Weekly Market Brief

AIB Treasury Economic Research Unit

12th – 16th February 2024

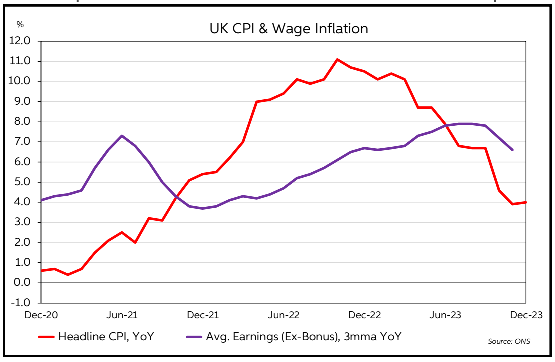
US Fiscal Credibility in Focus as Election Draws Near

- **It was a relatively quiet week in the markets, with activity across the main asset classes remaining muted.** The lack of macro data releases meant there was no new information to provide directional impetus. Notably, the largest-ever US Treasury 10-year auction took place, with a size of $42 billion. Demand was strong, resulting in a bid-to-cover ratio of 2.56 and a yield of 4.093%. However, this auction, along with newly published long-term fiscal forecasts, highlights the sustainability of the federal deficit in the long run as we enter the Presidential election season.

- **This week, the independent Congressional Budget Office published its annual forecasts for the US federal balance and debt up to 2034.** These forecasts indicate a further $1.4 trillion deterioration in the expected size of the US federal deficit compared to last year's projections. By 2034, the deficit is expected to reach 6.1% of GDP, up from 5.6% in 2024. Debt-to-GDP is set to rise from 97% in 2024 to 116% by 2034. Just a few years ago, in 2016, the deficit was running at 3.2% of GDP per annum, and debt-to -GDP stood at 75%. Interest payments on US government debt will account for three-quarters of the rise in the deficit between now and 2034, reaching 3.9% of GDP in a decades time. With long-term US GDP growth projections falling below 2%, the interest rate-growth differential, or the 'snowball effect', is expected to push up deficit spending and debt in the long term.

- **Under both recent US administrations the deficit has ballooned due to a confluence of policy and external factors.** Trump's 2017 Tax Cuts and Jobs Act and Biden's 2022 Inflation Reduction Act were signature policies that contributed to the increase in the federal deficit. Emergency measures during the Covid-19 pandemic have also pushed the debt ratio onto a higher trajectory. However, policymakers, including Fed Chair Powell, are now raising concerns about the current "unsustainable fiscal path" as an economic risk. This will likely bring both presidential candidates' tax and spending plans into focus in the coming months.

- **On the main currency markets, the price action over the past week has been subdued.** EUR/USD traded down close to the $1.07 level mid-week, before strengthening to 1.078 by Friday. Sterling also gained ground versus the dollar, reversing some of the losses at the back end of last week, following the stellar US jobs data. GBP/USD is trading above $1.26, up from $1.25. Bond yields were broadly higher on the week both Stateside and in Europe, rising 10-15bps across the curve, while market-implied rate cut expectations firmed marginally through the week.



- **Turning to the week ahead, a busy UK data schedule includes updates on inflation, the labour market and GDP.** Headline inflation has fallen sharply in recent months, to 4.0% in December from 6.7-6.8% in Q3, as steep increases in utility prices a year prior dropped out of the annual rate. However, core-CPI is proving to be quite sticky, and remained at an elevated 5.1% in September. The consensus is for both rates to edge up to 4.2% and 5.2%, respectively, in January. Looking further ahead, the BoE expects headline CPI to reach 2% in the coming months, before rising again in the second half of 2024. However, the BoE is closely monitoring signs of persistent inflationary pressures, notably the underlying tightness of labour market conditions and wage growth.

- **Conditions in the labour market have softened recently, but they remain tight overall.** The unemployment rate stood at 4.2% in the three months to November, which is still quite low by historical standards. Meanwhile, average earnings growth rose by a substantial 6.5% y/y in the three months to November, albeit this is the lowest pace of expansion since Q1 2023. The unemployment rate is forecast to fall to 4.0% in December, while average earnings growth is projected to slow to 5.7% y/y. **In terms of GDP, although the UK economy avoided the deep recession that had been widely predicted a year ago, growth remained weak at best.** GDP contracted by 0.1% in Q3, and data for Q4 indicate activity in the final three months of the year was subdued. Indeed, growth is expected to have contracted by 0.1% again in the final quarter of the year. In terms of timelier data, a 1.5% rebound in retail sales is pencilled in for January, following a sharp 3.2% drop in December.

- **In the US, CPI inflation and retail sales will also feature.** Headline CPI inflation has been range bound, in a 3.1-3.7% corridor since mid-2023, having fallen sharply in the first half of the year. It stood right in the heart of this range, at 3.4% in December. However, core inflation has trended lower, falling to 3.9% in December. A decline in both rates is anticipated in January, to 3.0% and 3.8%. Elsewhere in the US, in a continuation of the trend seen last year, retail sales are forecast to rise by 0.1% in January. Furthermore, the Michigan measure of consumer sentiment is set to improve again in February, suggesting consumption may continue to rise. Meanwhile, industrial production is projected to increase by 0.3% m/m in January.

- **Industrial production data are due in the Eurozone as well.** Industrial output has been rather weak, contracting in each of the last three months, meaning production was almost 7% lower year-on-year at the end of November. A further contraction of 0.3% is envisaged in December. Elsewhere, the second reading of GDP is set to confirm the economy stagnated in Q4.

