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BONHÔTE

Turbulent end to the week in markets

Overview

Christine Lagarde's comments on ECB monetary policy were major news for investors towards the end of last week. Although leaving rates are left unchanged at this stage, the direction of travel is clear: net asset purchases will cease on 1 July. This is what needs to happen first before rate hikes can be undertaken. Since beginning in 2015, the colossal asset purchases have amounted to more than EUR 5 trillion, inflating the ECB's total assets to EUR 8.8 trillion.

So the buying is over, although maturing debt will be rolled over in full. Next will probably be a quarter-point increase in the refi rate on 21 July and at least another quarter-point in September. By September, the ECB should be out of negative rate territory, whereby banks are currently charged 0.5% on all monies parked with the central bank.

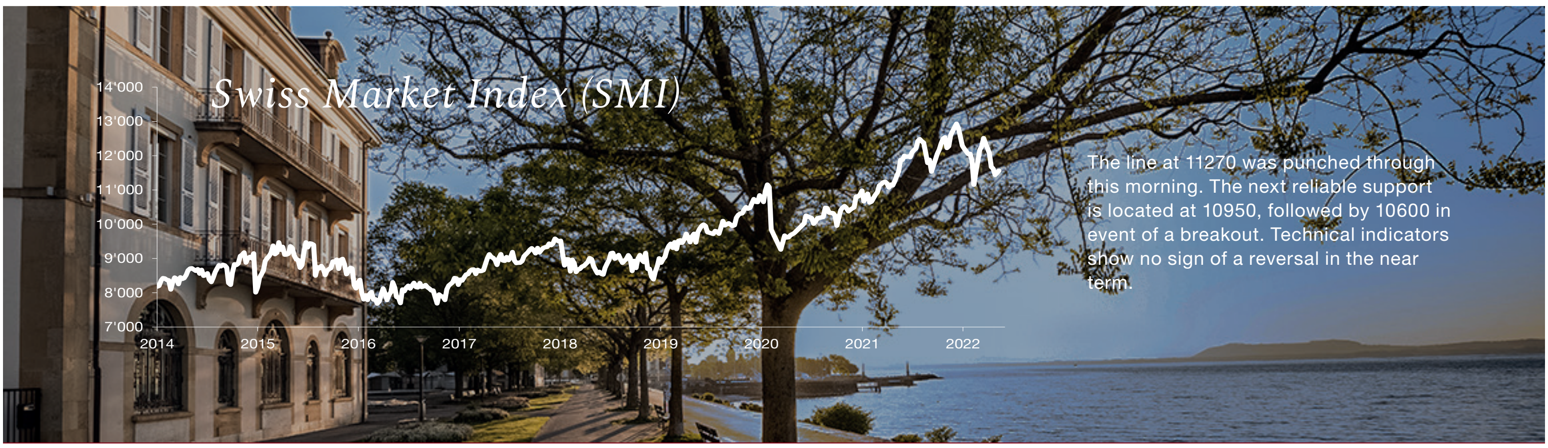
ECB to halt net asset purchases on 1 July

What unsettled investors with Lagarde's speech was undoubtedly that she left the door wide open to a half-point increase in September. Headline Eurozone inflation, most recently at 8.1% (a weighted average), conceals the fact that in almost three-quarters of EMU members, price growth is hurtling along above this figure.

For the most indebted Eurozone countries, the higher market rates have already spread widely along the yield curve. For example, Italy was still borrowing for 10 years at 0.6% a year ago, but this has now risen to 3.6%, representing a gain of 3 percentage points in the space of 12 months. Italy's debt equates to over 150% of its gross domestic product, and public borrowing totals EUR 3.1 trillion. On this amount of debt, the impact of a 2-3% increase in the funding cost is equivalent to an additional EUR 75 billion in interest charges. The ECB must therefore pay particular attention to how it communicates and to its timetable for making changes, which it is trying to keep as cogent as possible. This probably explains why it has not yet raised rates at all whereas many other central banks such as the Fed and the Bank of England already have.

US inflation at highest level since 1981

Friday's inflation data out of the US did nothing to calm markets. Just as many investors were hoping that the inflation spike was behind us, CPI for May clocked in at 8.6%, above the expected 8.3% and representing the hottest level since 1981, all of which dashed hopes for more moderate rate hikes from the Fed. It should be noted that headline inflation is calculated relative to the same period in the previous year, so the prior-year base is always a factor. Moreover, a reversal in the inflation trend cannot be determined on the basis of a single publication. Patience is the watchword at this juncture.

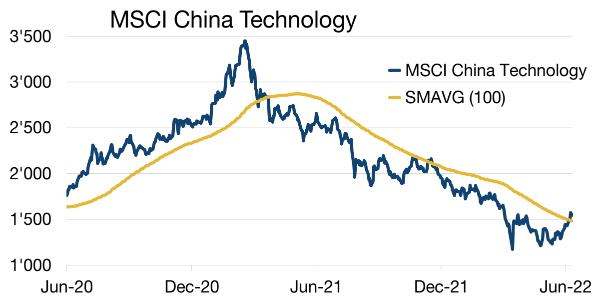


Key data

	USD/CHF	EUR/CHF	SMI	EURO STOXX 50	DAX 30	CAC 40	FTSE 100	S&P 500	NASDAQ	NIKKEI	MSCI Emerging Markets
Latest	0.99	1.04	11'084.62	3'599.20	13'761.83	6'187.23	7'317.52	3'900.86	11'340.02	27'824.29	1'054.64
Trend	↑	→	↓	↓	↓	↓	↓	↓	↓	↑	→
YTD	8.26%	0.12%	-13.91%	-16.27%	-13.37%	-13.50%	-0.91%	-18.16%	-27.52%	-3.36%	-14.40%

(values from the Friday preceding publication)

Better days for Chinese tech



A change of course is emerging for Chinese tech stocks. Recently, the sector has risen on renewed investor optimism – with Alibaba's stock up 40% since the beginning of the month – buoyed by a string of better-than-expected earnings releases and easing regulatory clampdowns.

Until a few months ago, some US banks considered the Chinese market off limits for investments in view of the regulatory haze and the lockdown measures from Beijing. A string of limitations imposed on internet firms such as Tencent – which was hit by limits on video-game time for teenagers and a ban on new game licences, or the banned listing of Ant, Alibaba's financial services arm – had earlier caused a massive sell-off in these stocks. In the last two months, however, the authorities have waved through the launch of 45 video games, ending a long freeze on approvals and suggesting more leniency towards the tech giants.

In addition, the easing of restrictions in Shanghai has enabled Chinese exporters and importers to stage an unexpectedly strong comeback, which is encouraging for the Chinese economy and, by extension, Chinese equities, which are going cheap at the moment. The government's long-term ambitions for automation, artificial intelligence and digitalisation are expected to part-solve supply chain issues, providing a further argument for investing in China's technology industry.

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