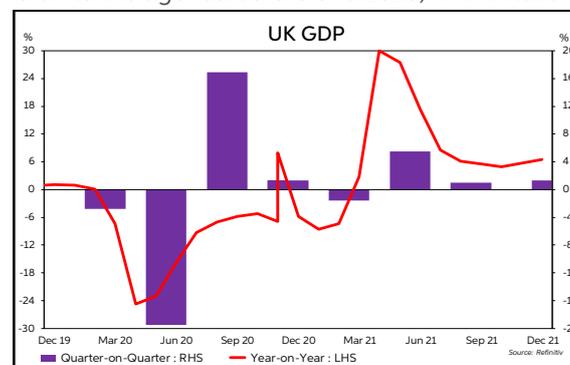


UK Rates May Not Rise That Much Further

- **The Bank of England Monetary Policy Committee voted to hike rates as expected by 25bps to 1% yesterday, but the minutes showed deep divisions amongst members as a period of stagflation beckons for the UK economy.** There were a number of surprises in the MPC deliberations. Three of its nine members voted for a 50bps hike, which was more than expected. However, it also seems from the minutes of the meeting that some members gave consideration to leaving rates unchanged. Indeed, at the previous meeting in March, one member voted to keep rates on hold. Furthermore, while most MPC members were happy with the guidance that some degree of further tightening in monetary policy might still be appropriate in the coming months, some others judged such guidance was not appropriate at this juncture given that the risks around activity and inflation were more evenly balanced.
- **The economic backdrop is becoming increasingly challenging, which is making monetary policy decisions all the more difficult.** The BoE revised its near-term inflation forecasts sharply upwards. It now expects the CPI rate to rise above 10% in the final quarter of the year and still be well above target, at 3.5%, by the end of next year. This seems grounds for a further significant tightening of policy as envisaged by the markets, which see rates climbing to 2.15% by end 2022 and just above 2.5% in late 2023. However, the Bank's forecasts, which are conditioned on current market rate expectations, also foresee a mild recession and a period of stagnation for the UK economy, with GDP projected to contract by 0.25% in 2023 and grow by just 0.25% in 2024. As a result, the unemployment rate is seen as climbing from 3.6% to 5.5% over the next three years. Crucially, the Bank is projecting that inflation will fall well below target to 1.3% by 2025, which argues against the degree of tightening priced in by markets.
- **Meanwhile, if interest rates are held constant at 1% over the next three years, growth is materially stronger and inflation would fall to 2.2% in 2025, which is slightly above target.** This suggests that a further modest tightening of monetary policy is required to return inflation to target. The BoE acknowledges there is considerable uncertainty around its economic forecasts. What is clear, though, is that a period of very high inflation and a marked weakening of growth, if not outright recession, lies in store for the UK economy. The economy is facing multiple headwinds, including a fall of 1.75% in real household disposable income this year, a deteriorating net external trade position following Brexit that is projected to knock 3.5 percentage points off GDP between 2021-23, as well as a tightening of monetary and fiscal policy.
- **The Bank seems strongly of the view that inflation will fall sharply from the end of this year onwards.** As such, given the risks facing the real economy and the guidance from the MPC, the markets look to be pricing in excessive policy tightening. In our view, it will prove difficult for the MPC raise rates to anywhere near 2.15% this year and continue hiking rates in 2023 as markets expect, if the economy deteriorates to the extent anticipated by the BoE. We would not be surprised if rates peaked at 1.5-1.75% later this year and rates cuts came on to the agenda before end 2023, with inflation falling rapidly next year.
- **For now though, UK growth is set to remain positive.** The first reading of Q1 GDP due this week is forecast to show a 1% increase in output in the quarter, as the economy benefitted from the Omicron wave receding at the start of the year. However, storm clouds are gathering for the UK economy. The reading of GDP for March is expected to show growth of just 0.1% for a second consecutive month. Retail sales and consumer confidence have both declined sharply recently, indicating households are already feeling the pinch from the rising cost of living. Meanwhile, industrial production is also projected to rise by just 0.1% in March, as manufacturing output stagnates. The latest BoE forecasts are for GDP to rise by 3.75% in 2022, although, growth is set to slow sharply over the course of the year.
- **Meanwhile, inflation is thought to have peaked in the US.** In this regard, the April reading of CPI should provide some clarity around this. In March, headline CPI jumped to 8.5% in annual terms, its highest level in 40-years. Core-CPI rose to 6.5% also. However, due to favourable base effects, the consensus is for both rates to ease to 8.1% and 6.0%, respectively. Elsewhere in the US, the May reading of the University of Michigan Consumer Sentiment survey will be released. The index moved slightly higher in April, albeit from very subdued levels. However, it is anticipated to fall once again in May, as high inflation and equity market weakness weigh on consumer confidence.
- **In the Eurozone, industrial production is forecast to decline by 1% in March, as German industrial production plunged by 3.5% in the month.** Elsewhere, the German ZEW (May) is expected to decline for the third month running.



