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GOVERNMENT BONDS RALLY AS INFLATION HOGS THE HEADLINES ONCE MORE

This week we have seen inflation dominate financial markets again. US inflation fell, slightly, although it remains at the highest level in decades. Markets are mulling whether this is a quirk in the data or a sign that inflation is peaking. The argument against is that, while headline inflation fell, core inflation is still rising. UK GDP also fell slightly in April and US and UK government bond yields have been falling as investors become wary of equities in the face of slowing growth. UK CPI is out next week and this will go a long way in determining the short-term path of gilts.

Meanwhile politics in the UK has returned to domestic policy. Although the Queen's Speech contained 38 bills in total, there was very little of substance for the economy and nothing to address the rising cost of living. The Northern Ireland protocol is also back with fresh threats to unilaterally dump parts of the deal if there is no movement from the EU. We've been here before with little result and Brussels will be asking whether the UK is seriously considering further damaging trade with an economic slowdown or even stagflation looming.

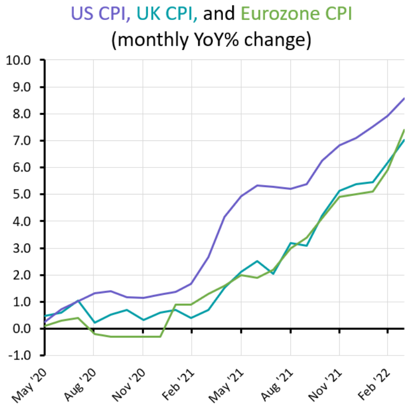
THE MARKETS THIS WEEK

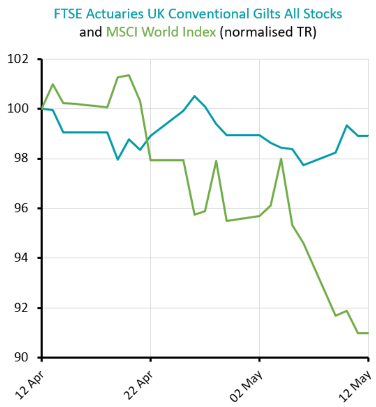
FTSE 100	S&P 500	Nikkei 225	MSCI Europe	Hang Seng	US 10 Yr	UK 10 Yr	Brent Crude	Gold	Iron Ore	GBP USD
-2.09%	-4.69%	-4.65%	-1.42%	-0.45%	-0.31%	-0.26%	-3.27%	-1.29%	-4.79%	-1.01%

GLOBAL: MARKETS EXPECT FASTER RATE HIKES AS INFLATION REMAINS HIGH

US inflation fell slightly to 8.3% in April, below the 8.5% figure seen in March but slightly above economists' expectations of 8.1%. Although headline inflation moderated for the first time in eight months, core inflation continued to increase. Markets are increasingly sure of a 0.5% interest rate rise from the US Federal Reserve at its June and July policy meetings. Shorter-dated bond yields rose following the release and the yield curve showed signs of flattening. The sell-off in equities has continued with technology stocks seeing the biggest impact as the Nasdaq index fell heavily.

Earlier in the week, the US Federal Reserve also warned of tightening liquidity in financial markets in its half yearly Financial Stability Report. The hawkish tone was also seen in other regions as European Central Bank president Christine Lagarde indicated that the ECB is likely to raise rates in July - a lot sooner than previous market expectations – as it also tries to tackle soaring inflation.





UK: GILTS REVERSE COURSE AS UK ECONOMIC GROWTH DISAPPOINTS

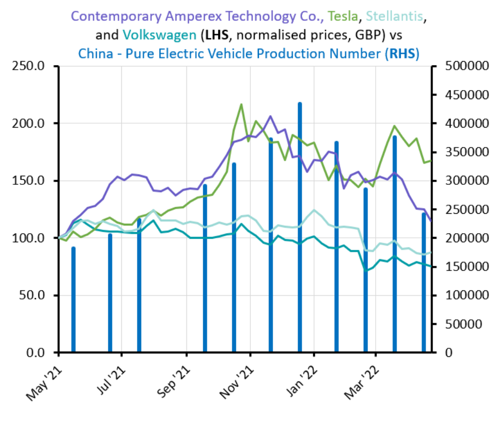
UK economic growth was slower than expected in Q1 as output fell unexpectedly in March. A slowdown in consumer services is the main reason that GDP slowed to 0.8% in the first quarter, slightly below expectations. The monthly figures show GDP fell 0.1% in March after February's figure was flat. Overall, production output grew strongly over the quarter but this masks a noticeable drop in output in March.

The slight tailing off in economic activity has helped gilts to rally this week as investors consider a less aggressive path for the Bank of England's interest rate rises. The yield on 10-year gilts has fallen from just under 2% last week to 1.7% as prices have risen and next week's release of employment and wage data, as well as inflation numbers, will receive a lot of interest. In contrast to UK gilts, global equities have continued to slide as coronavirus lockdowns in China and the slight fall in US inflation adds to fears of a global slowdown.

EQUITIES: SUPPLY DISRUPTION DIMS THE OUTLOOK FOR EV SALES

Supply-chain disruption and lockdowns in China are straining electric car production. Consumer demand remains robust but rising costs and shuttered factories in China have made it increasingly difficult for suppliers to meet demand. Electric vehicle battery maker CATL reported a 154% increase in revenue but a 24% fall in earnings as the increase in the price of raw materials pushed up operating costs.

Closures at Tesla's Shanghai plant saw production fall to 1,500 cars in April compared to an average of 66,000. Volkswagen also reported its plan to overtake Tesla as the biggest electric car maker are at risk due to disruption caused by Russia's invasion of Ukraine as it recently sold out of electric cars in Europe. Stellantis, the world's sixth largest car maker, said battery shortages will affect production for the next three or four years and Toyota, the world's largest car manufacturer, reported that rising commodity and energy prices could see profits reduced by 20% this year despite sales remaining robust.



Data Sourced from FE Analytics, and FactSet