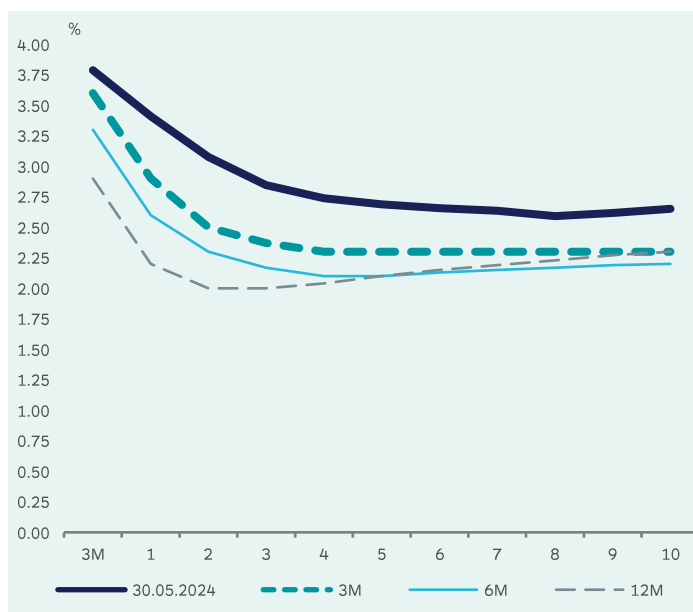
Sources: Bloomberg, NORD/LB Macro Research

Forecasts and total returns

	Total returns (in %) for horizons...		
	3M	6M	12M
3M	0.95	1.85	3.49
1Y	1.22	2.09	3.41
2Y	1.59	2.47	3.95
3Y	1.91	1.58	4.56
4Y	2.21	3.42	4.92
5Y	2.44	3.90	5.23
6Y	2.62	4.19	5.38
7Y	2.80	4.39	5.47
8Y	2.89	4.54	5.45
9Y	3.22	4.80	5.61
10Y	3.78	5.35	5.93

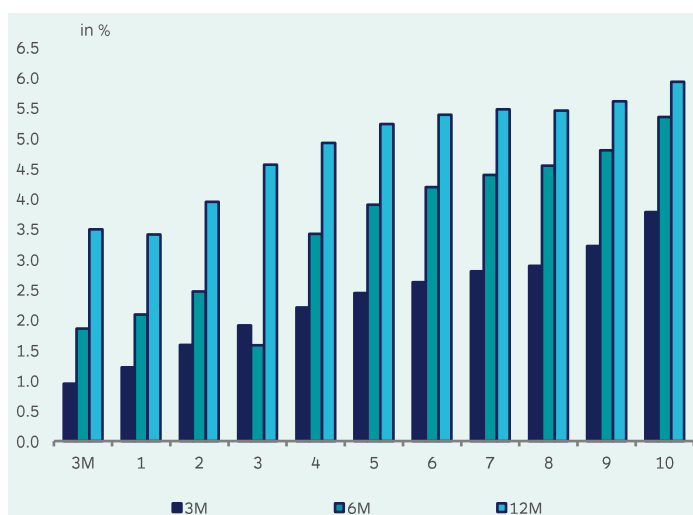
Sources: Bloomberg, NORD/LB Macro Research

Yield curve forecasts (Bunds)



Sources: Bloomberg, NORD/LB Macro Research

Expected total returns



Sources: Bloomberg, NORD/LB Macro Research

A total return is the absolute profit from an investment in the time period under consideration, with account being taken of the pro-rata yields plus the price gains or losses to be anticipated on the basis of the forecast yield curve change.

Portfolio strategies

International yield curve: 3-month & 12-month horizons

3-month horizon

Expected total returns (as percentage) in euro					
	EUR	USD	GBP	JPY	CHF
1Y	1.2	2.4	0.1	3.0	1.4
2Y	1.6	1.9	-0.5	3.3	1.7
3Y	1.9	1.8	-0.8	3.2	2.0
4Y	2.2	1.6	-0.3	3.1	2.2
5Y	2.4	1.2	-0.7	3.4	2.3
6Y	2.6	2.1	-0.8	3.1	2.1
7Y	2.8	0.6	-0.1	3.2	2.3
8Y	2.9	0.6	0.3	3.3	2.6
9Y	3.2	0.8	1.6	3.4	2.5
10Y	3.8	1.0	3.1	4.0	2.8

