

Cromwell's European Market Monitor

Q1 2024

Our Perspective on Financial Markets



ECB Signals v Market Expectations

Interest rate cut speculation has excited the market but we think it is being over-optimistic on when base rates will fall

ECB Does Not Signal Imminent Rate Cuts

- The market consensus is that the ECB Deposit Rate has peaked at 4.0%, however the expectation of aggressive cuts during 2024 may prove to be overly optimistic.
- Following the January meeting ECB President Christine Lagarde insisted it was “premature to discuss rate cuts” and their decision would be data dependent. Since then, the latest Eurozone inflation for January fell by 10 basis points to 2.8%₁ but the decline in core inflation was lower than consensus projections.
- We believe interest rates will be higher for longer and the first cut will be in H2 2024₂, dependant on inflation/recession indicators.

Next Few Data Readings Will Determine The Trajectory

- Market expectations at the end of 2023 suggested 4 or 5 interest cuts during 2024 with rates settling below 3% at the end of 2024. This was also represented in the 5Y swap curve bottoming out at 2.28% in December 2023₁.
- Since January however, these expectations have been tempered somewhat as 5Y Swap rates ended the month higher at 2.47%. This reflects higher inflation numbers in the Eurozone in December (2.9%). The 10Y Bund also reflects this sentiment increasing from 2.07% (early Jan) to 2.16% (early Feb)₁.
- Inconclusive data creates uncertainty about the future direction of interest rates. We expect some clarity as the next few data points are released.

Inflation Could Rise Again Given Supply Chain Risks

- ECB official statements are that rate cuts will only happen once there is evidence that inflation is under control, which we expect means successive months of falling inflation towards or below the 2% range.
- The ongoing situation in the Middle East and the Red Sea trade route, as well as the impact of drought on the Panama Canal, will create upward inflationary pressure. The next few readings will provide a clearer indication on the likely outlook for inflation and therefore rates.
- Initial Q4 2023 GDP growth estimates₃ were 0.1% for the Eurozone compared to -0.1% in Q3 2023 suggesting a recession was narrowly avoided. This reduces the need to lower interest rates in order to stimulate the economy.

Sources:
1: Reuters
2: Cromwell Property Group Q1 2024
3: ECB Data

Our Economic Forecasts

Weak near-term growth outlook and CPI inconsistency imply base rates cuts no sooner than H2 2024

Macro-economic Forecasts₁

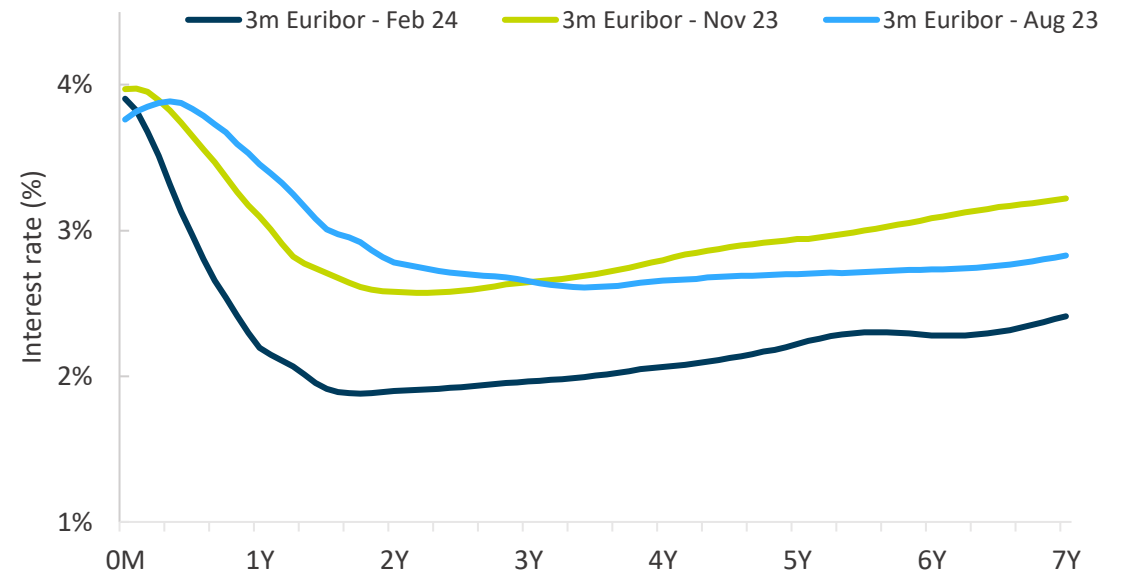
	2023		2024		2025		2026	
	UK	EU	UK	EU	UK	EU	UK	EU
GDP growth YoY	0.3	0.5	0.6	0.6	1.6	1.8	1.9	2.0
CPI average YoY	7.3	5.4	3.3	2.8	3.0	2.4	3.0	3.0
Unemployment rate	4.1	6.5	4.5	6.6	4.3	6.5	4.0	6.4

