Weekly Market Brief

AIB Treasury Economic Research Unit

5th – 9th September 2022

Cracking the Whip

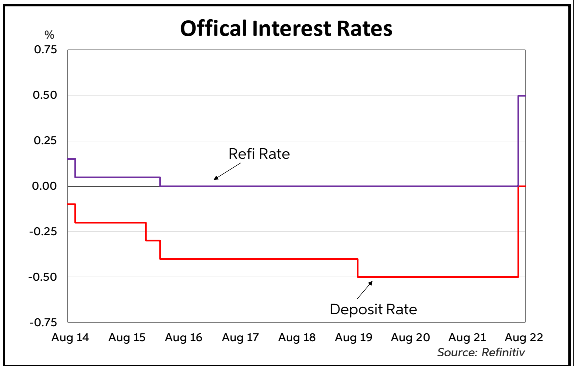
- **It has been a rough few weeks on financial markets.** Both the S&P 500 index in the US and Euro STOXX 50 are down by close to 10% since mid-August. Ten-year US Treasury yields have risen from 2.6% to 3.25% since the start of August, with ten-year German Bund yields climbing from 0.7% to 1.5%, and yields on ten-year UK Gilts soaring from 1.75% to 2.9%. The catalyst has been a marked hardening of interest rate hike expectations on the back of a worsening inflation outlook, as wholesale gas prices in particular continued to surge over the summer. Central bankers have been making it crystal clear that their number one objective is bringing inflation back down to its 2% target, not the rising recessionary risks facing economies.

- **Thus, the optimism in markets earlier in the summer that slowing economic growth would lessen the amount of rate tightening that central banks need to do has been crushed in recent weeks.** US rates are now seen rising to a peak of 4% by next spring compared to 3.25% a month ago. ECB rates are expected to get to 2.25% my mid-2023 compared to the 1% seen previously in early August. They are currently at zero. Meantime, UK rates are seen reaching 4.5% next summer, compared to the 3% peak expected a few weeks ago. It is difficult to square rates rising to higher levels in the UK than elsewhere, given the economy is expected to be one of the weakest performing in the G20 and Bank of England projections show that very weak economic growth will eventually see inflation fall below target.

- **Continuing robust labour market data have provided central banks with a window to continue to tighten policy aggressively in the coming months.** The number unemployed in the Eurozone fell to an all-time low in July, with the jobless rate declining to 6.6%. In the US and the UK, the unemployment rate is at close to fifty year lows, at 3.7% and 3.8%, respectively. Job growth remains very robust in the US, with payrolls averaging gains of 378k in the past three months. Meanwhile, job vacancies also remain exceptionally high. Thus, the only debate in markets at present is whether central banks will hike in 50bps or 75bps steps at their meetings over the balance of the year.

- **Not only that, the US Fed in particular has been indicating that rates will need to be kept higher for longer to squeeze inflationary pressures out of the system.** Fed Chair Powell, recently warned that policy will need to be restrictive for some time, with the historical record cautioning strongly against prematurely loosening monetary policy. Thus, markets now look for US rates to end 2023 in a 3.5-3.75% range compared to the circa 2.75% level expected at the start of August. Eurozone rates are now expected to stay above 2% post 2023 for many years to come, while US and UK rates are expected to settle at 3% or slightly above, over the longer term. The Fed Chair is probably correct that central banks will need to maintain a restrictive monetary policy stance for a period, likely until end 2023. Much weaker growth as a result of the combined energy shock and tighter interest rate policy, though, should see inflationary pressures eventually subside, opening the door for rates to move well below what markets currently anticipate post 2023.

- **This week, all eyes will be on the ECB monetary policy meeting on Thursday.** In July, the ECB raised its key interest rates by 50bps, bringing its negative interest rate strategy, which had been in place since 2014, to an end. The central bank decided to frontload its exit from negative interest rates by opting for a larger 50bps increase, "to make a transition to a meeting-by-meeting approach to interest rate decisions". In this regard, the ECB has dropped its explicit forward guidance regarding the pace of future rate increases, although, it has noted that further rate hikes should be expected.



- **Recent hawkish rhetoric from a number of Governing Council members, suggest the ECB may choose to continue frontloading rate hikes as it moves to normalise monetary policy.** A 75bps rate hike this week has been mooted. In a recent speech though, ECB Chief Economist Lane advocated for a "steady pace" of rate hikes, suggesting that a second consecutive 50bps increase may be in the offing. However, another above consensus increase in HICP inflation has seen market pricing move more in favour of the larger 75bps move. Current pricing suggests there is an 70% chance the ECB will raise rates by 75bps. Elsewhere, the latest ECB staff projections will be released this week, with the central bank likely to increase its inflation forecasts for this year and next, and lower its growth forecasts for 2022-23. At the press conference, President Lagarde can expect to face questions regarding the challenges of raising rates quickly to bring inflation down, without completely stifling the Eurozone economy.

