Weekly Market Brief

AIB Treasury Economic Research Unit

31st-4th August-September 2020

Once Bitten, Twice Shy!

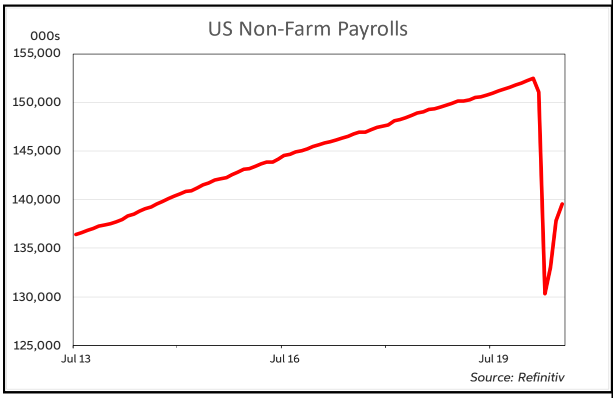
- **Little progress is being made in the EU-UK trade talks even as the clock ticks down** towards the end of the Brexit transition period in December. It is generally agreed that a deal needs to be in place by the end of October to allow time for it to be ratified and come into effect at the start of 2021. The EU's chief negotiator, Michel Barnier, provided a very downbeat assessment at the conclusion of the latest round of talks, saying "too often this week, it felt as if we were going backwards more than forwards", adding that at this stage an agreement seems unlikely. David Frost, the UK's chief negotiator, also acknowledged that little progress has been made and that an agreement "will not be easy to achieve". The two sides remain far apart on the key issues of regulatory alignment especially on state aid rules, a dispute resolution mechanism and fisheries. The next round of face-to-face talks are scheduled for the week of September 7th.

- **A failure to reach a trade deal and reversion to trading under WTO rules involving tariffs, quotas and non-tariff barriers would deal another severe blow to the UK economy** in the aftermath of a forecast 10% fall in GDP in 2020. Studies suggest that the hit to UK GDP could be in the order of 5-6% within the first few years. Quite surprisingly, sterling seems unperturbed by the lack of progress in the talks. The currency has strengthened over the past two months, with the euro falling back from 91.75p to 89.5p and cable rising from $1.23 to $1.33 since mid-year. Meanwhile, there is little sign of significant hedging against a sterling fall later in the year should the trade talks end in failure, with market positioning moving towards being long the currency.

- **It may be that markets believe that a trade deal will be agreed later this year** as neither the UK nor the EU will want to add more economic woes to the major problems caused by the Covid-19 pandemic. After all, following much procrastination last year, the UK and EU moved quickly to conclude a Withdrawal Agreement in October. However, quite apart from the risks posed by the trade talks, the grounds for optimism on sterling look slim. Markets expect a further 10bps rate cut from the BoE at some stage in the coming year. Meanwhile, the Bank is no longer ruling out negative rates, a move that would pose considerable downside risk for the currency. The recession caused by the Covid-19 pandemic has also been much deeper in the UK than the other major economies, reflecting the extent to which the economy was put into lockdown.

- **It all suggests that the risks for the currency are far from symmetric.** The likelihood at this stage is that if a trade deal is agreed, it will be a very limited agreement and far inferior to the current Single Market. Hence, sterling may not gain that much ground if an agreement is reached, with the euro dropping back to around the 87p level. On the other hand, history has shown as recently as the Brexit referendum in 2016 and the Covid-19 pandemic earlier this year, that sterling can fall very sharply and very quickly at times of crisis. Falls of ten per cent or more by the UK currency are not unusual as occurred this spring. The market may feel once bitten, twice shy in regard to sterling given the experience with EU-UK Brexit talks last autumn. However, it should also remember the harsh lesson of 2016 when it was far too sanguine about the outcome of the Brexit referendum.

- **Data-wise, the highlight this week is the release of the US employment report for August.** In July, non-farm payrolls once again surprised to the upside, increasing by 1.7m (vs. f'cast 1.5m) as the rapid rehiring of workers in states that had reopened continued. As restrictions remained in place in many southern and western sates for most of August, coupled with the fall in income support for many US households, the pace of hiring may be difficult to maintain. The forecast is for payrolls to have increased by 1.43m in August. It is worth remembering though, that payrolls in July were still almost 12m below their February peak.



- **Meanwhile, the unemployment rate is expected to fall back below 10%.** Overall, it is clear the recovery in the labour market has a very long way to run still. **The US calendar also contains the August readings of the ISMs**. The manufacturing ISM is expected to edge slightly higher as activity in the sector continues to recover. A slight fall has been pencilled in for the non-manufacturing ISM, although the index is expected to remain at an elevated level (58.1 prior vs. 57.0 f'cast).

