

Forex and Interest Rate Outlook

AIB Treasury Economic Research Unit



2nd December 2025

- Global economy has proven to be robust in 2025 despite ongoing geopolitical uncertainty, but risks still tilted to the downside
- US growth increasingly imbalanced toward AI investment, with consumer and labour market weakening
- Market focus now on central bank policy, with the Fed and Bank of England set for further cuts as the ECB sits on the sidelines. Bank of Japan pivoting towards a hawkish stance
- Dollar set for weakest year since early 2000s but currency has regained some lost ground during Q4 2025
- Further modest upside for the euro, while sterling could remain on the defensive amid a challenging macro environment

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Global economy has proven resilient to geopolitical uncertainty

Global economy has proven resilient in 2025

In recent months, incoming macro data suggest the global economy continues to grow at a decent pace, despite the ongoing uncertainty related to US trade policy. Institutional forecasters, including the IMF and OECD, have been revising up estimates for global growth in 2025 and 2026, albeit with risks still tilted to the downside.

In the dark on the strength of the US economy

In the US, the 43 day Government shutdown created a gap in the publication of key macro data. In particular, crucial payrolls for September and October were delayed, leaving markets and forecasters in the dark on the strength of the economy. The emerging data suggest the economy remains on a lower growth trajectory compared to recent years, but activity has remained robust.

Data signal subdued growth in Europe

In Europe, activity remains subdued outside of the surge in exports to the US in H1 2025, due to front-running of US tariffs. The latest forward-looking indicators suggest Eurozone and UK growth remained weak in Q4, with the PMIs hovering around the 50 no change level. Consumer and business confidence has also been dampened by the ongoing geopolitical uncertainty.

AI investment cycle is masking softness elsewhere in US economy

AI investment is materially boosting US GDP

While the most material impact of the AI boom has been on financial markets, there is also growing evidence of macroeconomic effects. In the US, AI-related investment has been offsetting weaker consumer spending, and boosting GDP. Spending on data centres and power infrastructure has surged and now accounts for 25% of all non-residential US construction. Indeed, AI-related investment and spending contributed over a third of total US GDP growth in Q2 2025. Any market correction or reversal in investment could prove material for the US economy and dollar in the coming years.

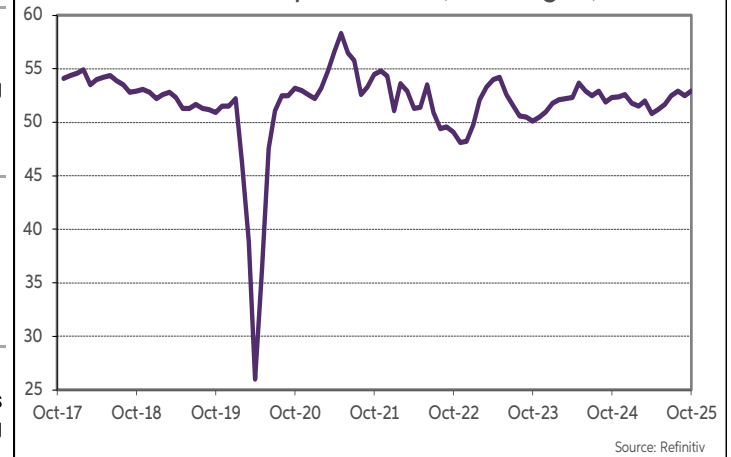
But few signs of AI impacts on labour market as yet

However, there is little evidence that AI is currently causing broad disruptions in the labour market. A report from the Yale Budget Lab indicates that AI is having a limited impact on the US labour market, as yet. However, in certain segments of the labour market the impact may be more pronounced. A study from Stanford University reported a 13% drop in the employment level of early-career workers (aged between 22-25) in the most AI-exposed sectors.

UK Autumn budget could be a further drag on growth

Fiscal policy uncertainty in the UK has driven some volatility in gilts and a modest weakening of sterling. The measures included further significant tax and spending increases. While markets were broadly stable in the aftermath of the budget, the fiscal headroom pencilled in by the Chancellor remains relatively tight in an historic context, raising the risk of further fiscal uncertainty in the years ahead if the economy deteriorates.

