Forex and Interest Rate Outlook

AIB Treasury Economic Research Unit

8th April 2025

- President Trump’s tariffs have unwound decades of global trade liberalisation, jolting markets and leading to revisions in global growth forecasts
- The ultimate impact of the tariffs remains unclear given the volatility of US trade policy announcements. Most forecasters expect the greatest hit to be on the US domestic economy
- Central bank outlook clouded by trade policy uncertainty
- Main currency pairs exhibiting extreme volatility due to Trump 2.0 impact. Dollar has weakened as US growth expectations have reversed
- Euro likely to hold most of its gains, but high uncertainty due to evolving tariff policy

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Global Economic Outlook

Global growth picture was robust ahead of Trump's April tariffs

Global growth robust so far in 2025 despite geopolitical risks

Economic data signalled robust global growth in recent months, despite current geopolitical risks. Recent PMI and economic surprise indices suggest growth has accelerated somewhat in Q1 2025 globally, while deteriorating in the US. Inflation continues to ease across all major economies, but there are signs of a plateauing in some regions such as the US and UK.

US growth looks set to slow, tariffs could precipitate a sharper slowdown

US GDP expanded at a robust pace of 2.8% in 2024, with the immediate outlook for 2025 and 2026 highly uncertain. While not yet reflected in the hard data, confidence surveys for US households and businesses have collapsed in Q1 2025, as the Trump administration has made dramatic policy moves on trade and tariffs.

Data signal subdued growth in UK and Eurozone

In Europe, there are signs of emerging growth in confidence and industry surveys, particularly on the back of the announcement of the German fiscal stimulus in March, and co-ordinated moves to boost defence spending at the European level. This fiscal boost will take time to feed through to growth, with short terms risk to the outlook from tariffs. In the UK, growth has softened following the Autumn Budget, but the UK has avoided the worst of the Trump tariffs thus far.

Risks to the outlook firmly tilted to the downside for growth

But global growth forecasts revised down, before tariffs were factored in

However, given the sudden downturn in US confidence surveys, the March 2025 OECD forecasts are factoring in weaker growth in the near term. It expects that world GDP will grow by a relatively subdued 3.1% in 2025 and 3% in 2026. For the US, the OECD has revised down its near-term outlook to 2.2% in 2025 (from 2.4%) and more sharply to 1.6% in 2026 (from 2.1%), a significant slowdown compared to the near 3% growth rate in recent years.

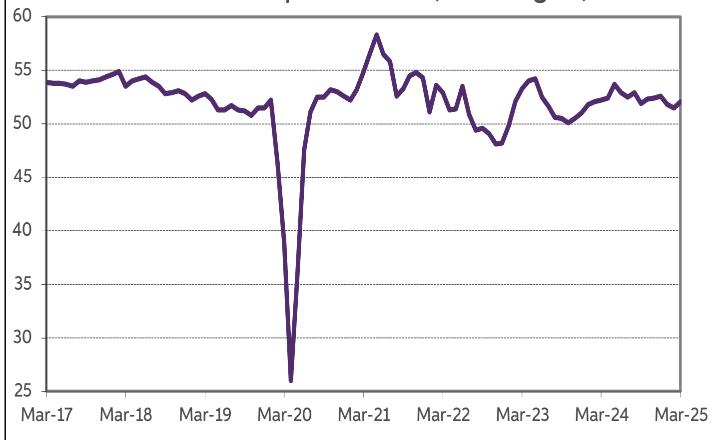
Geopolitics, including tariffs the key downside risk to the growth and inflation outlook.

Economic uncertainty spiked in Q1 2025, reflecting ongoing global trade tensions, to its highest level since the start of the pandemic in 2020. The imposition of the US tariffs of at least 10% on global trade partners, and much higher on the EU and Asian countries means the risks to the outlook are firmly tilted to the downside, with recession risks heightened for the US.

Main concern is an escalation in trade tensions following US tariff announcement

The ultimate impact of US tariffs will depend on the response of other countries and whether a negotiated settlement is reached in time. For now, institutional forecasters predict the greatest damage from unilateral US tariffs will be to the US economy. These models show the damage accumulates as other regions respond in kind to the US tariffs. However, even if Trump relents somewhat, both markets must now price in a higher baseline for US tariffs and lower GDP growth in the short-to-medium term.