- **In the Eurozone, the flash reading of August HICP will feature.** Headline inflation has remained well below 1% since April and this is expected to continue. The core rate may move lower as the reimposition of Covid restrictions throughout the month impacts activity. The July print for unemployment is also due. Furloughing schemes continue to keep the jobless rate artificially low. Indeed, this is set to continue as Germany announced it will keep its income support measures in place throughout 2021. **Eurozone retail sales for July will offer a further insight into the recovery in consumer spending.** Retail sales in the Eurozone were up 5.7% MoM in June, as they moved back above Februarys level. A smaller gain of 1.4% is expected in July, as the initial post-lockdown surge continues to fade. **There are no noteworthy releases this week in the UK.**

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	1.1881	1.18	1.18	1.18
EUR/GBP	0.8939	0.91	0.88	0.88
EUR/JPY	125.32	125	126	126
GBP/USD	1.3287	1.30	1.34	1.34
USD/JPY	105.48	106	107	107

Current Rates Reuters, Forecasts AIB's ERU

ECONOMIC DIARY

Monday 31st August - Friday 4th September

AIB Treasury Economic Research

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Date		*UK & Irish Time (GMT+1)*	*Release*	*Previous*	*Forecast*
This Week:	**ECB Speakers:**		de Guindos (Tuesday); Lane (Tuesday); Schnabel (Thursday); Lane (Friday)		
	BoE Speakers:		Broadbent, Haldane (Wednesday); Bailey (Thursday); Saunders (Friday)		
	Fed Speakers:		Brainard (Tuesday)		
Mon 31st	**JPN:**	00:50	Industrial Output (July)	+1.9%	+5.8%
	CHINA:	02:00	NBS Manufacturing PMI (August)	51.1	51.2
			- Non-manufacturing	54.2	
	ITA:	09:00	GDP (Q2: Final Reading)	-12.4% / (-17.3%)	-12.4% / (-17.3%)
	ITA:	10:00	Preliminary HICP (August)	(+0.8%)	(+0.2%)
	GER:	13:00	Preliminary HICP (August)	(0%)	(+0.1%)
Tue 1st	**JPN:**	00:30	Unemployment/ Jobs Applicants (July)	2.8%/ 1.11	3% / 1.08
	IRL:	***01:01***	***AIB Manufacturing PMI (August)***	***57.3***	
	CHINA:	02:45	Caixin Manufacturing PMI (August)	52.8	52.7
	GER:	08:55	Unemployment (August)	6.4%	6.4%
	EU-19	09:00	Final Markit Manufacturing PMI (August)	51.7	51.7
	UK:	09:30	BOE Mortgage Approvals (July)	40,010	55,000
	UK:	09:30	Final CIPS / Markit Manufacturing PMI (August)	53.3 / 55.3 (p)	55.3
	EU-19:	10:00	Flash HICP (August)	(+0.4%)	(+0.2%)
			- Ex-food & Energy	(+1.3%)	(+1%)
	EU-19:	10:00	Unemployment (July)	7.8%	8.0%
	IRL:	***11:00***	***Unemployment (August)***	***5.0%***	***5.2%***
			- Covid-19 Adjusted Rate	***16.7%***	***14.5%***
	US:	14:45	Final Markit Manufacturing PMI (August)	50.9 / 53.6 (p)	53.6
	US:	15:00	Construction Spending (July)	-0.7%	+0.7%
	US:	15:00	Manufacturing ISM (August)	54.2	54.5
Wed 2nd	**GER:**	07:00	Retail Sales (July)	-1.6%	+0.5%
	EU-19	10:00	PPI (August)	(-3.7%)	(-3.4%)
	US:	15:00	Factory Orders (July)	+6.2%	+5.8%
	IRL:	***16:30***	***Exchequer Returns (August)***	***Aug '19: -€0.6bn***	***-€11.0bn***
Thurs 3rd	***IRL:***	***01:01***	***AIB Services PMI (August)***	***51.9***	
	CHINA:	02:45	Caixin Services PMI (August)	54.1	
	ITA:	08:45	Final Markit Composite PMI (August)	51.6 / 52.5 (p)	52.5
	FRA:	08:50	Final Markit Composite PMI (August)	57.3 / 51.7 (p)	51.7
	GER:	08:55	Final Markit Composite PMI (August)	55.3 / 53.7 (p)	53.7
	EU-19:	09:00	Final Markit Composite PMI (August)	54.9 / 51.6 (p)	51.6
			- Services	54.7 / 50.1 (p)	50.1
	UK:	09:30	Final CIPS / Markit Composite PMI (August)	57.0 / 60.3 (p)	60.3
			- Services	56.5 / 60.1 (p)	60.1
	EU-19:	10:00	Retail Sales (July)	+5.7%	+1.4%
	US:	13:30	International Trade (July)	-$50.7bn	-$52.3bn
	US:	13:30	Initial Jobless Claims (w/e 24th August)	1,068,000	
	US:	14:45	Final Markit Composite PMI (August)	50.3 / 54.7 (p)	54.7
			- Services	50.0 / 54.8 (p)	54.8
	US:	15:00	Non-Manufacturing ISM (August)	58.1	57.0
Fri 4th	**GER:**	07:00	Industrial Orders (July)	27.9%	6%
	US:	13:30	Non-Farm Payrolls (August)	+1,763,000	+1,425,000
			- Unemployment	10.2%	9.8%
			- Average Earnings	(+0.2%)	(+0.0%)

♦ *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