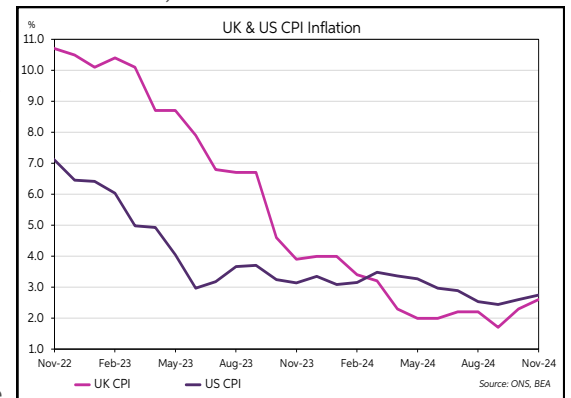


UK Chancellor's mettle tested by gilt sell-off

- This week's move in UK gilts have garnered much media attention, and even spurred a parliamentary statement by the Chief Secretary to the Treasury, Darren Jones, attempting to quell fears of a deterioration in UK debt sustainability or a shift in expected fiscal policy.** While not based on any new macro data, the move in gilt yields, nonetheless, adds to pressure on the Chancellor to meet her already ambitious fiscal rules set down in her first Budget in October.
- UK gilts have broadly tracked global bond market moves in recent months, with the 10-year yield up over 50bps over the past month alone to 4.85%, a similar rise to the move in the 10-year US Treasury.** A firming in rate expectations on the back of sticky inflation has been a factor in these moves, but the greater catalyst has been the rise in term premia on the back of the US election and expected fiscal stimulus by President Trump. However, the rise in UK gilt yields over the past week has been more rapid, about 25bps for long-dated bonds versus a 15-17bps rise in US Treasuries. Reflecting the negative sentiment around UK assets, sterling was also significantly lower on the week, down 1-2% against the major currencies, including breaking through a 12-month low against the dollar.
- This move may indicate some lingering concerns around the UK's growth prospects and fiscal sustainability post the Autumn Budget, alongside perhaps "vigilantism" by some investors in the current global environment.** Analyst commentary around the Chancellor's narrowing fiscal headroom to her new targets has also possibly created a negative feedback loop to markets. What hasn't been present are any specific macro drivers to spur the sell-off in gilts. The UK data calendar has been sparse so far this year. Furthermore, the PMI surveys, the only major releases of note, were in line with the flash estimate which was released before Christmas. Therefore, the market may settle back down in the coming weeks, but the current episode highlights the fragility of the UK Government's fiscal position. With GDP growth remaining muted and markets pricing in a shallow trajectory of rate cuts, this implies a 'stagflationary' outlook for investors, which may be amplified by incoming data. If sustained, this could pile pressure on the Chancellor to revisit her fiscal plans in the Spring statement in March, and abandon her commitment to having a single annual fiscal event each Autumn.
- Turning to the week ahead, a busy UK schedule will shed some light on the economy and may influence gilts and sterling.** Despite performing better than anticipated in the first half of 2024, the UK economy has lost some momentum recently. Worryingly, the monthly reading of GDP has printed below the consensus in three of the last four months, and it contracted by 0.1% m/m in September and October. However, a modest rebound of 0.2% is pencilled in for November. Meanwhile, industrial production has been volatile, but overall it has continued to struggle, registering a 0.6% m/m fall in October, leaving it down by 0.7% in year-on-year terms. Output is expected to stagnate in November. Like-wise, retail sales also fell sharply in October, by 0.7% m/m. A 0.4% m/m rise is forecast for November. **Elsewhere, UK CPI inflation for December will feature.** Both the headline and the core rates have increased in recent months. Base effects in energy prices and still elevated levels of services inflation, which is running at 5.0%, have contributed to the recent stickiness in inflation. The headline and core rates are projected to remain at 2.6% and edge down to 3.4%, respectively, in December.
- In the US, updates on inflation, retail sales and industrial production are also due.** Headline CPI inflation had been trending lower, before it rose to 2.6% in October and to 2.7% in November. Meantime, having slowly dissipated in the first seven months of the year, to a low of 3.2% in July and August, core-CPI rose to 3.3% in September and stayed at this rate in October and November. The consensus is for the headline rate to rise to 2.8% In December, while the core rate is forecast to stay at 3.3% once again. In terms of retail sales, the headline figure rose by 0.5% m/m and 0.7% m/m in October and November, respectively, although the control group measure has been somewhat softer. It contracted by 0.1% m/m before rebounding by 0.4% m/m over the same period. The former is expected to expand by 0.5% m/m in December, while the latter is projected to rise by 0.3% m/m. In contrast, industrial production has performed relatively poorly in Q4. Output continued to fall, declining by a cumulative 0.6% in the opening two months of the quarter. A modest rebound of 0.2% m/m is envisaged in December.
- Industrial production has also continued to trend lower in the Eurozone in recent months.** However, a slight 0.2% m/m increase is forecast in November. In Germany, industrial production has struggled in particular, and this is a significant part as to why overall German GDP is set to record a second consecutive year of contraction in 2024. An average annual decline of 0.2% is forecast for 2024. On the monetary policy front, the ECB Governing Council meeting account from December will be released on Thursday. Remarks from a number of ECB, Fed and BoE officials are also dotted throughout the week.



