Weekly Market Brief

AIB Treasury Economic Research Unit

11th - 15th May 2020

Brexit Still Lurking in the Long Grass

- **Generally speaking, the main FX rates have been relatively range bound in recent weeks.** However, as is often the case in times of elevated uncertainty and risk aversion, the yen has been strengthening. Indeed, the past week saw the euro/yen rate drop below the ¥115 level for the first time since 2016. Meanwhile, the dollar/yen rate is again testing strong support at ¥106. This is a level that has also held since 2016, with the notable exception of a temporary breach at the time of extreme volatility in markets in early March this year when the coronavirus pandemic was really starting to take hold. Overall though, foreign exchange markets have been quite calm in the past six weeks, with the extreme volatility seen in March subsiding.

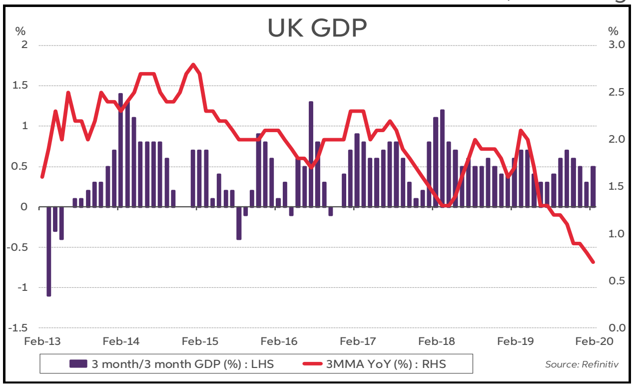
- **Sterling was one currency that suffered more than most during the difficult trading conditions in March.** It is worth recalling that the euro soared from 84p at end February to 95p by mid-March, while cable dropped from $1.31 to $1.15 in a little over a week in the first half of the month. Sterling subsequently recovered a lot of this lost ground in the second half of March. The euro/sterling rate has been confined to a very narrow corridor of 87-88.5p since the start of April, with $1.22-1.26 containing nearly all the action in cable. However, the big moves in March are illustrative of the degree to which there can be sudden large shifts in sterling in a short period of time, something we have seen on a number of occasions down through the years.

- **Risks remain for sterling. It could find itself in the line of fire again if markets once more become convulsed by the coronavirus.** Stock markets in particular seem to be anticipating a relatively smooth end to the coronavirus pandemic that allows a strong rebound to take hold in the global economy during the second half of this year. Such expectations could easily be disappointed, especially if there is a second wave to the virus. Another risk is Brexit, which seems to have disappeared off the radar in recent months. However, while trade negotiations between the EU and UK have resumed, they don't appear to be making much progress. Furthermore, the UK seems in no mood to seek an extension to the transition period beyond end 2020 that would allow the negotiations extend into next year. Thus, we could be heading for another cliff-edge Brexit date in December.

- **Sterling could come under some pressure over the summer if an extension to the transition period is not agreed by June 30th, the last date this is provided for under Article 132 of the Withdrawal Agreement.** The EU and UK would be really staring down the barrel of a gun in the autumn in this situation, given their very differing views on the need for adherence to common rules and regulatory alignment as part of any trade deal. It is hard to imagine that the UK government would want to impose the turmoil a reversion to WTO trading rules would bring on a British economy seeking to recover from the deepest recession in 300 years according to the Bank of England. Nonetheless, brinkmanship may be a key part of its negotiating tactics. Whatever way one views it, a failure to agree an extension to the transition period by end June would seem likely to be a precursor for renewed volatility in sterling in the second half of the year.

- **This week, the highlight of a busy US calendar is the retail sales report for April.** The headline measure of expenditure dropped by 8.7% in March as auto and gasoline sales plummeted when lockdowns began to be imposed. The forecast is for sales to have plunged by a further 12% in April, reflecting the near-total imposition of lockdowns in the month which saw retail outlets close and prompted a tidal wave of lay-offs. The control measure, a proxy for consumer spending, is projected to have sank by 3.9% after having risen by 1.7% in March. The industrial sector has also been hit hard by the restrictions. An unprecedented 11% decline in output is pencilled in for April. Meanwhile, it is envisaged that the recent collapse in oil prices will see headline CPI decelerate from 1.5% to just 0.4%. The core rate also looks to have eased from 2.1% to 1.7%, reflecting reduced household spending. With regard to timelier data, the flash reading of the Michigan measure of consumer sentiment is expected to have begun to stabilise in May, but at a low level.