Sources: Bloomberg, NORD/LB Macro Research

Expected total returns (as percentage) in national currencies				
	USD	GBP	JPY	CHF
1Y	1.2	1.2	0.1	0.5
2Y	0.6	0.6	0.2	1.1
3Y	0.6	0.2	0.2	1.1
4Y	0.3	0.7	0.2	1.3
5Y	-0.1	0.4	0.5	1.4
6Y	0.8	0.2	0.1	1.3
7Y	-0.6	1.0	0.3	1.4
8Y	-0.6	1.4	0.4	1.8
9Y	-0.5	2.7	0.5	1.6
10Y	-0.3	4.2	1.0	1.9

Sources: Bloomberg, NORD/LB Macro Research

12-month horizon

Expected total returns (as percentage) in euro					
	EUR	USD	GBP	JPY	CHF
1Y	3.4	4.1	3.7	8.4	2.0
2Y	3.9	3.6	3.7	8.7	2.2
3Y	4.6	3.6	3.9	8.8	2.5
4Y	4.9	3.9	4.4	8.8	2.7
5Y	5.2	4.3	4.5	9.2	3.1
6Y	5.4	6.0	4.7	8.8	3.0
7Y	5.5	5.0	5.8	8.9	2.9
8Y	5.5	5.3	6.3	8.8	2.6
9Y	5.6	5.7	7.6	8.7	2.1
10Y	5.9	6.0	8.6	9.0	1.5

Sources: Bloomberg, NORD/LB Macro Research

Expected total returns (as percentage) in national currencies				
	USD	GBP	JPY	CHF
1Y	4.8	4.8	0.2	1.1
2Y	4.2	4.8	0.5	1.3
3Y	4.2	5.0	0.5	1.6
4Y	4.6	5.5	0.6	1.8
5Y	4.9	5.6	1.0	2.2
6Y	6.6	5.9	0.6	2.1
7Y	5.7	7.0	0.7	2.0
8Y	6.0	7.4	0.6	1.7
9Y	6.4	8.8	0.5	1.2
10Y	6.7	9.8	0.8	0.6

Sources: Bloomberg, NORD/LB Macro Research

A total return is the absolute profit from an investment in the time period under consideration, with account being taken of the pro-rata yields plus the price gains or losses to be anticipated on the basis of the forecast yield curve and exchange rate change.

Portfolio strategies

Stock market strategy; 3-month, 6-month & 12-month horizons

Levels and performance

Index	Level		Status		Performance since	
	as at		Start of year	Previous month	Start of year	Start of year
	30.05.2024	Previous month				
DAX	18,496.79	17,932.17	16,751.64	3.15%	10.42%	
MDAX	26,805.43	26,264.39	27,137.30	2.06%	-1.22%	
EuroSTOXX50	4,982.18	4,921.22	4,521.44	1.24%	10.19%	
STOXX50	4,464.07	4,395.30	4,093.37	1.56%	9.06%	
STOXX600	516.50	504.89	478.99	2.30%	7.83%	
Dow Jones	38,111.48	37,815.92	37,689.54	1.65%	2.00%	
S&P 500	5,235.48	5,035.69	4,769.83	4.59%	10.42%	
Nikkei	38,054.13	38,405.66	33,464.17	-0.92%	13.72%	

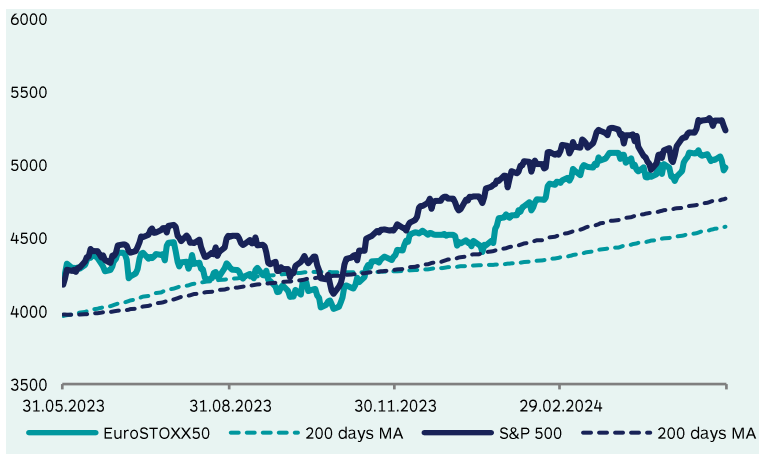
Sources: Bloomberg, NORD/LB Macro Research

Index forecasts

Index	NORD/LB forecast		
	for horizons ...		
	3M	6M	12M
DAX	17,500	18,500	19,000
MDAX	25,500	26,700	27,400
EuroSTOXX50	4,700	4,950	5,100
STOXX50	4,350	4,400	4,450
STOXX600	500	510	550
Dow Jones	37,500	38,000	38,500
S&P 500	5,000	5,000	5,100
Nikkei	37,500	38,000	38,500

Sources: Bloomberg, NORD/LB Macro Research

EuroSTOXX50 and S&P500



Sources: Bloomberg, NORD/LB Macro Research

Date of going to press for data, forecasts and texts was **Friday, 31 May 2024**.

