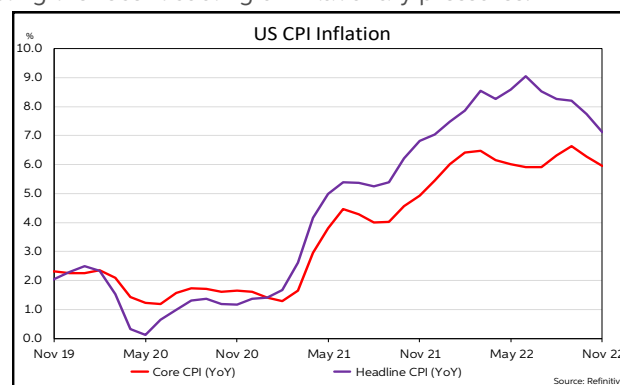


## Inflation Omens Looking Good

- **After decades of price stability, the return of inflation was one of the big stories of 2022.** CPI rates hit forty year highs, reaching double-digit levels in many countries, resulting in a marked tightening of monetary policy and a sharp slowdown in economic activity. Altogether, this inflicted considerable damage on financial markets which endured one of their worst years on record. There are concerns that with central banks indicating that a further significant tightening of policy is in store in the coming months, the global economy is set for a difficult year in 2023, while at the same time, financial markets will struggle for traction.
- **The recent omens on inflation, though, have been encouraging.** Headline rates are already declining. In the US, the CPI rate has been on a steady downward path since June, falling from 9.1% to 7.1% by November. Meanwhile, headline PCE inflation has fallen from 7.1% to 5.5% over the same period. In the Eurozone, the HICP rate fell from a peak of 10.6% in October to 9.2% in December. Core inflation is also easing in the US, with the core PCE rate falling to 4.7% in November from 5.2% in September. Indeed, the monthly rise in the core index slowed to 0.3% in October and 0.2% in November.
- **Developments in upstream price indicators suggest there could be a marked fall in inflation in 2023.** Supply chain disruptions were a key part of the rise in inflation in 2021-22. However, there has been a marked easing in supply chain constraints as evidenced by the downward trend since mid-2022 in the Global Supply Chain Pressure Index produced by the NY Fed. Meantime, wholesale oil and gas prices have fallen sharply since the summer. Experts in the UK are predicting there will be substantial falls in the energy price cap set by the energy regulator Ofgem in 2023, which would trigger big declines in the CPI rate. This fall should be replicated in other countries. Rising retail food prices have been a key factor in the sharp jump in inflation. The FAO World Commodity Food Price Index, though, fell sharply over the second half of 2022, reversing all of its upward spike following the Russian invasion of Ukraine. This points to a likely cooling of price pressures on food also in 2023.
- **There are other encouraging signs also.** Inventories are being rebuilt and shipping costs have fallen sharply, further favourable signals that price pressures will ease. PMI surveys also show price pressures are softening. Indeed, the US manufacturing ISM for December showed input prices falling at their fastest pace since 2016, bar during the early stages of the COVID-19 pandemic. Meanwhile, the upward pressure on house prices and rents is also moderating, most notably in the US. The lagged impact of the tightening of monetary policy in the past year should also start to dampen inflation in 2023, particularly with demand weakening. Central banks, though, are of the view that monetary policy will need to remain restrictive for an extended period of time to ensure inflationary pressures are squeezed out of the system, especially given tight labour markets and the pick-up in wage inflation. Thus, they will continue to hike rates in H1 2023, and be reluctant to start loosening policy before year end. A big fall in inflation, though, should provide a boost to financial markets this year, as well as enhancing economic growth prospects.
- **This week, inflation data will remain in focus, with the US CPI for December due for release.** As mentioned, headline CPI inflation has been in marked decline in recent months. It fell to 7.1% in November, down from 7.7% in October and 8.2% in September, well below its peak of 9.1% in June. Meantime, core CPI has been sticky, running in a 6.0-6.5% range throughout 2022. However, similar to core PCE inflation, the monthly rise in core CPI slowed to 0.3% in October, and to 0.2% in November. Despite the consensus for a small uptick in the pace of the monthly increase to 0.3% in December, core CPI inflation is projected to fall to 5.7%. Headline CPI inflation is forecast to decelerate sharply once again, to 6.6%. Elsewhere in the US, the University of Michigan measure of consumer sentiment - which is more focused on the strength of household finances than the Conference Board indicator - is expected to improve slightly in January, in part, reflecting the recent cooling of inflationary pressures.
- **Meanwhile, in the UK, the monthly GDP reading for November will be the highlight.** Following declines in the two months previous, UK GDP rose by 0.6% in October. However, the sharp rise in October was largely due to the unwinding impact of the Queen's funeral in September. GDP was also buoyed by a temporary rise in output in the health sector, from the rollout of COVID-19 booster jabs. A 0.3% contraction in GDP is pencilled in for November. Similarly, industrial production is projected to fall by 0.3% in November, having been unchanged in October.
- **Industrial production data for November will also feature in the Eurozone.** Overall, industrial production figures have been quite volatile in 2022, with the data heavily impacted by multinational activity in Ireland. Notably though, German industrial production has softened markedly in the second half of the year. A meagre 0.1% increase in German industrial output is anticipated in November, while the bloc wide measure is expected to rise by 0.2%. Meantime, the Eurozone unemployment rate is forecast to remain at a record low level of 6.5% in November.



