

Forex and Interest Rate Outlook

AIB Treasury Economic Research Unit



25th September 2025

- Risk appetite improves following decreased uncertainty on US trade policy as deals concluded with EU, UK, and Japan.
- Market focus now on central bank policy, with Fed pivot to rate cuts coming on the back of weak labour market data through the summer.
- Fed set to cut rates twice more by end-2025. The ECB has ended cutting cycle, while the BoE trajectory remains uncertain, with a further rate cut possible before end-2025.
- Dollar set for weakest year since early 2000s, amid softening in US rate expectations and continued trade uncertainty.
- Euro likely to hold most of its gains, while sterling could remain on the defensive ahead of difficult Autumn Budget.

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US trade policy uncertainty eases

US trade deals bring some certainty on tariffs

Following months of uncertainty, a succession of recent deals with key trade partners has brought some calm around US trade policy. For the EU, South Korea and Japan, a rate of 15% has been agreed, with little retaliation. However, there remains uncertainty on the outcome of ongoing trade negotiations with China, and domestic US legal cases against the reciprocal tariffs.

US labour market has weakened over the summer

In the US, major downward revisions to the payrolls survey have shifted the narrative on the US economy, precipitating a softening in rate expectations. The latest data show an average of just 27k jobs per month were created between May and August, compared to a 123k average in Jan-Apr 2025.

Data signal subdued growth in Europe

In Europe, activity remains subdued outside of the surge in exports in recent months, which have been front-running potential US tariffs. Latest forward-looking indicators suggest Eurozone and UK growth remained weak in Q3, with PMIs hovering around the 50 no change level. Consumer and business confidence has also been dampened by the ongoing geopolitical uncertainty.

Attention turns to fiscal sustainability

French political uncertainty brings focus back onto Eurozone fiscal risks

Following a relatively calm period in Europe of late, political risks have come to the fore once more in France. The loss of a confidence motion in September and change of Prime Minister has created some tremors in European financial markets. Attention is now on the ability of the new administration to push through the cuts needed to bring France's deficit back to a sustainable path. It now looks likely the original €44bn fiscal consolidation plan, which was expected to move the deficit back to 3% of GDP from 6% currently, will be watered down, with French yields moving sharply higher in recent weeks.

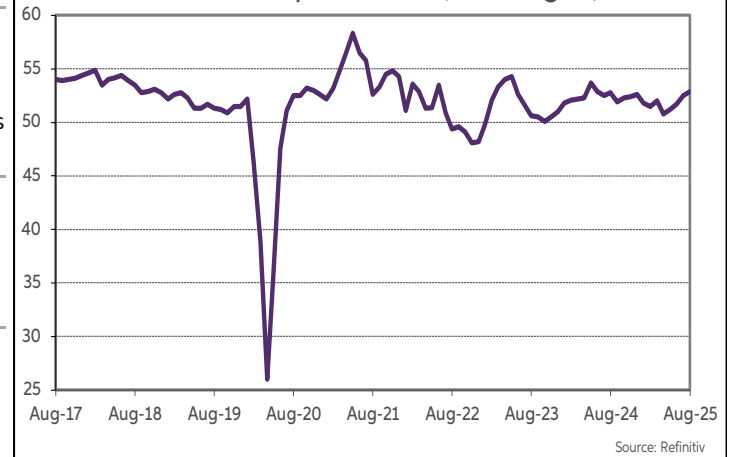
UK facing difficult Autumn budget, with tax rises expected

Fiscal policy uncertainty in the UK has also driven a sell-off in long-dated gilts. With both economic confidence and GDP growth fragile at present, the Government faces a difficult task in the Autumn Budget (26th Nov) to maintain fiscal credibility. With some planned spending cuts reversed during the summer, the Chancellor is likely to announce further tax rises to meet her medium term fiscal targets.

