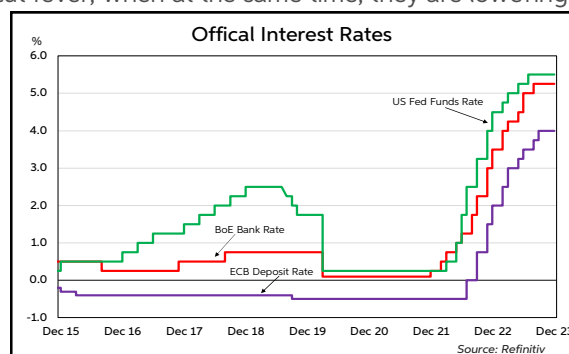


Great Expectations

- Markets have been on fire since late October, with equities marching higher and bond yields tumbling, as investors bet on rapid rate cuts in 2024.** The moves on stock markets have been large, with both the S&P 500 and Euro Stoxx 50 indices up by circa 11%. Meanwhile, ten year bond yields in the UK, Eurozone and US have fallen by 75-85bps. In October, markets were looking for rate cuts of just 50bps from the ECB and Fed next year. Futures contracts are now pricing in rate cuts of 140bps in the Eurozone in 2024, starting in the spring. US rates are expected to be cut by 120bps, beginning in May. Meanwhile, markets were pricing in further significant rate hikes from the Bank of England not that long ago, but now they expect over 75bps in rate cuts next year.
- The catalyst for the rate cut fever has been far bigger falls in inflation in recent months than had been expected by central banks and markets.** In the Eurozone, the HICP rate has fallen from 5.2% in August to 2.4% in November. Core inflation has declined from 5.3% to 3.6% over the same period. In the US, the core PCE rate had declined to 3.5% by October from 4.3% in July, with the annualised rate dropping to circa 2.5% in the last six months. Meantime, the Eurozone economy looks to be in a technical recession, while the US economy is showing some signs of a slowdown. The UK economy is close to stagnation.
- Overall, inflation looks set to return to its 2% target more quickly than central banks have been projecting.** This raises the possibility that monetary policy may have been tightened too much in 2023. Indeed, there is now a risk that inflation may move below target in the next couple of years, against a backdrop of subdued global growth and the continuing marked decline in commodity prices. Central bankers, though, have been pushing back on the notion of early rate cuts and will have the opportunity to do so again in the coming week, at the final policy meetings of 2023. Obviously, rate cuts would represent a change in policy direction and central banks will want to be sure inflation has been tamed before setting off down that road.
- While no changes to rates are expected this week, the Fed and ECB will publish their latest quarterly set of macro-economic forecasts at their upcoming meetings.** Downgrades to inflation forecasts seem likely in both cases. US core PCE inflation is already below the Fed's projected level for Q4 2023 of 3.7%. Meantime, the annualised rate has been at 2.4% since June, below the Fed's 2.6% forecast for Q4 2025. In the Eurozone, the ECB forecast is for inflation to average 3.2% next year, but the rate has already dropped to 2.4%. While it is likely to pick up in December, it looks set to fall below 2% in Q1 2024. Meantime, further sharp falls in the annual rate of core Eurozone inflation are likely in the spring, pushing it down close to 2%. The ECB's projection is that core inflation will average 2.9% next year. Thus, the ECB's headline and core inflation forecasts for 2024 both look set to be cut appreciably. It is going to be hard for central bankers to dampen rate cut fever, when at the same time, they are lowering their inflation projections significantly.
- Thus, both Fed Chair Powell and ECB President Lagarde face precarious communication challenges at their press conferences this week.** Their comments will need to reflect that inflation has fallen markedly, while at the same time, they will not want to sound overly dovish. Meantime, investors will be paying close attention to any changes in the pace of quantitative tightening from the ECB, given the topic of PEPP reinvestments is due to come under consideration soon.
- Aside from the key central bank meetings, a busy data schedule next week includes the flash PMIs for December.** In the Eurozone, the PMIs have been in contraction mode for a number of months, albeit they edged higher in November. Despite a further modest improvement this month, they are expected to remain consistent with declining activity. The UK PMIs also moved higher in November. Indeed, the services PMI climbed above 50 for the first time since July, although, the manufacturing PMI stayed well below the key 50 mark. Both UK PMIs are forecast to rise in December, but manufacturing is forecast to remain in contraction. Likewise in the US, the services PMI was in expansion mode, while the manufacturing PMI was not in November. Both sector readings are projected to maintain this trend, but deteriorate marginally in December.
- Elsewhere in the US, an update on CPI inflation will be of keen interest.** The consensus is for the headline rate to edge back to 3.1% in November, down slightly from 3.2%. However, the core rate is projected to remain at 4%, ending a seven month run of easing. Meanwhile, US retail sales are projected to decline by 0.1% for the second consecutive month in November. At the same time, US industrial production is anticipated to rebound by 0.3% m/m in November. In contrast, a 0.3% m/m fall in Eurozone industrial production is pencilled in for October. In the UK, we will get updates on the labour market and the monthly reading of GDP for October. Labour market conditions remain tight overall in the UK, but they have softened somewhat recently. This trend is set to continue, with the unemployment rate remaining at 4.2% in October, while average earnings growth is forecast to slow to 7.8% y/y from 7.9% y/y. Meantime, having increased by 0.2% m/m in September, GDP is projected to contract by 0.1% in October. Furthermore, industrial production is also expected to decline by 0.1% in October.



