Weekly Market Brief

AIB Treasury Economic Research Unit

5th February-9th February 2018

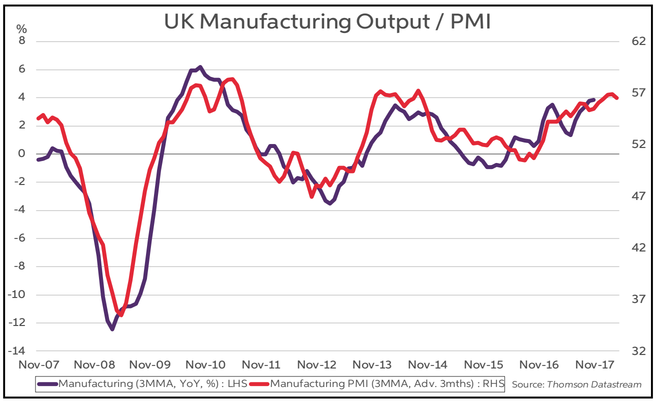
Yields on the Rise

- **Government bond yields rose last week as market participants adjusted further to the realisation of a gradual normalisation to global monetary policy from the major central banks.** Ten year US Treasury yields rose above 2.8% to their highest level since early 2014 and are now up around 40bps since the start of the year. Likewise, the yield on German 10 year bunds rose above 0.7%, representing their highest level since September 2015, while the 5 year bund yield got back into positive territory for the first time in over 2 years. Meanwhile, UK gilts also saw their yields move higher, with the 10 year yield rising above 1.5% (+40bps year to date), reaching a near two year high. **The move higher in yields unsettled equity markets somewhat, with the S&P 500 edging back from its record highs, falling by around 2% on the week.**

- In terms of the most recent monetary policy update, last week's Fed meeting statement remained consistent with the consensus view that the Fed will hike interest rates by 25bps in March. **Market expectations have become more hawkish on the US rate outlook over the past six months, with the gap between the market and the Fed narrowing.** Futures contracts indicate that the market is now broadly in line with the Fed's guidance of three hikes this year. **These changes in market expectations have been a key driver in the aforementioned rise in Treasury yields.** However, the market is anticipating a less aggressive path of hikes over the period 2019-2020. Current pricing suggests the market is expecting rates edging up to near 2.5% by end 2020, well below the Fed's 3.1% projection. This suggests that the market may either be expecting inflation to remain subdued and/or the economy to slow, resulting in the Fed being unable to raise rates by as much as they are currently guiding.

- **This week we get the latest major central bank update, with the Bank of England meeting. No changes to policy are anticipated.** However, markets will be looking to the Inflation Report, minutes and BoE Governor Carney's press conference for updated guidance on the outlook for policy. UK inflation has not fallen back towards its 2% target to the same extent as had been predicted at the time of the November Inflation Report (3% in December vs 2.7% expectation), partly due to higher oil prices. Governor Carney recently stated that the economy is operating near "full capacity" and thus, the policy decision was becoming "more conventional" (i.e. related more closely to the inflation target). Futures contracts suggest markets expect the MPC to hike rates by 25bps to 0.75% in H2 this year, with another hike anticipated in 2019. **Overall, the BoE is unlikely to deviate much from its recent policy guidance that "further modest increases in Bank Rate would be warranted over the next few years".**

- Data-wise, UK industrial output is anticipated to have declined in December following eight consecutive months of increases, while the goods trade deficit looks set to have remained significant in December. Meanwhile, **the timelier services PMI for January will give us an early read on the economy's key sector (c.80% of GDP).** It looks set to have remained consistent with a solid pace of growth.



- **Likewise, the US non-manufacturing ISM is anticipated to have remained at a solid level.** Meantime, international trade for December should confirm what the preliminary Q4 US GDP data showed, that trade was a significant drag on growth in the quarter. **Finally, in the Eurozone, December retail sales are due.** National level data released in recent days suggest we should see a decline, following on from November's strong Black Friday aided jump. December industrial production data from Germany, France and Italy will be looked to ahead of next week's Eurozone aggregate figures.

