# The Emperor Has No Clothes

- **Markets are very pre-occupied with trends in currency markets even though it is very difficult to forecast what is going to happen with exchange rates.** Currency markets certainly are the most tricky to forecast – stock markets tend to rise over time, while central banks are now providing enhanced forward guidance on the likely path of interest rates that extends out over a number of years. On the other hand, numerous factors seem to impact currency markets, factors which can vary in importance over time. Despite the difficulty in forecasting exchange rates, we still spend a lot of time trying to predict where currencies will go. This is because they are hugely important, both in terms of international trade and investment activity and returns.

- **There is no more important currency than the US dollar**. As the dollar is a safe-haven currency, it tends to appreciate at times of stress in financial markets when risk-off sentiment dominates. It is also the funding currency of choice given its liquidity, which adds to its tendency to appreciate at times of stress as borrowings are repaid. Longer term, it would appear that the trend is your friend in regard to the greenback. The currency appreciated in the 1990s, fell during the first decade of this century before appreciating over the past decade. As a result the US dollar is now at elevated levels. The question is could the dollar be about to change direction again in the coming decade. Spotting such big turning points, though, is notoriously difficult.

- **Nonetheless, we could be in the midst of some key changes to the dollar medium-term prospects.** First, favourable interest rate spreads have been a key factor in supporting the dollar for much of the past decade, with the Fed pitching US rates considerably higher than in the other large advanced economies. This advantage has now largely gone. Furthermore, under its new policy framework, the Fed is more or less promising to keep rates near zero over the next few years. Second, the past decade starting with the financial crises up to the Covid-19 pandemic, has been characterised by subdued growth and quite brittle risk sentiment. This has benefitted the dollar. Given though, the amount of stimulus injected into economies this year and the extent of pent-up demand, there is scope for a period of strong robust growth and much reduced uncertainty once the coronavirus subsides – developing a vaccine is crucial in this regard - which could prove negative for the dollar.

- **Third, if the opinion polls are correct, then a regime change is likely in Washington.** It is not fully clear what a Democrat controlled administration would mean for the dollar, but a continuing loose fiscal stance in a country with an already very large budget deficit, as well as a significant balance of payments deficit, would be a risk for the currency. The US fiscal deficit is put at over 15% of GDP in 2020, the largest since 1945 and compares to a deficit of circa 8.5% in the Eurozone. The so-called twin deficits could return to haunt the dollar in an environment of close to zero interest rates, and where the demand for safe-haven currencies has abated. It may not happen immediately, but longer-term the downside risks for the dollar are building.

- **Turning to the week ahead, we get a raft of UK data. The highlight being October's flash PMIs** with a further pullback deemed likely. The manufacturing PMI is forecast to fall from 54.1 to 53.1. The services PMI is expected to fall from 56.1 to 54.0, although the risks are to the downside, as further restrictions were introduced in October. Sticking with survey data, and the consumer confidence index is expected to fall to –28 a very subdued level. In terms of hard data, **retail sales for September are forecast to rise by 0.4%**, the smallest increase since the UK emerged from lockdown, although the index is 4% above its pre-Covid levels. Finally, it is envisaged that headline CPI inflation for September will rise to 0.5%, with the core rate picking up to 1.3%.

Markit - Composite PMIs
US, Eurozone, UK

- **Across the Atlantic, the PMIs also feature.** The consensus is for the services PMI to be broadly unchanged at 54.6 to 54.5 in October, with the manufacturing index expected to edge higher to 53.3 from 52.3. This would suggest that the recovery has maintained momentum so far in the fourth quarter. An update on the housing market will be provided in the form of the October reading of homebuilder sentiment, existing home sales and housing starts (both September). The builder sentiment index is projected to remain at 83, while existing sales and housing starts are both forecast to register small increases.

- **The highlight of the Eurozone calendar are also the PMIs for October.** The indices are forecast to move lower, as they did in September due to increasing coronavirus cases and tighter restrictions across the continent. The manufacturing index is anticipated to remain expansionary, but to dip lower to 53.1 from 53.7. The services index is expected to remain in contractionary territory, with the index expected to fall further to 47.0 from 48.0. It is also envisaged that the composite index will fall below 50. On the demand side, the flash EC consumer confidence measure for October is forecast to move lower to -15.0, from an already very subdued level of -13.9. Elsewhere, German consumer sentiment for November is envisaged to drop to –3.0 from –1.6, while the French INSEE measure of business sentiment will also feature.
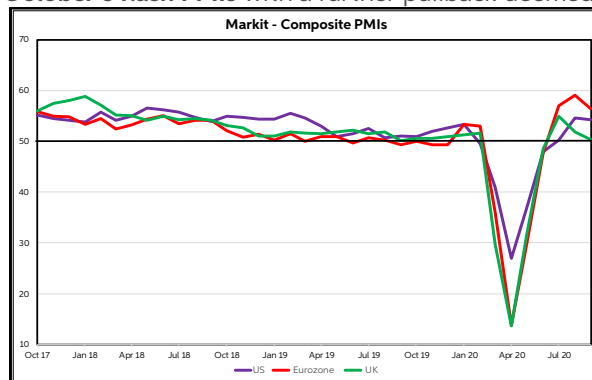
Interest Rate Forecasts			
	Current	End Q4 2020	End Q1 2021	End Q2 2021
Fed Funds	0.125	0.125	0.125	0.125
ECB Deposit	-0.50	-0.50	-0.50	-0.50
BoE Repo	0.10	0.10	0.10	0.10
BoJ OCR	-0.10	-0.10	-0.10	-0.10
Current Rates Reuters, Forecasts AIB's ERU				

