Weekly Market Brief

AIB Treasury Economic Research Unit

21st – 25th August 2023

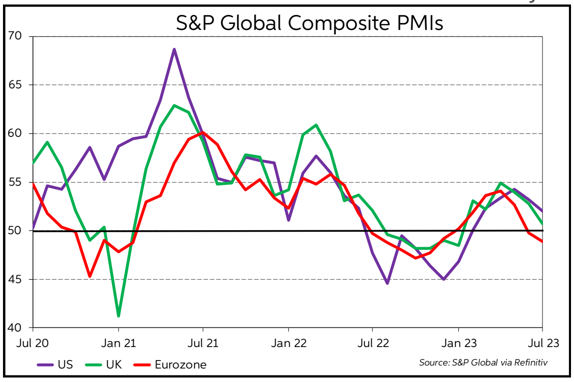
On the High Road

- **Market attention this year has been very much focused on hikes in central bank rates and when they might end.** Futures contracts indicate that traders believe US rates have now reached a peak and the ECB will deliver just one more hike this autumn. There has been little change in this view over the past couple of months. However, where there has been a marked change in expectations recently is in relation to the extent that central banks lower rates in 2024-2025 and where rates settle at over the longer term. During the past month, markets have been scaling back their expectations for policy easing and upping the level at which they expect rates will eventually settle.

- **Significant rates cuts are still expected in the US in 2024-2025, with rates falling from 5.375% to 3.75%, but they are then expected to settle around this level in subsequent years.** By contrast, US rates were pitched at or close to 0.1% for most of the period 2009 to 2022, apart from one occasion when they rose briefly above 2%. Meanwhile, in the Euro area, rates cut of 100bps are priced in for 2024-25, taking the deposit rate back down to 3%. It is then expected to remain at this level for the rest of the decade, a far cry from the negative interest rates that prevailed from 2014 until last year. Even more dramatic is the UK, where rates are expected to peak at 6% early next year and then fall back to a trough of 4.5% in subsequent years. UK rates were pitched at between 0.25% and 0.75% between 2009 and 2022.

- **This hardening of expectations in regard to the level of official rates over the longer term has pushed up bond yields in the past month.** Ten year US Treasury yields have risen from 3.75% to 4.3% since mid-July, close to their highest level since 2009. Ten year German bund yields have climbed from 2.3% to 2.7% over the same period, while ten year UK gilt yields have risen from 4.2% to 4.75%. Rising bond yields have seen stock markets come under downward pressure in the past month following a strong opening half to the year. Meantime on forex markets, the dollar and sterling have benefitted as rates in these economies are now expected to remain particularly elevated in coming years, while the yen's decline has resumed, with official rates in Japan still pitched at close to zero.

- **The primary driver of the higher-for-longer rate outlook is the diminishing risk of recession and growing expectations of a soft landing for the world economy.** GDP printed ahead of expectations in all the main developed economies in the second quarter. Indeed, the US economy is not even slowing down, never mind going into recession. GDP growth in the US in 2023 now looks set to match the 2% rate recorded last year. Meanwhile, unemployment remains at or very close to record lows, apart from the UK where it is now edging up. Wage growth is also strong everywhere, while core inflation rates remain well above the 2% target level. This points to an environment where central banks are likely to keep monetary policy tight until the next downturn in the global economy, which markets seem increasingly convinced is no longer a near-term risk as growth proves more durable than anticipated.



- **Turning to the week ahead, the flash PMIs in the US, Eurozone and UK for August are the main data highlight.** This year has seen a divergence in performance between the manufacturing and services sectors. The manufacturing sector has been printing in contraction territory. In contrast, the services PMIs have been in expansion mode on both sides of the Atlantic, although, the pace of growth slowed recently. This variance in performance is set to continue in August, with the manufacturing surveys staying below 50, and the services PMIs remaining in growth mode.

