GOVERNMENT BOND MARKETS RATTLED BY ANOTHER STRONG INFLATION READING IN THE US

This week bond markets were unsettled by US inflation rising for the second month in a row. CPI and core inflation both increased as services prices continue to rise swiftly. Markets have quickly reversed assumptions they held only a few weeks ago and the Federal Reserve is now expected to cut rates no earlier than August and the number of rate cuts expected has fallen to just two. The big drop in bond values serves as a reminder of how poor markets and central banks have been at forecasting inflation over the last few years.

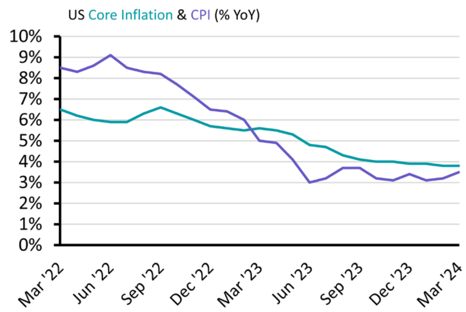
The sell off in US treasuries spilled over to UK and European bonds. However, the outlook for the UK and Europe is quite different. For example, UK CPI is tipped to fall below 2%, yet the yield on 10-year gilts tracked the rise of US yields mid-week. The European Central Bank indicated a June rate cut is still likely and this reminded markets that other central banks don't have to blindly follow the Fed. This helped European government bonds recover and gilts have also risen as markets have had time to consider whether one-size fits all when it comes to interest rate policies.

THE MARKETS THIS WEEK

FTSE 100	S&P 500	Nikkei 225	MSCI Europe	Hang Seng	US 10 Yr	UK 10 Yr	Brent Crude	Gold	Iron Ore	GBP USD
+1.53%	+0.66%	+0.53%	+1.09%	-0.75%	+0.20%	+0.11%	-0.03%	+5.62%	+1.47%	-0.95%

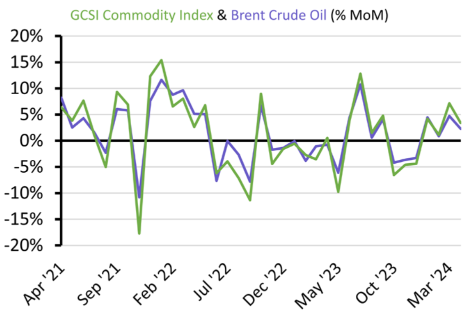
US: RISING INFLATION CAUSES GOVERNMENT BOND SELL OFF

An unexpected increase in US inflation sent bond yields up as investors were forced to reconsider their assumptions for interest rate cuts this year. Two weeks ago Federal Reserve chair Jerome Powell was talking about the potential for rate cuts if there was progress with inflation. However, this is the second successive increase as CPI has risen to 3.5%, up from 3.1% in January, mainly due to the rising cost of services. Core inflation, excluding more volatile energy and food prices, also increased last month.



Rising inflation caused markets to push back their expectations for when the Fed will cut rates and this caused bond values to fall, pushing yields up. US equities also fell mid-week and the prospect of US rates remaining high helped the dollar extend its gains against most major currencies, with the yen experiencing the biggest decline. The European Central Bank left interest rates on hold as expected, but the changed outlook in the US means the timing of future rate cuts in the UK and Europe has also been questioned.

OIL: MIDDLE EAST TENSION AND RISING DEMAND PUSH UP OIL PRICE

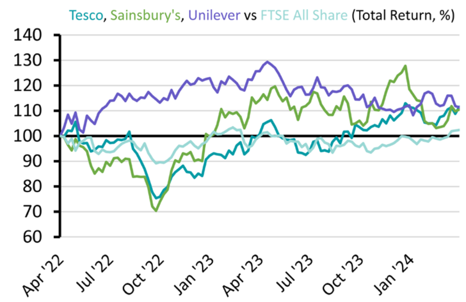


The price of crude oil has increased around 10% in recent weeks as fears that conflict in the Middle East may broaden and begin to affect supply. In 2023 oil peaked around $92 a barrel for Brent crude. It has been trading around $80 for the last six months but appreciated to $90 earlier this month. Israel's ongoing invasion of Gaza is raising tension in the region and if Iran gets directly involved this could significantly disrupt oil supplies. In addition, signs that Chinese industrial production is increasing means greater demand when oil supply is being kept tight by the OPEC countries.

Separately, Shell has raised the possibility of moving its stock market listing to the US as it views the higher valuations of its US-based rivals. The current CEO and his immediate predecessor both said this week that a move to the US may be in the best interest of the company as it would make financing cheaper, increase the share price and it would face what the company sees as a more positive attitude from investors.

EQUITIES: LOWER INFLATION EXPECTED TO BOOST RETAILERS' PROFITS

Tesco announced a big increase in annual profits as it forecast that falling inflation should help boost profitability. The company said sales increased more than 7% for the year to February and profits were up from £882m in 2023 to £2.3bn this year. It said slowing inflation and improving consumer sentiment have helped it grow market share and it plans a £1bn share buyback.



Rising food prices have been one of the biggest drivers of headline inflation as general food inflation topped 15% in the first half of 2023. This has dropped back to 3.7% in March, and competition between retailers means considerable downward pressure on supermarket pricing. Tesco and Sainsbury's are both looking for efficiency savings and increasing overall customer spending rather than raising prices to boost profits. Companies with higher pricing power, such as Unilever, have been able to protect profits by passing on higher costs but they are also looking to falling inflation to boost profits as they target greater sales.

Data sourced from Trading Economics and Yahoo Finance