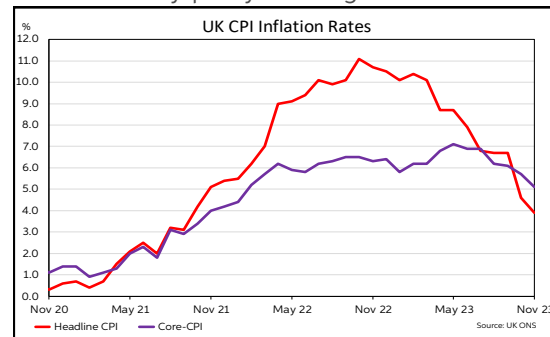


Further Marked Fall in Inflation Needed for Rate Cuts

- **Further significant declines in headline and core inflation rates look to be in store this spring virtually everywhere, as large price increases a year earlier drop out of the annual comparison.** Monthly increases in core inflation last spring, averaged 0.8% in the Eurozone and 1% in the UK, with the core US PCE deflator rising by an average of almost 0.4%. These monthly rises have moderated greatly since then. Meanwhile, economic activity remains very weak in Europe and appears to be starting to slow in the US. Taking all the above together, markets are pricing in 130-170bps of rate cuts in the main economies this year, most likely beginning with the Fed FOMC meeting on the 20th of March, the ECB on April 11th, and BoE on May 9th.
- **There is a risk, though, that rates may not be cut as quickly as markets expect, especially in the Eurozone.** First, headline inflation has been quite volatile in recent months, and central banks will want to see a clear downtrend re-emerge before loosening policy. Second, labour markets remain tight, with resulting strong growth in wage earnings and unit labour, as referenced by the BoE and ECB. Third, core inflation is also still quite some way above target, most notably in the UK. Central banks will want to be sure that inflation is on a clear path to 2% on a sustained basis before embarking on rate cuts.
- **Indeed, central banks have been sounding words of caution in relation to market expectations for extensive rate cuts in 2024.** In December, the ECB noted its forecast for a return of inflation to its 2% target was based on a much higher trajectory for interest rates than priced in by markets. Its macro projections are based on three month rates averaging 3.6% this year and troughing at around 2.75% next year, well above current market pricing. Meanwhile, the BoE Governor stated that the MPC is not in a position to even discuss cutting rates. Indeed, it still retains a tightening bias. Most noteworthy, the Fed's December dot-plot showed the median projection of FOMC members is that rates would be cut by just 75bps this year, less than half of current market expectations for easing of around 170bps.
- **The central banks, though, do acknowledge that they have moved to a 'data dependent' mode in terms of monetary policy decisions.** Thus, policy easing could prove to be greater than they currently envisage if warranted by incoming data. Hence, the importance of inflation figures this coming spring, as they will need to show that price stability is coming onto the horizon. Headline inflation could fall to circa 2% or below, with core rates coming within sight of this level. It will be difficult for central banks not to begin easing policy if this is what the inflation data show. Even then, central banks will need to be convinced that it is a sustained fall in inflation. Indeed, the possibility of near-term inflationary shocks, such as the current Red Sea shipping disruption, could temper rate-cutting plans for central banks. Thus, it is hard to envision rates being cut before June, with the possible exception of the US where the Fed has acknowledged that rates are now at a relatively high level in real terms and that cuts are coming into view. It may also be the case that central banks don't cut rates at every policy meeting in H2 2024 once easing gets underway, as is currently anticipated by markets.
- **Given the attention on inflation data currently, the main focus of a busy UK macro-calendar this week, will be on CPI data for December.** Recently, both the headline and core rates have fallen sharply, albeit the latter remains elevated. Headline CPI fell from 6.7-6.8% between July-September, to 4.6% in October, and down to 3.9% in November, as steep increase in utility prices in 2022 dropped out of the annual rate. Meantime, core-CPI declined to 5.1% in November, from 5.7% and 6.1% in the two months prior. Both rates are forecast to edge lower again in December, to 3.8% and 4.9%, respectively. The UK's inflation problem has been made more complicated by very high levels of wage growth. Tight conditions in the labour market have placed upward pressure on average earnings, which were running above 8% year-on-year between June to September, before falling sharply to 7.2% in October. A small rise in the unemployment rate to 4.3% from 4.2% is pencilled in for November, while average earnings growth is expected to slow further to 6.8% y/y. Elsewhere, retail sales are forecast to decline by 0.5% in December.
- **Retail sales data are also due in the US this week.** Having increased throughout the year, the consensus is for a second consecutive 0.3% m/m rise in December, leaving retail sales 5.1% higher in year-on-year terms. US industrial production though, has been much more volatile in 2023. Output is expected to stagnate in December, having partially rebounded in November from a steep contraction in October. In terms of more timely indicators, the Michigan measure of consumer sentiment is projected to edge back from a subdued level of 69.7 in December, to 69.0 in January.
- **In the Eurozone, industrial production is forecast to fall for a third month running in November, by 0.3% m/m.** Meanwhile, the final reading of HICP inflation is set to confirm headline inflation rose to 2.9%, and that the core rate slowed to 3.9% in December. Markets will also pay close attention to the minutes from the December Governing Council meeting, due on Thursday. Elsewhere, the full year reading of German GDP is expected to show the economy contracted by 0.3% in 2023.



