Weekly Market Brief

AIB Treasury Economic Research Unit

1st-5th October 2018

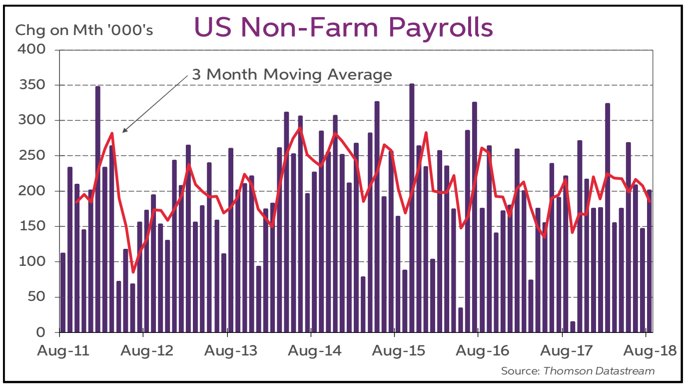
Inflating Expectations

- **Central banks have been doing a good job in recent times in terms of influencing market expectations on interest rates through so called forward guidance.** The ECB has been guiding that interest rates are set to remain very low for a prolonged period in the Eurozone. More recently, it has indicated that the key deposit rate will be maintained at -0.4% until at least autumn 2019. This shifted rate expectations downwards, with markets of the view that rates will remain lower for an even longer period of time in the Eurozone.

- It was a bit of a surprise then, to hear ECB President Mario Draghi talk about "a relatively vigorous pick-up in underlying inflation" in his testimony last Monday to the European Parliament. **The ECB sees accelerating wage growth, with core inflation rising to 1.8% by 2020.** Given the solid growth of the Eurozone economy over the past five years, with the unemployment rate on a steady downward trajectory, one has to wonder why the ECB is not moving away from its negative interest rate policy if it expects a vigorous pick-up in underlying inflation. **Negative interest rates were introduced back in 2014 to counter the risk of deflation in the Eurozone, but this danger has surely passed with the headline HICP rate now above 2%.**

- **Granted, the core inflation rate is still just above 1% and the ECB expects that inflation will be slightly below target in two years' time.** However, this hardly seems to be grounds for keeping interest rates negative into 2020, but this is what the ECB is guiding. Bond yields spiked higher in response to Mr Draghi's comments, before falling back again by end week. The forward policy guidance seems clear - rates are on hold until next autumn. What happens after that will be greatly influenced by wage growth and the outlook for core inflation, but some ECB Council members are starting to sound a bit hawkish.

- **In terms of the week ahead, the main release is the US employment report for September.** The consensus is that non-farm payrolls rose by 188,000, above the July/August average increase of 174,000. The unemployment rate looks set to have dipped back to the 18-year low level of 3.8% reached in May, after increasing over the summer due to a firmer pace of labour force growth. Meanwhile, it is envisaged that the year-on-year growth rate of average hourly earnings will dip slightly to 2.8%, having hit a nine-year high of 2.9% in August. A number of leading indicators such as the NHIB's 'jobs hard to fill index', which is at a historically high level, point to rising wage pressures.



- **Meanwhile, the US schedule also contains the ISM indices for September.** The manufacturing index is expected to fall back slightly, albeit from August's very high level. The key non-manufacturing ISM is anticipated to be little changed on the month. This is indicative of continued strong growth in the US.

- **Survey data are set to feature in the UK with September PMIs due for release.** The key services index (c. 80% of GDP) is expected to have dipped slightly, while still remaining at an encouraging level. This suggests that the sector is continuing to expand at a moderate pace. It is anticipated that the manufacturing index has weakened further. Overall, the PMIs for Q3 indicate that GDP growth is likely to be close to Q2's 0.4% rise. However, of greater interest to sterling watchers may be this week's Conservative party conference.

- **There is a comparatively light schedule in the Eurozone.** The unemployment rate stood at 8.2% in August, a near ten year low, and looks set to have held at this rate in September. Eurozone retails sales figures for August are also due out. Additionally, the Italian budget is likely to command much attention, especially with a Eurogroup meeting of Finance Ministers on Monday.

