# Forex and Interest Rate Outlook

## AIB Treasury Economic Research Unit

24th May 2024

- World economy continues to exhibit resilience. However, subdued growth expected again in 2024, with US outperformance starting to wane, UK and Eurozone accelerating

- Inflation remains sticky in key markets, particularly the US and UK, with consumer spending underpinning high core inflation, and higher oil prices a renewed inflationary risk

- Central banks, remain cautious on timing and scale of policy easing. Fed has dampened expectations of near term cuts. ECB likely to be first to cut in June

- Main currency pairs exhibiting some volatility as central bank policy diverges. Dollar underpinned by geopolitical risks and higher-for longer rate trajectory

- But expectation dollar will weaken modestly from current high levels versus other majors

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# Global Economic Outlook



## Slow and steady global growth

**Global growth** expected to match **subdued** 2023

The recent forecasts published by the IMF and OECD point to a broadly resilient profile for global growth. Nonetheless, forecasts are little changed from their previous updates. The IMF noted the world economy still faces considerable challenges from high core inflation and elevated geopolitical tensions. Against this backdrop, the IMF is projecting that the global economy will expand by a sluggish 3.2% in 2024 and 3.1% in 2025, little changed from the pace of growth in 2023.

**US growth slowing** but expected to outperform others

Having confounded pessimistic expectations last year, growing by 2.5% up from 1.9% in 2022, US GDP expanded more slowly than anticipated in Q1 2024 at +1.6% annualised. There have also been signs that labour market conditions are starting to ease. The unemployment rate rose to 3.9% in February, its highest level since January 2022. It printed at 3.9% in April also. Meantime, jobless claims have ticked higher in recent weeks.

Soft data signal **up-turn in UK and Eurozone** growth

In the UK and Eurozone, surveys and hard data suggest activity may have bottomed out. Q1 GDP data show a bounce back in growth, while the April/May PMIs suggest services sector activity strengthened further in Q2 2024.

## Risks to the outlook more balanced

**Risks** to the outlook now more **balanced**

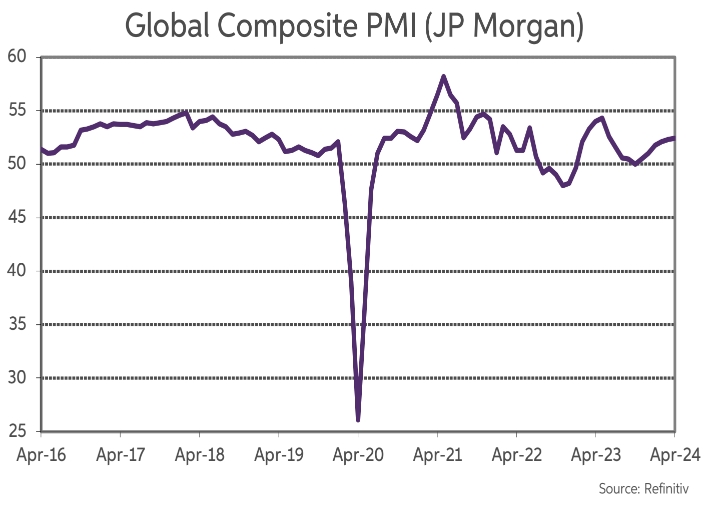
In its April World Economic Outlook, the IMF stated that "risks to the global economic landscape have diminished since 2023, leading to a broadly balanced distribution of possible outcomes". The IMF highlights continued downside risks including inflation and geopolitical tensions, alongside upside risks such a productivity gains from AI and monetary policy easing.

**Geopolitics** the key downside risk to the growth and inflation outlook..

Geopolitical risks remain historically elevated, primarily due to ongoing tensions in the Middle East. The risk of spillovers to economic activity necessitates, in our view. These risks would likely materialise directly through a spike in commodity prices and inflation and indirectly through a decline in consumer and business sentiment, which would dampen GDP and labour market growth.

..But **economy** and commodity prices have proved **resilient** to recent geopolitical events

The rise in oil prices in 2024 reflects supply constraints by OPEC members and stronger-than-expected global demand. However, while the flare up in Middle East tensions caused a spike in oil prices above $90/barrel, prices have since eased towards $80, and reflect resilience to recent geopolitical events.