Global Composite PMI (JP Morgan)



Source: Refinitiv

GDP (Vol % Change)

	2023	2024 (e)	2025 (f)	2026 (f)
World	3.3	3.2	3.1	3.0
Advanced Economies	1.7	1.8	1.9	1.8
US	2.9	2.8	2.2	1.6
Eurozone	0.4	0.7	1.0	1.2
UK	0.3	0.9	1.4	1.2
Japan	1.5	0.1	1.1	0.2
Emerging Economies	4.4	4.2	4.2	4.3
China	5.2	5.0	4.8	4.4
India	8.2	6.3	6.4	6.6
World Trade Growth (%)	0.7	3.4	3.2	3.3
Inflation -CPI				
Advanced Economies (%)	4.6	2.6	2.1	2.0

Sources: IMF World Economic Outlook January 2025 & OECD Interim Economic Outlook March 2025

Interest Rate Outlook

Central banks awaiting clarity on global trade developments

Global trade uncertainty has added layer of complications to rate deliberations

The main central bank meetings in Q1 have been broadly in line with expectations. They re-emphasised that they are taking a careful, data dependent approach to any policy changes. Central Banks have also noted the increased level of uncertainty regarding the economic outlook amid the escalation of trade tensions and protectionism. They have stated they will assess the trade developments and their implications for inflation and, in turn, their policy settings. Meanwhile, there has been a noticeable softening in rate expectations (especially in US) in the aftermath of President Trump's new tariffs policy. Rate expectations will remain reactive to tariff related developments.

US Fed content with current level of rates and see's no hurry in cutting again

The Fed left rates on hold in March in a 4.25-4.50% range for a second straight meeting. It reduced rates by 100bps in H2'2024. Its rate projections continue to indicate a very gradual pace of easing. The median projection is for 50bps of cuts this year, which would see rates near 3.9% by year end. The Fed envisages rates troughing at 3.1% in 2027. Amid elevated global trade tensions, Chair Powell noted the "really high uncertainty" regarding the economic outlook while also stating that tariff-related inflation could be "transitory". He re-iterated that the Fed is in no hurry to cut rates. Market rate expectations have softened in recent days (by c. 50bps) with around 100bps of cuts now expected by year end. We believe at least 50bps of easing is on the cards for this year, with the potential for more if global trade tensions remain elevated.

ECB cuts again in March but **less certain on timing/extent of further rate cuts**

The ECB cut rates in March, as expected, for a second consecutive meeting. It reduced them by 25bps, with the Deposit rate lowered to 2.50%. This was the sixth 25bps rate cut since it started its easing cycle last June. In an important change to its statement, the ECB now states that "monetary policy is becoming meaningfully less restrictive". President Lagarde stressed that "if the data points to a pause, we will pause, if the data points to a cut, we will cut". Thus, while the ECB retains an easing bias, the timing/extent of further policy easing is now less clear. In the aftermath of President Trump's tariffs, the market is now anticipating the Depo rate falling to near 1.75% by year end. We believe that if trade tensions ease, a 2% rate by year end is plausible. However, if there is no progress in trade talks, then rates falling below 2% cannot be ruled out.

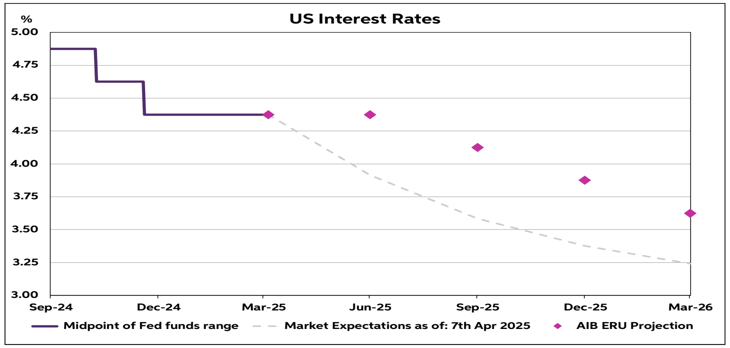
BoE will take a gradual approach to further easing