German stimulus will take time to emerge

Elsewhere, the planned surge in defence and infrastructure spending in Germany, has driven a steepening in its yield curve, alongside brighter growth forecasts for the coming years. Nonetheless, the stimulus may take time to emerge, with the second half of 2026 the likely earliest point before the impact will begin to be felt. There also remains a risk that the spending plans fail to provide the economic multiplier anticipated.

Global Composite PMI (JP Morgan)



GDP (Vol % Change)

	2023	2024	2025 (f)	2026 (f)
World	3.4	3.3	3.2	2.9
G20	3.6	3.4	3.2	2.9
US	2.9	2.8	1.8	1.5
Eurozone	0.5	0.8	1.2	1.0
UK	0.4	1.1	1.4	1.0
Japan	1.4	0.1	1.1	0.5
Emerging Economies				
China	5.4	5.0	4.9	4.4
India	9.2	6.5	6.7	6.2
World Trade Growth (%)	1.0	3.5	2.6	1.9
Inflation -CPI				
G20 Economies (%)	6.1	6.2	3.4	2.9

Sources: OECD Economic Outlook, Interim Report, September 2025, IMF World Economic Outlook Update, July 2025

Interest Rate Outlook

Central banks easing timelines diverging

Divergence in easing cycles among the main central banks

The September round of central bank meetings were very much in line with markets expectations. It has become clear though that central banks are at different stages of their respective easing cycles. The ECB kept policy on hold again and provided no indication that it is contemplating any near term rate cuts and in fact may have completed its easing phase. The BoE also maintained its current interest rate setting after easing in August. It retains a bias to reduce rates again, but there was no sign of any imminent rate cuts. In contrast, the Fed resumed its easing cycle, cutting rates for the first time this year and became more dovish on its near term rate outlook. Elsewhere, the BoJ also kept its policy on hold, but a rate hike before year end remains a possibility.

Fed resumes policy easing and more dovish for near term rate outlook

The Fed, as expected, cut rates for the first time this year in September, to a 4.00-4.25% range, amid the recent labour market 'softness'. The new 'dots' indicated a more dovish view on the near term outlook. The median projection for 2025 now implies three 25bps cuts (two in June), which would see the rates at 3.6% by end year. The 'dots' for 2026 and 2027 continue to project one 25bps in each year, which indicates a 3.1% rate by end-27. Chair Powell characterised the rate cut as a "risk management cut" and continued to emphasise a "meeting-by-meeting" approach. Market pricing is broadly aligned to the Fed's dots for 2025. However, it is anticipating a more aggressive pace of rate cuts than the Fed for next year. The market sees rates near 3% by end 2026. For this to materialise, the US labour market would likely need to weaken significantly.

ECB remains on hold and may be done with rate cuts

For the second successive meeting, the ECB left policy on hold in September, with the Depo rate kept at 2.00%. The ECB has cut by a total of 200bps in its easing cycle which begun last June. The meeting statement offered little in the way of new guidance. President Lagarde's comments during the press conference suggest that while the ECB retains a willingness to cut again, if needed, there was no indication of any appetite within the ECB for additional near term rate cuts. The market is attaching around a 40% probability to one further 25bps reduction to 1.75% by mid-2026. We remain of the view, barring any new macro shock, that the current 2% rate represents the trough for Eurozone rates.