	Interest Rate Forecasts			
	Current	End Q2	End Q3	End Q4
	2022			
Fed Funds	0.875	1.375	2.125	2.625
ECB Deposit	-0.50	-0.50	0.00	0.25
BoE Repo	1.00	1.25	1.50	1.75
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	End Q3	End Q4
	2022			
EUR/USD	1.0564	1.04	1.05	1.06
EUR/GBP	0.8567	0.85	0.86	0.87
EUR/JPY	137.81	138	142	143
GBP/USD	1.2328	1.22	1.22	1.22
USD/JPY	130.43	133	135	135

Current Rates Reuters, Forecasts AIB's ERU

Date	UK & Irish Time	Release	Previous	Forecast
This Week:	ECB Speakers:	de Guindos (Tue); Lagarde , Schnabel (Wed); Schnabel, de Guindos (fri)		
	BoE Speakers:	Saunders (Mon)		
	Fed Speakers:	Williams, Kashkari, Mester, Waller (Tue); Bostic (Wed); Daly (Thu); Kashkari (Fri)		
Mon 9th	CHINA: 04:00	Trade Balance (April)	+\$47.4bn	+\$50.7bn
		- Exports	+14.7%	+3.2%
	EU-19: 09:30	EU Sentix Index (May)	-18.0	-20.8
Tue 10th	ITA: 09:00	Industrial Output (March)	+4.0% (+3.3%)	-2.0% (+0.4%)
	GER: 10:00	ZEW Economic Sentiment (May)	-41.0	-42.5
	US: 11:00	NFIB Business Optimism (April)	93.2	
Wed 11th	CHINA: 02:30	CPI (April)	+0.0% (+1.5%)	+0.2% (+1.9%)
	GER: 07:00	Final HICP (April)	+0.7% (+7.8%)	+0.7% (+7.8%)
	US: 13:30	CPI (April)	+1.2% (+8.5%)	+0.2% (+8.1%)
		- Core-CPI	+0.3% (+6.5%)	+0.4% (+6.0%)
Thu 12th	UK: 00:01	RICS Housing Survey (April)	74	
	UK: 07:00	Goods Trade Balance (March)	-£20.6bn	
		- Non-EU	-£12.1bn	
	UK: 07:00	GDP (Q1: First Reading)	+1.1% (+6.6%)	+1.0% (+9.0%)
	UK: 07:00	GDP (March)	+0.1% (+9.5%)	+0.1% (+6.8%)
	UK: 07:00	Industrial Output (March)	-0.6% (+1.6%)	+0.1% (+0.4%)
		- Manufacturing Output	-0.4% (+3.6%)	+0.0% (+1.7%)
	IRL: 11:00	CPI Inflation (April)	+1.9% (+6.7%)	+1.1% (+7.2%)
	US: 13:30	Initial Jobless Claims (w/e 2nd May)	+200,000	+203,000
	US: 13:30	PPI Final Demand (April)	+1.4% (+11.2%)	+0.5% (+10.7%)
		- Ex-Food & Energy	+1.0% (+9.2%)	+0.6% (+8.9%)
Fri 13th	FRA: 07:45	Final HICP (April)	+0.5% (+5.4%)	+0.5% (+5.4%)
	SPA: 08:00	Final HICP (April)	-0.2% (+8.3%)	-0.2% (+8.3%)
	EU-19: 10:00	Industrial Production (March)	+0.7% (+2.0%)	-1.0% (-0.8%)
	US: 15:00	Preli. Uni. Michigan Consumer Sentiment (May)	65.2	63.6

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

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