- **In the UK, the first estimate of GDP for the opening quarter of the year is due.** The available monthly data suggest that even before the Covid-19 outbreak hit, the economy was lacking momentum. The introduction of lockdown measures in March could see output fall by 7% in the month, leaving the Q1 growth rate at –2%. However, much worse is to come in Q2, with the BoE forecasting that the economy may contract by as much as 25% in the quarter. Very weak industrial output figures are also expected for March.



- **Meanwhile, there is a relatively quiet look to the Eurozone data schedule.** The flash reading of Eurozone jobs growth for Q1 will be of some interest. Employment is forecast to have dipped by 0.4%, reflecting the initial impact of lockdowns in the region from March. The March print of industrial production is also due, with the available country-level data suggesting output may have dropped by as much as 12%. Nationally, the first estimate of German GDP for Q1 is due. Output is projected to have fallen by circa 2% in the quarter.

Interest Rate Forecasts

	Current	End Q2 2020	End Q3 2020	End Q4 2020
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 Q2 2020	End Q3 2020	End Q4 2020
EUR/USD	1.0822	1.09	1.10	1.11
EUR/GBP	0.8745	0.89	0.92	0.88
EUR/JPY	115.40	117	118	120
GBP/USD	1.2374	1.22	1.20	1.26
USD/JPY	106.63	107	107	108

Current Rates Reuters, Forecasts AIB's ERU

ECONOMIC DIARY

Monday 11th - Friday 15th May

AIB Treasury Economic Research

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Date		*UK & Irish Time (GMT+1)*	*Release*	*Previous*	*Forecast*
This Week:	**ECB Speakers:**		Mersch (Monday); de Guindos, Lane (Wednesday); de Guindos (Thursday)		
	Fed Speakers:		Evans (Monday); Bullard, Harker, Mester, Quarles (Tuesday); Kashkari (Thursday) Evans (Friday)		
Mon 11th	**ITA:**	09.00	Industrial Output (March)	-1.2%	-20.0%
Tue 12th	**JPN:**	06.00	Leading Indicators' Index (March)	1.0	
	US:	11.00	NFIB Business Optimism (April)	96.4	
	US:	13.30	CPI (April)	(+1.5%)	(+0.4%)
			- Core	(+2.1%)	(+1.7%)
Wed 13th	**UK:**	00.01	BRC Retail Sales (April)	(-3.5%)	
	UK:	07.00	GDP (Q1: First Estimate)	+0.0% (+1.1%)	-2.0% (-1.6%)
	UK:	07.00	Industrial Output (March)	+0.1% (-2.8%)	-5.8% (-9.2%)
			- Manufacturing	+0.5% (-3.9%)	-5.6% (-10.2%)
	UK:	07.00	Goods Trade Balance (March)	-£11.5bn	
			- Non-EU	-£5.6bn	
	EU-19:	10.00	Industrial Production (March)	-0.1% (-1.9%)	-12.0% (-12.0%)
	US:	13.30	PPI (April)	(+0.7%)	(-0.4%)
Thurs 14th	**FRA:**	06.30	Unemployment (Q1)	8.1%	8.3%
	GER:	07.00	Final HICP (April)	(+0.8%)	(+0.8%)
	IRL:	***11.00***	***CPI (April)***	***+0.4% (+0.7%)***	***+0.0% (+0.3%)***
	IRL:	***11.00***	***Residential Property Prices (March)***	***-0.1% (+1.1%)***	***+0.1% (+1.1%)***
	US:	13.30	Initial Jobless Claims (w/e 9th May)	3,169,000	2,500,000
Fri 15th	**CHINA:**	03.00	Industrial Output (April)	(-1.1%)	(+1.5%)
	GER:	07.00	GDP (Q1: First Estimate)	+0.0% (+0.3%)	-2.1% (-1.6%)
	FRA:	07.00	Final HICP (April)	(+0.5%)	(+0.5%)
	ITA:	10.00	Final HICP (April)	(+0.1%)	(+0.1%)
	EU-19:	10.00	Employment (Q1: First Estimate)	+0.3% (+1.1%)	-0.4% (+0.3%)
	EU-19:	10.00	GDP (Q1: Second Reading)	-3.8% (-3.3%)	-3.8% (-3.3%)
	US:	13.30	NY Fed / Empire State Index (May)	-78.2	-65.0
	US:	13.30	Retail Sales (April)	-8.7%	-12.0%
			- Ex-Autos	-4.5%	-8.6%
			- Ex-Gas, Autos & Building Materials	+1.7%	-3.9%
	US:	14.15	Industrial Production (April)	-5.4%	-11.0%
			- Manufacturing	-6.3%	-9.0%
			- Capacity Utilisation	72.7%	65.1%
	US:	15.00	Prelim' Michigan Consumer Sentiment (May)	71.8	68.0

♦ *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