Weekly Market Brief

AIB Treasury Economic Research Unit

11th – 15th January 2021

Sombre Sterling

- **The EU-UK trade deal that was finally agreed on Christmas Eve has had little impact on sterling.** EUR/GBP has traded in an 88.5-93p range since last May and has been confined to an even narrower 89-91p corridor since the deal was announced. One reason for this is that an agreement was widely expected by the markets. Furthermore, it is a very limited or 'skinny' trade deal which does not include services and is far inferior to the EU Single Market. Thus, it can hardly be classed as a positive development for the UK economy, although it avoided a much worse outcome in the form of a no-deal Hard Brexit.

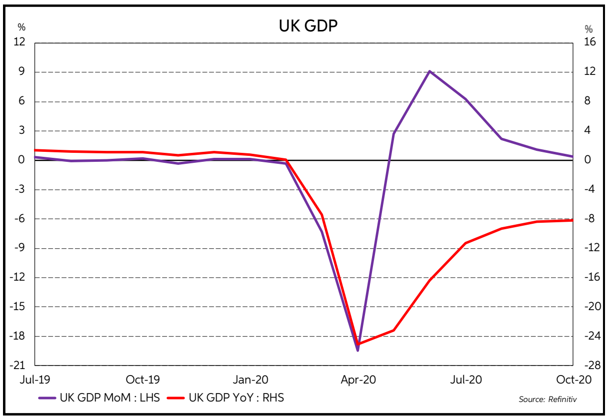
- **Overall, the UK's departure from the EU and its Customs Union and Single Market is viewed by many as lowering the potential growth rate of the economy over the medium term, via negative impacts on investment and trade.** Indeed, BoE Governor Bailey stated that the deal will likely see a hit of 2% of GDP to the economy over the next three years, and endorsed forecasts from the OBR that this will rise to 3-4% over time. Meanwhile, it is also the case that the recession caused by the Covid-19 pandemic has been much deeper in the UK than in other major economies, with the economy contracting by around 11% last year. Furthermore, the country has just entered a third lockdown which could remain in force until the end of the first quarter. As a result, UK growth forecasts are being scaled back for 2021.

- **The deep recession has seen the UK budget deficit soar to close on 20% of GDP in FY2020/21, much higher than in other countries and another negative for the currency in an economy with a persistent balance of payments deficit.** Meanwhile, given the headwinds facing the economy from both Covid-19 and Brexit, markets are pricing in a further 10 to 15bps in rate cuts from the BoE by mid-2022. This could see the UK move to negative interest rates, which would hardly be positive news for the currency. Although we think that the BoE is likely to continue to eschew this option, with a strong economic rebound still in prospect over the second half of the year.

- **Taking all these factors into consideration, sterling seems likely to remain a relatively weak currency on a historic basis, trading in an 88-92p range against the euro in the months ahead.** Meanwhile, cable could trade close to the $1.40 level. To put this into perspective, sterling hardly ever dipped below the $1.40 level throughout the whole period from the mid-1980s up until the Brexit Referendum in 2016, despite a number of serious crises over this time frame. The sterling market, then, does not seem to be anticipating that the UK is on its way to the promised post-Brexit 'sunlit uplands'.

- **Turning to the week ahead, the main release will be the monthly estimate of UK GDP for November.** Output is forecast to fall by 4% m/m in November, as the UK entered its second national lockdown. A fall in output of this magnitude would bring GDP back to –11.6% below its pre-Covid levels. However, the second national lockdown was less severe than the lockdown in the spring, with manufacturing, construction and schools allowed to stay open in November. Thus, industrial output is expected to increase by 0.4% m/m in November. Although, the risks to the GDP consensus forecast are tilted to the downside, with a greater fall in output a distinct possibility. The fall in output in November is also likely to see Q4 GDP contract overall, while the third (and more severe than the second) national lockdown will probably cause the UK economy to enter a double-dip recession in Q1 2021.

- **In the US, industrial production is expected to remain on its upward trend as the strong recovery in China and a weaker dollar continue to help the manufacturing sector.** Production is expected to rise by 0.4% in December, although, this would still leave output circa 4.6% below its pre-pandemic level. The Empire State index for January, a regional measure of sentiment in the manufacturing sector is projected to rise to 6.15 from 4.9, suggesting that the rebound in manufacturing has carried into the New Year. Elsewhere, the Michigan measure of consumer sentiment is forecast to move backwards to 79.2 from 80.7 in January. In terms of inflationary developments, the headline CPI index is expected to rise to 1.3% in December from 1.2%. The core rate of CPI is forecast to remain at 1.6%.



