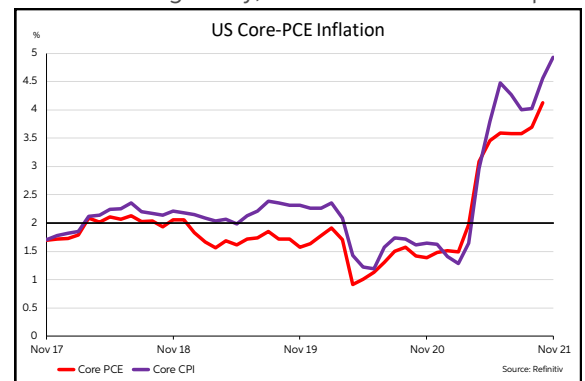


## We Have a Problem

- The outcome of the policy meetings held by three of the world's main central banks this week was a distinct pivot towards tighter monetary conditions to a greater degree than had been expected.** The Fed, as it had signalled, will wind down its bond buying programme at a much more rapid pace in the coming months and bring it to conclusion by March. This paves the way for it to begin raising rates within the following couple of months. The tightening path, as anticipated by the Fed, is quite aggressive though, with three 25bps hikes signalled for both 2022 and 2023 and two more in 2024, taking the funds rate to 2.125%. This is far greater than the market has priced in. It sees rates getting to a 1.5-1.625% range by end 2024. Meanwhile, the BoE surprised markets by hiking rates by 0.15% to 0.25%. The ECB then followed up with a bigger rundown plan for its asset purchases than had been anticipated.
- These decisions were all taken against the backdrop of a rising threat to global growth prospects in 2022 from the new variant of Covid-19, Omicron, that is proving highly transmissible.** This is forcing countries to re-impose restrictions curtailing economic activity as case numbers soar. Thus, central banks are not taking lightly, the decisions to withdraw monetary stimulus, given the circumstances. However, they are becoming increasingly concerned that the sharp rise in inflation this year is proving both more aggressive and persistent than had been anticipated, as evidenced in their latest forecasts. The Fed now sees the core PCE inflation rate averaging 4.4% in Q4 compared to 3.7% previously, while remaining well above its 2% target, at 2.7%, by Q4 2022. Meanwhile, the BoE, which only last month saw inflation topping out at around 5% in the spring, now sees the rate getting to 6%. Finally, the ECB is now forecasting that inflation will average 3.2% next year, almost double the previous forecast of 1.7% made in September.
- Markets, though, largely took the policy announcements in their stride, with little fall out for equities, bonds or currencies.** Stock markets remain at elevated levels, while bond yields are close to historic lows. They may be taking a more benign view of the inflation outlook than central banks. Monetary authorities, though, are clearly worried that there is a risk of high inflation becoming embedded in economies, with labour markets tightening rapidly and wages picking up, as well as demand exceeding output amidst a large build-up of savings, but ongoing disruptions to production and supply chains. Inflation risks, then, certainly lie to the upside.
- Official interest rates are now starting to rise, but the wind down of large scale QE programmes is equally important.** These have injected an enormous amount of liquidity into markets over the past two years. However, we are beginning to see bouts of greater volatility and less liquidity in markets in recent weeks. These episodes could become more pronounced next year in the context of a tightening of global monetary conditions. Meanwhile, the long end of bond markets, especially in Europe, are in no way prepared if inflation proves sticky next year. Yields are either negative or just above zero in many countries. This is not a great starting point as rates start to rise globally, markets become less liquid and there is elevated uncertainty about the outlook for inflation.
- Turning to the week ahead, the focus will be on the Fed's preferred measure of inflation, the core-PCE deflator.** Headline and core-PCE inflation rose to 5% and 4.1% respectively, on the back of broad based price increases in October. Meanwhile, in November, CPI inflation rose to near 40 year highs, with the headline and core rates jumping to 6.8% and 4.9%. This has led the Fed to stop describing the causes of inflation as transitory. The consensus is for prices to rise by circa 0.5% in November, lifting the PCE deflator to 5.6%, and core-PCE inflation to 4.5%.
- Elsewhere in the US, the latest consumption and income data are due.** Another month of solid spending growth is anticipated, with consumer spending forecast to rise by 0.6% in November, while personal income is projected to grow more slowly, increasing by 0.4%. We will also get an update on the housing market, in the form of existing and new home sales, with both segments of the market expected to rise once again in November. The final reading of Q3 GDP is set to confirm that the economy expanded by 2.1% in annualised terms. In terms of survey data, the Conference Board measure of consumer confidence is forecast to edge slightly higher in December, having declined sharply since mid-year.
- In Europe, the macro schedule is quite bare as markets prepare to wind down for Christmas.** The only release of note in the Eurozone, is the flash consumer confidence reading for December. It is envisaged that sentiment will decline for the third month in-a-row, owing to concerns regarding the Omicron variant. **Lastly in the UK, the final reading of Q3 GDP is expected to confirm the economy grew by 1.3% in the quarter.**



