Weekly Market Brief

AIB Treasury Economic Research Unit

21st –25th September 2020

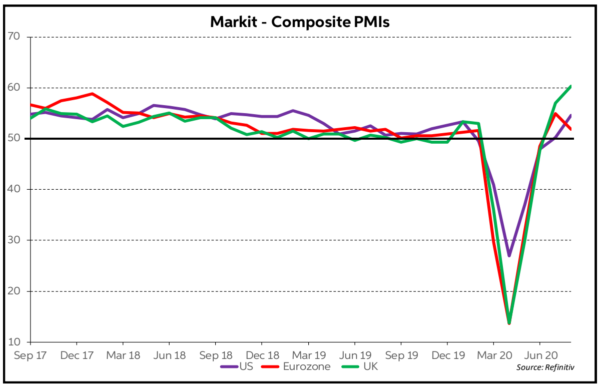
What's Going On?

- **While Covid remains the primary concern of the Irish Government, Brexit has come right back up the agenda as fears grow that the UK and EU will fail to conclude a trade deal later this autumn.** The Government is now stepping up preparations for a "hard" Brexit, where the UK would move to trading under WTO rules from the start of next year. This would involve the imposition of tariffs on certain goods and be very disruptive to trade between the UK and EU. With 40% of Irish indigenous exports going to the UK, and 43% of UK exports going to the EU, the economic consequences of a "hard" Brexit would be very serious. Various studies suggest that it could lower the level of GDP in both Ireland and the UK by some 5-6% within a short number of years, compared to if Great Britain remained within the EU Single Market and Customs Union.

- **The trade talks have been bogged down for some time around the issue of state aid.** The EU is insisting that any deal needs to include rules on state aid that are legally enforceable to help ensure a level playing field on trade. The UK, though, wants to have a free hand on setting state aid, with full autonomy over future state subsidies for industry. In a bizarre twist, though, the bilateral trade agreement reached between the UK and Japan last week has rules limiting state aid. Not only that, the *Financial Times* has reported the template for the state aid rules is that contained in the EU-Japan trade deal agreed last year. In other words, the UK is replicating the state aid rules in the EU-Japan trade agreement, in its trade deal with Japan. However, so far it has not been prepared to contemplate similar rules being included in an EU-UK trade deal. In another bizarre twist, the UK government introduced the Internal Market Bill in parliament, allowing it to renege on elements of the Withdrawal Agreement negotiated with the EU last year, thereby breaking international law. This hardly builds trust in the current trade negotiations.

- **The question being asked by virtually everyone is what's going on? Are these just negotiating tactics? Is the UK government interested in securing a trade deal at all?** Is it hoping the EU will just walk away from the talks in frustration? Or else by playing it tough, is it looking to secure favourable terms in a last minute deal, especially on state aid and fisheries. Whatever the answer, the sterling market has become much more nervous, with the pound coming under significant downward pressure this month on the growing risk of a no-deal Brexit. The euro climbed from below 89p at the start of the month up to near the 93p level a week ago. Meanwhile against the dollar, sterling fell from a high of $1.35 to $1.28. The UK currency has managed to recover a bit of ground in the last few days, but it remains well down on it levels at the start of the month.

- **We warned back in August that sterling has limited upside, but would fall back if no trade deal looked increasingly likely.** With the recent heightened uncertainty about the outcome of the trade talks, sterling has weakened and become much more volatile. The 93p rate against the euro is a key support level for the currency. It has held this month, just as it did last autumn when there were real fears that the UK could crash out of the EU without a deal. It can be expected to hold in the next few weeks until we get some clarity on the outcome of the EU-UK trade talks. However, if there is no trade deal agreed and a "hard" Brexit is indeed on the cards, then the 93p support level will crumble. Parity with sterling could well beckon for the euro in these circumstances.



- **Data-wise, in the Eurozone we get a raft of survey data.** Markets will be looking to September's flash PMI's for further signs of recovery. In August, the Composite PMI slipped back to 51.9 from 54.9, as growth across the Eurozone slowed. The softening recovery was most pronounced in the services sector. The September services PMI is forecast stay at its current level of 50.5. The manufacturing index is projected to nudge down to 51.7 from 51.9. On the demand side, the flash consumer confidence measure for September is forecast to stay at the same very subdued level, as in August at –14.7. National measures of business sentiment in Europe are predicted to show signs of a continued recovery. The German Ifo is projected to continue on the upward trend evident since April, rising from 92.6 to 93.8, while the French INSEE measure of business sentiment is expected to rise further also.

