Weekly Market Brief

AIB Treasury Economic Research Unit

8th – 12th May 2023

The Next Cycle

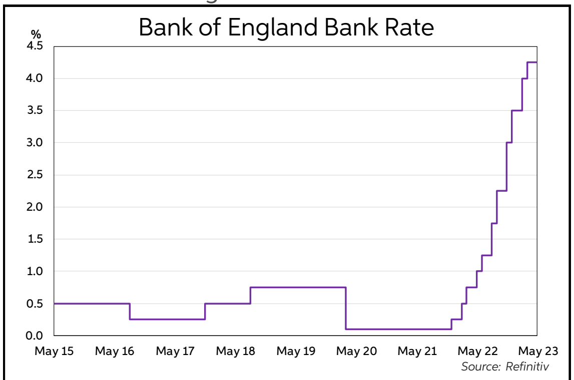
- **The US Fed has opened the door to pausing its rate hiking campaign, following a 25bps rate increase at its latest policy meeting, which brought the funds rate up a 5.0-5.25% range.** It is no longer guiding that additional tightening in monetary policy may be appropriate. Instead, it will now take into account a number of factors in determining the extent to which further policy firming may be needed. The language used in its policy statement suggests that the bar is going to be high for further rate hikes to be implemented. In particular, the Fed noted that the current stresses in the US banking system are expected to result in tighter credit conditions for households and businesses that will likely weigh on economic activity, hiring and inflation.

- **Meanwhile, markets believe that we are approaching the peak in rates in the Eurozone and UK as well.** Following a 25bps hike on Thursday, the ECB is expected to deliver either one or two further 25bps rate increases this summer, with the key deposit rate peaking in a 3.5-3.75% range. It is also anticipated that the BoE will hike rates by 25bps at its policy meeting this Thursday, and then deliver one or two more similar-sized rate increases by September, taking the bank rate to a peak level of 4.75-5.0%. Overall, this represents a large amount of rate tightening of the order of 425-500bps by these three central banks over a relatively short period of time. With rates at or approaching a peak, and given the scale of policy tightening, attention will soon focus on when central banks may begin to lower rates and the extent of such policy easing.

- **A number of points are worth making in this regard. With inflation still high, central banks are indicating that policy will need to be kept tight for some time after rates reach their peak.** Chair Powell repeated again this week that the Fed's view is that inflation will be slow to come down. Core inflation has remained sticky in the US, with the core CPI rate stuck at 5.5-5.6% and the core PCE rate running at 4.6-4.7%, in recent months. Powell indicated that if the Fed's view on inflation proves correct, then it would not be appropriate to cut rates this year. Meantime, ECB President Lagarde emphasised this week that once rates reach a peak, they would be kept on hold for as long as necessary to return inflation to the 2% medium-term target. With core inflation also proving very sticky in the Eurozone, this does not sound like a central bank contemplating an early reversal of rates hikes

- **Nonetheless, rate cuts are being priced in everywhere, starting this autumn in the US and early next year in the UK and Eurozone.** It may be that markets believe a marked tightening of credit conditions will weigh heavily on growth over the remainder on the year and put significant downward pressure on underlying inflation, allowing central banks to start lowering rates. However, it is not anticipated by markets that rates will return to anywhere near the previous super-low levels that prevailed before the current rate tightening cycle commenced. Rates are seen as falling to around 2.75% in the US and 3.75% in the UK by mid-2025, with ECB rates declining to around 2.5%, far above their previous zero or negative levels.

- **Looking to the week ahead, as mentioned above, it is the turn of the Bank of England to enter the monetary policy spotlight.** Like the ECB and Fed, the BoE is also expected to raise rates by 25bps. Last time round, the BoE hiked rates by 25bps in March, and highlighted that it retained a willingness to tighten further if there were clear signs of persistent inflationary pressures. Since then, both CPI inflation and average earnings growth have printed ahead of forecast. Thus, in recent weeks, market rate hike expectations have hardened. Indeed, the market is now of the view that the BoE will raise rates at least once more after this week's meeting. Therefore, the updated Monetary Policy Report and the post-meeting press conference will garner very close attention, as investors look for the BoE's view on the economic outlook and the future path of interest rates.



- **Elsewhere, the first reading of Q1 GDP is due at the end of a holiday shortened week in the UK.** Monthly readings of UK GDP rebounded by 0.4% in January, having fallen sharply in December, before stagnating in February. The consensus is for GDP to rise by 0.1% in the quarter, consistent with growth remaining stagnant in March. This means that the UK economy has essentially flat-lined since Q1 of last year. Meanwhile, industrial production is forecast to increase marginally in March, by 0.1%, having contracted in the previous two months. However, this would leave it down 2.9 y/y.