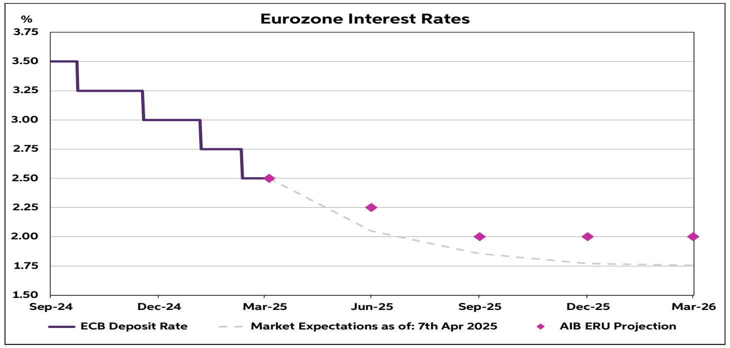
As expected, the BoE kept rates unchanged at 4.50% in March, having cut by 25bps at its previous meeting. Once again there was no unanimity within the MPC. Its current easing cycle, which began in August last year, has seen a total of 75bps of cuts. In terms of policy guidance, the BoE retains a bias to ease policy further. However, the extent of further rate cuts remains unclear. The Bank emphasised at the March MPC meeting that a gradual and careful approach to the further withdrawal of monetary policy restraint is "appropriate". A Bank rate of 3.75% by year end would be consistent with both the macro outlook and the BoE's preference for a measured approach to further rate cuts.

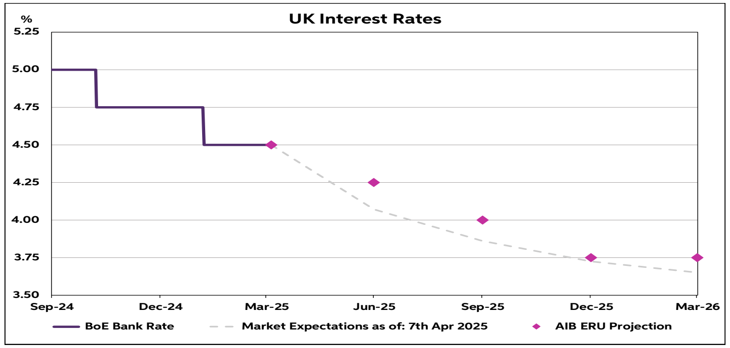
Interest Rate Forecasts

	Current	End Q2 2025	End Q3 2025	End Q4 2025	End Q1 2026
Fed Funds	4.375	4.375	4.125	3.875	3.625
ECB Deposit	2.50	2.25	2.00	2.00	2.00
BoE Repo	4.50	4.25	4.00	3.75	3.75

Current Rates Reuters, Forecasts AIB's ERU







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Forex Market Outlook

Dollar has lost ground in recent weeks

Dollar has lost ground in 2025

The dollar strengthened considerably post the US election, but the greenback has given back these gains in 2025. The trade-weighted DXY index is now c.5% lower year-to-date. Against the euro, the dollar is down c.5.5% YTD. EUR/USD has rebounded sharply from below the $1.02 level earlier in the year, to up towards its resistance level of $1.12 in March. The dollar also lost ground against sterling, falling by c.1.6% compared to its recent peak, with GBP/USD trading in a $1.27-1.31 range of late.

Tariff announcements and growth fears have weighed on the dollar

With several US tariff announcements during Q1 2025, culminating in the ‘Liberation Day’ plan on April 2nd, forex markets have been digesting the impact on the US economy and the dollar. Key to the major one-day moves in the dollar in Q1 has been the downside surprises in US macro surveys, which have driven a repricing in US rate expectations and a weakening in the currency. The uncertainty created by the tariffs, could yield further negative news on the macro front in the coming months.

Near term risks more broadly balanced with tariffs now priced in

However, we expect the greenback to maintain at close to its current level given much of the expected impact of Trump 2.0 has been priced in by markets. The currency could regain some lost ground if the US administration decides to pare back its more aggressive tariff rates announced on April 2nd. The flight to safe haven assets in recent weeks has also provided a floor for the dollar following the sharp falls earlier in March.

