Weekly Market Brief

AIB Treasury Economic Research Unit

1st – 5th March 2021

On the Rebound

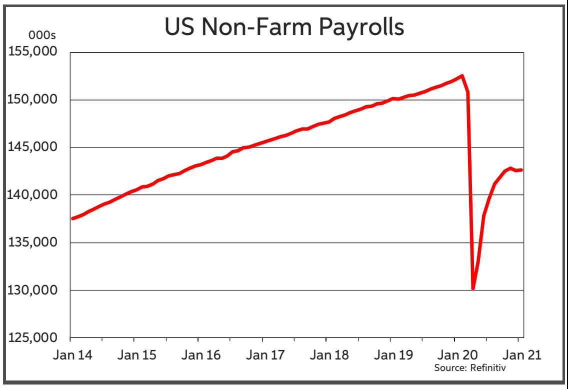
- **The Covid-19 pandemic has had a particularly severe impact on the UK economy, with GDP contracting by 10% in 2020, despite a strong rebound in activity during the second half of the year.** More recently, very weak retail sales data for January showed an 8.2% fall in the month, and PMI services data for the opening two months of the year have been downbeat. These suggest that with the economy back in lockdown, UK GDP is set to contract again in Q1 2021. However, it won't be anything on the scale of the fall in output seen during H1 2020. Large parts of the economy have remained open on this occasion, while many services businesses are better adapted to Covid restrictions via online sales, remote working etc. Furthermore, on the back of the rapid roll out of vaccines in the UK, with almost 30% of the population receiving at least one shot, and with Covid case numbers falling, the government has unveiled a plan to gradually reopen the economy in the coming months.

- **The impressive vaccine roll out should lay the basis for a strong and sustained rebound in UK economic activity from the second quarter onwards.** Thus, despite a decline in first quarter GDP, growth forecasts are quite upbeat for the UK. The IMF is predicting GDP growth of 4.5% for this year and 5% in 2022. The BoE is even more bullish, projecting GDP growth of 5% and 7.25% in 2021 and 2022, respectively. This positive economic outlook forms the backdrop for Chancellor Sunak's Budget on Wednesday. The deep recession has created an enormous hole in the public finances, with the budget deficit put at 18% of GDP in FY2020/21, far greater than elsewhere. Thus fiscal tightening will be required in the UK, but not just yet. The Chancellor will need to extend supports for the economy for a number of more months until it fully reopens. However, he could still signal in Wednesday's budget that fiscal tightening can be expected from 2022 onwards when the economy has returned to a sounder footing. There is speculation he could announce in the budget that the corporation tax rate will rise over the next few years.

- **Brighter economic prospects are reflected in markets no longer expecting additional monetary policy loosening from the BoE.** Futures contracts have moved to price out further rate cuts – a move to negative UK rates had been expected by markets until recently. Instead, markets are now beginning to contemplate when UK rates could start to rise. Short sterling contracts suggest we would see a 15bps hike in the bank rate to 0.25% in the latter part of 2022. At the start of the year, markets believed UK rates would not begin to rise from current levels until end 2025. Not surprisingly, like elsewhere the UK yield curve has also steepened, with 10 year gilt yields soaring by over 50bps to 0.8% in the past month.

- **Sterling has been a major beneficiary of the improved UK economic outlook as a result of the rapid roll out of vaccines there.** It has made significant gains in the opening two months of the year, with cable rising from \$1.35 to \$1.40 and the euro dropping back from 90p to below 87p. Brexit, though, could remain a lingering headwind for the currency. There are festering disputes with the EU around the financial services industry and Northern Ireland Protocol, while Brexit is also resulting in delays in supply chains and higher trade costs. Sterling still remains at relatively low levels. The negative effects of Brexit on trade and investment, could limit the upside potential of the currency from the good news story around vaccines and the rebounding economy.

- **This week, the highlight will be the US labour market report for February.** The jobs market recovery stagnated over the winter months, as payrolls increased by just 86k between November and January, despite being circa 10m below their pre-Covid level. Although, the unemployment rate has continued to edge lower, this masks the fact that there are 4 million fewer people in the labour force than before the pandemic began. Indeed, this week, Fed Chair Powell emphasised the grim state of the labour market in testimony to Congress. The consensus is for payrolls to rise by 148k in February. Meanwhile, the unemployment rate is forecast to edge higher to 6.4% from 6.3%. Elsewhere, both the manufacturing and non-manufacturing ISMs are expected to remain well above the 50 threshold in February.



- **In the Eurozone, the Flash reading of February HICP inflation will garner close attention.** The newly weighted headline index rose to 0.9% in January, up from –0.3% a month previous. However, this was largely due to base effects as the German VAT cut ended in December and energy prices recovered. The forecast is for the annual rate to edge up to 1.0% in February, while the core rate is predicted to fall from 1.4% to 1.1%. Meanwhile, producer prices for January are expected to rise by 1%, with the annual rate forecast to rise to –0.4% from –1.1%. Eurozone retail sales for January are also due. The consensus is for sales to fall by 1.1% in the month, as restrictions were tightened across the region. However, tighter restrictions are not believed to have impacted the labour market, with the Euro-area unemployment rate expected to remain at 8.3% in January.