- **In terms of other survey data due this coming week, the flash Eurozone EC consumer sentiment index is projected to improve, marginally,** to –14.3 in August, from a low level of –15.1 in July. The German Ifo is forecast to decline for the fourth consecutive month to 86.6 in August, from 87.3, while the French INSEE is expected to edge slightly lower this month. **The latest ECB monetary policy meeting account, from their July deliberations, will garner close attention.**

- **Elsewhere, on the monetary policy front, Chair Powell's is expected to speak at the annual Jackson-Hole Economic Symposium, which runs from Thursday to Saturday.** Investors will be hoping for some updated guidance regarding the future path of interest rates, ahead of the next Fed meeting, on September 20th. The current 'dot plot' from the Fed (released in June) shows a majority of the FOMC expect to raise rates by a further 25bps, **However, the degree of guidance or insight from Jackson Hole may be limited as the Fed has adapted a data dependent, meeting-by-meeting approach to setting policy**. Since its last meeting in July, labour market data have softened somewhat, while CPI inflation data for July showed price pressures have continued to ease. Meanwhile, in China, the PBOC is expected to follow up on last week's cut to its MLF (medium-term lending facility) rate, with similar cuts to its LPR rates.

Interest Rate Forecasts

	Current	End Q3 2023	End Q4 2023	End Q1 2024
Fed Funds	5.375	5.375	5.375	5.375
ECB Deposit	3.75	4.00	4.00	4.00
BoE Repo	5.25	5.50	5.75	5.75
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 Q3 2023	End Q4 2023	End Q1 2024
EUR/USD	1.0861	1.12	1.13	1.14
EUR/GBP	0.8529	0.86	0.87	0.87
EUR/JPY	157.89	159	161	162
GBP/USD	1.2733	1.30	1.30	1.31
USD/JPY	145.35	142	142	142

Current Rates Reuters, Forecasts AIB's ERU

AIB Treasury Economic Research

Oliver Mangan
Chief Economist

John Fahey
Senior Economist

Daniel Noonan
Economist

ECONOMIC DIARY

Monday 21st - Friday 25th August

Date	*UK & Irish Time*		*Release*	*Previous*	*Forecast*
This Week:	**ECB Speakers:**		**Lagarde (Fri)**		
	BoE Speakers:				
	Fed Speakers:				
			Jackson Hole Economic Symposium (Thurs-Sat)		
Mon 21st	**CHINA:**	02:15	PBOC Loan Prime Rate (1 Year)	3.55%	3.40%
			PBOC Loan Prime Rate (5 Year)	4.20%	4.05%
	GER:	07:00	Producer Price Inflation (July)	-0.3% (+0.1%)	-0.2% (-5.1%)
Tue 22nd	**UK:**	07:00	PSNB Ex Banks (July)	18.487bn	5.6bn
	UK:	11:00	CBI Trends - Orders	-9	
	US:	15:00	Existing Home Sales (July)	4.16m / -3.3%	4.15m
Wed 23rd	**JPN:**	01:30	Flash Jibun Composite PMI (August)	52.2	
	FRA:	08:15	Flash HCOB Composite PMI (August)	46.6	
	GER:	08:30	Flash HCOB Composite PMI (August)	48.5	48.3
	EU-20:	09:00	Flash HCOB Composite PMI (August)	48.6	48.5
			- Services / Manufacturing	50.9 / 42.7	50.5 / 42.8
	UK:	09:30	Flash CIPS / S&P Composite PMI (August)	50.8	50.3
			- Services / Manufacturing	51.5 / 45.3	50.8 / 45.0
	US:	14:45	Flash S&P Composite PMI (August)	52.0	52.1
			- Services / Manufacturing	52.3 / 49.0	52.3 / 49.4
	EU-20:	15:00	Flash Consumer Confidence (August)	-15.1	-14.3
	US:	15:00	New Home Sales (July)	+0.697m / -2.5%	+0.707m
Thu 24th	**FRA:**	07:45	INSEE Business Climate (August)	100	99
	IRE:	***11.00***	***Labour Force Survey (Q2 2023)***		
			- Unemployment Rate	***4.1%***	***4.2%***
	UK:	11:00	CBI Distributive Trades (Aug)	-25	
	EU-20:	11:00	ECB Monetary Policy Account (26th-27th July)		
	US:	13:30	Durable Goods (July)	+4.6%	-3.8%
			- Ex-Transport	+0.5%	+0.2%
	US:	13:30	Initial Jobless Claims (w/e August)	+239,000	+240,000
Fri 25th	**UK:**	00:01	Gfk Consumer Confidence (August)	-30.0	-29.0
	GER:	07:00	GDP (Q2: Detailed Reading)	+0.0% (-0.6%)	+0.0% (-0.6%)
	GER:	09:00	German IFO Business Climate (August)	87.3	86.6
	US:	13:30	Final Uni. Michigan Consumer Sentiment (Aug)	71.2	71.0

♦ *Month-on-month changes (year-on-year shown in brackets)*