Interest Rate Forecasts

	Current	End Q4 2018	End Q1 2019	End Q2 2019
Fed Funds	1.875	2.375	2.625	2.875
ECB Deposit	-0.40	-0.40	-0.40	-0.40
BoE Repo	0.75	0.75	0.75	1.00
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 2018	End Q1 2019	End Q2 2019
EUR/USD	1.1588	1.19	1.20	1.21
EUR/GBP	0.8908	0.89	0.88	0.87
EUR/JPY	131.63	133	133	133
GBP/USD	1.3005	1.34	1.36	1.39
USD/JPY	113.57	112	111	110

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ECONOMIC DIARY

Monday 1st—Friday 5th October 2018

Date	*UK & Irish Time (GMT+1)*		*Release*	*Previous*	*Forecast*
This Week:	**ECB Speakers:**		Mersch, Smets (Wednesday); de Galhau (Tuesday); Mersch (Wednesday); Coeure, Rehn (Thursday); de Guindos (Friday)		
	BoE Speakers:		Tenreyro (Monday); Haldane, Haskel (Tuesday)		
	Fed Speakers:		Bostic, Rosengren (Monday); **Powell**, Quarles (Tuesday); Barkin, Bullard, Evans, Mester (Wednesday); Quarles (Thursday); Bostic (Friday)		
	UK:		Conservative Party Conference (Sunday to Wednesday)		
Mon 1st	**JPN:**	00.50	Tankan Big Manufacturing Index (Q3)	21	22
			- Non-Manufacturing	24	22
	GER:	07.00	Retail Sales (August)	-0.4%	+0.3%
	ITA:	09.00	Unemployment (August)	10.4%	10.5%
	EU-19:	09.00	Final Markit Manufacturing PMI (September)	54.6 / 53.3 (p)	53.3
	UK:	09.30	BoE Mortgage Approvals (August)	64,768	64,500
	UK:	09.30	CIPS/Markit Manufacturing PMI (September)	52.8	52.5
	EU-19:	10.00	Unemployment (August)	8.2%	8.2%
	US:	14.45	Final Markit Manufacturing PMI (September)	54.7 / 55.6 (p)	55.6
	US:	15.00	Construction Spending (August)	+0.1%	+0.4%
	US:	15.00	Manufacturing ISM (September)	61.3	60.4
Tue 2nd	**UK:**	07.00	Nationwide House Prices (September)	-0.5% (+1.9%)	+0.2% (+1.9%)
	UK:	09.30	CIPS/Markit Construction PMI (September)	52.9	52.5
	IRL:	***11.00***	***Unemployment (September)***	***5.6%***	***5.5%***
	IRL:	***16.30***	***Underlying Exchequer Balance (September)***	***Sept' 17: -€1.1bn***	***-€1.1bn***
	US:	20.30	Total Vehicle Sales (September)	16.72m s.a.a.r.	16.75m
Wed 3rd	**FRA:**	08.50	Final Markit Composite PMI (September)	54.9 / 53.6 (p)	53.6
	GER:	08.55	Final Markit Composite PMI (September)	55.6 / 55.3 (p)	55.3
	EU-19:	11.00	Final Markit Composite PMI (September)	54.5 / 54.2 (p)	54.2
			- Services	54.4 / 54.7 (p)	54.7
	UK:	09.30	CIPS/Markit Services PMI (September)	54.3	54.0
	EU-19:	10.00	Retail Sales (August)	-0.2% (+1.1%)	+0.2% (+1.6%)
	US:	13.15	ADP National Employment (September)	163,000	184,000
	US:	14.45	Final Markit Services PMI (September)	54.8 / 52.9 (p)	52.9
	US:	15.00	Non-Manufacturing ISM (September)	58.5	58.2
			- Business Activity	60.7	60.0
Thurs 4th	***IRL:***	***11.00***	***Live Register (September)***	***-6,800/209,900***	***-2,900/207,000***
	US:	13.30	Initial Jobless Claims (w/e 29th September)	214,000	210,000
	US:	15.00	Factory Orders (August)	-0.8%	+1.8%
Fri 5th	**JPN:**	06.00	Leading Indicators Index (August)	-1.1	
	GER:	07.00	Industrial Orders (August)	-0.9%	+0.3%
	FRA:	07.45	Trade Balance (August)	-€3.49bn	
	UK:	08.30	Halifax House Prices (September)	+0.1% (+3.7%)	+0.2% (+3.3%)
	US:	13.30	Non-Farm Payrolls (September)	201,000	184,000
			- Unemployment	3.9%	3.8%
			- Average Hourly Earnings	(+2.9%)	(+2.8%)
	US:	13.30	International Trade Balance (August)	-$50.1bn	-$52.6bn
	US:	20.00	Consumer Credit (August)	$16.64bn	$15.0bn
	IRL:	***23.59***	***Pre-Budget 2019 White Paper Published***		

♦ *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