The next English issue of Economic Adviser will be appearing on **1 July 2024**.

Overview of forecasts

Fundamental forecasts

in %	GDP growth			Rate of inflation			Unemployment rate ¹			Budgetary balance ²		
	2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025
USA	2.5	2.2	1.7	4.1	3.2	2.3	3.6	3.9	4.2	-6.5	-5.9	-6.1
Euroland	0.5	0.7	1.4	5.4	2.3	2.0	6.6	6.4	6.3	-3.6	-2.8	-2.6
Germany	-0.2	0.2	1.1	6.0	2.4	2.1	5.7	5.9	5.7	-2.5	-1.7	-1.0
Japan	1.9	0.2	1.5	3.3	2.4	1.8	2.6	2.5	2.4	-5.2	-4.2	-3.6
Britain	0.1	0.5	1.2	7.3	2.9	2.2	4.0	4.4	4.5	-5.0	-3.5	-3.0
Switzerland	1.2	1.2	1.8	2.1	1.2	1.1	2.0	2.3	2.2	0.5	0.6	0.5
China	5.2	4.8	4.5	0.3	0.7	1.5	5.5	5.2	5.2	-4.6	-4.8	-4.8

Change vs previous year as percentage; ¹ as percentage of the labour force (Germany: as per Federal Employment Office definition); ² as percentage of GDP

Sources: Feri, NORD/LB Macro Research

Key interest rates

In %	30.05.24	3M	6M	12M
USD	5.50	5.25	5.00	4.25
EUR	4.50	4.25	3.65	3.15
JPY	0.10	0.20	0.20	0.25
GBP	5.25	5.00	4.75	4.25
CHF	1.50	1.25	1.00	1.00
CNY	1.50	1.50	1.50	1.50

Sources: Bloomberg, NORD/LB Macro Research

Exchange rates

EUR in...	30.05.24	3M	6M	12M
USD	1.08	1.07	1.09	1.09
JPY	170	165	165	157
GBP	0.85	0.86	0.86	0.86
CHF	0.98	0.97	0.97	0.97
CNY	7.83	7.76	7.85	7.79

Interest rates (government bonds)

	3M rates				Yields 2Y				Yields 5Y				Yields 10Y			
	30.05.	3M	6M	12M	30.05.	3M	6M	12M	30.05.	3M	6M	12M	30.05.	3M	6M	12M
USD	5.35	5.00	4.70	4.10	4.92	4.60	4.30	3.90	4.57	4.30	4.10	3.60	4.55	4.00	3.70	3.50
EUR	3.79	3.60	3.30	2.90	3.08	2.50	2.30	2.00	2.69	2.30	2.10	2.10	2.65	2.30	2.20	2.30
JPY	0.29	0.25	0.30	0.35	0.06	0.20	0.25	0.30	0.26	0.35	0.40	0.45	0.66	1.00	1.10	1.20
GBP	5.20	4.78	4.55	4.03	4.47	4.68	4.46	3.96	4.23	4.35	4.08	4.22	4.35	3.80	3.68	3.50
CHF	1.38	0.90	0.90	0.90	1.09	0.75	0.70	0.80	1.01	0.75	0.70	0.70	0.88	0.70	0.70	0.90

Sources: Bloomberg, NORD/LB Macro Research

Spreads (bp)

	3M EURIBOR				2Y Bunds				5Y Bunds				10Y Bunds			
	30.05.	3M	6M	12M	30.05.	3M	6M	12M	30.05.	3M	6M	12M	30.05.	3M	6M	12M
USD	156	140	140	120	185	210	200	190	188	200	200	150	189	170	150	120
JPY	-350	-335	-300	-255	-302	-230	-205	-170	-243	-195	-170	-165	-199	-130	-110	-110
GBP	141	118	125	113	139	218	216	196	155	205	198	212	170	150	148	120
CHF	-240	-270	-240	-200	-199	-175	-160	-120	-168	-155	-140	-140	-177	-160	-150	-140

Sources: Bloomberg, NORD/LB Macro Research

Annex



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