*GDP (Vol % Change)*

| | 2022 | 2023 | 2024 (f) | 2025 (f) |
|---|---|---|---|---|
| World | 3.5 | 3.2 | 3.2 | 3.2 |
| Advanced Economies | 2.6 | 1.6 | 1.7 | 1.8 |
| US | 1.9 | 2.5 | 2.7 | 1.9 |
| Eurozone | 3.4 | 0.6 | 0.8 | 1.5 |
| UK | 4.3 | 0.1 | 0.5 | 1.5 |
| Japan | 1.0 | 1.9 | 0.9 | 1.0 |
| Emerging Economies | 4.1 | 4.3 | 4.2 | 4.2 |
| China | 3.0 | 5.2 | 4.6 | 4.1 |
| India | 7.2 | 7.8 | 6.5 | 6.5 |
| World Trade Growth (%) | 5.2 | 0.3 | 3.0 | 3.3 |
| Inflation -CPI | | | | |
| Advanced Economies (%) | 7.3 | 4.6 | 2.6 | 2.0 |

*Sources: IMF World Economic Outlook April 2024*

# Interest Rate Outlook

## Varying degrees of dovishness among central banks

**Rate cuts** on the horizon, but commencement times likely to diverge

The recent Central Bank meetings have seen differences in the degree of dovishness. The Riksbank cut interest rates for the first time in eight years, the ECB guided for a rate cut in June, while the BoE did not rule out cutting rates next month. However, the Fed stated that rates will have to remain at current levels for longer than previously envisaged. The reason for the divergence is varying degrees of confidence that inflation is on a sustained downward trajectory.

**US Fed** guides rates higher for longer

The US Fed kept the funds rate in a 5.25%-5.50% range in May and indicated that it intends to keep rates at their current level for longer than previously planned. This is due to the downtrend in inflation stalling. It is waiting for more data to give it confidence that it will achieve its 2% inflation target before cutting rates. Chair Powell noted that rate cuts could occur if the FOMC has confidence that inflation is moving sustainably to 2% or if the labour market weakens unexpectedly. Market expectations for US rate cuts have been scaled back significantly in recent months. There is now only c. 35bps of rate cuts anticipated by year end, with the first 25bps cut expected in November. However, a rate cut in September may be warranted if the inflation outlook improves.

**ECB** signals that a June rate cut is on the cards

The ECB left its key deposit rate unchanged at 4% at its most recent meeting in April. There was consensus rather than unity within the Governing Council on this decision. The ECB's communications indicated that a rate cut is very much on the cards at its next meeting on June 6th. It commented that if its updated assessment of the inflation outlook (due in June) gives it further confidence that underlying inflation is converging to its 2% target, it would be "appropriate to reduce the current level of monetary policy restrictions". Futures contracts indicate the market is attaching around a 90% probability of a rate cut in June. The market anticipates circa 60bps of rate cuts by year end. Recent remarks from ECB officials indicate the Bank will take a cautious approach to lowering rates to avoid easing prematurely. With five meetings left this year (including June), 75bps worth of rate cuts seems likely in our view.

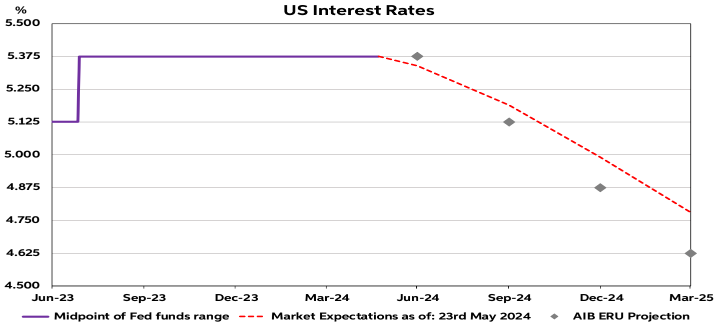
**BoE** does not rule out a rate cut as soon as June