Global Composite PMI (JP Morgan)



GDP (Vol % Change)

	2024	2025 (f)	2026 (f)	2027 (f)
World	3.3	3.2	2.9	3.1
G20	3.4	3.2	2.9	3.1
US	2.8	2.0	1.7	1.9
Eurozone	0.8	1.3	1.2	1.4
UK	1.1	1.4	1.2	1.3
Japan	-0.2	1.3	0.9	0.9
Emerging Economies				
China	5.0	5.0	4.4	4.3
India	6.5	6.7	6.2	6.4
World Trade Growth (%)	3.9	4.2	2.3	2.8
Inflation -CPI				
G20 Economies (%)	6.3	3.4	2.8	2.5

Sources: OECD Economic Outlook, December 2025

Interest Rate Outlook

Central banks easing timelines diverging

Divergence in easing cycles among the main central banks

The October/November series of central bank meetings provided the market with some news to digest. While the policy action taken, or in some cases lack of, was in line with market expectations, the tone of communications did generate some reaction. The Fed's press conference entailed less dovish guidance on the potential for a December rate cut. The BoE remained on hold, but teed markets up to the potential for a cut in December. The BoJ, as expected kept rates on hold, but had a less hawkish tone. Elsewhere, the ECB meeting was uneventful, with no change to its view that the current policy setting is appropriate.

Fed implemented its second rate cut of the year, but left the door open for a "hold" in December

The Fed, as expected, cut rates for a second successive meeting by 25bps in October, to 3.75-4.00%. However, Chair Powell espoused a less dovish tone in the press conference, noting that a December cut was "not a foregone conclusion", as had been priced-in by markets as well as guided by the Fed's own projections. A complicating factor for the Fed has been the limited official macro data due to the government shutdown. Futures contracts initially firmed in the aftermath of the October FOMC. However, amid some soft labour market data and recent dovish FOMC rhetoric, the market is now attaching a 90% probability to a December cut. We believe the Fed will ease again in December. The market sees rates getting towards 3% by end-2026. This is more aggressive than the Fed's guidance (3.4%). For rates to get near 3%, it will likely take a further softening in the jobs market, which is not an unrealistic scenario.

ECB remains on hold and may be done with rate cuts

The ECB left policy on hold in October, with the Depo rate kept at 2.00%, for a third consecutive meeting. The ECB has lowered rates by 200bps since it began its easing cycle last June (most recent rate cut occurring in June of this year). President Lagarde's most recent press conference remarks continued to show that, while the ECB retains a willingness to ease policy again, if required, it is not currently contemplating any further rate changes. Instead, she repeated that policy is "still in a good place". The market is attaching around a 30% probability to one further 25bps reduction to 1.75% by mid-2026. We continue to hold the view that the current 2% level represents the low point for Eurozone rates.

BoE signals December rate cut is on the cards

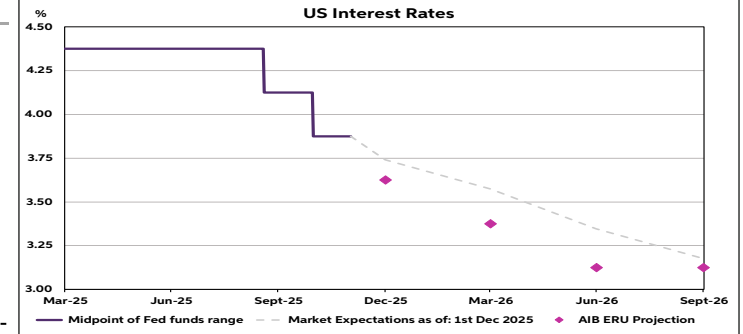
The BoE kept the Bank Rate at 4.00% for a second meeting in-a-row in November. It was a close call, with the vote split 5:4. So far, its easing cycle which began in Aug'24 has seen a total of 125bps of cuts (incl. 75bps YTD). The statement, minutes and Governor Bailey's press conference suggest there is potential for a rate cut at its next meeting in December. Only one more vote is needed to swing the MPC in favour of a cut. Of the five voting for no change in November, Governor Bailey stated that "rather than cutting now" he wanted to see more data on the disinflation trend and he explicitly stated more data would be available for the December MPC. Overall then, a cut in December is now on the cards. Looking further ahead, a 3.5% terminal rate being reached by mid-2026 seems a reasonable situation and is broadly consistent with market pricing.