- **In the Eurozone, the main release is also industrial production.** Output is expected to rise by 0.2% in November, as despite tighter restrictions being introduced throughout the month, manufacturing and construction were allowed to remain open. However, this would still leave output 3.4% below its February level. On a national level, the preliminary result of German GDP for 2020 and Q4 GDP growth is expected to show that the economy dipped in the final quarter of the year, with economic activity contracting by 5.1% overall in 2020. On the home front, CPI inflation is projected to remain at –1.1% in December. Meanwhile, ECB President Lagarde will take part in an online Q&A session with Reuters on Wednesday which may be of interest to markets.

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	1.2244	1.24	1.25	1.26
EUR/GBP	0.9013	0.90	0.90	0.90
EUR/JPY	127.24	128	128	127
GBP/USD	1.3580	1.38	1.39	1.40
USD/JPY	103.92	103	102	101

Current Rates Reuters, Forecasts AIB's ERU

ECONOMIC DIARY

Monday 11th - Friday 15th January

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Date	*UK & Irish Time (GMT+1)*		*Release*	*Previous*	*Forecast*
This Week:	**ECB Speakers:**		**Lagarde** (Wed)		
	BoE Speakers:		Tenreyro (Mon); Broadbent (Tue)		
	Fed Speakers:		Brainard (Tue); **Powell** (Wed)		
Mon 11th	**CHINA:**	01:30	CPI (December)	-0.6% (-0.5%)	+0.4% (+0.1%)
	CHINA:	01:30	PPI (December)	-1.5%	(-0.8%)
	EU-19:	09:30	Sentix Index (January)	-2.7	0.4
Tue 12th	**UK:**	00:01	BRC Retail Sales (December)	(+7.7%)	
	JPN:	05:00	Economy Watchers Poll (December)	45.6	
	ITA:	09:00	Retail Sales (November)	+0.6% (+2.9%)	
	US:	11:00	NFIB Business Optimism (December)	101.4	
	US:	15:00	JOLTS Job Openings (November)	6.652m	
Wed 13th	**ITA:**	09:00	Industrial Output (November)	+1.3% (-2.1%)	+0.4% (+3.7%)
	EU-19:	10:00	Industrial Production (November)	+2.1% (-3.8%)	+0.2% (-3.4%)
	US:	13:30	CPI (December)	+0.2% (+1.2%)	+0.4% (+1.3%)
			- Core	+0.2% (+1.6%)	+0.1% (+1.6%)
	JPN:	23:50	Machinery Orders (November)	+17.1% (+2.8%)	-6.2% (-15.4%)
Thurs 14th	**CHINA:**	01:30	Trade Balance (December)	+$75.4bn	+$70.0bn
			- Exports	(+21.1%)	(+15.0%)
	UK:	00:01	RICS Housing Survey (December)	66	61
	GER:	08:00	GDP (Full Year 2020)	(+0.6%)	(-5.1%)
	IRL:	***11:00***	***CPI (December)***	***+0.3% (-1.1%)***	***+0.2% (-1.1%)***
	US:	13:30	Initial Jobless Claims (w/e 28th December)	+787,000	+800,000
Fri 15th	**UK:**	07:00	GDP (November)	+0.4% (-8.2%)	-4.0% (-11.6%)
	UK:	07:00	Industrial Output (November)	+1.3% (-5.5%)	+0.4% (-4.3%)
			- Manufacturing	+1.7% (-7.1%)	+0.7% (-5.2%)
	UK:	07:00	Goods Trade Balance (November)	-£11.99bn	-£11.20bn
			- Non-EU	-£4.54bn	
	FRA:	07:45	Final HICP (December)	+0.2% (+0.0%0	
	EU-19:	10:00	Total Trade Balance (November)	€30bn	
	US:	13:30	NY Fed / Empire State Index (January)	4.9	6.15
	US:	14:15	Industrial Production (December)	+0.4% (-5.5%)	+0.4% (-4.8%)
			- Capacity Utilisation	73.3%	73.5%
			- Manufacturing Output	+0.8%	+0.3%
	US:	15:00	Preli. Michigan Consumer Sentiment (January)	80.7	79.2

♦ *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