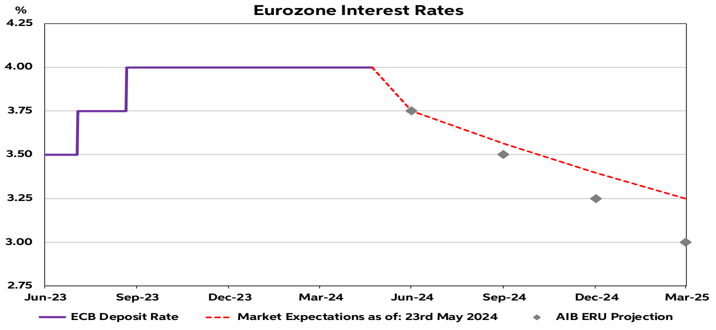
The BoE's Bank Rate was left at 5.25% in May. There was a dovish shift in the voting split of 7:2 (2 members voting for a rate cut vs. 1 in March). The statement was also dovish in tone noting that the restrictive stance of monetary policy is weighing on inflationary pressures and indicators of inflation persistence were moderating. Meanwhile, Governor Bailey remarked that it is likely the BoE will cut rates over the coming quarters and by "possibly more" than markets currently expect. He also stated that a cut in June is "neither ruled out, nor a fait accompli". Since then though, sticky inflation data have reduced the market odds for a rate cut in June. Current futures pricing is c. 35bps of rate cuts by year end. If inflation data trend lower in the coming months, we would expect 50bps of easing in the UK by year end, starting in August.

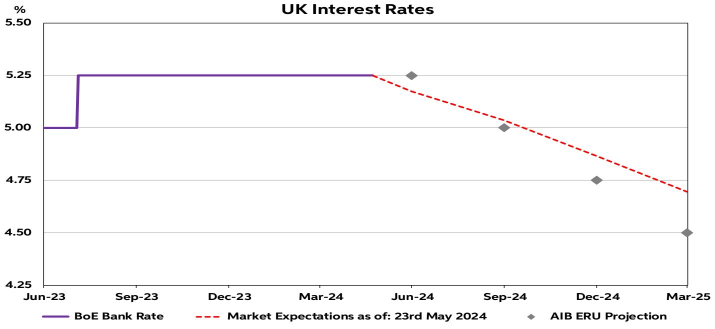
**Interest Rate Forecasts**

| | Current | End Q2 2024 | End Q3 2024 | End Q4 2024 | End Q1 2025 |
|---|---|---|---|---|---|
| **Fed Funds** | 5.375 | 5.375 | 5.125 | 4.875 | 4.625 |
| **ECB Deposit** | 4.00 | 3.75 | 3.50 | 3.25 | 3.00 |
| **BoE Repo** | 5.25 | 5.25 | 5.00 | 4.75 | 4.50 |

Current Rates Reuters, Forecasts AIB's ERU



# Forex Market Outlook



## Dollar strength tested by weakening macro data

Dollar **remains at relatively high** level..

The dollar has been underpinned recently by a revision in market interest rate expectations, with markets now pricing in less than two cuts by the Fed this year. Geopolitical tensions have also supported the currency as capital moved to safe haven dollar-denominated assets following the flare up in tensions in the Middle East. On a trade weighted basis, dollar remains at historically high levels, albeit well down on its 2022 highs.

..but **weaker US macro data** have tempered dollar gains

However, US macro data have begun to surprise to the downside in recent weeks, putting pressure on the currency. Both US GDP and labour market data have been trending weaker, suggesting growing slack in the economy. Having plumbed $1.06 in April, EUR/USD has risen steadily since to just under $1.09, as Eurozone data have picked up. Similarly, GBP/USD has traded higher following a weak start to 2024 for sterling.

Dollar expected to **weaken gradually** from here

In the near term, we expect the dollar to retreat further from its historically high level. A strengthening macro environment across its key trading partners and a more modest US growth outlook will support this trend. Overall, the other currencies may make modest gains against the dollar this year, with the euro rising towards $1.12 by end 2024.

## Eurozone growth and ECB rate cuts will temper Euro gains

Temporary **divergence in central bank policy** could bring **volatility**

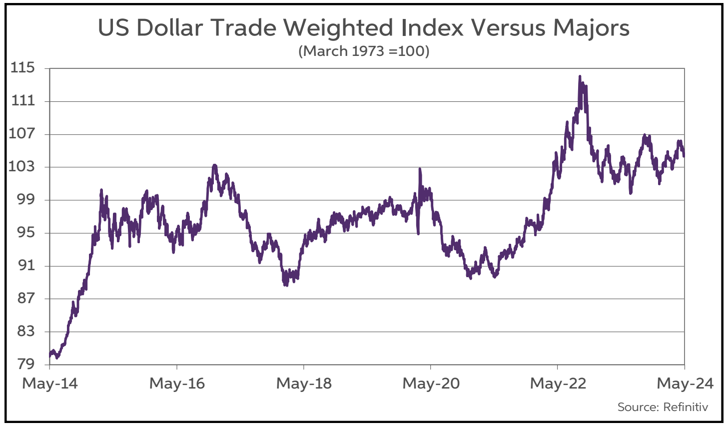
Monetary policy has been a crucial driver of forex markets in the past three years. The main central banks have kept policy unchanged in the past few months and are guiding that policy will begin to be eased soon. However, markets are now pricing in an ECB rate cut in June compared to a Fed cut in November. This suggests that the main currency pairs could experience some volatility, as central banks move at varying speeds on rate cuts.