Exchange Rate Forecasts (Mid-Point of Range)			
	Current	End Q4 2020	End Q1 2021	End Q2 2021
EUR/USD	1.1729	1.18	1.20	1.22
EUR/GBP	0.9074	0.88	0.88	0.89
EUR/JPY	123.51	124	126	127
GBP/USD	1.2922	1.34	1.36	1.37
USD/JPY	105.29	105	105	104
Current Rates Reuters, Forecasts AIB's ERU				

ECONOMIC DIARY
Monday 19th - Friday 23rd October

AIB

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Treasury
Economic
Research

Oliver
Mangan
Chief
Economist

John Fahey
Senior
Economist

Daniel
Noonan
Economist

Date	UK & Irish Time (GMT+1)	Release	Previous	Forecast
This Week:		**ECB Speakers:** Lane, Lagarde, Fernandez-Bollo (Monday); **Lagarde**, Lane (Wednesday); Panetta (Thursday**)**		
		BoE Speakers: Cunliffe (Monday); Ramsden (Tuesday); Haldane, **Bailey** (Wednesday)		
		Fed Speakers: Powell, Clarida (Monday); Brainard (Tuesday)		
Mon 19th	JPN:	00:50	Trade Balance (September)	+¥248.3bn	+¥989.8bn
			- Exports	(-14.8%)	(-2.4%)
	CHINA:	03:00	Industrial Output (September)	(+5.6%)	(+5.8%)
	CHINA:	03:00	GDP (Q3)	(+3.2%)	(+5.2%)
	US:	15:00	NAHB Homebuilder Sentiment (October)	83	83
Tue 20th	US:	13:30	Housing Starts (September)	1.42m / -0.5%	1.451m / +2.5%
			- Building permits	1.48m / -5.1%	1.50m / +1.6%
Wed 21st	UK:	07:00	CPI (September)	-0.4% (+0.2%)	+0.4% (+0.5%)
			- Core	-0.6% (+0.9%)	+0.6% (+1.3%)
	UK:	07:00	PPI Output Prices (September)	0.0% (-0.9%)	+0.1% (-0.9%)
			- Input	-0.4% (-5.8%)	-5.8% (-5.4%)
Thurs 22nd	GER:	07:00	Gfk Consumer Sentiment (November)	-1.6	-2.5
	FRA:	07:45	INSEE Business Climate (October)	96	97
	US:	13:30	Initial Jobless Claims (w/e 12th October)	+898,000	
	US:	15:00	Existing Home Sales (September)	6.0m / +2.4%	6.16m / +2.7%
	EU-19:	15:00	Flash Consumer Confidence (October)	-13.9	-15.0
Fri 23rd	UK:	00:01	Gfk Consumer Confidence (October)	-25	-28
	JPN:	00:30	CPI (September)	+0.2%	
			- Core	-0.4%	-0.4%
	JPN:	01:30	Flash Jibun Manufacturing PMI (October)	47.7	
	UK:	07:00	Retail Sales (September)	+0.8% (+2..8%)	+0.6% (+3.7%)
	FRA:	08:15	Flash Markit Composite PMI (October)	48.5	47.5
	GER:	08:30	Flash Markit Composite PMI (October)	54.7	53.5
	EU-19:	09:00	Flash Markit Composite PMI (October)	50.4	49.5
			- Manufacturing / Services	53.7 / 48.0	53.1 / 47.0
	UK:	09:30	Flash CIPS Markit Composite PMI (October)	56.5	54.0
			- Manufacturing / Services	54.1 / 56.1	53.1 / 54.0
	US:	14:45	Flash Markit Composite PMI (October)	54.3	54.3
			- Manufacturing / Services	53.2 / 54.6	53.3 / 54.5

♦ *Month-on-month changes (year-on-year shown in brackets)*
All forecasts AIB ERU, historical data in the Economic Diary derived from publicly available sources