- **In the US, CPI inflation data for April will garner close attention.** Headline inflation has been in marked decline, falling to 5% in March, from 6% in February, and a peak of 9.1% in June. Core inflation, though, has been quite sticky, printing in a 5.5-5.6% range in Q1. The consensus is for the headline rate to be unchanged at 5% in April, while core CPI is forecast to edge lower to 5.5% from 5.6% in March. Encouragingly though, producer price inflation is projected to continue trending lower, declining to 2.5% in April, from 2.7%. Elsewhere, the Michigan measure of consumer sentiment is expected to be little changed in May. **Meanwhile, the Fed Senior Loan Officer Survey, and the NFIB Small Business Optimism index will be closely followed for information on credit conditions in the US, given the recent focus on stresses in the regional banking sector.**

Interest Rate Forecasts

	Current	End Q2 2023	End Q3 2023	End Q4 2023
Fed Funds	5.125	5.125	5.125	4.625
ECB Deposit	3.25	3.50	3.75	3.75
BoE Repo	4.25	4.50	4.75	4.75
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 Q2 2023	End Q3 2023	End Q4 2023
EUR/USD	1.0985	1.11	1.13	1.14
EUR/GBP	0.8731	0.88	0.88	0.88
EUR/JPY	148.14	150	150	150
GBP/USD	1.2584	1.26	1.28	1.30
USD/JPY	134.83	135	133	132

Current Rates Reuters, Forecasts AIB's ERU

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ECONOMIC DIARY

Monday 8th - Friday 12th May

Date	*UK & Irish Time*		*Release*	*Previous*	*Forecast*
This Week:	**ECB Speakers:**		Lane (Mon); Lane, Schnabel (Tue); **Lagarde,** Panetta, Schnabel, de Guindos (Thu); de Guindos (Fri)		
	BoE Speakers:				
	Fed Speakers:		Jefferson, Williams (Mon); Waller (Thu); Bullard, Jefferson (Fri)		
Mon 8th	**UK:**		**Bank Holiday (Coronation of King Charles III)**		
	GER:	07:00	Industrial Output (March)	+2.0% (+0.7%)	-1.0%
	EU-20:	09:30	EU Sentix Index (May)	-8.7	-8.0
Tue 9th	**CHINA:**	04:00	Trade Balance (April)	$88.2bn	+$74.3bn
			- Exports	(+14.8%)	(+8.0%)
	US:	11:00	NFIB Business Optimism (April)	90.1	
Wed 10th	**GER:**	07:00	Final HICP (April)	+0.6% (+7.6%)	+0.6% (+7.6%)
	ITA:	09:00	Industrial Output (March)	-0.2% (-2.3%)	+0.3%
	US:	13:30	CPI Inflation (April)	+0.1% (+5.0%)	+0.4% (+5.0%)
			- Core CPI	+0.4% (+5.6%)	+0.4% (+5.5%)
Thu 11th	**CHINA:**	02:30	CPI Inflation (April)	-0.3% (+0.7%)	
	IRL:	***11:00***	***CPI Inflation (April)***	***+1.1% (+7.7%)***	***+0.3% (+7.0%)***
			- Final HICP Inflation (April)	***Flash: +0.3% (+6.3%)***	***+0.3% (+6.3%)***
	UK:	12:00	BoE Interest Rate Announcement		
			- Bank Rate	4.25%	4.50%
	UK:	12:30	BoE MPR Press Conference		
	US:	13:30	Initial Jobless Claims (w/e 1st May)	+242,000	+243,000
	US:	13:30	PPI Final Demand (April)	-0.5% (+2.7%)	+0.3% (+2.5%)
			- Ex-Food & Energy	-0.1% (+3.4%)	+0.2% (+3.3%)
Fri 12th	**UK:**	07:00	GDP (Q1: First Reading)	+0.1% (+0.6%)	+0.1% (+0.2%)
			- GDP (March)	+0.0% (+0.5%)	+0.0% (+0.4%)
	UK:	07:00	Industrial Output (March)	-0.2% (-3.1%)	+0.1% (-2.9%)
			- Manufacturing Output	+0.0% (-2.4%)	-0.1% (-2.5%)
	UK:	07:00	Trade Balance (March)	-£17.5bn	
			- Non-EU	-£6.5bn	
	FRA:	07:45	Final HICP (April)	+0.7% (+6.9%)	+0.7% (+6.9%)
	SPA:	08:00	Final HICP (April)	+0.5% (+3.8%)	+0.5% (+3.8%)
	US:	15:00	Preli. Uni. Michigan Sentiment (May)	63.5	63.0

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