STRENGTH OF THE US ECONOMY CAUSES MARKETS TO REVIEW EXPECTATIONS FOR RATE CUTS

This week markets have again been unsettled by US economic strength. Since last autumn bond investors have been testing central banks' willingness to keep rates high and have regularly had to adjust their outlooks when confronted by sticky inflation, high economic growth and central bank intransigence. In this instance it is robust US consumer demand which prompted US Fed governor Jerome Powell to concede that rates are likely to remain high after all. Government bonds initially fell, but sentiment improved during the week and bond markets mostly recovered. The drop in equities has been more significant as fears of a wider conflict in the Middle East triggered some profit taking after recent gains.

Although the potential delay to rate cuts in the US has been the main driver of recent market moves, this week also made it more likely that the EU and UK will cut rates before the US. The better inflation picture in Europe means the ECB remains on track for a June cut and the continued decline of inflation in the UK, combined with the weaker jobs market, gives the Bank of England some room to diverge from the Fed's path.

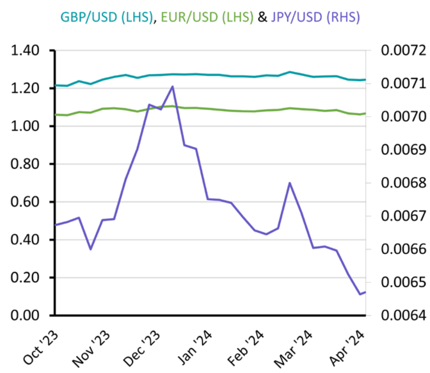
THE MARKETS THIS WEEK

FTSE 100	S&P 500	Nikkei 225	MSCI Europe	Hang Seng	US 10 Yr	UK 10 Yr	Brent Crude	Gold	Iron Ore	GBP USD
-2.40%	-4.15%	-5.90%	-2.91%	-3.09%	+0.05%	+0.07%	-3.50%	-0.07%	+3.60%	-0.60%

US: CONSUMER SPENDING FORCES MARKETS TO RECONSIDER RATE CUTS

Evidence of the strength of the US economy caused further volatility in bond markets. US retail sales increased by 4% in March compared to last year - far more than forecast - and the International Monetary Fund has tipped the US to grow at twice the average rate of the G7 countries. Evidence of robust economic activity prompted Federal Reserve governor Jerome Powell to concede it would take "longer than expected" for inflation to return to target.

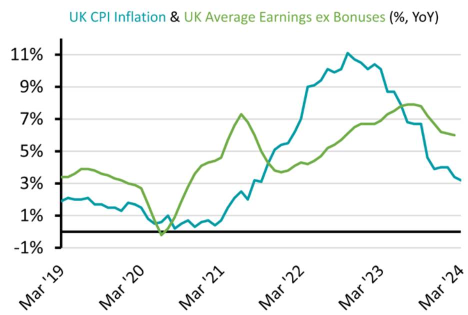
Investors have pushed back the forecast for the timing of rate cuts and this caused government bonds to fall mid-week, pushing yields towards their highest since early November. However, sentiment improved towards the end of the week as yields fell back. US equities have also been unsettled by the changed outlook and concerns about the spread of war in the Middle East also contributed to a big decline. The potential for US rates to remain high helped the dollar make further gains against most major currencies.



UK: FALLING INFLATION OPENS THE WAY FOR UK TO CUT RATES BEFORE US

UK CPI inflation slowed to 3.2% in March due to falling food prices and lower energy costs. This is down from 3.4% in February. Core inflation (excluding volatile food and energy prices) also fell, but inflation within the services sector remains high. The reduction in the price cap for domestic energy bills is expected to help inflation return to target in the short term, however, the Bank of England remains concerned about the potential for inflation to pick up again later this year, partly due to rising wages.

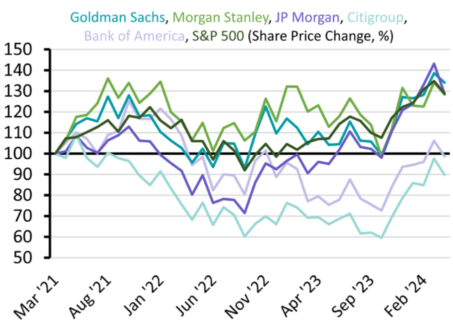
Wages continue to rise faster than inflation, as average wages excluding bonuses are up 6% compared to last year. Job vacancies remain higher than usual, but the unemployment rate and the number of economically inactive people increased. Meanwhile, the UK's listed recruitment companies have reported a drop in revenues and profits as companies become more cautious about hiring new staff. The weaker outlook allowed Bank of England governor Andrew Bailey to raise the prospect of the UK cutting rates before the US.



EQUITIES: VOLATILE MARKETS HELP BOOST WALL STREET BANK PROFITS

Wall Street banks got the latest round of earnings updates off to a relatively strong start as most of the big five US banks announced higher profits. Overall profits at Goldman Sachs increased by 28% in the first quarter. This was far above expectations, as revenues from its trading business benefited from volatile markets. Morgan Stanley reported profits for its first quarter had risen 14%, helped by higher fees from stock market listings and growth in its wealth management division. These follow higher profits from JP Morgan and Citibank, which reported last week. Strong earnings have been reflected in their share prices in 2024, with most of the big banks outperforming the S&P 500 since the start of the year.

However, there are some signs that higher interest rates are beginning to drag on bank earnings. Most of the big banks have reported a sharp decline in the volume of corporate lending as businesses become more cautious of taking on additional debt.



Data sourced from Trading Economics and Yahoo Finance