Weekly Market Brief

AIB Treasury Economic Research Unit

7th - 11th March 2022

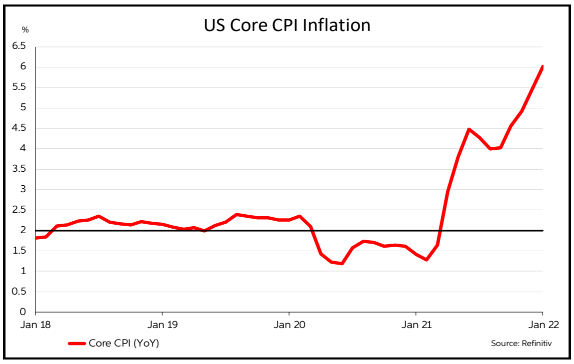
Euro in Retreat

- **It was a particularly volatile week in financial markets as they struggle to assess the implications for economies of the war in Ukraine, not to mention the major humanitarian crisis that is unfolding as each day passes.** It is clear that inflation will now rise even further in 2022, which has negative implications for growth in advanced economies. Markets agree, with European stock markets under pressure in particular. Meanwhile, there has been a scaling back of rate hike expectations in 2022 in all economies, though rates are still expected to be increased. Bond markets have rallied on the back of the more benign rate outlook, as well as a flight to quality into safer asset classes. Meanwhile, liquidity is poor in markets at present, making it difficult to execute trades and adding to volatility.

- **The Eurozone economy is more exposed than others to the crisis given its closer links with Russia, including its reliance on oil and gas imports from there.** Exports to Russia, including services, while not large, will be hit by trade sanctions. Real household incomes, and thus consumer spending will be impacted by the further surge in inflation. Uncertainty is an additional headwind for growth, especially as the conflict now seems likely to be drawn out. However, there are offsetting factors including a looser policy stance, with a slower pace to monetary tightening, as well as a more expansionary fiscal policy from increased military expenditure and spending on the refugee crisis. It is very difficult to quantify all the impacts, but some preliminary estimates from the ECB suggest that the crisis could reduce Eurozone GDP growth this year by 0.3-0.4%.

- **It is not surprising that a major war in Europe has resulted in the euro coming under some downward pressure.** Rate hikes are still imminent in the US and UK, but there are growing doubts about whether Eurozone rates will be increased at all this year. The past week has seen key euro supports of $1.11 against the dollar and 83p versus sterling give way. The euro has now fallen to near $1.09, its lowest level against the US currency in two years. It is nearly six years, going back to the 2016 Brexit referendum, since the single currency has traded below 83p against sterling. There is good support for the euro at around the $1.08 level that most notably held against a strong dollar in the first half of 2020. Versus sterling, the euro has support in the 80-82p trading range.

- **ECB monetary policy will have a crucial bearing on the currency.** In this regard, this week's Governing Council policy meeting is an important event. Having edged towards taking the first steps in normalising monetary policy at its last meeting, a difficult communication challenge awaits the central bank, as it tries to balance a higher inflation outlook with the still uncertain economic impact of the war in Ukraine. Indeed, inflation jumped to a new record high of 5.8% in February, and since then, energy prices, the main contributor to the surge in inflation, have risen further. However, the ECB is likely to avoid giving any clear policy guidance in the current highly uncertain environment.



- **The ECB will also publish a new set of macro forecasts.** There will be considerable interest in regard to the central bank's medium-term projections on inflation. If the HICP rate is forecast to settle around the 2% target level by end 2024. This would question the need for the continuation of the ECB's non-standard policy measures over the next couple of years. Thus, while futures contracts have scaled back their rate hike expectations, they still see an end to the negative interest rate regime next year. Negative interest rates have proved a major headwind for the euro since they were introduced in 2014. While it is out of favour at the present time, inflation and its impact on monetary policy is likely to be a key driver of the longer-term prospects for the single currency.

- **In the UK, the monthly reading of GDP for January is the main release of note.** In December, GDP declined by 0.2%, as a mixture of restrictions and increased cases/self-isolation weighed on activity. However, output is projected to rise at the start of the year, increasing by 0.2% in the month, as Omicron started to recede. Meanwhile, industrial production is forecast to rise by 0.3% in January.

- **In the US, the latest CPI inflation data will garner close attention.** The Fed has become more concerned by inflation recently and as a result, the market expects an aggressive tightening path from the central bank in response. Headline CPI rose to 7.5% in January, while core-CPI inflation surged to 6.0% from 5.5%. This week, headline CPI is forecast to rise by 0.8% in the month, lifting the year-on-year rate to 7.9%. The core-rate is projected to jump by 0.6% in February, with the annual reading accelerating to 6.4%. Elsewhere, the Michigan measure of consumer sentiment is expected to edge lower to 61.3 in March from 62.8.

