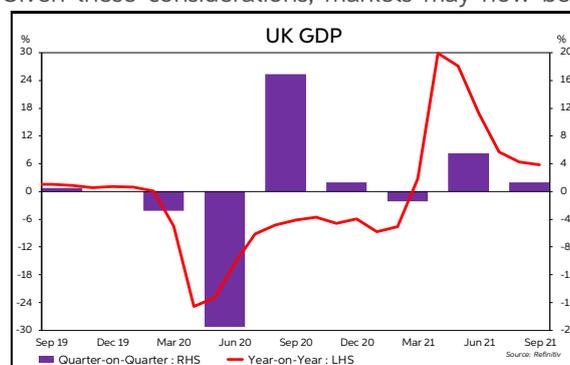


## Change in Tune

- The ECB policy meeting statement did not signal that there was much of a change in thinking at yesterday's Governing Council meeting.** A change was not expected given that the ECB had outlined its policy agenda for 2022 at its previous meeting. Hence, the press conference caused quite a stir when President Lagarde demurred on continuing to push back on market expectations of rate hikes in late 2022. She refused to re-affirm the ECB's well espoused view that the conditions needed to be met to warrant rate hikes were very unlikely to be in place this year. As a result, the ECB opened the door for rate hikes before end year. This is a big shift in the policy outlook. It certainly caught the markets off guard, even though, they have been doubtful for some time that the ECB would keep rates on hold in 2022, especially with headline inflation having risen to circa 5%, and with other central banks gearing up for a series of rate increases this year. The euro jumped by almost 1.5%, while interest rate futures contracts hardened further, and Eurozone bond yields rose by 10-25bps. The spread between core and periphery bond yields widened also.
- The catalyst for the changed ECB outlook is the deteriorating inflation picture, including the renewed surge in energy prices over the winter.** The ECB noted in its statement that inflation has continued to surprise to the upside and is now likely to remain elevated for longer than previously expected. We would also point out that the labour market is tightening more quickly than anticipated, with the unemployment rate in the Eurozone falling to a record low of 7% in December, compared to the ECB forecast that it will average 7.3% this year. Disruptions to supply chains are also lasting longer than forecasted. As a result, the ECB acknowledged that the risks to the inflation outlook are tilted to the upside, particularly in the near term.
- Greater clarity on the monetary policy outlook will be provided at the ECB's next policy meeting in March when it will be able to consider updated staff macroeconomic forecasts.** There is now a clear risk that it will announce an acceleration of the tapering of its QE programme, which could be wound up earlier than expected, most likely during the third quarter. The ECB stated again yesterday that it expects net purchases would end shortly before it starts raising interest rates. Thus accelerating tapering would open up scope for rate hikes to begin in the autumn. These would be the first ECB rate hikes in over a decade.
- The markets have turned quite aggressive and are now close to pricing in two full 25bps rate hikes for September and December, which would take the deposit rate back to zero.** Further rate increases are expected in 2023. Futures contracts indicate that another 50bps of tightening at least is anticipated for next year. Such tightening would clearly mark the end of the negative interest rate policy that has been in place since 2014. Of course, this is very much contingent on the evolution of inflation and in particular energy prices. We also would point out that core inflation in the Eurozone is running at 2.5%, much lower than in the US and UK. Given these considerations, markets may now be pricing in too much rate tightening for later this year
- The ECB is not the only central bank that has become more concerned about inflation though.** The Fed has become more perturbed by elevated levels of inflation too. It has stopped describing inflation as transitory, and has struck a more hawkish tone at its recent policy meetings. In the US, headline CPI rose to 7% in December, its highest level in almost 40 years. Similarly, core-CPI inflation rose to 5.5% from 4.9%, as price pressures became more broad based. This week, headline CPI is forecast to rise by 0.5% in the month, lifting the year-on-year rate to 7.3%. The core-rate is projected to jump by 0.5% in January also, resulting in the annual reading accelerating to 5.9%. Elsewhere, the Michigan measure of consumer sentiment is forecast to edge higher to 67.5 in February from 67.2 previously.
- In the UK, the first reading of Q4 GDP is the main release of note this week.** In Q3, growth slowed to 1.1% from 5.5% in Q2. The available hard data suggest a similar economic growth rate in Q4. The monthly readings show GDP expanded by just 0.2% in October, although, growth picked-up to 0.9% in November. However, a mixture of restrictions and increased cases/self-isolation caused by the Omicron wave of Covid-19 is likely to see GDP contract in December. Output is projected to decline by 0.5% in December, while it is envisaged that GDP grew by 1.1% overall in the final quarter of 2021. Meanwhile, the consensus is that industrial output inched higher by 0.1% in December.
- There is a quieter look to the Eurozone data schedule this week.** Of the limited releases of note, industrial output data from Germany and Italy for December are due.