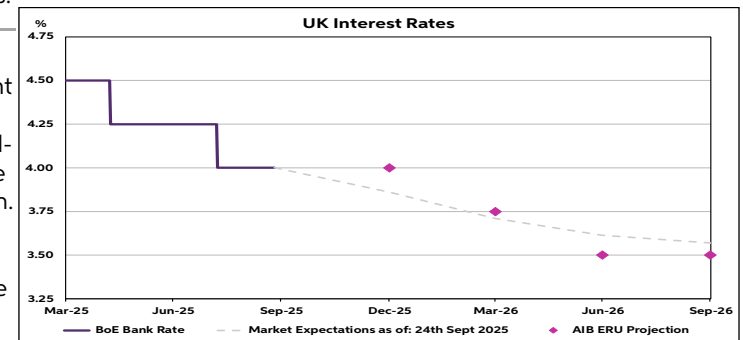
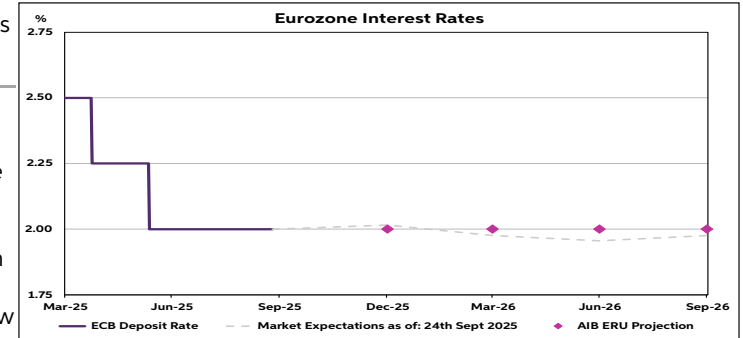
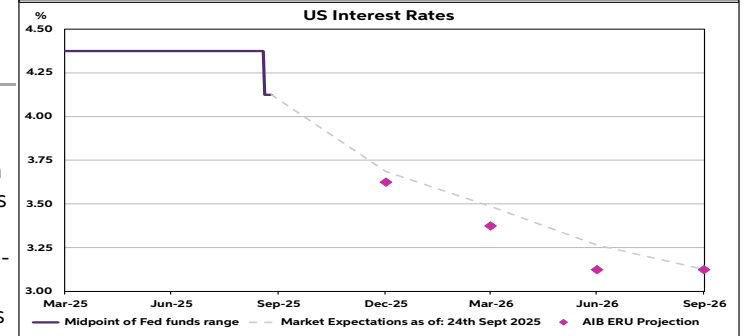
BoE on hold, with no signs of any further imminent rate cuts

The BoE kept the Bank Rate at 4.00% in September. Once again, there was no unanimity within the MPC, with two members voting for a 25bps cut. Its current easing cycle, which began in Aug'24, has seen a total of 125bps of cuts (incl. 75bps YTD). The BoE retains an easing bias and continues to emphasise a gradual approach. The latest minutes suggest a less dovish stance, as it appears the BoE is less concerned about the labour market and is more focused on inflation. Futures contracts are not fully pricing in the next 25bps rate cut until April'26. with rates seen getting towards 3.50% by end'26. We would not completely rule out another rate cut before year end, given the challenging outlook for the UK economy. A 3.5% terminal rate seems a reasonable assumption.

Interest Rate Forecasts

	Current	End Q4 2025	End Q1 2026	End Q2 2026	End Q3 2026
Fed Funds	4.125	3.625	3.375	3.125	3.125
ECB Deposit	2.00	2.00	2.00	2.00	2.00
BoE Repo	4.00	4.00	3.75	3.50	3.50

Current Rates Reuters, Forecasts AIB's ERU



Forex Market Outlook

Dollar set for weakest year since 2003, but holding recent levels

Dollar has held levels of late

The dollar has seen significant falls in 2025, with the trade-weighted DXY index down 10% this year. If sustained the currency is on track for its worst year since 2003. Against the euro, the dollar is down c.13.5% year-to-date, reflected in EUR/USD testing above \$1.19 recently. The dollar also lost ground against sterling, falling by c.7.5% since the beginning of 2025, with GBP/USD trading around \$1.35 of late.

Monetary policy now back in focus for currencies

Currencies had been driven more by tariff events rather than fundamentals such as relative interest rates and growth differentials in 2025. However, these fundamentals have reasserted themselves in recent weeks, with a renewed focus on central bank policy, particularly in the US. Following a first cut in September, the market is pricing in two further US rate cuts in 2025, followed by modest cuts in 2026/27. Nonetheless, uncertainty on the path for rates could impact the FX majors in the coming months.

Near term risks on both sides for the dollar

Against this uncertain backdrop, the dollar has maintained recent levels, albeit with 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, compared to an FOMC median projection of 3.4%. Thus, the currency could recover some ground if the Fed sticks to its current cautious guidance in the coming months.