	Interest Rate Forecasts			
	Current	End Q1	End Q2	End Q3
		2025	2025	2025
Fed Funds	4.375	4.125	3.875	3.625
ECB Deposit	3.00	2.50	2.25	2.00
BoE Repo	4.75	4.50	4.25	4.00
BoJ OCR	0.25	0.50	0.50	0.50

Current Rates Reuters, Forecasts AIB's ERU

	Exchange Rate Forecasts (Mid-Point of Range)			
	Current	End Q1	End Q2	End Q3
		2025	2025	2025
EUR/USD	1.0253	1.07	1.08	1.08
EUR/GBP	0.8378	0.83	0.84	0.84
EUR/JPY	161.67	161	161	160
GBP/USD	1.2234	1.28	1.28	1.28
USD/JPY	157.65	150	150	149

Current Rates Reuters, Forecasts AIB's ERU

Date	UK & Irish Time	Release	Previous	Forecast
This Week:	ECB Speakers:	Lane (Mon); Lane (Tue); Lane, de Guindos (Wed); Cipollone (Fri)		
	BoE Speakers:	Breedon (Tue); Taylor (Wed)		
	Fed Speakers:	Schmid, Williams (Tue); Barkin, Williams, Goolsbee, Kashkari (Wed)		
Mon 13th				
Tue 14th	ITA:	09:00 Industrial Output (November)	+0.0% (-3.6%)	
	FRA:	11:00 NFIB Small business optimism (December)	101.7	
	US:	13:30 PPI Inflation (December)	+0.4% (+3.0%)	+0.3% (+3.4%)
		- Ex-Food & Energy	+0.2% (+3.4%)	+0.2%
Wed 15th	UK:	07:00 CPI Inflation (December)	+0.1% (+2.6%)	+0.4% (+2.6%)
		- Core-CPI	+0.0% (+3.5%)	+0.5% (+3.4%)
		- Services CPI	-0.1% (+5.0%)	(+4.9%)
	UK:	07:00 PPI Output Price Inflation (December)	+0.3% (+1.6%)	
		- PPI Input Price Inflation	+0.0% (-1.9%)	
	FRA:	07:45 Final HICP Inflation (December)	+0.2% (+1.8%)	+0.2% (+1.8%)
	SPA:	08:00 Final HICP Inflation (December)	+0.4% (+2.8%)	+0.4% (+2.8%)
	GER:	09:00 Full Year GDP (2024)	-0.3%	-0.2%
	EU-20:	10:00 Industrial Production (November)	+0.0% (-1.2%)	+0.2% (-1.9%)
	US:	13:30 CPI Inflation (December)	+0.3% (+2.7%)	+0.3% (+2.8%)
		- Core-CPI	+0.3% (+3.3%)	+0.2% (+3.3%)
	US:	13:30 NY Fed / Empire State Index (January)	0.20	5.00
Thu 16th	UK:	00:01 RICS Housing Survey (December)	25.0	
	GER:	07:00 Final HICP Inflation (December)	+0.7% (+2.9%)	+0.7% (+2.9%)
	UK:	07:00 GDP (November)	-0.1% (+1.3%)	+0.2%
		- 3m / 3m	+0.1%	+0.0%
	UK:	07:00 Industrial Output (November)	-0.6% (-0.7%)	+0.0% (-1.0%)
		- Manufacturing Output	-0.6% (+0.0%)	+0.0% (-0.3%)
	UK:	07:00 Goods Trade Balance (November)	-£19.0bn	
		- Non-EU	-£7.3bn	
	ITA:	09:00 Final HICP Inflation (December)	+0.1% (+1.3%)	+0.1% (+1.3%)
	EU-20:	10:00 Total Trade Balance (November)	+€6.1bn	
		- EuroStat Trade	+€6.8bn	
	IRE:	11:00 CPI Inflation (December)	-0.5% (+1.0%)	
		- HICP Inflation	Flash -0.5% (+0.5%)	
	EU-20:	12:00 ECB Monetary Policy Meeting Account (11-12th Dec)		
	US:	13:30 Initial Jobless Claims (w/e 6th January)	+201,000	+215,000
	US:	13:30 Philly Fed Index (January)	-16.4	-4.0
	US:	13:30 Retail Sales (December)	+0.7% (+3.8%)	+0.5% (+%)
		- Ex-Autos	+0.2%	+0.4%
		- Control Group	+0.4%	+0.3%
	US:	15:00 NAHB Homebuilder Sentiment (January)	46.0	46.0
Fri 17th	UK:	07:00 Retail Sales (December)	+0.2% (+0.5%)	+0.4% (+3.3%)
		- Ex-Fuel	+0.3% (+0.1%)	+0.1% (+2.8%)
	EU-20:	10:00 Final HICP Inflation (December)	+0.4% (+2.4%)	+0.4% (+2.4%)
		- Ex-Food & Energy	+0.4% (+2.8%)	+0.4% (+2.8%)
		- Ex-Food, Energy, Alcohol & Tobacco	+0.5% (+2.7%)	+0.5% (+2.7%)
	US:	13:30 Building Permits (December)	+1.49m / +5.2%	+1.46m / -2.1%
		- Housing Starts	+1.29m / -1.8%	+1.31m / +1.6%
	US:	14:15 Industrial Production (December)	-0.1% (-0.9%)	+0.2% (-0.5%)
		- Manufacturing Output (December)	+0.2%	
		- Capacity Utilisation	76.8%	76.9%

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

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