- **There is a quiet data schedule in the UK.** However, on the home front February's PMI data, Exchequer Returns and unemployment rate are due. The national accounts for Q4 2020 will be released also, with a 3% rise in GDP expected in 2020.

Interest Rate Forecasts

	Current	End Q1 2021	End Q2 2021	End Q3 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 Q1 2021	End Q2 2021	End Q3 2021
EUR/USD	1.2119	1.20	1.22	1.24
EUR/GBP	0.8696	0.87	0.88	0.89
EUR/JPY	129.00	126	127	128
GBP/USD	1.3933	1.38	1.39	1.39
USD/JPY	106.45	105	104	103

Current Rates Reuters, Forecasts AIB's ERU

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ECONOMIC DIARY

Monday 1st - Friday 5th March

Date	*UK & Irish Time (GMT+1)*		*Release*	*Previous*	*Forecast*
This Week:	**ECB Speakers:**		**Lagarde** (Mon); Panetta (Tue); Panetta, de Guindos, Schnabel (Wed);		
	BoE Speakers:				
	Fed Speakers:		Brainard (Mon); Brainard (Tue); **Powell** (Thu)		
Mon 1st	**JPN:**	00:30	Final Jibun Manufacturing PMI (February)	50.6	
	IRL:	***01:01***	***AIB Manufacturing PMI (February)***	***51.8***	
	CHINA:	01:45	Final Caixin Manufacturing PMI (February)	51.5	51.5
	EU-19:	09:00	Final Manufacturing PMI (February)	57.7	57.7
	UK:	09:30	BoE Mortgage Approvals (January)	103,381	96,000
	UK:	09:30	Final Manufacturing PMI (February)	54.9	54.9
	ITA:	10:00	Flash HICP (February)	-0.9% (+0.7%)	
	IRL:	***11:00***	***Retail Sales (January)***	***+14.3% (+8.2%)***	***-25.0% (-17.5%)***
	GER:	13:00	Flash HICP (February)	+0.6% (+1.6%)	+0.6% (+1.6%)
	US:	14:45	Final Manufacturing PMI (February)	58.5	
	US:	14:45	Construction Spending (January)	+1.0%	+0.7%
	US:	15:00	Manufacturing ISM (February)	58.7	58.9
	JPN:	23:30	Unemployment rate (January)	2.9%	3.0
Tue 2nd	**GER:**	07:00	Retail Sales (January)	-9.6% (+1.5%)	-0.5% (-2.6%)
	UK:	07:00	Nationwide House Prices (February)	-0.3% (+6.4%)	
	GER:	08:55	Unemployment Rate (February)	6.0%	6.0%
	EU-19:	10:00	Flash HICP (February)	(+0.9%)	(+1.0%)
			- ex-Food & Energy	(+1.4%)	(+1.1%)
	IRL:	***16:30***	***Exchequer Returns (February)***	***Feb'20: +€1.0bn***	***+€0.0bn***
Wed 3rd	**JPN:**	00:30	Final Jibun Services PMI (February)	46.1	
	IRL:	***01:01***	***AIB Services PMI (February)***	***36.2***	
	CHINA:	01:45	Final Caixin Manufacturing PMI (February)	52.0	
	ITA:	08:45	Composite PMI (February)	47.2	
	FRA:	08:50	Final Composite PMI (February)	45.2	
	GER:	08:55	Final Composite PMI (February)	51.3	51.3
	ITA:	09:00	GDP (Q4:Final)	-2.0% (-6.6%)	-2.0% (-6.6%)
	EU-19:	09:00	Final Composite PMI (February)	48.1	48.1
			- Services	44.7	44.7
	UK:	09:30	Final Composite PMI (February)	49.8	49.8
			- Services	49.7	49.7
	EU-19:	09:00	Producer Prices (January)	+0.8% (-1.1%)	+1.0% (-0.4%)
	IRL:	***11:00***	***Unemployment Rate (February)***	***5.8%***	***5.8%***
			- Covid Adjusted Rate	***25.0%***	***25.0%***
	US:	14:45	Final Composite PMI (February)	58.8	
			- Services	58.9	
	US:	15:00	Non-Manufacturing ISM (February)	58.7	58.7
Thurs 4th	**EU-19:**	10:00	Retail Sales (January)	+2.0% (+0.6%)	-1.1% (-1.3%)
	EU-19:	10:00	Unemployment Rate (January)	8.3%	8.3%
	US:	13:30	Initial Jobless Claims (w/e 22nd February)	+927,000	+755,000
	US:	15:00	Factory Orders (January)	+1.1%	+1.9%
Fri 5th	**GER:**	07:00	Industrial Orders (January)	-1.9%	+1.0%
	UK:	08:30	Halifax House prices (February)	-0.3% (+5.4%)	
	IRL:	***11:00***	***National Accounts (Q4 2020)***		
			- GDP (Q4 2020)	***(+8.1%)***	***(+1.0%)***
	US:	13:30	Non-Farm Payrolls (February)	+49k	+148k
			- Unemployment Rate	6.3%	6.4%
			- Average Earnings	+0.2% (+5.4%)	+0.2% (+5.4%)
	US:	13:30	International Trade (January)	-$66.6bn	-$67.5bn
	US:	20:00	Consumer Credit (January)	$9.7bn	$12.0bn

♦ 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