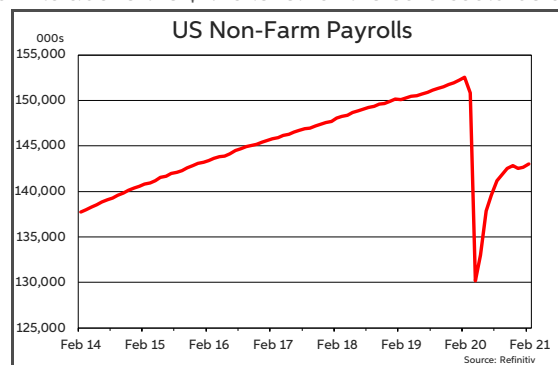


Euro Needs Vaccine Boost

- **The most significant change in financial markets in the first quarter of 2021 has been the marked hardening of interest rate expectations in the US and the consequent sharp rise in long term bond yields.** The expectation in markets at the end of last year was that US interest rates would be raised very, very slowly, with three month rates only getting to 1% by the end of 2025. Now, markets see wholesale rates rising to over 2% by end 2025, which implies almost 200bps of rate tightening, starting in the second half of next year. Not surprisingly, this has put upward pressure on bonds yields, with ten year Treasury yields climbing from 0.9% to as high as 1.7% in the past three months.
- **The main factor behind the expectations for higher rates is the marked upgrade to US growth prospects for 2021 and 2022, thanks to the enormous Biden fiscal stimulus package, as well as the rapid roll out of vaccines.** The firming in rate expectations has been much less pronounced in other markets, most notably in the Eurozone and Japan. Even in the UK where futures contracts have hardened, markets see rates rising by less than 100bps between now and end 2025, far less than in the US.
- **This upward pressure on US interest rates is impacting currency markets.** The dollar lost considerable ground during the second half of last year, partly due to the erosion of its significant interest differential over most other markets. It was expected that the dollar would remain under downward pressure in 2021, given the relatively stable outlook for interest rates prevailing at the start of the year. The dollar, though, has rallied over the first quarter in line with rising US interest rates. This has seen the euro drop back below the \$1.18 level from \$1.23 at the start of the year. The market is still very short the US currency so further gains could be in store for the dollar as these positions are closed out.
- **We had expected that EUR/USD would spend most of this year trading in a \$1.20-1.25 range, but the changes in market rate expectations make this seem unlikely.** Vaccinations are becoming an important influencer in currency markets as they are a key driver of economic growth prospects and interest rate expectations. A look back at the recent past illustrates just how potent a rising US interest rate differential vis-a-vis the euro can be. In early 2018, the US Fed increased the pace of rate hikes, with the Fed Funds rate rising from 1.5% to 2.5% in the year, while the ECB rate remained rooted at -0.4%. Meanwhile, the 10 year Treasury-Bund spread widened by 90bps at one point, with the euro falling from just below the \$1.25 level in January 2018, to \$1.13 by the end of the year.
- **Fresh lockdowns in the Eurozone have put the euro under pressure in the past week.** There is good support for the euro in the \$1.16-1.18 range. However, for this to hold, the EU will need to deliver on its promise to step up the pace of Covid vaccinations considerably in the second quarter. Even then, the US is racing ahead of the EU in its economic recovery, making it difficult to see a narrowing of US-Euro interest rate spreads anytime soon. Overall, a return to above the \$1.20 level for the euro could be a difficult challenge this year.
- **Turning to the week ahead, the main highlight will be the latest US labour market report, due on Good Friday.** In February the labour market recovery picked up pace, having stalled throughout the winter months. The consensus is for the upward trend to gain momentum in March, with payrolls forecast to rise by 655k (vs. 379k previous). However, this would still leave payrolls close to 9m below their pre-pandemic levels. The jobless rate is expected to edge slightly lower to 6.0% from 6.2%. Elsewhere, consumer confidence is projected to rise to 96.0 from 91.3 in March, as the rapid pace of the vaccine rollout programme and substantial recent fiscal transfers to households boosts economic sentiment. Meanwhile, the manufacturing ISM for March is expected to edge higher to 61.2 from 60.8.
- **In the Eurozone, flash HICP inflation for March is due.** The forecast is for the headline rate to rise to 1.3% from 0.9%. However, the ex-food & energy measure is projected to remain unchanged at 1.2%, as underlying price pressures remain weak. Indeed the latest staff projections from the ECB foresees inflation climbing to around a 2% peak this year, before slipping to an average rate of 1.2% in 2022, and 1.4% in 2023, well below the central bank's 2% target. The German measure of HICP inflation though, is expected to rise to 2.0%, owing to the ending of the VAT cut, higher energy prices and a new carbon tax. The EC sentiment indices will also be released. The headline index is projected to continue its recent upward trend in March, rising to 96.0 from 93.4. However, a wide divergence between sectors is likely to remain, as restrictions continue to more adversely affect the services than manufacturing. On a national level, retail sales in Germany (Feb) and unemployment rate (March) will be released.
- **In the UK, Nationwide house prices (March) and the third reading of Q4 GDP are the only noteworthy items set to be released.** On the home front, we will get an update on the jobs market and public finances, while retail sales are also due.