Interest Rate Forecasts

	Current	End Q1 2022	End Q2 2022	End Q3 2022
Fed Funds	0.125	0.375	0.875	1.375
ECB Deposit	-0.50	-0.50	-0.50	-0.50
BoE Repo	0.25	0.75	1.00	1.25
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 Q1 2022	End Q2 2022	End Q3 2022
EUR/USD	1.0909	1.10	1.11	1.12
EUR/GBP	0.8248	0.82	0.83	0.83
EUR/JPY	125.41	126	127	128
GBP/USD	1.3224	1.34	1.34	1.35
USD/JPY	114.94	115	114	114

Current Rates Reuters, Forecasts AIB's ERU

ECONOMIC DIARY
Monday 7th - Friday 11th March

AIB Treasury Economic Research

Oliver Mangan Chief Economist

John Fahey Senior Economist

Daniel Noonan Economist

Date	*UK & Irish Time*		*Release*	*Previous*	*Forecast*
This Week:	**ECB Speakers:**		**Lagarde** (Mon); **Lagarde,** Schnabel, de Guindos (Wed)		
	BoE Speakers:		Cunliffe (Mon)		
	Fed Speakers:				
Mon 7th	**CHINA:**	03:00	Trade Balance (February)	+$94.5Bn	+$99.5Bn
			- Exports	(+20.9%)	(+15.0%)
	UK:	07:00	Halifax House Prices (February)	+0.3% (+9.7%)	
	GER:	07:00	Industrial Orders (January)	+2.8%	+1.0%
	GER:	07:00	Retail Sales (January)	-5.5% (+0.0%)	+1.5% (+9.5%)
	EU-19:	09:30	EU Sentix Index (March)	16.6	10.0
Tue 8th	**GER:**	07:00	Industrial Output (January)	-0.3% (-4.2%)	+1.5% (+9.5%)
	ITA:	09:00	Retail Sales (January)	+0.9% (+9.4%)	
	EU-19:	10:00	Employment (Q4: Final Reading)	+0.5% (+2.1%)	+0.5% (+2.1%)
	EU-19:	10:00	GDP (Q4: Final Reading)	+0.3% (+4.6%)	+0.3% (+4.6%)
	US:	11:00	NFIB Business Optimism (February)	97.1	
	US:	13:30	International Trade (January)	-$80.7Bn	-$87.0Bn
	JPN:	23:50	GDP (Q4: Revised Reading)	+5.4% s.a.a.r.	+5.6 s.a.a.r.
Wed 9th	**CHINA:**	01:30	CPI (February)	+0.4% (+0.9%)	+0.3% (+0.8%)
	CHINA:	01:30	PPI (February)	(+9.1%)	(+8.7%)
	ITA:	09:00	Industrial Output (January)	-1.0% (+4.4%)	+0.0% (+2.9%)
	US:	15:00	JOLTS Job Openings (January)	+10.9m	+10.6m
Thu 10th	**UK:**	00:01	RICS Housing Survey (February)	74	72.5
	UK:	07:00	Goods Trade Balance (January)	-£12.5bn	-£13.28bn
	IRL:	***11:00***	***CPI Inflation (February)***	***-0.4% (+5.0%)***	***+1.2% (+5.9%)***
	EU-19:	12:45	ECB Refi Rate Announcement	+0.00%	+0.00%
			- Deposit Rate	-0.50%	-0.50%
	EU-19:	13:30	ECB Press Conference		
	US:	13:30	CPI Inflation (February)	+0.6% (+7.5%)	+0.8% (+7.9%)
			- Core CPI	+0.5% (+6.0%)	+0.5% (+6.4%)
	US:	13:30	Initial Jobless Claims (w/e 28th February)	+215,000	+205,000
Fri 11th	**UK:**	07:00	GDP (January)	-0.2%	+0.2%
			- 3m/3m	+1.0%	+0.8%
	UK:	07:00	Industrial Output (January)	+0.3% (+0.4%)	+0.3% (+1.9%)
			- Manufacturing Output (January)	+0.2% (+1.3%)	+0.2% (+3.1%)
	GER:	07:00	Final HICP Inflation (February)	+0.9% (+5.5%)	+0.9% (+5.5%)
	SPA:	08:00	Final HICP Inflation (February)	+0.7% (+7.5%)	+0.7% (+7.5%)
	US:	15:00	Preli. Uni. Michigan Consumer Sentiment (Mar)	62.8	61.3

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