Hawks in the Ascendancy

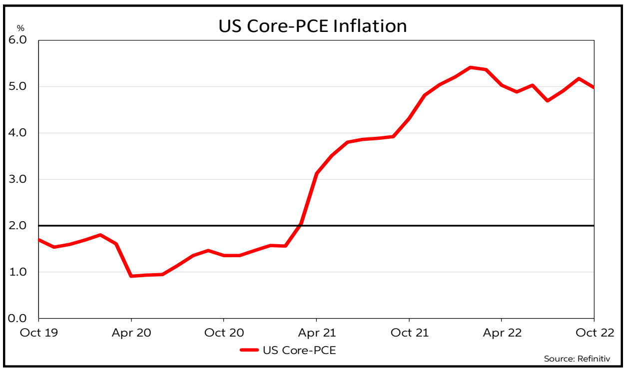
- **Markets could be in for more pain in 2023 after central banks re-asserted their inflation fighting credentials this week.** In particular, both the Fed and ECB signalled that markets have not built in enough tightening for next year and are too optimistic on the timing of a shift to policy loosening. Both central banks revised up their inflation forecasts and revised down their projections for GDP growth in 2023. Despite the weaker growth outlook, with stagnation now seen in the US economy and a technical recession in the Eurozone, inflation is expected to prove more persistent than previously anticipated. The clear message from both central banks was that rates will need to rise by more than markets expect and policy will have to remain restrictive for a prolonged period of time to return inflation back to its 2% target.

- **The most striking thing about the Fed is the strong bias among FOMC members to take rates above 5%; ten of the nineteen FOMC members see rates getting to 5.125%, while seven more see rates peaking above this level.** This is very much at variance with the market's view that rates will top out at 4.875%. Moreover, the market's expectation that rates will be cut by 50bps to 4.375% by end 2023, is completely at odds with the Fed projection that they will end the year above 5%. Further out, the market's view is that rates will end 2024 at 3.125%, which is 100bps below the 4.125% level projected by the Fed.

- **Meanwhile, the very hawkish rhetoric from the ECB caught the markets by surprise.** While there was the anticipated downshift to a 50bps hike, this was accompanied by a clear message that the ECB will have to maintain rate increases at this pace for some time. It indicated that rates will have to rise significantly more at a steady pace to reach levels that are sufficiently restrictive, and then keep them there to ensure a timely return of inflation to its 2% target. The deposit rate has now been increased to 2% and the ECB's clear guidance suggests it could rise to 3.5% or above next year. Futures contracts have hardened by about 40bps in the aftermath of the ECB meeting and they are now pricing in a peak of 3.25% in rates next year. Markets still anticipate that rates will be cut by 50bps in 2024.

- **Central banks are clear that they will stay the course and do what is required to get inflation back down to target.** Markets, though, seem doubtful that they will tighten policy to the extent they are guiding, or indeed maintain such a restrictive policy stance for a prolonged period of time. The markets may well be taking a more benign view of inflation in 2023-24. Recent declines in headline CPI rates, marked falls in commodity prices over the second half of this year and the likelihood of very weak growth or recession in 2023 may be encouraging markets to believe that inflation will fall more quickly than anticipated by central banks. Nonetheless, interest rates seem likely to rise by more than markets expect in H1 2023 given the strong bias of central banks to continue on an aggressive tightening path. Markets, though, may well be correct that policy can begin to be eased at a quicker pace than central banks are guiding.

- **This week, the latest release of the Fed's preferred measure of inflation, core-PCE for November will be the main highlight.** In October, core-PCE edged lower to 5%, the same rate as December 2021, but down from a peak of 5.4% in February/ March. However, since mid-year, core-PCE has hovered in and around the 5% mark. A 0.2% increase in the month is projected to result in the year-on-year rate falling to 4.7%. Looking ahead, the Fed expects that core-PCE will fall slowly back to its 2% target by 2025.



- **Meanwhile, solid income growth throughout this year and a run-down in the large swell of savings accrued during the pandemic**, has seen personal consumption rise at a steady clip, despite inflation running at elevated levels and a sharp fall in consumer confidence. Personal income is forecast to rise by 0.3% in November, while consumption is projected to rise by 0.2% in nominal terms. Meantime, the Conference Board measure of consumer confidence is expected to inch lower in December. Elsewhere, a slew of housing market metrics, including housing starts, existing home sales (Nov) and homebuilder sentiment (Dec) will provide an update on the sector, which has weakened considerably.