Interest Rate Forecasts

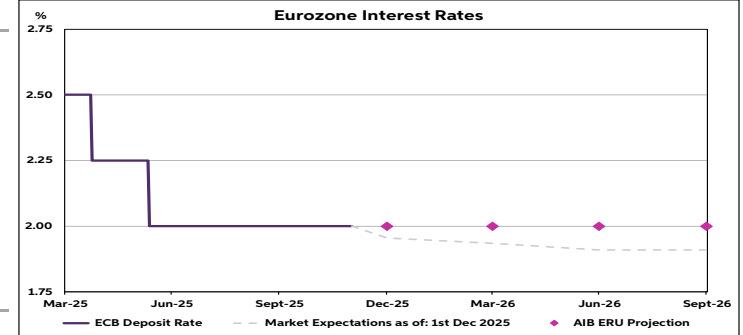
	Current	End Q4 2025	End Q1 2026	End Q2 2026	End Q3 2026
Fed Funds	3.875	3.625	3.375	3.125	3.125
ECB Deposit	2.00	2.00	2.00	2.00	2.00
BoE Repo	4.00	3.75	3.50	3.50	3.50

Current Rates Reuters, Forecasts AIB's ERU

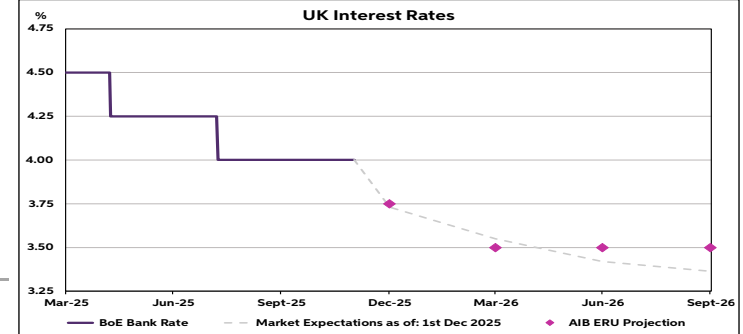
US Interest Rates



Eurozone Interest Rates



UK Interest Rates



Forex Market Outlook

Dollar regained some lost ground in Q4, but risks still to downside

Dollar has regained ground of late

The dollar has gained some ground, with the trade-weighted DXY index up c.2% since October 1st. Against the euro, the dollar is up c.1% over the same period, and has tested (but not broke) the \$1.15 level recently. The dollar also gained ground against sterling, rising by c.2% since the beginning of October, with GBP/USD trading around \$1.32 of late. Nevertheless, the dollar is still set for one of its worst years this century, with the DXY down by 8.5% YTD in 2025.

Monetary policy now back in the driving seat for FX pairs

Currencies were driven more by tariff events rather than fundamentals such as relative interest rates and growth differentials in H1 2025. However, these fundamentals have reasserted themselves in recent months, with a renewed focus on central bank policy, particularly in the US. Following a cut in September, the market is all but pricing in a further US rate cut in December, followed by modest cuts in 2026/27. The current uncertain Fed path could be a key determinant of dollar moves next year.

Risks still to the downside for the dollar

While the dollar has strengthened of late, there are obvious risks to the downside. The policy trajectory of the Fed could be a key driver here, with markets now pricing in a Fed funds rate at 3% by end-2026. The strength of the US economy will be in focus, with clear signs of a slow down in the consumer side of the economy, and growth becoming increasingly reliant on AI investment, suggesting the risks remain tilted to the downside.