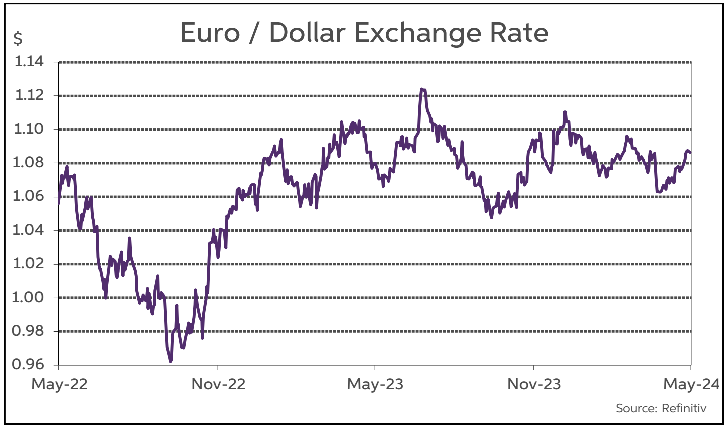
**Strengthening Eurozone** economy will support the currency

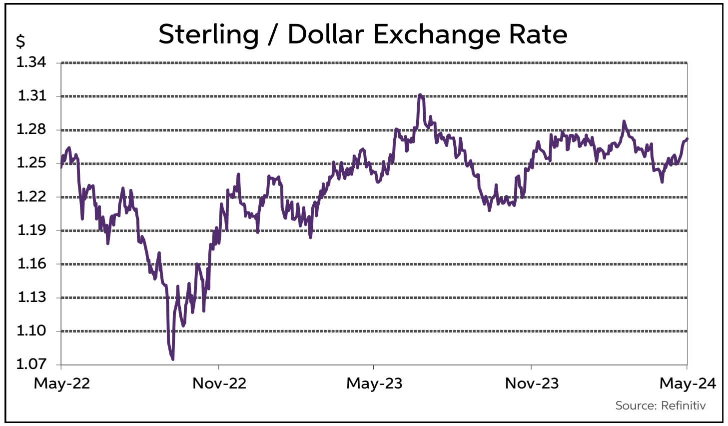
In the Eurozone, surveys and hard data suggest activity may be picking up. In particular, the German economy appears to have bottomed out following a long period of moribund growth. Brighter growth prospects should underpin the Euro in the near term.

**Euro expected to modestly strengthen** from here

Overall, we expect a modest strengthening in the Euro in the near term. EUR/USD is expected to rise towards $1.12 by the end of the year, from the current $1.08-1.09 range, continuing the recent trend in the currency pair. The risks here remain tilted to the downside, with a further flare up in geopolitical tensions or a prolonged rupture between the ECB and Fed on interest, the keys risks which could put downward pressure on the Euro.



# Forex Market Outlook

## Sterling-Euro to remain range bound

Some **clarity** on Bank of England **rate trajectory**

The May BoE meeting was an important staging post towards a first UK rate cut this summer, with clarity now that the Bank will soon begin its rate cutting cycle. This should proceed broadly in-line with the Fed and ECB trajectory, so directionally, central bank policy is unlikely to drive significant divergences in the main sterling pairs.

Some strengthening in sterling vs. dollar

Sterling has gained ground in recent weeks against the dollar, and with UK macro data showing significant signs of improvement, this should add further support to the currency. We expect cable (GBP/USD) to reach $1.28 by end-2024 from the current $1.26-1.27 range.

EUR/GBP will **remain range bound** in the near term

EUR/GBP is expected to remain range bound in the near term as central bank policy pivot in the UK and Eurozone over the summer. Both economies are also showing signs of strengthening economic growth, so macro fundamentals  are unlikely to drive a significant break-out from the current range. We have EUR/GBP reaching 88p by Q4 from the current 85-86p range.

## Dramatic swings in Yen as authorities intervene to support

Yen **moved through 30-year lows** against dollar.