- The UK/EU avoided a recession last year but the **near-term growth outlook remains weak**. GDP growth of just 0.6% is expected in 2024₁ and it will not exceed 2.0% until beyond our forecast period. **Unemployment is set to rise this year** although it will remain low by historical standards and should fall from 2025. We see **labour availability as a major strategic challenge** for the UK/EU as it faces an ageing population, strong resistance to higher immigration and a need for new skills.
- UK/EU CPI has fallen markedly over the last year but rose in December. **Core inflation is higher and we see high potential of upwards price pressure in 2024** from wages due to specific blue and white collar worker shortages, and food due to supply chain issues and climatic risk. Thus we think **base rates will be held until H2 2024**, later than the market currently expects, and **medium-term CPI will average 3.0%**.
- 3m Sonia** is expected to stabilise at **3.5%**. **3m Euribor** expected to stabilise at **2.75% in H2 2025**.

Central bank interest rates have peaked, but no cuts until H2 2024₁

Base Rates	Feb 1 '24	1 month ago	6 months ago	12 months ago
UK	5.25%	5.25%	5.25%	4.00%
Eurozone	4.00%	4.00%	3.75%	2.50%
US	5.25%-5.50%	5.25%-5.50%	5.25%-5.50%	4.50%-4.75%

Euribor Forward Curves₂

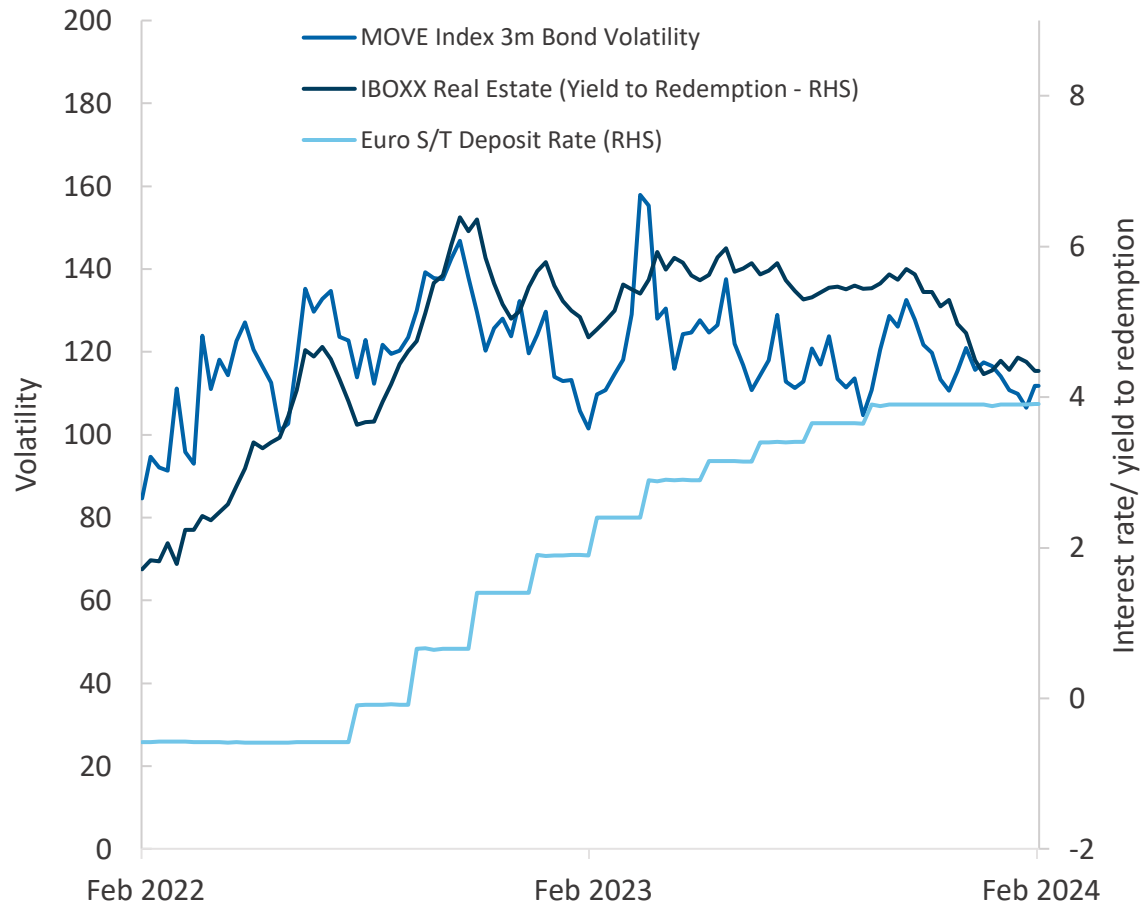


Sources: 1: Oxford Economics/Cromwell Property Group, Q1 2024, 2: Reuters

Market Indicators

Interest rates have peaked yet market uncertain about pace of downward movement

High Corporate Real Estate Bond Yields due to volatility & rising base rate₁



5 Year Sonia and Euribor Swap rates₁



Swap Rates	Feb 1 '24	1 month ago	6 months ago	12 months ago
5 Yr Sonia	3.62%	3.38%	4.89%	3.61%
5 Yr Euribor	2.44%	2.36%	3.17%	2.82%

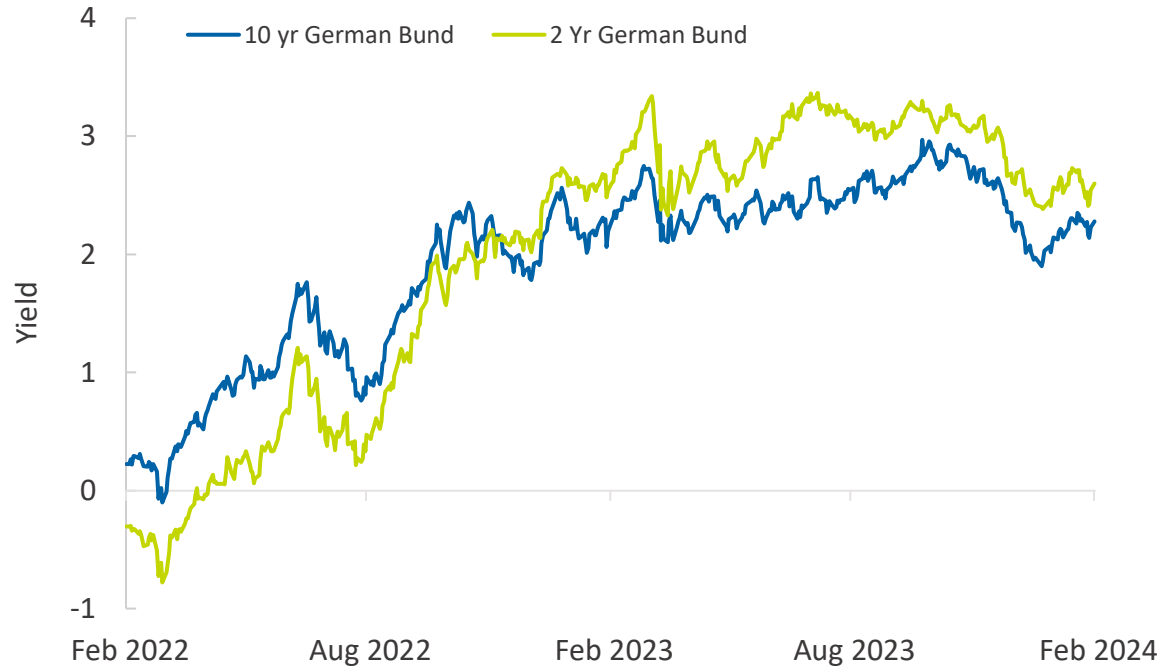
Glossary: iBoxx represents the IG bond market for the Real estate sub-sector. The MOVE index calculates the volatility of U.S. Treasury options by capturing the expected fluctuations in interest rates, the index is a proxy for the bond market's overall sentiment on future interest rates.