- **In terms of data releases next week, there is a relatively quiet schedule ahead.** Meanwhile in the US, the non-manufacturing ISM is forecast to fall to 54.9 from 56.7. Eurozone retail sales are projected to rise by 0.4% in July.

Interest Rate Forecasts

	Current	End Q3 2022	End Q4 2022	End Q1 2023
Fed Funds	2.375	2.875	3.375	3.625
ECB Deposit	0.00	0.50	1.00	1.25
BoE Repo	1.75	2.25	3.00	3.25
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 Q3 2022	End Q4 2022	End Q1 2023
EUR/USD	1.0008	1.02	1.03	1.05
EUR/GBP	0.8645	0.85	0.85	0.86
EUR/JPY	140.30	140	141	142
GBP/USD	1.1574	1.20	1.21	1.22
USD/JPY	140.17	137	137	135

Current Rates Reuters, Forecasts AIB's ERU

ECONOMIC DIARY

Monday 5th - Friday 9th September

AIB Treasury Economic Research

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Date		UK & Irish Time	Release	Previous	Forecast
This Week:	ECB Speakers:				
	BoE Speakers:				
	Fed Speakers:		Mester, Brainard, Barr (Wed); **Powell,** Evans (Thu); Evans, Waller (Fri)		
			OPEC+ Meeting (5th - 6th September)		
Mon 5th	**US:**		***Labour Day (Market Holiday)***		
	IRL:	***01:01***	***AIB Services PMI (August)***	***56.3***	
	ITA:	08:45	S&P Composite PMI (August)	47.7	
	FRA:	08:50	Final S&P Composite PMI (August)	49.8	49.8
	GER:	08:55	Final S&P Composite PMI (August)	47.6	47.6
	EU-19:	09:00	Final S&P Composite PMI (August)	49.2	49.2
			- Final S&P Services PMI (August)	50.2	50.2
	EU-19:	09:30	Sentix Index (September)	-25.2	-27.5
	UK:	09:30	Final S&P/CIPS Composite PMI (August)	50.9	50.9
			- Final S&P/CIPS Services PMI (August)	52.5	52.5
	EU-19:	10:00	Retail Sales (July)	-1.2% (-3.7%)	+0.4% (-0.7%)
Tue 6th	**US:**	14:45	Final S&P Composite PMI (August)	45.0	45.0
			- Final S&P Services PMI (August)	44.1	44.1
	US:	15:00	Non-Manufacturing ISM (August)	56.7	54.9
Wed 7th	**CHINA:**	04:00	Trade Balance (August)	+$101.3bn	+$93.0bn
			- Exports	(+18.0%)	(+13.0%)
	GER:	07:00	Industrial Output (July)	+0.4% (-0.4%)	-0.2% (-1.4%)
	UK:	07:00	Halifax House Prices (August)	-0.1% (+11.8%)	
	ITA:	09:00	Retail Sales (July)	-1.1% (+1.4%)	
	EU-19:	10:00	Employment (Q2: Final Reading)	+0.3% (+2.4%)	+0.3% (+2.4%)
	EU-19:	10:00	GDP (Q2: Final Reading)	+0.6% (+3.9%)	+0.6% (+3.9%)
	US:	13:30	International Trade (July)	-$79.6bn	-$70.5bn
Thu 8th	**UK:**	00:01	RICS Housing Survey (August)	63	61
	JPN:	00:50	GDP (Q2: Revised Reading)	+2.2% s.a.a.r.	+2.9% s.a.a.r.
	JPN:	06:00	Economy Watchers Poll (August)	43.8	
	IRL:	***11:00***	***CPI Inflation (August)***	***+0.4% (+9.1%)***	***+0.1% (+8.6%)***
			- HICP Inflation	***+0.4% (+9.6%)***	***+0.1% (+8.9%)***
	EU-19:	13:15	ECB Deposit Rate Announcement	+0.00%	+0.50%
			- Refi Rate	+0.50`%	+1.00%
	EU-19:	13:45	ECB Press Conference		
	US:	13:30	Initial Jobless Claims (w/e 29th August)	+232,000	+243,000
Fri 9th	**CHINA:**	02:30	CPI Inflation (August)	+0.5% (+2.7%)	+0.2% (+2.8%)
	CHINA:	02:30	PPI Inflation (August)	(+4.2%)	(+3.1%)
	FRA:	07:45	Industrial Output (July)	+1.4%	-0.5%

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