Weekly round up (Week 25)

This week's headline story asks whether investors are becoming less sensitive to global risks, given the recurring news about the US administration.

Last week was short due to Juneteenth, a US holiday commemorating the end of slavery, but there was no shortage of news. Investors may have been surprised by the relative moderation in prices despite the G7 and eleven central bank meetings, combined with rising geopolitical tensions in the Middle East.

Our preferred volatility indicator, the VIX, hovered around 20, reflecting persistent uncertainty but no further deterioration in sentiment. The big winner was oil, with WTI crude prices rising more than 8% over the week on supply concerns and geopolitical tensions. Most other asset classes traded within normal ranges: government bond yields fell slightly, credit markets remained stable, and the Bloomberg World Large & Mid Cap Index declined 0.35%.

The most notable aspect of the G7 meeting was undoubtedly the leaders' statement, which was only 121 words long, in stark contrast to the 19,834 words published in June 2024 and the 5,108 words in December 2023. While this brevity could be interpreted as a show of unity among members, it more likely reflects a lack of consensus on key issues such as Ukraine, climate, and the Middle East.

Divergence among central banks

On the central bank front, Brazil's Central Bank unanimously raised the Selic rate by 25 basis points to 15.00%, the seventh consecutive increase in this tightening cycle. The bank indicated that it plans to keep rates at this level until early 2026. Norway and Sweden both lowered their key rates by 25 basis points, following the European Central Bank's lead.

At the same time, the Swiss National Bank became the first major central bank to cut its key rate to zero, in a move aimed at discouraging investors from rushing to buy the franc after its recent appreciation contributed to the first decline in consumer prices in four years (**"Chart of the week"**).

Other central banks kept their rates unchanged. In Asia, the Bank of Japan (BoJ) meeting was the highlight, with the central bank leaving its short-term interest rate unchanged at 0.5%, as expected.

However, in what could be a move to support its domestic bond market, the monetary policy committee announced its intention to slow the pace of its quantitative tightening. From April 2026, the BOJ will reduce its balance sheet at a pace of around 200 billion yen per quarter, down from the current 400 billion. To reinforce this support, the Ministry of Finance (MOF) announced that it would reduce the issuance of ultra-long-term bonds by 3.2 trillion yen until the end of March 2026, a larger reduction than expected by the markets. It should be noted that the planned reductions in 20-year bond issuance are twice as large as had been suggested in the media.

What could higher Japanese bond yields mean for other markets?

Since the beginning of the year, the Japanese government bond market has underperformed its developed market counterparts, with a downward adjustment in the yield curve and a rise in long-term yields of more than 60 basis points. These movements have often been cited as catalysts for a similar adjustment in government bond curves globally.

With Japanese yields historically extremely low, domestic investors such as pension funds and insurers have long sought higher returns on foreign government bonds. However, as Japanese government bond yields rise, the relative appeal of foreign bonds (especially after hedging costs are taken into account) diminishes. This should logically prompt Japanese investors to reduce their foreign bond positions, which would put upward pressure on long-term yields abroad and contribute to a steeper global curve. Looking ahead, the combined slowdown in bond supply and quantitative tightening should provide technical support for the long end of the Japanese yield curve, making economic fundamentals the main driver of future rate movements.

At his press conference, Bank of Japan Governor Ueda reiterated his concerns about tariff uncertainty and its potential impact on economic growth, while highlighting upside risks to inflation. The latest inflation data in Japan, which once again exceeded consensus forecasts ("**Chart of the week**"), should reinforce the Bank of Japan's conviction that its 2% inflation target is gaining traction.

In May, Japan's core consumer price index rose 3.7% year-on-year, up from 3.5% in April. This increase was mainly due to higher inflation in services, a priority for the Bank of Japan, which indicates that companies are increasingly passing on higher costs to consumers in areas such as accommodation and food services. According to the latest Reuters survey of Bank of Japan observers, most economists now expect the next 25 basis point hike to come in early 2026, with January appearing to be the most likely timing.

In Europe, all eyes were on the Bank of England (BOE), which kept interest rates unchanged at 4.25%. The vote was more divided than economists had expected, with six members voting to keep rates unchanged and three in favor of an immediate 25-basis-point cut, compared with forecasts of a 7-2 vote.