ECB done on rate cuts, further catalyst need to drive euro higher

Could EU bonds underpin the euro?

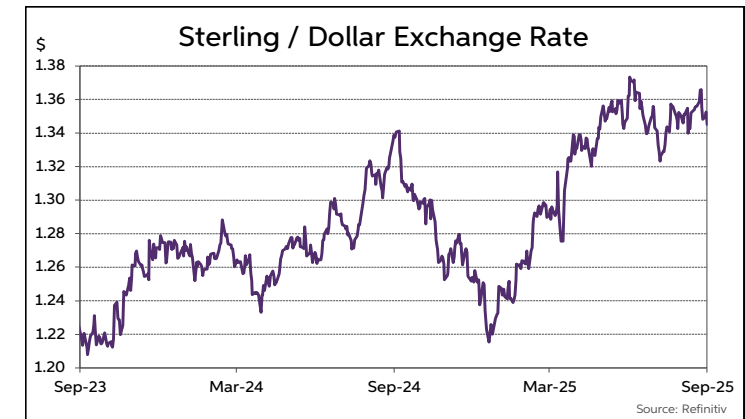
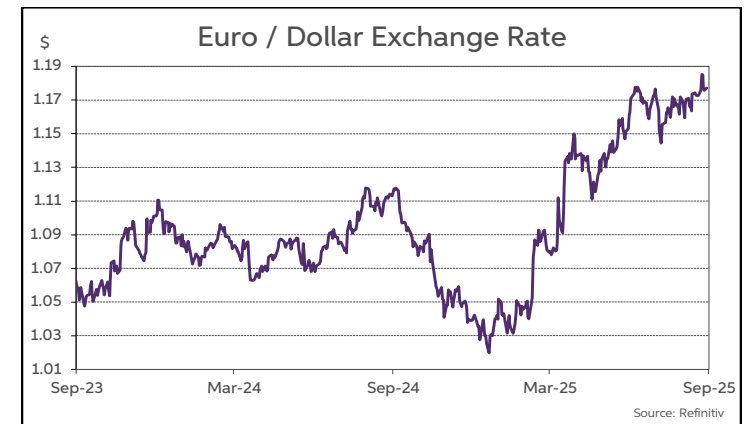
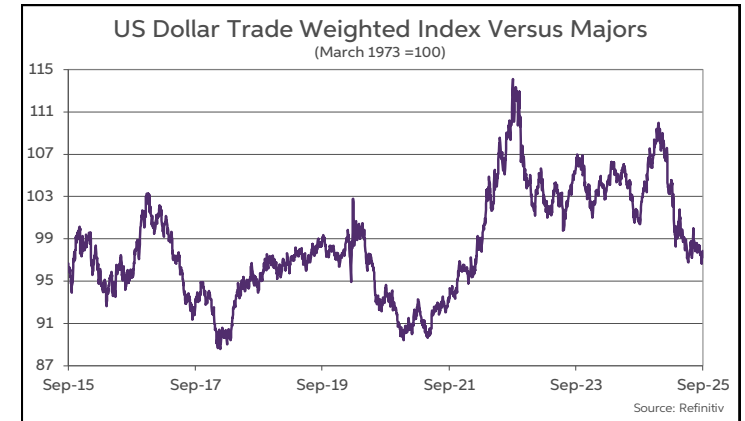
The ECB paused rate cuts for several months and we expect the deposit rate to remain at 2% in the near term. While the market is pricing in a 40% chance of a further cut in early 2026, but expectations have hardened post the September ECB meeting. As discussed earlier in the report, it now appears ECB members have a high bar to justify further rate cuts from here.

Real US interest rate converging with euro rates - supportive for EUR/USD

Against this backdrop, near term US real interest rate expectations (2yr OIS – 2yr inflation swap) have rapidly converged with euro rates recently, falling from c.1.5% in January 2025 to just c.0.4% in September. These relative interest rate dynamics should be supportive for EUR/USD holding the gains from recent months, if not rising further from here.