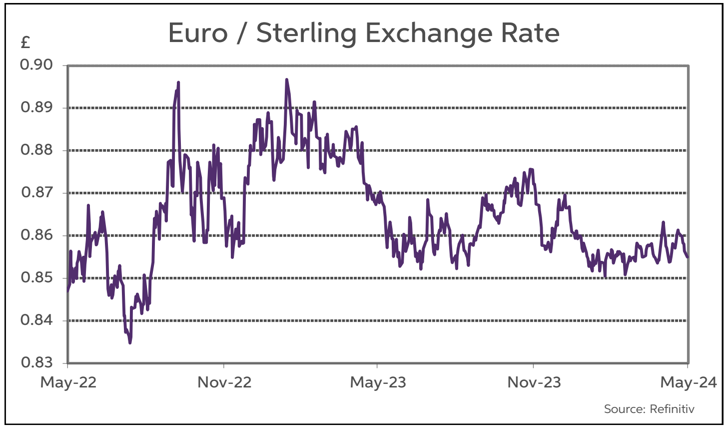
In March, BoJ raised interest rates for the first time since 2007, bringing to an end to its negative interest rate strategy in place since 2016. However, the BoJ messaging was dovish in tone. This saw the yen weaken further in the aftermath of the meeting. This weakening trend continued and gained momentum throughout April, reflected in USD/JPY rising to its highest level since 1990 (high of ¥160.03). EUR/JPY also traded up to a high of ¥171.42

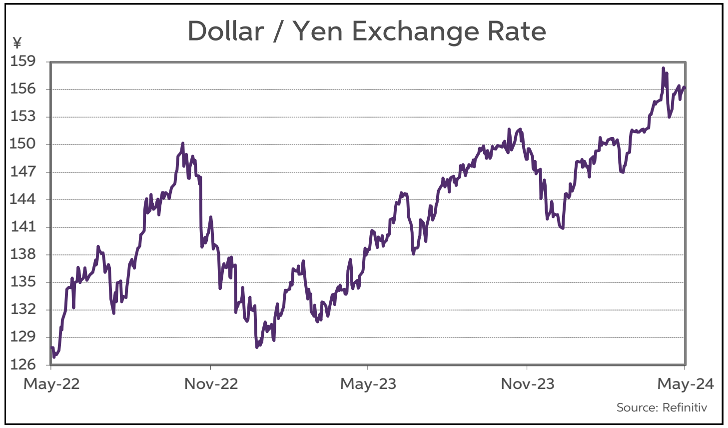
..**spurring intervention** by authorities to support the currency

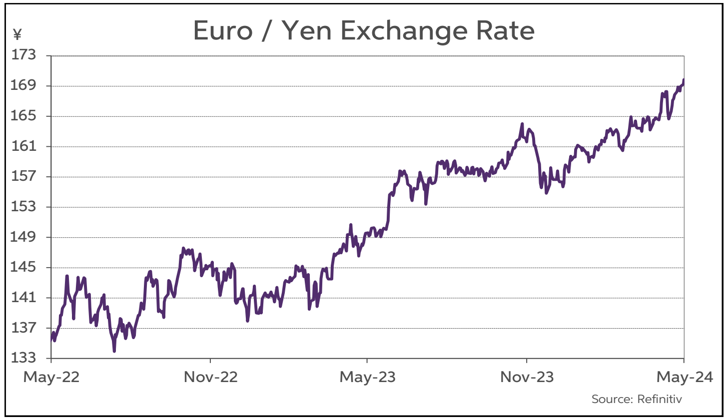
This led to increased speculation that Japanese authorities would intervene to support the Yen. Evidence suggests that this intervention occurred on two occasions in late April/early May. This has seen the yen recover some ground, but still remain at weak levels overall versus both the euro and the dollar. Nonetheless, the "official" support level for the currency is now clearer than it was previously.

Yen support level now clear and **expected to strengthen** modestly

The yen is likely to remain under pressure in the short term, particularly in light of US rates remaining close to current peak levels for a prolonged period. However, FX intervention may provide some support to the yen, but it will likely need a hawkish policy stance from the BoJ to sustain it. This could emerge over the remainder of this year, as the BoJ ramps up its policy tightening, but we expect only modest strengthening in the yen vs. the dollar, while the euro is likely to remain in the ascendancy against the yen.