- **In the UK, the flash September PMIs will also be of interest after the very strong readings in August.** Given August's PMI's were at elevated levels, a pullback seems likely, with services expected to fall from 58.8 to 56.0, and manufacturing forecast to slip from 55.2 to 54.0. The composite index is projected to decline from 59.1 to 56.5, although this still represents a strong reading. Elsewhere, the Gfk consumer confidence index is expected to remain at –27, a very subdued level. **The preliminary PMIs in September are also the highlight in the US.** The consensus is for the services PMI to fall to 54.7 in September, while the manufacturing index is forecast to stay at its current level, 53.1. This suggests, that the recovery has broadly maintained its momentum at the end of Q3, having rebounded strongly over the summer. Lastly, durable goods are forecast to have increased by 1.5% in August, having recovered strongly at the end of Q2 and carried this through to July.

Interest Rate Forecasts

	Current	End Q3 2020	End Q4 2020	End Q1 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 Q3 2020	End Q4 2020	End Q1 2021
EUR/USD	1.1834	1.19	1.21	1.23
EUR/GBP	0.9141	0.92	0.92	0.92
EUR/JPY	123.53	127	127	127
GBP/USD	1.2940	1.29	1.32	1.34
USD/JPY	104.38	107	105	103

Current Rates Reuters, Forecasts AIB's ERU

AIB
Treasury
Economic
Research

Oliver Mangan
Chief Economist

John Fahey
Senior Economist

ECONOMIC DIARY

Monday 21st September - Friday 24th September

Date		*UK & Irish Time (GMT+1)*	*Release*	*Previous*	*Forecast*
This Week:	**ECB Speakers: Lagarde** (Monday); Panetta, Lane (Tuesday);				
	BOE Speakers: Bailey (Tuesday); **Bailey** (Thursday)				
	Fed Speakers: Brainard (Monday); **Powell** (Tuesday); **Powell** (Wednesday); **Powell** (Thursday)				
Mon 21st	**UK:**	13:30	National Activity Index (August)	1.18	
Tue 22nd	**UK:**	11:00	CBI Industrial Orders (September)	-44	-43
	US:	15:00	Existing Home Sales (August)	5.86m / +24.7%	5.98m / +2.0%
	EU-19:	15:00	Consumer Confidence Flash (September)	-14.7	-14.7
Wed 23rd	**JPN:**	01:30	Flash Jibun Bank Manufacturing PMI (Sept.)	47.2	
	GER:	07:00	Gfk Consumer Confidence (October)	-1.8	-1.0
	FRA:	08:15	Flash Markit Composite PMI (September)	51.6	51.9
	GER:	08:30	Flash Markit Composite PMI (September)	54.4	54.2
	EU-19:	09:00	Flash Markit Composite PMI (September)	51.9	51.7
			- Manufacturing / Services	51.9 / 50.5	51.7 / 50.5
	UK:	09:30	Flash CIPS Markit Composite PMI (September)	59.1	56.5
			- Manufacturing / Services	55.2 / 58.8	54.0 / 56.0
	US:	14:45	Flash Markit Composite PMI (September)	54.6	54.4
			- Manufacturing / Services	53.1 / 55.0	53.1 / 54.7
Thurs 24th	**FRA:**	07:45	INSEE Business Climate (September)	93	95
	GER:	09:00	Ifo Business Climate (September)	92.6	93.8
	UK:	11:00	CBI Distributive Trades (September)	-6	-10
	US:	13:30	Initial Jobless Claims (w/e 14th September)	860,000	
	US:	15:00	New Home Sales (August)	0.901m / +13.9%	0.89m / -1%
Fri 25th	**UK:**	00:01	Gfk Consumer Sentiment (September)	-27	-27
	EU-19:	09:00	M3 Money Supply (August)	(+10.2%)	(+10.4%)
	US:	13:30	Durable Goods Orders (August)	+11.4%	+1.5%

♦ *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