- **In the Eurozone, consumer confidence is also due.** A slight improvement for the third month running is anticipated in December, to –22.3 from –23.9. However, this is still a very low level historically. Meanwhile, the Q3 reading of labour costs in the Eurozone will be released. In the second quarter, wages were up 4.1% y/y, although the data were somewhat distorted by the impact of the pandemic. A further increase is envisaged in Q3. In terms of some key national data, the German Ifo and consumer sentiment measures for December will be released.

Interest Rate Forecasts

	Current	End Q1 2023	End Q2 2023	End Q3 2023
Fed Funds	4.375	5.125	5.125	5.125
ECB Deposit	2.00	3.00	3.50	3.50
BoE Repo	3.50	4.25	4.25	4.25
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 2023	End Q2 2023	End Q3 2023
EUR/USD	1.0641	1.08	1.09	1.10
EUR/GBP	0.8709	0.87	0.88	0.88
EUR/JPY	145.62	146	146	146
GBP/USD	1.2216	1.24	1.24	1.25
USD/JPY	136.84	135	134	133

Current Rates Reuters, Forecasts AIB's ERU

ECONOMIC DIARY

Monday 19th - Friday 23rd December

AIB Treasury Economic Research

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Date	UK & Irish Time		Release	Previous	Forecast
This Week:	**ECB Speakers:**		De Guindos (Mon)		
	BoE Speakers:				
	Fed Speakers:				
Mon 19th	**GER:**	09:00	Ifo Business Climate (December)	86.3	87.4
	EU-19:	10:00	Labour Costs (Q3)	(+4.0%)	
			- Wages	(+4.1%)	
	UK:	11:00	CBI Trends - Orders (December)	-5	
	US:	15:00	NAHB Homebuilder Sentiment (December)	33	33
Tue 20th	**GER:**	07:00	Producer Prices (November)	-4.2% (+34.5%)	-2.2% (+30.6%)
	US:	13:30	Housing Starts (November)	1.4m / -4.2%	1.4m / -1.8%
			- Building Permits	1.5m / -3.3%	1.5m / -2.2%
	EU-19:	15:00	Flash Consumer Confidence (December)	-23.9	-22.0
	JPN:		BOJ Rate Decision	-0.10%	-0.10%
Wed 21st	**GER:**	07:00	Gfk Consumer Sentiment (January)	-40.2	-38.0
	US:	15:00	Conference Board Consumer Confidence (Dec)	100.2	100.0
	US:	15:00	Existing Home Sales (November)	4.4m / -5.9%	4.2m / -5.2%
Thu 22nd	**UK:**	07:00	GDP (Q3: Revised Reading)	-0.2% (+2.4%)	-0.2% (+2.4%)
	US:	13:30	GDP (Q3: Final Reading)	+2.9% s.a.a.r.	+2.9% s.a.a.r.
	US:	13:30	PCE Prices (Q3: Final Reading)	+4.3% s.a.a.r.	+4.3% s.a.a.r.
			- Core-PCE Prices	+4.6% s.a.a.r.	+4.6% s.a.a.r.
	US:	13:30	Initial Jobless Claims (w/e 12th December)	+211,000	+225,000
	JPN:	23:30	CPI Inflation (November)	(+3.6%)	(+3.7%)
Fri 23rd	**FRA:**	07:45	Producer Prices (November)	-0.1% (+24.7%)	
	SPA:	08:00	GDP (Q3: Final Reading)	+0.2% (+3.8%)	+0.2% (+3.8%)
	ITA:	09:00	INSEE Business Confidence (Dec)	102.5	101.8
	ITA:	09:00	INSEE Consumer Confidence (Dec)	98.1	98.3
	US:	13:30	Personal Income / Consumption	+0.7% / +0.8%	+0.2% / +0.2%
			- Core-PCE Prices	+0.2% (+5.0%)	+0.2% (+4.7%)
	US:	13:30	Durable Goods (November)	+1.1%	-0.6%
			- Ex-Transport	+0.5%	+1.1%
	US:	15:00	Final Uni. Michigan Consumer Sentiment (Dec)	59.1	59.1

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