	Interest Rate Forecasts			
	Current	End Q1	End Q2	End Q3
		2023	2023	2023
Fed Funds	4.375	5.125	5.125	5.125
ECB Deposit	2.00	3.00	3.50	3.50
BoE Repo	3.50	4.25	4.25	4.25
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
		2023	2023	2023
EUR/USD	1.0509	1.07	1.08	1.10
EUR/GBP	0.8836	0.88	0.89	0.90
EUR/JPY	140.80	141	140	140
GBP/USD	1.1892	1.22	1.21	1.22
USD/JPY	133.95	132	130	127

Current Rates Reuters, Forecasts AIB's ERU

Date	UK & Irish Time	Release	Previous	Forecast
<b>This Week:</b>	<b>ECB Speakers:</b>	Schnabel (Tue)		
	<b>BoE Speakers:</b>	Pill (Mon); <b>Bailey</b> (Tue)		
	<b>Fed Speakers:</b>	Bostic (Mon); <b>Powell</b> (Tue); Harker, Bullard, Barkin (Thu); Harker (Fri)		
<b>Mon 9th</b>	<b>GER:</b>	07:00 Industrial Production (November)	-0.1% (+0.2%)	+0.1% (-0.2%)
	<b>EU-19:</b>	09:30 Sentix Index (January)	-21.0	-18.0
	<b>EU-19:</b>	10:00 Unemployment Rate (November)	6.5%	6.5%
<b>Tue 10th</b>	<b>FRA:</b>	07:45 Industrial Output (November)	-2.6% (-2.7%)	+0.9% (-0.9%)
	<b>US:</b>	11:00 NFIB Business Optimism (December)	91.9	91.4
	<b>IRL:</b>	<b>11:00 Unemployment Rate (December)</b>	<b>4.4%</b>	<b>4.4%</b>
<b>Wed 11th</b>				
<b>Thu 12th</b>	<b>CHINA:</b>	01:30 CPI (December)	-0.2% (+1.6%)	-0.1% (+1.8%)
	<b>CHINA:</b>	01:30 PPI (December)	(-1.3%)	(-0.1%)
	<b>JPN:</b>	05:00 Economy Watchers Poll (December)	48.1	
	<b>US:</b>	13:30 CPI Inflation (December)	+0.1% (+7.1%)	+0.0% (+6.6%)
		- Core CPI	+0.2% (+6.0%)	+0.3% (+5.7%)
	<b>US:</b>	13:30 Initial Jobless Claims (w/e 2nd January)	+204,000	+222,000
<b>Fri 13th</b>	<b>CHINA:</b>	02:00 Trade Balance (December)	+\$69.9bn	
		- Exports	(-8.7%)	
	<b>UK:</b>	07:00 Goods Trade Balance (November)	-£14.5bn	
	<b>UK:</b>	07:00 GDP (November)	+0.5% (+1.5%)	-0.3% (+0.3%)
		- 3m/3m	-0.3%	-0.4%
	<b>UK:</b>	08:00 Industrial Output (November)	+0.0% (-2.4%)	-0.3% (-3.2%)
		- Manufacturing Output (November)	+0.7% (-4.6%)	-0.2% (-5.1%)
	<b>FRA:</b>	07:45 Final HICP (December)	-0.1% (+6.7%)	-0.1% (+6.7%)
	<b>SPA:</b>	08:00 Final HICP (December)	+0.1% (+5.6%)	+0.1% (+5.6%)
	<b>ITA:</b>	09:00 Industrial Output (November)	-1.0% (-1.6%)	+0.0% (-2.8%)
	<b>EU-19:</b>	10:00 Total Trade Balance (November)	-€28.3bn	-€24.0bn
		- Eurostat Trade Balance	-€26.5bn	
	<b>EU-19:</b>	10:00 Industrial Production (August)	-2.0% (-3.4%)	+0.2% (+0.5%)
	<b>US:</b>	15:00 Prelim. Uni. Michigan Consumer Sentiment (Jan)	59.7	60.0

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

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