The division within the committee reflects the difficulty of balancing a weakening labor market and sluggish economic growth, as highlighted by May retail sales, which suffered their sharpest decline since 2023. The Office for National Statistics said the decline was due to widespread weakness. With geopolitical risks and the resulting inflationary pressures persisting, the overnight interest rate swap market is anticipating two further 25-basis-point cuts by the BOE this year.

The Fed maintains a hawkish tone

In the United States, the Federal Reserve maintained its restrictive policy for the fourth consecutive meeting, leaving the federal funds rate unchanged at 4.25-4.50%, as expected. The updated chart indicates a more cautious stance on rate cuts, with the number of Fed officials expecting no cuts this year rising from four in May to seven in June. Two members moved from forecasting one cut to no cuts, and another moved from two cuts to no cuts, resulting in a clearly bimodal distribution for 2025: either zero or two cuts.

Staff projections provide no sign of an administration-driven “MAGA” stimulus; rather, they point to a risk of stagflation. Growth has been revised down for 2025 (1.4% vs. 1.7%) and 2026 (1.6% vs. 1.8%), while inflation has been revised up for the entire forecast period, remaining above the Committee's 2% target. As a result, unemployment projections have also been revised upward.

At his press conference, Fed Chair Jerome Powell warned that the inflationary effects of tariffs could prove more persistent than expected. The Committee now expects the federal funds rate to be 3.9% at the end of 2025, 3.6% at the end of 2026, and 3.4% at the end of 2027, implying rate cuts of 50 basis points in 2025, followed by 25 basis points in 2026 and 2027.

Tolerance or immunity?

One explanation put forward for the lack of market reaction despite escalating geopolitical tensions is that investors have developed greater tolerance, or even immunity, to shocks, given the frequency and diversity of disruptions in recent years. Since 2020, markets have had to contend with COVID-19, the Taliban's takeover of Afghanistan in 2021 (and the chaotic withdrawal of the United States), while 2022 has been marked by Russia's invasion of Ukraine, the UK mini-budget fiasco, turmoil in the Chinese real estate sector, and a surge in global inflation that triggered aggressive interest rate hikes around the world.

More recently, in 2023, we witnessed the war between Israel and Hamas, disruptions to shipping in the Red Sea, and a regional banking crisis in the US, marked by the collapse of Silicon Valley Bank and Signature Bank. In 2024, markets faced the collapse of Assad's Syria and renewed political uncertainty following Trump's re-election.

Taking a more quantitative approach with a longer time series dating back to 1939, the median decline in the S&P 500 during major geopolitical events is around 6.1%, with markets typically taking 17 days to reach their lowest point and then recovering completely over the following 16 days. Historical examples that may be relevant today include include the Cuban missile crisis (7 days to bottom, 9 days to recover, 6.6% decline), the impeachment of President Clinton (6 days to bottom, 5 days to recover, 3.9% decline) and Brexit (14 days to bottom, 9 days to recover, 5.6% decline).

A closer look at the data shows that larger and more prolonged market declines, as well as prolonged recovery periods, tend to occur when a geopolitical shock causes a disruption in supply. A relevant historical parallel is the first Gulf War in 1990-1991, when Iraq's invasion of Kuwait deprived the market of a significant volume of oil exports, leading to a much larger decline (15.9%), a deeper trough reached in 50 days, and a slower recovery over 87 days.

At present, however, this does not appear to be the case, as neither Iran nor Israel appears to be targeting critical energy infrastructure, while oil tanker traffic through the strategic Strait of Hormuz has remained broadly stable.

Another, slightly more original hypothesis is that President Trump and his improvised and unpredictable messages remain the center of attention, diverting investors' attention from central banks and international diplomats. Last week, President Trump indicated that he would give diplomacy a chance before deciding whether to attack Iran, saying that he would make his decision within the next two weeks. Despite this statement, the US launched strikes against three nuclear sites in Iran over the weekend.

With President Trump remaining the key player on the international stage, perhaps the most underestimated risk at present is the series of deadlines looming in early July. These include a diplomatic solution for Iran, the July 4 deadline that the US Congress has set for the final adoption of tax reform, the July 8 expiration of the 90-day reprieve on reciprocal tariffs, and the July 9 expiration of the EU's 50% tariff reprieve.

It is never advisable to put yourself in a difficult position with multiple complex deadlines. Just like when you juggle too many balls at once, you end up dropping one.

Chart of the week: Japanese inflation vs. Swiss deflation