ECB done on rate cuts, slight upward bias for EUR/USD

ECB happy on the sidelines for now

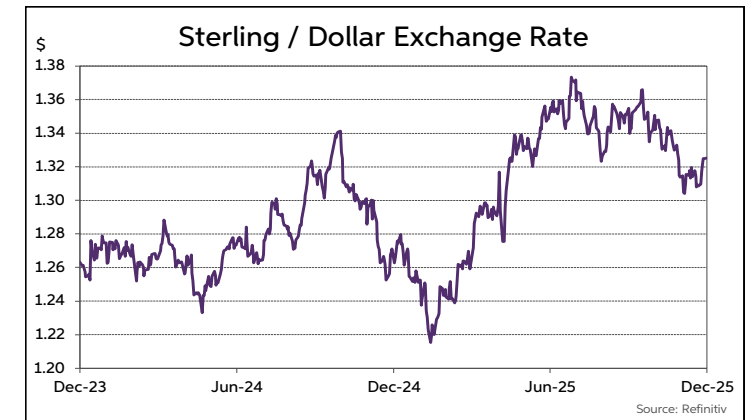
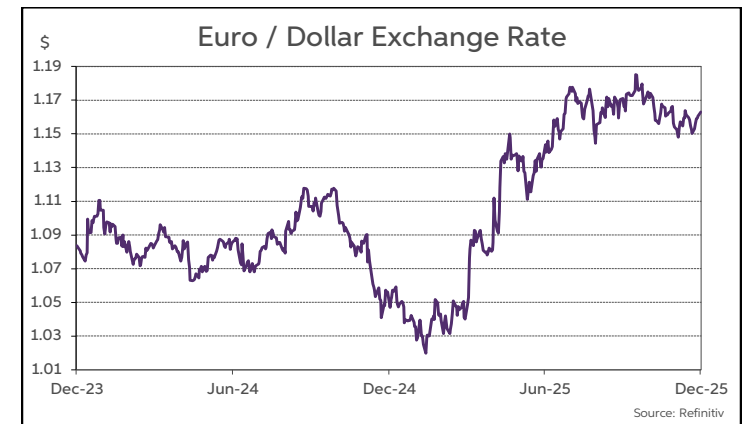
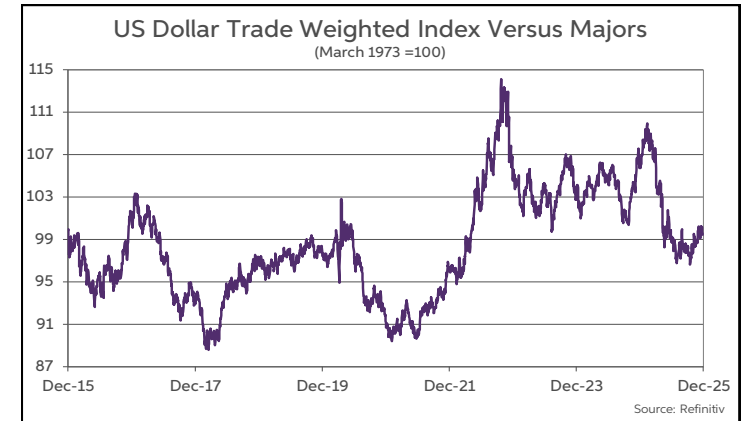
The ECB has paused rate cuts for several months and we expect the deposit rate to remain at 2% in the near term. Expectations have hardened post the September ECB meeting as inflation has surprised to the upside. As discussed earlier in the report, it now appears ECB members have a high bar to justify further rate cuts from here. However, growth prospects also remain dim amid disappointing data from France and Germany.

Real US interest rates have diverged with euro rates, but this trend could soon unwind

Against this backdrop, near term US real interest rate expectations (2yr OIS – 2yr inflation swap) have diverged with euro rates recently, rising from c.0.4% in September to 0.75% of late. These relative interest rate dynamics have been supportive for the dollar vs the euro, but could unwind somewhat if the Fed takes a more dovish turn from December.

Euro to hold gains, but further catalyst required to sustain a break of \$1.18 vs. dollar

We expect the euro to make modest gains versus the dollar in 2026 from the current \$1.16 level to \$1.18. However, a further Eurozone growth catalyst will be required to enable EUR/USD to make a sustained break through the key resistance levels of \$1.18, and thereafter \$1.20, as the pair has not traded consistently above the later level since 2014.



UK macro weak, potential for near term weakness in sterling

UK macro data remain weak, but US trade deal a boost

Sterling has steadily lost ground in recent weeks. The currency has also exhibited more cyclical in the face of recent global market volatility, particularly around shifts in gilt markets ahead of the Autumn budget. Following a stronger start to the year, macro data have dipped once again, as confidence remains fragile following a difficult Budget. On the upside, the UK was one of the first countries to conclude a trade deal with the US at a lower rate of 10%, and the consumer has built up significant balance sheet resilience via deleveraging and higher savings, which could boost spending if economic and political uncertainty diminishes.

BoE set for further cuts in 2026

The BoE held rates in November with an ongoing split on the MPC. Our expectation is for a continued steady easing cycle by the BoE, including a cut at its December meeting. This, combined with weak current GDP growth prospects, could act as a drag on sterling in the near term, with the currency regaining some ground in the second half of 2026.