	Interest Rate Forecasts			
	Current	End Q1	End Q2	End Q3
		2022	2022	2022
Fed Funds	0.125	0.50	1.00	1.25
ECB Deposit	-0.50	-0.50	-0.50	-0.40
BoE Repo	0.25	0.75	1.00	1.25
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 Q1	End Q2	End Q3
		2022	2022	2022
EUR/USD	1.1434	1.14	1.14	1.15
EUR/GBP	0.8451	0.84	0.84	0.85
EUR/JPY	131.83	131	131	131
GBP/USD	1.3528	1.36	1.36	1.35
USD/JPY	115.27	115	115	114

Current Rates Reuters, Forecasts AIB's ERU

Date	UK & Irish Time	Release	Previous	Forecast
<b>This Week:</b>	<b>ECB Speakers:</b>	<b>Lagarde</b> (Mon); de Guindos, Lane (Wed)		
	<b>BoE Speakers:</b>	Pill (Wed); <b>Bailey</b> (Thu)		
	<b>Fed Speakers:</b>	Bowman, Mester (Wed)		
<b>Mon 7th</b>	<b>UK:</b>	07:00 Halifax House Prices (January)	+1.1% (+9.8%)	
	<b>GER:</b>	07:00 Industrial Output (December)	-0.2% (-2.3%)	+0.4% (-3.9%)
	<b>EU-19:</b>	09:30 EU Sentix Index (February)	14.9	15.2
<b>Tue 8th</b>	<b>JPN:</b>	05:00 Economy Watchers Poll (January)	56.4	
	<b>ITA:</b>	09:00 Retail Sales (December)	-0.4% (+12.5%)	
	<b>US:</b>	11:00 NFIB Business Optimism (January)	98.9	
	<b>US:</b>	13:30 International Trade (December)	-\$80.2Bn	-\$83.0Bn
<b>Wed 9th</b>	<b>GER:</b>	07:00 Trade Balance (December)	+€10.9Bn	+€10.4Bn
		- Exports	+1.7%	-0.1%
	<b>ITA:</b>	09:00 Industrial Output (December)	+1.9% (+6.3%)	-0.6% (-0.3%)
<b>Thu 10th</b>	<b>UK:</b>	00:01 RICS Housing Survey (January)	69	
	<b>US:</b>	13:30 CPI Inflation (January)	+0.5% (+7.0%)	+0.5% (+7.3%)
		- Core	+0.6% (+5.5%)	+0.5% (+5.9%)
	<b>US:</b>	13:30 Initial Jobless Claims (w/e 31st January)	+238,000	+230,000
<b>Fri 11th</b>	<b>UK:</b>	07:00 GDP (Q4: First Reading)	+1.1% (+6.8%)	+1.1% (+6.5%)
	<b>UK:</b>	07:00 GDP (December)	+0.9% (+8.0%)	-0.5% (+6.3%)
	<b>UK:</b>	07:00 Industrial Output (December)	+1.0% (+0.1%)	+0.1% (+0.6%)
		- Manufacturing Output	+1.1% (+0.4%)	+0.2% (+1.7%)
	<b>GER:</b>	07:00 Final HICP (January)	+0.9% (+5.1%)	+0.9% (+5.1%)
	<b>US:</b>	15:00 Preli. Uni. Michigan Consumer Sentiment (Feb)	67.2	67.5

◆ Month-on-month changes (year-on-year shown in brackets)

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