|             | Interest Rate Forecasts |        |        |        |
|-------------|-------------------------|--------|--------|--------|
|             | Current                 | End Q1 | End Q2 | End Q3 |
|             |                         | 2022   | 2022   | 2022   |
| Fed Funds   | 0.125                   | 0.125  | 0.375  | 0.625  |
| ECB Deposit | -0.50                   | -0.50  | -0.50  | -0.50  |
| BoE Repo    | 0.25                    | 0.25   | 0.50   | 0.75   |
| 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 Q4 | End Q1 | End Q2 |
|         |  | 2021   | 2022   | 2022   |
| EUR/USD | 1.1304                                       | 1.12   | 1.11   | 1.11   |
| EUR/GBP | 0.8512                                       | 0.85   | 0.84   | 0.83   |
| EUR/JPY | 128.16                                       | 128    | 128    | 129    |
| GBP/USD | 1.3281                                       | 1.32   | 1.32   | 1.34   |
| USD/JPY | 113.36                                       | 114    | 115    | 116    |

Current Rates Reuters, Forecasts AIB's ERU

| Date              | UK & Irish Time         | Release                                    | Previous       | Forecast        |
|-------------------|-------------------------|--|----------------|-----------------|
| <b>This Week:</b> | <b>ECB Speakers:</b>    |  |                |                 |
|                   | <b>BoE Speakers:</b>    |  |                |                 |
|                   | <b>Fed Speakers:</b>    |  |                |                 |
| <b>Mon 20th</b>   | <b>UK:</b> 11:00        | CBI Trend Orders (Dec)                     | 26             |                 |
| <b>Tue 21st</b>   | <b>GER:</b> 07:00       | Gfk Consumer Sentiment (Jan)               | -1.6           | -2.5            |
|                   | <b>EU-19:</b> 15:00     | Flash Consumer Confidence (Dec)            | -6.8           | -8.0            |
| <b>Wed 22nd</b>   | <b>UK:</b> 07:00        | GDP (Q3: Final Reading)                    | +1.3% (+6.6%)  | +1.3% (+6.6%)   |
|                   | <b>FRA:</b> 07:45       | Producer Prices (Nov)                      | +2.9% (+14.9%) |                 |
|                   | <b>US:</b> 13:30        | GDP (Q3: Final Reading)                    | +2.1% s.a.a.r. | +2.1% s.a.a.r.  |
|                   | <b>US:</b> 13:30        | PCE Prices (Q3: Final Reading)             | +5.3%          | +5.3%           |
|                   |                         | - Core PCE Prices (Q3: Final Reading)      | +4.5%          | +4.5%           |
|                   | <b>US:</b> 15:00        | Existing Home Sales (Nov)                  | +6.34m / +0.8% | +6.50m / +2.5%  |
|                   | <b>US:</b> 15:00        | Conference Board Consumer Confidence (Dec) | 109.5          | 110.0           |
| <b>Thu 23rd</b>   | <b>GER:</b> 08:00       | GDP (Q3: Final Reading)                    | +2.0% (+2.7%)  | +2.0% (+2.7%)   |
|                   | <b>ITA:</b> 09:00       | ISTAT Business Confidence (Dec)            | 116.0          | 115.0           |
|                   | <b>ITA:</b> 09:00       | Consumer confidence (Dec)                  | 117.5          | 116.0           |
|                   | <b>US:</b> 13:30        | Personal Income / Consumption (Nov)        | +0.5% / +1.3%  | +0.4% / +0.6%   |
|                   |                         | - Core-PCE Prices                          | +0.4% (+4.1%)  | +0.4% / (+4.5%) |
|                   | <b>US:</b> 13:30        | Durable Goods (Nov)                        | -0.4%          | +1.5%           |
|                   |                         | - Ex-Transport                             | +0.5%          | +0.6%           |
|                   | <b>US:</b> 13:30        | Initial Jobless Claims (w/e 13th December) | +206,000       | +205,000        |
|                   | <b>US:</b> 15:00        | Final Uni. Michigan Sentiment (Dec)        | 70.4           | 70.4            |
|                   | <b>US:</b> 15:00        | New Home Sales (Nov)                       | +0.75m / +0.4% | +0.77m / +3.0%  |
| <b>Fri 24th</b>   | <b>IRL/UK/EU-19/US:</b> | <b>Christmas Eve (Early Market Close)</b>  |                |                 |

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