



The Bulletin

May 2015

Sharp rise in bond yields

Overview Having fallen further in the weeks following the commencement of the ECB's QE in early March, German 10-year bond yields have risen by 60bps - to almost 0.7% - over the past month, thus more than reversing the decline that had occurred since the start of the year. This sudden and swift spike in yields seems to be related to a large extent to some unwinding of the extreme market positioning that had driven yields to exceptionally low levels. It may also in part reflect the improved outlook for the Euro area economy - growth has gathered momentum recently - and diminished fears of a continuing fall in inflation in the zone. US yields have also risen since mid-April but by less than the increase in German yields, with the narrowing differential between the two perhaps contributing to the euro's recent rebound against the dollar. It is more likely than not, though, that US yields will again rise relative to German yields as the Fed starts to raise interest rates later this year while the ECB maintains a highly accommodative monetary policy stance. This in turn is likely to be accompanied by a renewed rise in the dollar.

Euro area gathers momentum

UK growth eases in Q1

US unemployment falls further

Diary	Euro Area	UK	US
Central Bank Meetings	Jun 3	Jun 4	Jun 17
GDP	Jun 5	May 29	May 29
Inflation	Jun 2	May 19	May 22
Labour Market	Jun 2	Jun 17	Jun 5

Forecasts

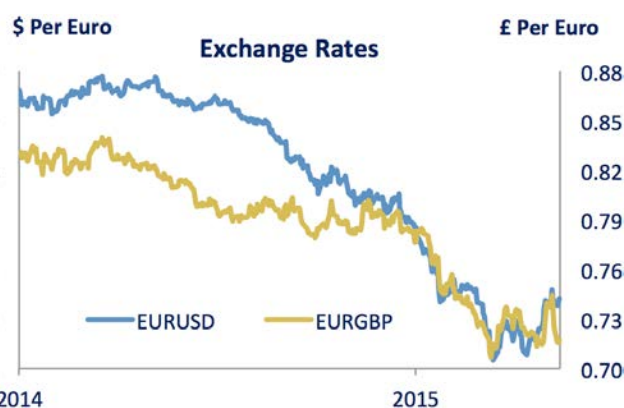
	End Jun 2015	End Sep 2015	End Dec 2015	End Mar 2016
Exchange Rates				
€/\$	1.08	1.05	1.03	1.03
€/£	0.72	0.71	0.70	0.70
£/\$	1.50	1.48	1.47	1.47
Swap Rates (5 year)				
Euro Area	0.40	0.50	0.70	0.90
UK	1.60	1.80	2.00	2.30
US	1.80	2.00	2.30	2.60

Euro Area gathers momentum

The economy gathered momentum in Q1 with GDP rising by 0.4% q-o-q. France led the way amongst the large economies - GDP rose by 0.6% - while growth in Germany eased to 0.3%. The Italian economy expanded for the first quarter in six. The available data suggests activity in the zone is being sustained at a solid pace in Q2, while the EU Commission has revised up its growth forecast for this year to 1.5%. Inflation rose to 0% in April, up from a low of minus 0.6% in January. The ECB's QE continues with asset purchases to date totalling almost €135bn. This notwithstanding, bond yields have risen recently led by a 60bps increase in German 10-year yields (to 0.7%) Peripheral yields have also risen but generally by less than the increase in German yields, hence spreads have narrowed. The euro has strengthened to \$1.13. These moves seem to reflect for the most part some unwinding of extreme positioning in markets, though they may also reflect the improved economic outlook and diminished fears of a continuing fall in inflation. Negotiations continue between Greece and its creditors to secure an agreement.

UK growth eases in Q1

The economy grew by 0.3% q-o-q in Q1 having expanded by 0.6% in Q4 2014. Activity slowed in the services sector, although it was still the sole driver of growth as both industrial and construction output fell. The latest survey data suggests GDP growth should pick up in Q2 with the Purchasing Managers' composite index in April running well ahead of its level in the first quarter. Employment rose by 0.7% in Q1 while the unemployment rate fell to 5.5%, its lowest level since July 2008. The BOE kept interest rates unchanged in April and in its May Inflation Report reiterated that rates are likely to rise gradually over the next few years. The market currently expects a first hike in the second quarter of 2016. In the general election, the Conservative Party won an overall majority, securing 331 of the 650 seats in parliament, with PM Cameron restating his pledge to hold an in-out referendum on UK membership of the EU. The election outcome saw sterling recover to 72p against the euro from a low of c.75p prior to the vote.



US unemployment falls further

GDP was flat in Q1 having expanded by 0.5% q-o-q in Q4 2014. Consumer spending slowed from the brisk pace in the previous quarter, while exports and investment both fell. The Fed acknowledged the Q1 slowdown in its April policy statement but said it 'in part reflected transitory factors' (e.g. poor weather). Hence it expects activity to pick up again and to expand at a 'moderate pace' over the remainder of 2015. Employment rebounded in April, increasing by 223k, while the unemployment rate fell to 5.4%, its lowest level since May 2008. The Fed left interest rates unchanged in April and reiterated that it will be appropriate to start raising them when 'it has seen further improvement in the labour market'. This leaves it on course to hike rates this year, though it may not hold off until as late as December as the market expects. US 10-year bond yields have risen by c.30bps over the past month, seemingly taking direction from the rise in German yields, while the dollar has fallen to \$1.13 against the euro.

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