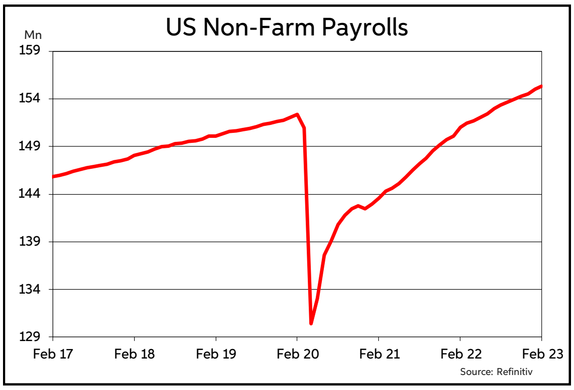
Weekly Market Brief

AIB Treasury Economic Research Unit

3rd – 7th April 2023

Reversal of Fortune

- **Interest rates have been a key driver of currency markets in the past couple of years.** The dollar was in the ascendancy from mid-2021 through to autumn 2022, as a rapid pace of increase in US interest rates, and rising US bond yields drove the currency higher. It rose by circa 25% in trade-weighted terms during this period, making significant gains against a broad range of currencies. The final quarter of 2022 through to end January 2023, though, saw a change in the dollar's fortunes. It lost significant ground as other central banks stepped up the pace of rate tightening, with 75bps hikes becoming the norm, boosting currencies like the euro and sterling. Meanwhile, in marked contrast to other central banks, the BoJ continued with its very accommodative policy in 2022, keeping the key official rate in negative territory. Widening interest rate differentials saw severe downward pressure on the yen, which fell to over 30-year lows against the dollar in the autumn, with the US currency rising above ¥150.
- **More recently, most of the major currency pairs have been relatively range bound, despite significant volatility on financial markets.** Expectations that interest rates would go even higher than previously anticipated evaporated everywhere, following the emergence of stresses in parts of the banking system, and the associated risk of tighter credit conditions. The market view now, is that we are near the end of the tightening cycle, with rates cuts being priced in for the US in the second half of this year. Against this changing backdrop, EUR/USD has been confined to a narrow $1.05-1.10 range in Q1, while GBP/USD has traded between $1.18-1.24, with the yen moving in a wider ¥128-138 corridor.
- **While the dollar is now well below the 20-year highs hit last September, it still remains at elevated levels.** The stresses that have emerged in parts of the global banking system recently could have a bigger impact on the US economy than elsewhere, as it is likely to experience a more pronounced tightening of credit conditions, given the uncertainties around deposits flows in small to medium-sized US regional banks. Hence, markets see rate cuts being implemented in the US later this year, well ahead of elsewhere. The extent of Fed easing is also expected to be greater than in most other economies. Markets see US rates falling below UK levels next year and the Fed's own rate guidance suggests that the current wide gap between US and Eurozone rates could be largely eliminated by 2025.
- **As already noted, interest rates have been a key driver of currencies in the past number of years.** Thus, if US rates start to be cut later this year, before elsewhere, then the dollar could be expected to lose ground, especially given that it is still at an elevated level. Meantime, in terms of the euro, the ECB continues to attach a very high importance to getting inflation back down to its 2% target, meaning it will be slow to ease policy. Overall, if markets are correct in their pricing of the future course of interest rates, then EUR/USD could rise to around the $1.13 level later this year and make further gains against the dollar in 2024 as the gap between US and Eurozone rates narrows.
- **This week, the main release of note will be the latest US labour market report.** The pace of job creation has gathered steam so far in 2023. Payrolls rose by 504k in January and by 311k in February, up from an average of 284k in Q4. The unemployment rate remains very low also, standing at 3.6% in February. Thus, conditions in the labour market are very tight. However, despite the tight conditions in the US job's market, wage growth has slowed slightly in recent months. Monthly average earnings rose by 0.4% during Q4, 0.3% in January, and by 0.2% in February. As the year progresses, the Fed anticipates that supply and demand conditions in the labour market will come into better balance, "easing upward pressure on wages and prices". In March, payrolls are forecast to rise by 240k, while the unemployment rate is expected to be unchanged at 3.6%. Meanwhile, a 0.3% increase in average earnings is pencilled in for the month, resulting in a modest fall in the year-on-year rate to 4.3% from 4.6% in February.