‘Fiscal bazooka’ has given impetus to euro

German spending announcement takes markets by surprise

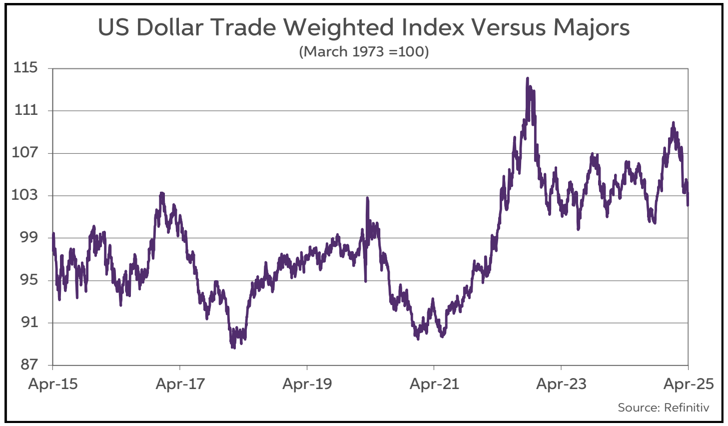
The announcement in early March that the new German Government would revise its strict fiscal rules to boost deficit spending on defence and infrastructure took markets by surprises, and underpinned a rapid ascent in the euro, alongside dollar weakness. The euro has also been underpinned by planned spending at an EU level, which could boost the medium-term growth outlook for the bloc.

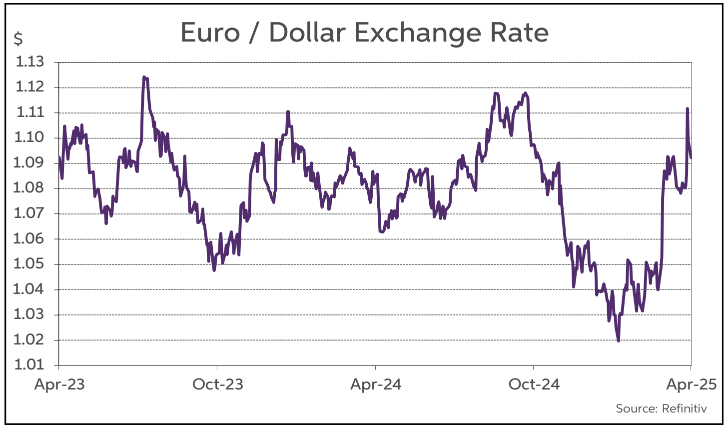
However, more stringent US tariffs also a downside risk to growth

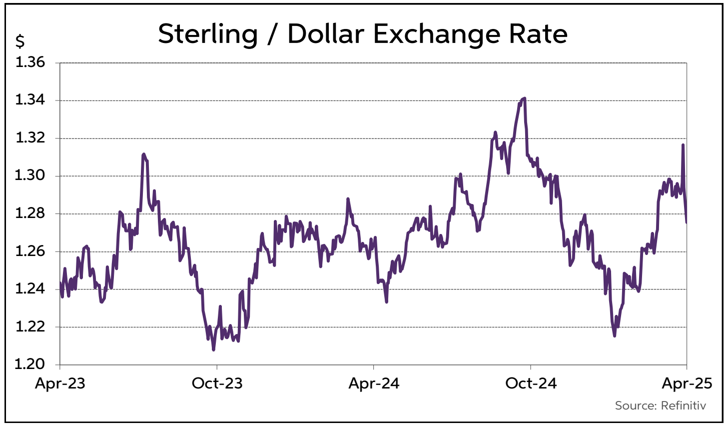
While expectations for stronger growth have been boosted, Eurozone macro data remain weak. There have been tentative signs of improvement in consumer and business surveys, but hard data suggest the bloc is set for another year of weak growth. Additionally, the 20% tariffs announced by the US on April 2nd, could blunt the near term outlook, particularly for Germany, and lead to further cuts by the ECB.

Euro to hold gains, but further catalyst required to break higher vs. dollar

Overall, we expect the euro to remain within its current range in the near term, with a slight upward bias versus the dollar for the remainder of the year. We see risks more balanced from here, with a further catalyst required to enable EUR/USD to break through its $1.12 resistance level.







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Forex Market Outlook

Rate cuts and uncertain macro to weigh on sterling

Weak macro environment a drag on sterling

Sterling has lost ground in recent weeks, with UK macro data suggesting growth has remained weak in recent months. Sterling has also displayed more cyclicality in the face of recent global market weakness. The currency is only slightly higher versus the dollar YTD, while falling c.3.5% against the euro to a 85-86p range of late.

UK rate expectations have softened, likely priced into the currency

The BoE cut by 25bps in August, November and February, with splits on the MPC committee. Our expectation of a continued steady easing cycle by the BoE to move rates to 3.75% by Q4 2025 was slightly ahead of market pricing until recently, but rate expectations have softened further in recent weeks.