Sterling to remain close to current levels in the near term

Sterling is expected to broadly maintain current levels versus the euro in the near term. The pair is likely to remain largely range-bound as relative macro fundamentals are unlikely to drive a notable break-out from the current range. EUR/GBP is expected to remain around 88p by Q2 2026. However, we see the potential for GBP/USD to strengthen to around \$1.34 by Q2 2026, from the current \$1.32 level.

Upside for yen as BoJ signals further hikes

Yen has strengthened in 2025

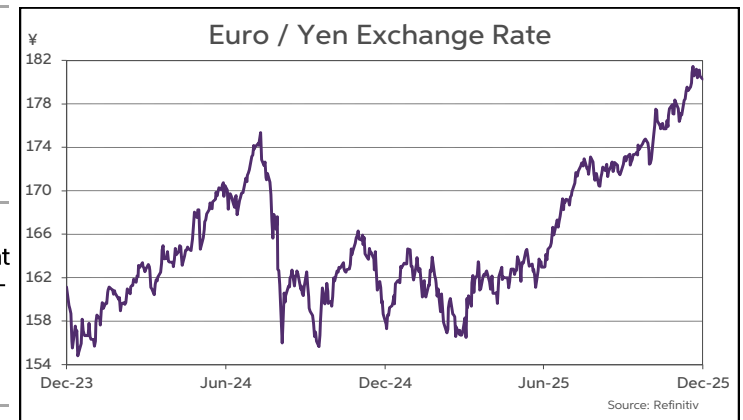
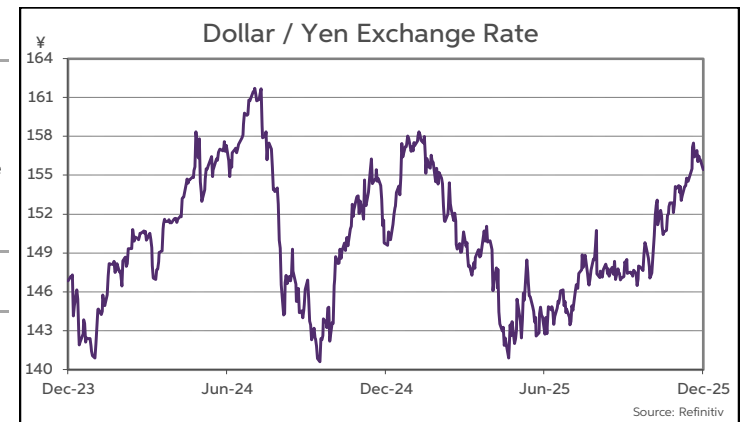
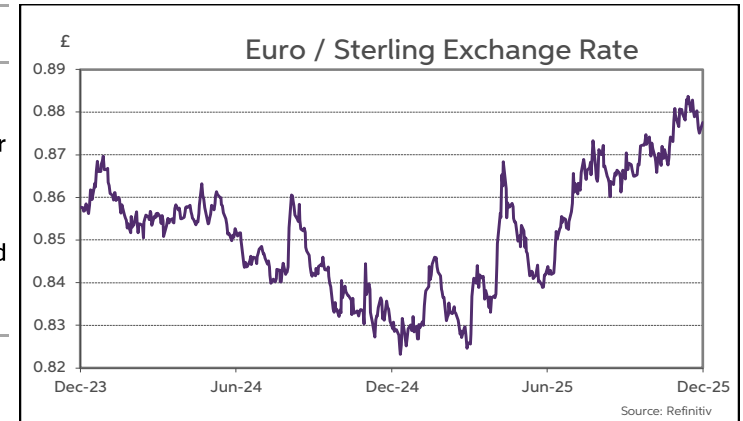
The yen has traded in a wide range in 2025, despite a strong start to 2025. However, since the beginning of October the yen is down near 6% versus the dollar, falling from ¥147 to the current ¥155-156 band. Against the euro, the currency is weaker, trading towards ¥181 currently from ¥171 on October 1st.

Political and fiscal policy uncertainty has weakened the currency

The election of a new Prime Minister, Sanae Takaichi, with a focus on reviving an "Abenomics" boost to fiscal spending, has raised concerns about Japan's debt sustainability, pushing up government yields and driving a fall in the yen. However, Governor Ueda recently stated the BOJ will consider raising rates at the December meeting. Markets now see a higher probability of a hike, supporting a moderate strengthening in the currency in early December.