	Interest Rate Forecasts			
	Current	End Q4	End Q1	End Q2
		2023	2024	2024
Fed Funds	5.375	5.375	5.375	5.125
ECB Deposit	4.00	4.00	4.00	3.75
BoE Repo	5.25	5.25	5.25	5.25
BoJ OCR	-0.10	-0.10	-0.10	0.25

Current Rates Reuters, Forecasts AIB's ERU

	Exchange Rate Forecasts (Mid-Point of Range)			
	Current	End Q4	End Q1	End Q2
		2023	2024	2024
EUR/USD	1.0770	1.08	1.09	1.10
EUR/GBP	0.8584	0.86	0.86	0.86
EUR/JPY	155.44	160	157	153
GBP/USD	1.2546	1.26	1.27	1.28
USD/JPY	144.29	148	144	139

Current Rates Reuters, Forecasts AIB's ERU

Date	UK & Irish Time		Release	Previous	Forecast
This Week:	ECB Speakers:				
	BoE Speakers:		Ramsden (Fri)		
	Fed Speakers:				
	EU Leaders Summit (14th-15th December)				
Mon 11th					
Tue 12th	UK:	07:00	ILO Unemployment Rate (October)	4.2%	4.2%
	UK:	07:00	Employment Change (October)	+54,000	
	UK:	07:00	Claimant Count (November)	+33,000	
	UK:	07:00	Average Earnings (October)	(+7.9%)	(+7.8%)
			- Ex-Bonus	(+7.7%)	
	GER:	10:00	ZEW Economic Sentiment (December)	-79.8	-75.5
	US:	11:00	NFIB Small Business Optimism (December)	90.7	
	US:	13:30	CPI Inflation (November)	+0.0% (+3.2%)	+0.1% (+3.1%)
		- Core-CPI	+0.2% (+4.0%)	+0.3% (+4.0%)	
Wed 13th	UK:	07:00	GDP (October)	+0.2% (+1.3%)	-0.1% (+0.6%)
			- 3m/3m	+0.0%	+0.1%
	UK:	07:00	Industrial Output (October)	+0.0% (+1.5%)	-0.1% (+1.1%)
			- Manufacturing Output	+0.1% (+3.0%)	+0.0% (+1.9%)
	EU-20:	10:00	Industrial Production (October)	-1.1% (-6.9%)	-0.3% (-4.5%)
	IRL:	11:00	Residential Property Price (October)	+0.8% (+1.4%)	+0.3% (+1.5%)
	US:	19:00	Fed FOMC Meeting Announcement		
			- Fed Funds Target Range	5.25-5.50%	5.25-5.50%
US:	19:30	Fed FOMC Post-Meeting Press Conference			
Thu 14th	IRL:	11:00	CPI Inflation (November)	+0.3% (+5.1%)	-1.0% (+3.7%)
			- Final HICP Inflation	+0.2% (+3.6%)	-1.1% (+2.3%)
	UK:	12:00	BoE Interest Rate Announcement		
			- Bank Rate	5.25%	5.25%
	EU-20:	13:15	ECB Interest Rate Announcement		
			- Deposit Rate	4.00%	4.00%
			- Re-fi Rate	4.50%	4.50%
	US:	13:30	Initial Jobless Claims (w/e 4th December)	+220,000	+220,000
	US:	13:30	Retail Sales (November)	-0.1 (+2.5%)	-0.1% (+3.8%)
			- Ex-Autos	-0.1%	-0.1%
		- Control	+0.2%	+0.3%	
EU-20:	13:45	ECB Post-Meeting Press Conference			
Fri 15th	UK:	00:01	Gfk Consumer Confidence (December)	-24.0	-23.0
	CHINA:	02:00	Retail Sales (November)	(+7.6%)	(+12.5%)
	FRA:	08:15	Flash HCOB Composite PMI (December)	44.6	44.9
	GER:	08:30	Flash HCOB Composite PMI (December)	47.8	48.3
	EU-20:	09:00	Flash HCOB Composite PMI (December)	47.6	48.0
			- Manufacturing / Services	44.2 / 48.7	44.5 / 49.0
	UK:	09:30	Flash CIPS Composite PMI (December)	50.7	50.9
			- Manufacturing / Services	47.2 / 50.9	47.5 / 51.0
	US:	14:15	Industrial Production (November)	-0.6% (-0.7%)	+0.3% (-0.5%)
			- Manufacturing Output	-0.7%	
			- Capacity Utilisation	78.9%	79.1%
	US:	14:45	Flash S&P Composite PMI (December)	50.7	50.4
			- Manufacturing / Services	49.4 / 50.8	49.1 / 50.5

♦ Month-on-month changes (year-on-year shown in brackets)

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