No catalyst for EUR/GBP to break out of current range

Sterling is expected to maintain current levels versus the euro in the near term, and the pair is likely to remain largely range bound as relative macro fundamentals are unlikely to drive a significant break-out from the current range. We have EUR/GBP holding around a midpoint of 85p throughout 2025, following the weakening in sterling through Q1 2025. We expect cable (GBP/USD) to strengthen to around $1.28-1.34 by end-2025 from the current $1.27-1.30 range.

Slight upside for yen as BoJ hikes rates

Yen has strengthened in 2025

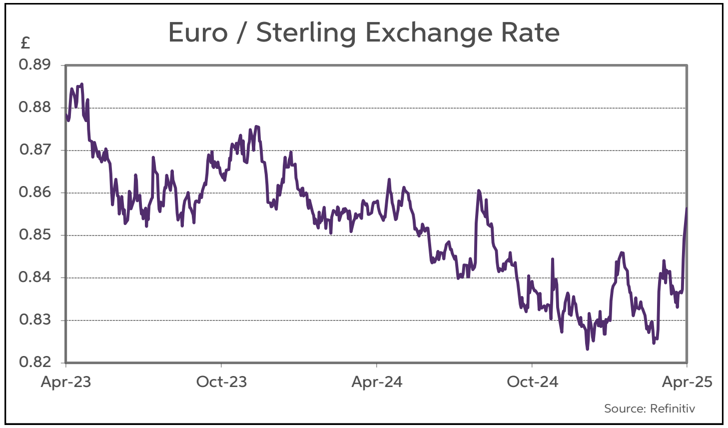
The yen has strengthen in 2025, due to a combination of dollar weakness and the Bank of Japan's steady progress in normalising monetary policy. Year-to-date, the yen is up nearly 6% versus the dollar, rising from nearly ¥160 at the start of 2025 to the current ¥146-148 range. Against the euro, the currency is marginally weaker, trading in a ¥160-163 range of late.

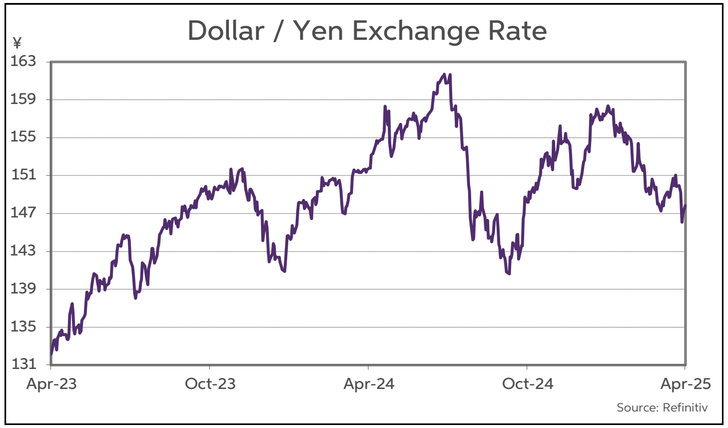
Bank of Japan expected to continue to hike rates, supportive of yen

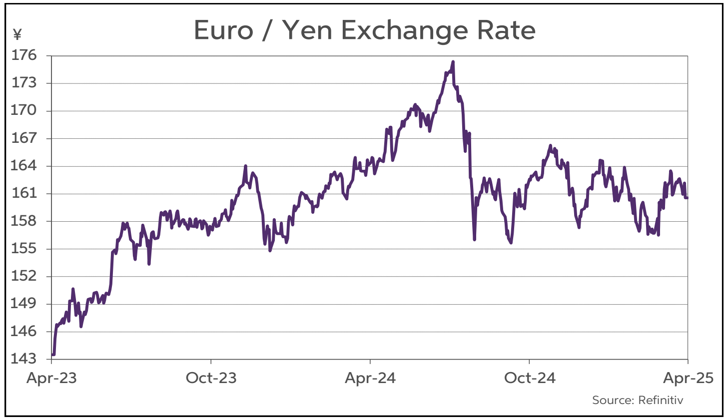
Interest rate hikes by the Bank of Japan in July, October and January has seen the base rate move from −0.1% to the current 0.5%. Markets are pricing in a further c.10bps of rate hikes by end-2025, but with inflation proving stickier than expected, the BOJ may choose to hike rates more rapidly. A further source of uncertainty is the outcome of trade talks with the US, with Japanese goods receiving a tariff rate of 24% on April 2nd.