	Interest Rate Forecasts			
	Current	End Q1	End Q2	End Q3
		2024	2024	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	End Q2	End Q3
		2024	2024	2024
EUR/USD	1.0975	1.10	1.11	1.12
EUR/GBP	0.8593	0.86	0.86	0.87
EUR/JPY	158.66	158	155	152
GBP/USD	1.2768	1.28	1.29	1.29
USD/JPY	144.57	144	140	136

Current Rates Reuters, Forecasts AIB's ERU

ECONOMIC DIARY

Monday 15th - Friday 19th January

Date	UK & Irish Time		Release	Previous	Forecast
This Week:	ECB Speakers:		Lagarde (Wed); Lagarde (Thu); Lagarde (Fri)		
	BoE Speakers:		Bailey (Tue)		
	Fed Speakers:		Waller (Tue); Barr, Bowman, Williams (Wed); Bostic (Thu); Barr, Daly (Fri)		
			World Economic Forum Davos (Monday 15th - Friday 19th)		
Mon 15th	US:		Martin Luther King Day (Market Holiday)		
	EU-20:	10:00	Total Trade Balance (November)	+€10.9bn	
			- Eurostat Trade	+€11.1bn	
	EU-20:	10:00	Industrial Production (November)	-0.7% (-6.6%)	-0.3% (-5.9%)
	GER:	08:00	Full Year GDP (2023)	+1.8%	-0.3%
Tue 16th	GER:	07:00	Final HICP (December)	Flash: +0.2% (+3.8%)	+0.2% (+3.8%)
	UK:	07:00	ILO Unemployment Rate (November)	4.2%	4.3%
	UK:	07:00	Employment Change (November)	+50,000	
	UK:	07:00	Claimant Count (December)	+16,000	
	UK:	07:00	Average Earnings (November)	(+7.2%)	(+6.8%)
			- Ex-Bonus	(+7.3%)	(+6.6%)
	GER:	10:00	ZEW Economic Sentiment (January)	12.8	12.7
	IRL:	11:00	CPI Inflation (December)	-0.8% (+3.9%)	+0.4% (+4.4%)
			- HICP Inflation	-0.9% (+2.5%)	+0.4% (+3.2%)
	US:	13:30	NY Fed / Empire State Index (January)	-14.5	-5.0
Wed 17th	CHINA:	02:00	GDP (Q4)	+1.3% (+4.9%)	
	CHINA:	02:00	Retail Sales (December)	(+10.1%)	
	CHINA:	02:00	Industrial Output (December)	(+6.6%)	
	CHINA:	02:00	Unemployment Rate (December)	5.0%	
	UK:	07:00	CPI Inflation (December)	-0.2% (+3.9%)	+0.2% (+3.8%)
			- Core-CPI	-0.3% (+5.1%)	+0.4% (+4.9%)
	EU-20:	10:00	Final HICP (December)	Flash: +0.2% (+2.9%)	+0.2% (+2.9%)
			- Ex-Food & Energy	Flash: +0.3% (+3.9%)	+0.3% (+3.9%)
			- Ex-Food, Energy, Alcohol & Tobacco	Flash: +0.4% (+3.4%)	+0.4% (+3.4%)
	IRL:	11:00	Residential Property Price Index (November)	+1.1% (+2.3%)	+0.5% (+2.6%)
	US:	13:30	Retail Sales (December)	+0.3% (+4.1%)	+0.3% (+5.1%)
			- Ex-Autos	+0.2%	+0.2%
			- Control Group	+0.4%	
	US:	13:30	Industrial Production (December)	+0.2% (-0.4%)	+0.0% (+1.2%)
			- Manufacturing Output	+0.3%	
			- Capacity utilisation	78.8%	78.7%
	US:	15:00	NAHB Homebuilder Sentiment (January)	37.0	39.0
Thu 18th	UK:	00:01	RICS Housing Survey (December)	-43.0	
	EU-20:	11:00	ECB Monetary Policy Meeting Account (Dec 13-14th)		
	US:	13:30	Philly Fed Business Index (January)	-10.5	-8.0
	JPN:	23:30	CPI Inflation (December)	(+2.8%)	
			- Core-CPI	(+2.5%)	(+2.3%)
Fri 19th	UK:	07:00	Retail Sales (December)	+1.3% (+0.1%)	-0.5% (+1.1%)
			- Ex-Fuel	+1.3% (+0.3%)	-0.6% (+1.3%)
	US:	15:00	Existing Home Sales (December)	+3.8m / +0.8%	3.8m / +0.3%
	US:	15:00	Preli. Uni. Michigan Consumer Sentiment (Jan)	69.7	69.0

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

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