	Interest Rate Forecasts			
	Current	End Q2	End Q3	End Q4
		2021	2021	2021
Fed Funds	0.125	0.125	0.125	0.125
ECB Deposit	-0.50	-0.50	-0.50	-0.50
BoE Repo	0.10	0.10	0.10	0.10
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
		2021	2021	2021
EUR/USD	1.1798	1.17	1.18	1.19
EUR/GBP	0.8549	0.85	0.86	0.87
EUR/JPY	129.38	129	129	129
GBP/USD	1.3799	1.38	1.37	1.37
USD/JPY	109.66	110	109	108
Current Rates Reuters, Forecasts AIB's ERU				

Date	UK & Irish Time (GMT+1)		Release	Previous	Forecast
This Week:	ECB Speakers: BoE Speakers: Fed Speakers: Waller (Mon); Quarles, Williams (Tue); Harker (Thu)				
Mon 29th	UK:	09:30	Consumer Credit (February)	-£2.4bn	-£1.0bn
	UK:	09:30	Mortgage Approvals (February)	98,994	95,000
	EU-19:	10:00	Business Climate (March)	-0.14	
	IRL:	11:00	Retail Sales (February)	-21.8% (-14.1%)	+7% (-7.6%)
Tue 30th	JPY:	00:30	Jobs/Applicants Ratio (February)	1.10	1.10
	JPY:	00:30	Unemployment Rate (February)	2.9%	3.0%
	JPY:	00:50	Retail Sales (February)	(-2.4%)	(-2.8%)
	FRA:	07:45	Consumer Confidence (March)	91	90
	SPA:	08:00	Flash HICP (March)	-0.6% (+0.0%)	
	SPA:	08:00	Retail Sales (February)	(-9.5%)	
	EU-19:	10:00	Economic Sentiment (March)	93.4	96.0
			- Industrial / Services / Consumer	-3.3 / -17.1 / -10.8	0.0 / -14.5 / -10.8
	GER:	13:00	Flash HICP (March)	+0.6% (+1.6%)	+0.5%(+2.0%)
	US:	14:00	CaseShiller House Price Index (January)	+1.3% (+10.1%)	(+10.7%)
	US:	15:00	Consumer Confidence (March)	91.3	96.0
Wed 31st	JPN:	00:50	Industrial Production (February)	-1.0%	-1.2%
	CHINA:	02:00	NBS Manufacturing PMI (March)	50.6	51.0
	UK:	07:00	GDP (Q4: Third Reading)	+1.0% (-7.8%)	+1.0% (-7.8%)
	UK:	07:00	Nationwide House Prices (March)	+0.7% (+6.9%)	+0.5% (+5.8%)
	FRA:	07:45	Consumer Spending (February)	-4.6%	
	FRA:	07:45	Flash HICP (March)	(+0.8%)	(+1.3%)
	GER:	08:55	Unemployment Rate (March)	6.0%	6.0%
	EU-19:	10:00	Flash HICP (March)	+0.9% (+1.2%)	(+1.3%)
			- Ex-Food & Energy	(+1.2%)	(+1.2%)
	IRL:	11:00	Unemployment Rate (March)	5.8%	5.8%
			- Covid-19 Adjusted Rate	24.8%	24%
	ITA:	11:00	Flash HICP (March)	(+1.0%)	(+1.3%)
	US:	15:00	Pending Home Sales (February)	-2.8%	-2.6%
Thurs 1st	IRL:	01:01	AIB Manufacturing PMI (March)	52.0	
	GER:	07:00	Retail Sales (February)	-4.5% (-8.7%)	+2.0% (-4.0%)
	ITA:	08:45	Manufacturing PMI (March)	56.9	59.7
	EU-19:	09:00	Final Manufacturing PMI (March)	62.4	62.4
	UK:	09:30	Final Manufacturing PMI (March)	57.9	57.9
	US:	13:30	Initial Jobless Claims (w/e 22nd March)	+684,000	+690,000
	US:	14:45	Final Manufacturing PMI (March)	59.0	59.0
	US:	15:00	Construction Spending (February)	+1.7%	-0.9%
	US:	15:00	Manufacturing ISM (March)	60.8	61.2
Fri 2nd	IRL/UK/US/Most EU: Good Friday (Market Holiday)				
	US:	13:30	Non-Farm Payrolls (March)	+379,000	+655,000
			- Unemployment Rate	6.2%	6.0%
			- Average Earnings	+0.2% (+5.3%)	+0.1% (+4.6%)
	IRL:	16:30	Exchequer Returns (March)	Mar'20: -€2.5bn	-€4.5bn

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

All forecasts AIB ERU, historical data in the Economic Diary derived from publicly available sources

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