Yen expected to strengthen slightly in the near term as rate differentials reduce vs. trading partner

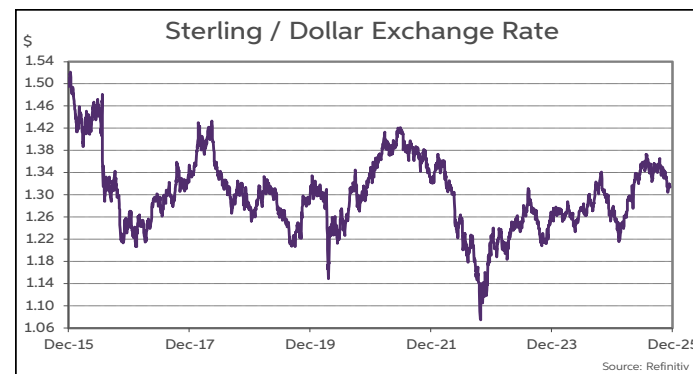
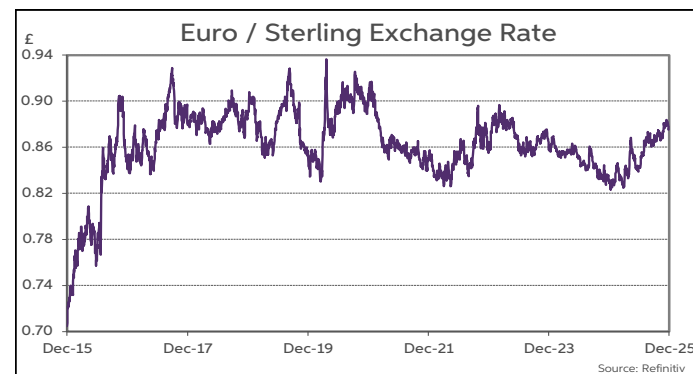
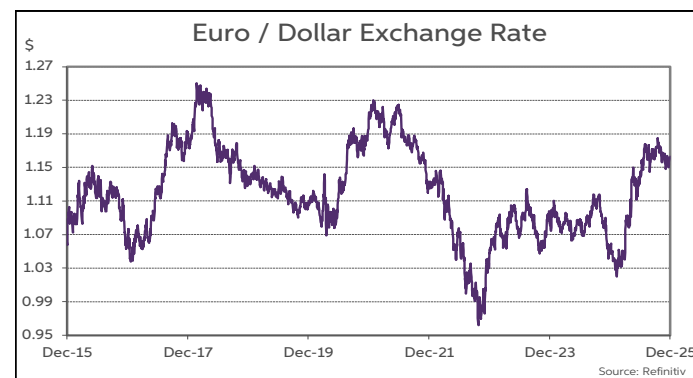
The yen is expected to appreciate modestly. We see the currency strengthening towards a range of ¥149-155 by Q2 2026 versus the dollar, from the current ¥155-157 corridor. Versus the euro, the currency is expected to remain relatively static, trading in the ¥174-180 range out to Q4-2026. BoJ rates will be a key catalyst, with current sticky inflation raising the risk of more rate hikes than currently priced in, which could support the currency further.



Summary of Exchange Rate Forecasts

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

	Current	Q4-2025	Q1-2026	Q2-2026	Q3-2026
Euro Versus					
USD	1.160	1.13-1.19	1.14-1.20	1.15-1.21	1.15-1.21
GBP	0.879	0.85-0.91	0.85-0.91	0.85-0.91	0.84-0.90
JPY	181.10	175-181	176-182	176-182	176-181
CHF	0.93	0.93	0.93	0.94	0.95
US Dollar Versus					
JPY	156.11	150-156	150-156	149-155	148-154
GBP	1.320	1.29-1.35	1.30-1.36	1.31-1.37	1.31-1.37
CAD	1.40	1.39	1.38	1.37	1.36
AUD	0.66	0.65	0.66	0.67	0.68
NZD	0.57	0.57	0.58	0.58	0.60
CNY	7.07	7.08	7.09	7.10	7.10
Sterling Versus					
JPY	206	202	203	204	202
CAD	1.85	1.83	1.83	1.84	1.84
AUD	2.01	2.03	2.02	2.00	1.97
NZD	2.31	2.32	2.29	2.31	2.23



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