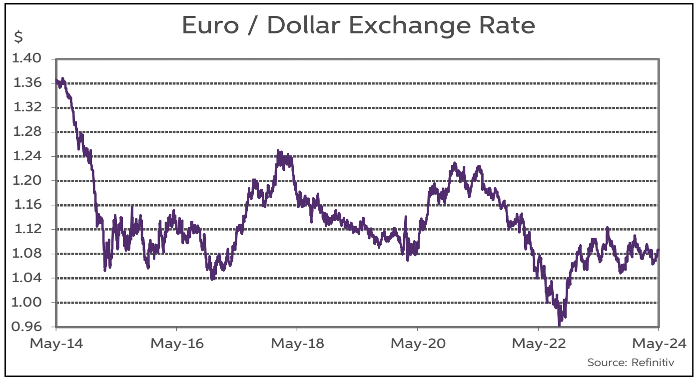



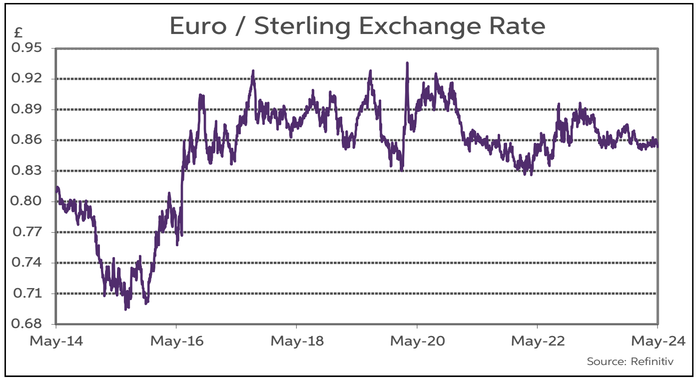

AIB Treasury Economic Research Unit

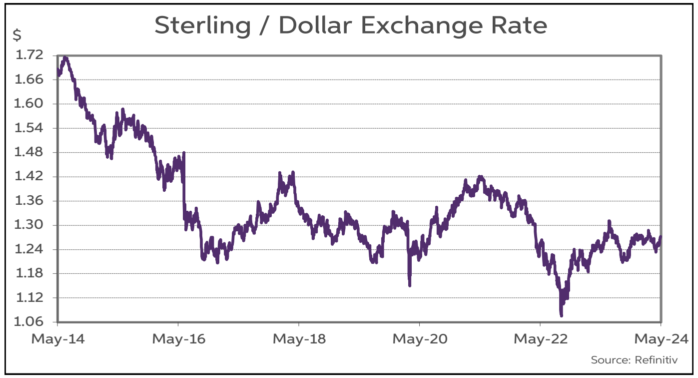
# Summary of Exchange Rate Forecasts

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

| | Current | Q2-2024 | Q3-2024 | Q4-2024 | Q1-2025 |
|---|---|---|---|---|---|
| **Euro Versus** | | | | | |
| **USD** | 1.084 | 1.05-1.11 | 1.07-1.13 | 1.08-1.14 | 1.09-1.15 |
| **GBP** | 0.852 | 0.83-0.89 | 0.84-0.90 | 0.84-0.90 | 0.85-0.91 |
| **JPY** | 170.18 | 162-172 | 168-173 | 167-173 | 165-171 |
| **CHF** | 0.99 | 0.99 | 0.99 | 1.00 | 1.01 |
| **US Dollar Versus** | | | | | |
| **JPY** | 156.95 | 152-159 | 152-158 | 150-156 | 148-154 |
| **GBP** | 1.273 | 1.23-1.29 | 1.23-1.29 | 1.25-1.31 | 1.25-1.31 |
| **CAD** | 1.37 | 1.35 | 1.33 | 1.32 | 1.32 |
| **AUD** | 0.66 | 0.67 | 0.68 | 0.69 | 0.69 |
| **NZD** | 0.61 | 0.62 | 0.63 | 0.64 | 0.64 |
| **CNY** | 7.24 | 7.20 | 7.10 | 7.00 | 7.00 |
| **Sterling Versus** | | | | | |
| **JPY** | 200 | 195 | 195 | 196 | 193 |
| **CAD** | 1.74 | 1.70 | 1.68 | 1.68 | 1.67 |
| **AUD** | 1.92 | 1.88 | 1.85 | 1.86 | 1.86 |
| **NZD** | 2.08 | 2.03 | 2.00 | 2.00 | 2.00 |



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