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

We expect the euro to maintain its gains versus the dollar, with a slight bias towards further modest euro strengthening in the near term. A further catalyst will likely be required though, to enable EUR/USD to make a sustained break through the key resistance levels of \$1.18, and thereafter \$1.20 as the



Forex Market Outlook

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 versus the euro and remained range-bound versus the dollar. The currency has also exhibited more cyclical in the face of recent global market volatility, particularly around shifts in gilt markets. Following a stronger start to the year, macro data have dipped once again, as confidence remains fragile ahead of what is expect to be a difficult Autumn 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 Government has touted technology investments from the US as crucial to future growth potential.

BoE might move more quickly than the market expected

The BoE held rates in September with a continued split on the MPC, as two dovish members voted for a 25bps cut. Our expectation is for a continued steady easing cycle by the BoE, which could be slightly faster than the market expects. This, combined with weak current GDP growth prospects, could act as a drag on sterling in the near term.

Slight bias towards sterling vs. euro

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 could edge up to near 88p by end-2025. However, we see the potential for GBP/USD to strengthen to around \$1.36 by Q1 2026, from the current \$1.34-1.35 band.

Slight upside for yen as BoJ mulls further hikes

Yen has strengthened in 2025

The yen has strengthened in 2025, largely due to dollar weakness. Since the start of 2025, the yen is up 5% versus the dollar, rising from just below ¥160 at the start of 2025 to the current ¥146-149 range. Against the euro, the currency is weaker, trading towards ¥174 currently from ¥162 in January.

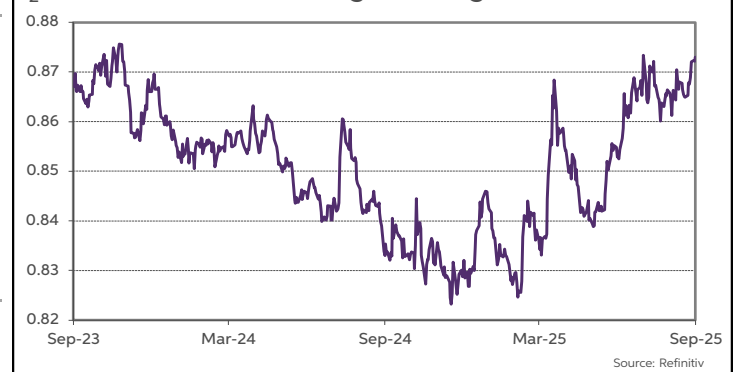
Bank of Japan expected to continue to gradually hike rates, supportive of yen

Interest rate hikes by the BoJ in July '24, Oct '24 and Jan '25 have seen the base rate move from -0.1% to the current 0.5% level. The BoJ held rates in September, but two dissenters favoured a 25bps hike. Markets are not fully pricing in further rate hikes by year end. However, we would not rule out a 25bps rate hike by December, given current inflation dynamics.

Yen expected to strengthen slightly in the near term

The yen is expected to appreciate modestly. We see a rise in the currency towards a range of ¥144-150 by Q4 2025 versus the dollar, from the current ¥146-149 corridor. Versus the euro, the currency is expected to remain relatively static, trading in the ¥171-177 range out to Q3-2026. 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.