- **Elsewhere in the US, the manufacturing and non-manufacturing ISMs are due.** In recent months, the services sector has been outperforming manufacturing. The non-manufacturing ISM has printed comfortably in expansion mode near 55 in January and February, while the manufacturing ISM has been in contractionary territory. Both indices are forecast to deteriorate slightly in March, but the recent trend is set to continue, with the non-manufacturing ISM remaining well above 50, at 54.5, and the manufacturing ISM below 50, at 47.5.
- **There is a quiet data schedule in the Eurozone and UK this week.** Meantime, on the home front, the PMIs, unemployment rate and Exchequer Returns for March, will provide a timely update on the Irish economy.

Interest Rate Forecasts

	Current	End Q2 2023	End Q3 2023	End Q4 2023
Fed Funds	4.875	5.125	5.125	4.625
ECB Deposit	3.00	3.50	3.50	3.50
BoE Repo	4.25	4.50	4.50	4.50
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	1.0883	1.09	1.11	1.13
EUR/GBP	0.8793	0.88	0.88	0.88
EUR/JPY	144.75	140	139	138
GBP/USD	1.2373	1.24	1.26	1.28
USD/JPY	133.00	128	125	122

Current Rates Reuters, Forecasts AIB's ERU

ECONOMIC DIARY

Monday 3rd - Friday 7th April

AIB Treasury Economic Research

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Date		UK & Irish Time	Release	Previous	Forecast
This Week:	**ECB Speakers:**		Lane (Wed)		
	BoE Speakers:		Pill, Tenreyro (Tue)		
	Fed Speakers:		Mester (Tue); Bullard (Fri)		
Mon 3rd	***IRL:***	***01:01***	***AIB Manufacturing PMI (March)***	***51.3***	
	EU-20:	09:00	Final S&P Manufacturing PMI (March)	47.1	47.1
	UK:	09:30	Final CIPS / S&P Manufacturing PMI (March)	48.0	48.0
	US:	14:45	Final S&P Manufacturing PMI (March)	49.3	49.3
	US:	15:00	Manufacturing ISM (March)	47.7	47.5
Tue 4th	**GER:**	07:00	Trade Balance (February)	+€16.7bn	+€17.0bn
			- Exports	+2.1%	+1.4%
	EU-20:	10:00	Producer Prices (February)	-2.8% (+15.0%)	-0.3% (+13.5%)
	US:	15:00	Factory Orders (February)	-1.6%	-0.5%
			- Ex-Transport	+1.2%	
	US:	15:00	JOLTS Job Openings (February)	+10.8mn	
	IRL:	***16:30***	***Exchequer Returns (March)***	***March'22: +€0.2bn***	***+€0.8bn (Ex-NRF Transfer)***
Wed 5th	***IRL:***	***01:01***	***AIB Services PMI (March)***	***58.2***	
	JPN:	01:30	Final Jibun Composite PMI (March)	51.9	
	FRA:	07:45	Industrial Output (February)	-1.9%	+0.6%
	ITA:	08:45	S&P Composite PMI (March)	52.2	
	FRA:	08:50	Final S&P Composite PMI (March)	54.0	54.0
	GER:	08:55	Final S&P Composite PMI (March)	52.6	52.6
	EU-20:	09:00	Final S&P Composite PMI (March)	54.1	54.1
			- Final S&P Services PMI (March)	55.6	55.6
	UK:	09:30	Final CIPS / S&P Composite PMI (March)	52.2	52.2
			- Final CIPS/ S&P Services PMI (March0	52.8	52.8
	IRL:	***11:00***	***Unemployment Rate (March)***	***4.3%***	***4.3%***
	US:	13:15	ADP Employment (March)	+242,000	+200,000
	US:	14:45	Final S&P Composite PMI (March)	53.3	53.3
			- Final S&P Services PMI (March)	53.8	53.8
	US:	15:00	Non-Manufacturing ISM (March)	55.1	54.5
Thu 6th	**GER:**	07:00	Industrial Output (February)	+3.5% (-1.2%)	+0.1% (-1.5%)
	US:	13:30	Initial Jobless Claims (w/e 27th March)	+198,000	
Fri 7th	**IRL/US/EU-20/UK:**		**Good Friday (Market Holiday)**		
	FRA:	07:45	Trade Balance (February)	-€13bn	
			- Exports	+€49.4bn	
	US:	13:30	Non-Farm Payrolls (March)	+311,000	+240,000
			- Unemployment Rate	3.6%	3.6%
			- Average Earnings	+0.2% (+4.6%)	+0.3% (+4.3%)

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