Interest Rate Forecasts

	Current	End Q1 2024	End Q2 2024	End Q3 2024
Fed Funds	5.375	5.375	4.875	4.375
ECB Deposit	4.00	4.00	3.75	3.25
BoE Repo	5.25	5.25	5.00	4.50
BoJ OCR	-0.10	-0.10	0.25	0.25

Current Rates Reuters, Forecasts AIB's ERU

Exchange Rate Forecasts (Mid-Point of Range)

	Current	End Q1 2024	End Q2 2024	End Q3 2024
EUR/USD	1.0784	1.10	1.11	1.12
EUR/GBP	0.8535	0.86	0.86	0.87
EUR/JPY	161.01	158	155	152
GBP/USD	1.2633	1.28	1.29	1.29
USD/JPY	149.28	144	140	136

Current Rates Reuters, Forecasts AIB's ERU

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ECONOMIC DIARY

Monday 12th - Friday 16th February

Date	*UK & Irish Time*		*Release*	*Previous*	*Forecast*
This Week:	**ECB Speakers:**		Lane, Cipollone (Mon); de Guindos, Cipollone (Wed); **Lagarde,** Lane (Thu); Schnabel (Fri)		
	BoE Speakers:		**Bailey** (Mon); Greene; Mann (Thu)		
	Fed Speakers:		Kashkari (Mon); Goolsbee (Wed); Bostic (Thu); Daly (Fri)		
Mon 12th					
Tue 13th	**UK:**	07:00	ILO Unemployment Rate (December)	4.2%	4.0%
	UK:	07:00	Employment Change (December)	+73,000	
	UK:	07:00	Claimant Count (November)	+11,700	
	UK:	07:00	Average Earnings (November)	(+6.5%)	(+5.7%)
			- Ex-Bonus	(+6.6%)	(+6.0)
	GER:	10:00	ZEW Economic Sentiment (February)	15.2	17.5
	US:	11:00	NFIB Business Optimism (January)	91.90	
	US:	13:30	CPI inflation (January)	+0.3% (+3.4%)	+0.2% (+3.0%)
			- Core-CPI	+0.3% (+3.9%)	+0.3% (+3.8%)
Wed 14th	**UK:**	07:00	CPI Inflation (January)	+0.4% (+4.0%)	-0.3% (+4.2%)
			- Core-CPI	+0.6% (+5.1%)	-0.8% (+5.2%)
	UK:	07:00	PPI Input Prices (January)	-1.2% (-2.8%)	
			- PPI Output Prices	-0.6% (+0.1%)	
	EU-20:	10:00	Employment (Q4: Flash Reading)	+0.2% (+1.3%)	+0.2%
	EU-20:	10:00	GDP (Q4: Flash Reading)	+0.0% (+0.1%)	+0.0% (+0.1%)
	EU-20:	10:00	Industrial Production (December)	-0.3% (-6.8%)	-0.3% (-4.1%)
	IRL:	***11:00***	***Residential Property Price Index (December)***	***+0.8% (+2.9%)***	***+0.5% (+3.1%)***
Thu 15th	**UK:**	07:00	GDP (Q4: Preliminary Reading)	-0.1% (+0.3%)	-0.1%
	UK:	07:00	GDP (December)	+0.3% (+0.2%)	-0.1% (+0.4%)
	UK:	07:00	Industrial Output (December)	+0.3% (-0.1%)	-0.1%
			- Manufacturing Output	+0.4% (+1.3%)	+0.0%
	UK:	07:00	Goods Trade Balance (December)	-£14.2bn	
	SPA:	08:00	Final HICP Inflation (January)	-0.2% (+3.5%)	-0.2% (+3.5%)
	EU-20:	10:00	Total Trade Balance (December)	+€14.8bn	
	IRL:	***11:00***	***CPI Inflation (January)***	***+0.5% (+4.6%)***	***-1.2% (+4.5%)***
			- HICP Inflation	***+0.4% (+3.2%)***	***-1.4% (+2.7%)***
	US:	13:30	NY Fed / Empire State Index (February)	-43.7	-12.5
	US:	13:30	Initial Jobless Claims (w/e 5th February)	+218,000	+220,000
	US:	13:30	Philly Fed Index (February)	-10.6	-8.0
	US:	13:30	Retail Sales (January)	+0.6% (+5.6%)	+0.1% (+2.6%)
			- Ex-Autos	+0.4%	+0.3%
			- Control Group	+0.8%	+0.5%
	US:	13:30	Industrial Production (January)	+0.1% (+1.0%)	+0.3% (+0.2%)
			- Manufacturing Output	+0.1%	
			- Capacity Utilisation	78.6%	78.8%
	US:	15:00	NAHB Homebuilder Sentiment (February)	44.0	46.0
Fri 16th	**UK:**	07:00	Retail Sales (January)	-3.2% (-2.4%)	+1.5%
			- Ex-Fuel	-3.3% (-2.1%)	+1.7%
	FRA:	07:00	Final HICP Inflation (January)	-0.2% (+3.4%)	-0.2% (+3.4%)
	US:	13:30	Housing Starts (January)	+1.46m / -4.3%	+1.47m / +0.7%
			- Building Permits	+1.49m / +1.8%	+1.51m / +1.3%
	US:	13:30	PPI Final Demand (January)	-0.1% (+1.0%)	+0.1% (+0.7%)
			- Ex-Food & Energy	+0.0% (+1.8%)	+0.1% (+1.7%)
	US:	15:00	Preli. Uni. Michigan Consumer Sentiment (Feb)	79.0	80.0

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