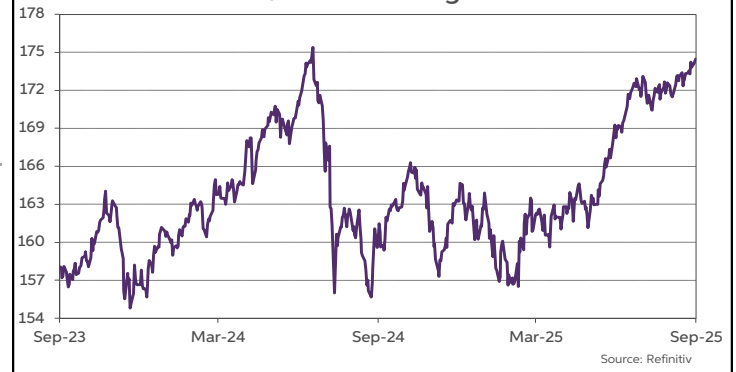
Euro / Sterling Exchange Rate



Dollar / Yen Exchange Rate



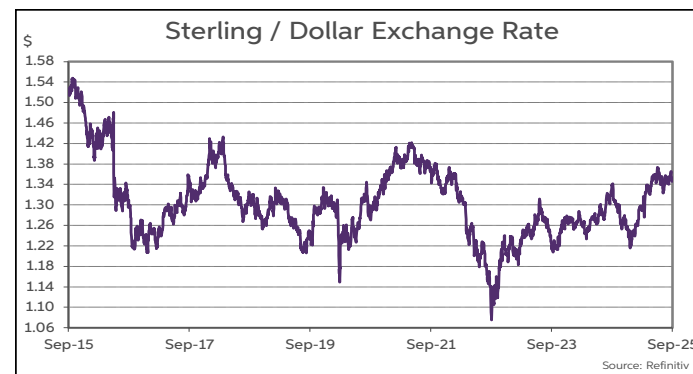
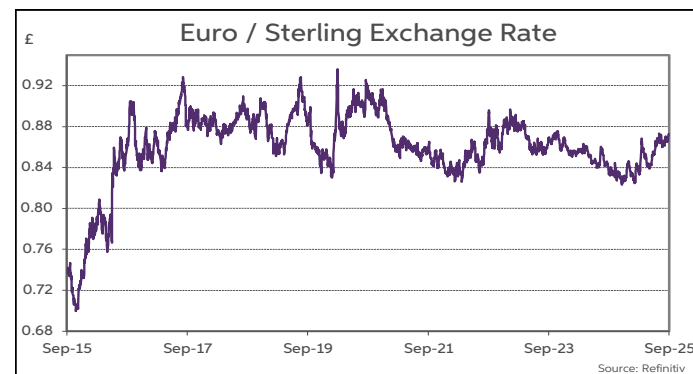
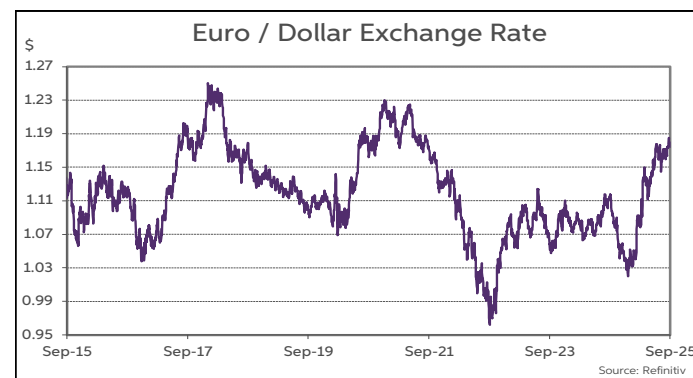
Euro / Yen Exchange Rate



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	1.170	1.16-1.22	1.17-1.23	1.17-1.23	1.17-1.23
GBP	0.874	0.85-0.91	0.85-0.91	0.84-0.90	0.84-0.90
JPY	174.64	171-177	171-177	171-177	171-177
CHF	0.93	0.94	0.94	0.95	0.95
US Dollar Versus					
JPY	149.23	143-149	142-148	142-148	142-148
GBP	1.339	1.32-1.38	1.33-1.39	1.35-1.41	1.35-1.41
CAD	1.39	1.38	1.37	1.36	1.36
AUD	0.66	0.67	0.68	0.68	0.68
NZD	0.58	0.60	0.61	0.62	0.62
CNY	7.13	7.15	7.10	7.10	7.10
Sterling Versus					
JPY	200	197	197	200	200
CAD	1.86	1.87	1.87	1.88	1.88
AUD	2.04	2.01	2.00	2.03	2.03
NZD	2.31	2.25	2.23	2.23	2.23



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