Source 1: Reuters

Market Indicators

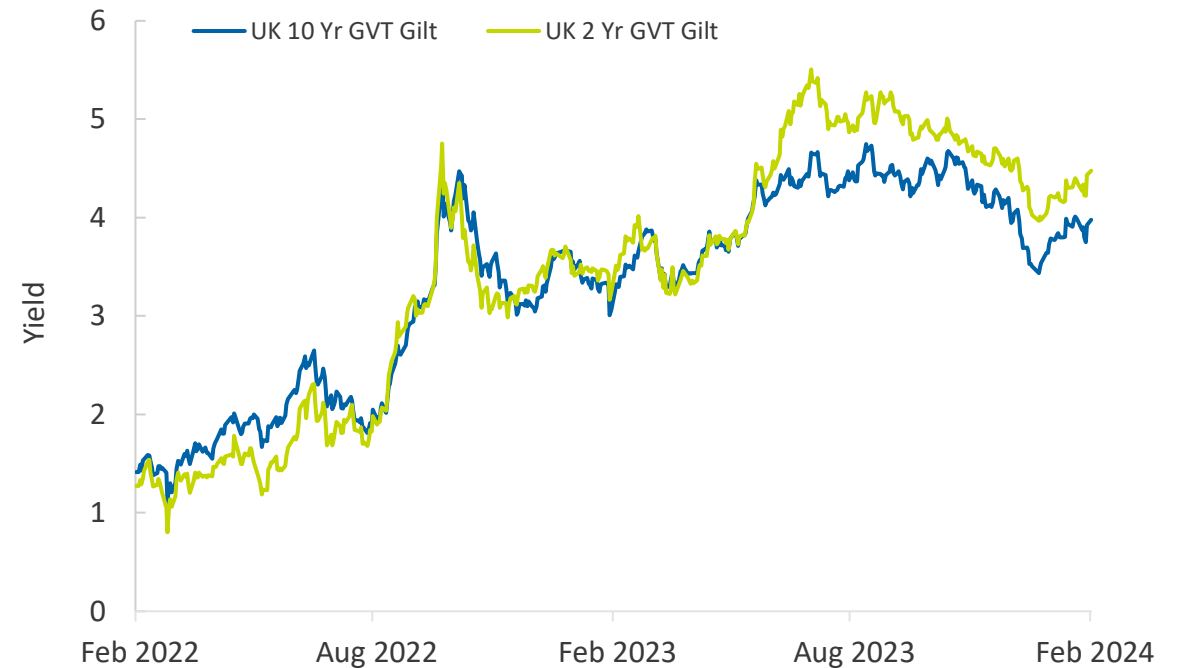
Government bonds yields rise since the December 2023 low

German Bunds₁



German Bunds	Feb 1 st '24	1 week ago	1 month ago	12 months ago
2 Yr	2.45%	2.62%	2.45%	2.67%
5 Yr	2.08%	2.17%	1.95%	2.43%
7 Yr	2.03%	2.19%	1.98%	2.28%
10 Yr	2.16%	2.28%	2.07%	2.30%

UK Gilts₁



UK Gilts	Feb 1 st '24	1 week ago	1 month ago	12 months ago
2 Yr	4.24%	4.37%	4.04%	3.42%
5 Yr	3.71%	3.92%	3.54%	3.17%
7 Yr	3.60%	3.83%	3.46%	3.31%
10 Yr	3.76%	3.99%	3.64%	3.31%

Source: 1: Reuters

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