Interest Rate Forecasts	Current	End Q1 2018	End Q2 2018	End Q3 2018
Fed Funds	1.375	1.625	1.875	1.875
ECB Deposit	-0.40	-0.40	-0.40	-0.40
BoE Repo	0.50	0.50	0.50	0.50
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 Q1 2018	End Q2 2018	End Q3 2018
EUR/USD	1.2455	1.22	1.19	1.17
EUR/GBP	0.8790	0.89	0.88	0.87
EUR/JPY	137.32	135	134	135
GBP/USD	1.4168	1.37	1.35	1.34
USD/JPY	110.25	111	113	115

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ECONOMIC DIARY

Monday 5th February—Friday 9th February 2018

Date	*UK & Irish Time (GMT)*		*Release*	*Previous*	*Forecast*
This Week:	**Fed Speakers:**		Bullard (Tuesday); Dudley, Evans, Williams (Wednesday); George, Kaplan, Harker, Kashkari (Thursday)		
	ECB Speakers:		Mersch (Thursday)		
Mon 5th	**CHINA:**	01.45	Caixin Services PMI (January)	53.9	
	FRA:	08.50	Final Markit Composite PMI (January)	59.6 / 59.7 (p)	59.7
	GER:	08.55	Final Markit Composite PMI (January)	58.9 / 58.8 (p)	58.8
	EU-19:	09.00	Final Markit Composite PMI (January)	58.1 / 58.6 (p)	58.6
			- Services	56.6 / 57.6 (p)	57.6
	UK:	09.30	CIPS/Markit Services PMI (January)	54.2	54.3
	EU-19:	09.30	Sentix Index (February)	32.9	33.0
	EU-19:	10.00	Retail Sales (December)	+1.5% (+2.8%)	-1.0% (+1.8%)
	US:	15.00	Non-Manufacturing ISM (January)	55.9	56.3
			- Business Activity	57.3	
Tue 6th	**UK:**	00.01	BRC Retail Sales (January)	(+0.6%)	
	AUS:	03.30	RBA Interest Rate Announcement	1.50%	1.50%
	GER:	07.00	Industrial Orders (December)	-0.4%	+0.6%
	IRL:	***11.00***	***Residential Property Prices (December)***	***+1.1% (+11.6%)***	***0.0% (+12.0%)***
	US:	13.30	International Trade Balance (December)	-$50.5bn	-$51.7bn
Wed 7th	**JPN:**	05.00	Leading Indicators Index (December)	+2.1% / 108.3	
	GER:	07.00	Industrial Output (December)	+3.4%	-0.5%
	FRA:	07.45	Trade Balance (December)	-€5.69bn	
			- Exports	-1.6%	
	UK:	08.30	Halifax House Prices (January)	-0.6% (+2.7%)	
Thurs 8th	**UK:**	00.01	RICS House Price Survey (January)	8	5
	CHINA:	02.00	Trade Balance (January)	$54.7bn	$54.0bn
			- Exports	(+10.9%)	(+9.5%)
	JPN:	05.00	Economy Watchers Index (January)	53.9	
	GER:	07.00	Trade Balance (December)	€22.3bn	€21.7bn
			- Exports	+4.1%	-1.0%
	UK:	12.00	BoE Interest Rate Announcement	0.50%	0.50%
			- Inflation Report Published		
	UK:	12.30	BoE Press Conference		
	US:	13.30	Initial Jobless Claims (w/e 3rd February)	230,000	230,000
	NZL:	20.00	RBNZ Interest Rate Announcement	1.75%	1.75%
Fri 9th	**FRA:**	07.45	Industrial Output (December)	-0.5%	+0.2%
	ITA:	09.00	Industrial Output (December)	0.0%	+0.4%
	UK:	09.30	Industrial Output (December)	+0.4% (+2.5%)	-0.9% (+0.3%)
			- Manufacturing	+0.4% (+3.5%)	+0.3% (+1.2%)
	UK:	09.30	Goods Trade Balance (December)	-£12.23bn	-£11.60bn
			- Non-EU	-£4.68bn	

♦ *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