Yen expected to strengthen slightly in the near term

The yen is expected to trade close to its current range in the near term. Thereafter, we see a modest appreciation in the yen as US rates edge lower, and Japanese rates move in the opposite direction, towards a range of ¥142-148 by Q4 2025 versus the dollar, from the current ¥144-150 range. Versus the euro, the currency is expected to operate in a ¥158-164 range out to end-2025, although the risks are tilted towards the top half of the corridor if BoJ rate hikes fail to materialise.







Summary of Exchange Rate Forecasts

("Spot" Forecasts for end Quarter can be taken as Mid-Point of expected Trading Range)

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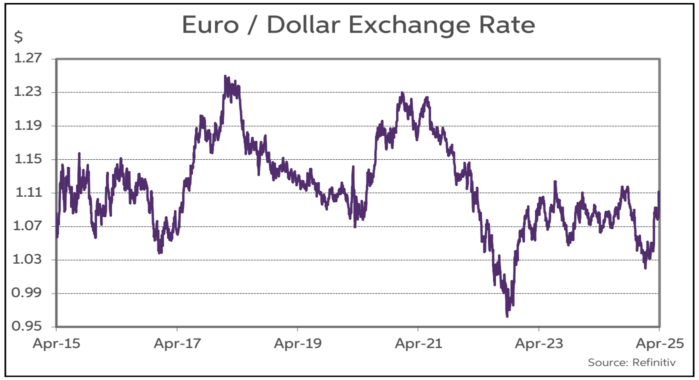
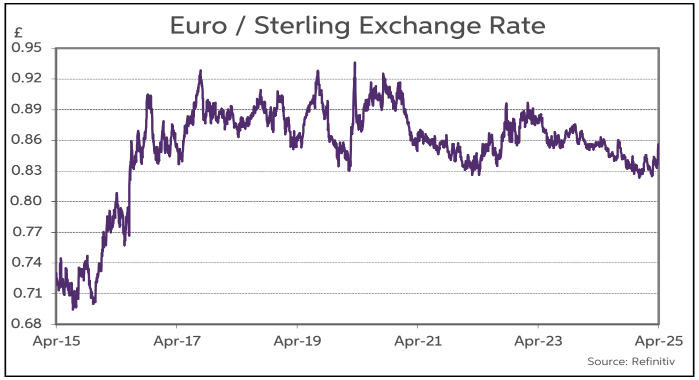
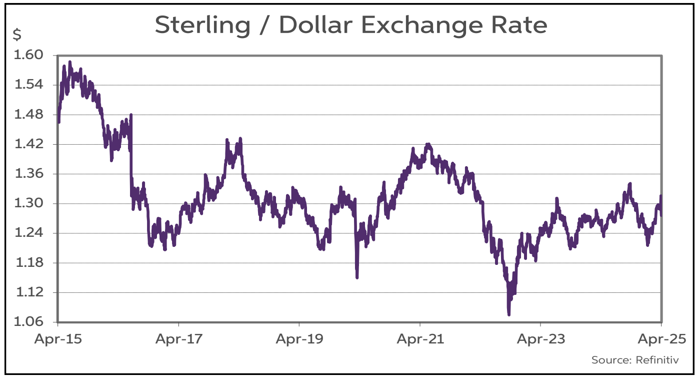
	Current	Q2-2025	Q3-2025	Q4-2025	Q1-2026
Euro Versus					
USD	1.092	1.06-1.12	1.07-1.13	1.08-1.14	1.08-1.14
GBP	0.854	0.82-0.88	0.82-0.88	0.82-0.88	0.82-0.88
JPY	161.01	157-163	158-164	158-164	158-164
CHF	0.94	0.94	0.95	0.96	0.96
US Dollar Versus					
JPY	147.42	144-150	143-149	142-148	142-148
GBP	1.278	1.25-1.31	1.26-1.32	1.28-1.34	1.28-1.34
CAD	1.42	1.42	1.42	1.41	1.40
AUD	0.61	0.60	0.60	0.61	0.62
NZD	0.56	0.55	0.55	0.56	0.57
CNY	7.34	7.35	7.32	7.31	7.30
Sterling Versus					
JPY	188	188	188	190	190
CAD	1.81	1.82	1.84	1.84	1.83
AUD	2.10	2.13	2.15	2.15	2.11
NZD	2.28	2.33	2.35	2.34	2.30







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