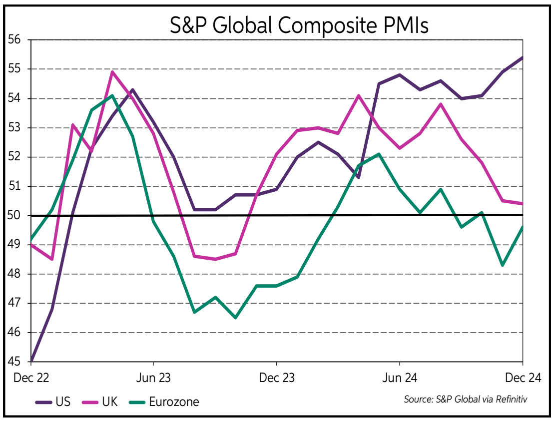
Weekly Market Brief

AIB Treasury Economic Research Unit

20th-24th January 2025

Keeping bond markets on the QT?

- **As we have discussed in our daily and weekly publications, global bond markets have experienced heightened volatility in recent weeks.** Following the sharp rise in government yields, the past week has seen something of a relief rally in bonds, with yields lower in recent days. The US 10-year Treasury has fallen by nearly 20bps over the course of the week, with similar declines in UK gilt yields. The underlying theme here is bond markets are now adjusting to the relatively new environment of quantitative tightening (QT), driving heightened volatility, with central banks no longer the marginal buyer in the secondary markets.
- **Since the major central banks embarked on QT in 2022, their balance sheets have shrunk significantly.** In the US, the Fed has reduced its balance sheet from nearly $9trn in 2022 to a current $6.9trn, albeit, it has slowed the pace of its QT programme in recent months. The ECB has also proceeded at a steady pace, reducing its balance sheet to the current €6.4trn, from a peak of €8.7trn. The ECB also completely discontinued reinvestments under it bond-buying programme at the end of 2024. The Bank of England has adopted a similar approach.
- **This leaves bonds more exposed to the vagaries of the market, highlighted by the recent events in the UK, which has heaped pressure on the new Chancellor ahead of her next fiscal statement in March.** Growing debt burdens across major developed economies (France, UK, Canada), in particular, have also garnered the renewed attention of investors amid an increasing issuance flow by public debt agencies. In this context, nations running both large fiscal and current account deficits – again the UK is a prime example - which relay on the 'kindness of strangers' are particularly exposed to sudden shifts in investor sentiment. Indeed, the Bank of Canada has announced plans to pause QT in the first half of 2025, making it one of the first major central banks to signal an end to its QT program.
- **While yields have settled back down for now, the recent events highlight a new market fragility in the current uncertain policy environment.** Looking ahead, central bank policy and geopolitical risks could continue to spur further volatility in the coming months, and might force other central banks to temporarily reassess their QT plans.
- **Turning to this week, the main release of note will be the flash PMIs for January in the Eurozone, UK and the US.** Across the board, manufacturing has underperformed versus services recently. Most notably, the manufacturing PMI remained very weak in the Eurozone, staying in contraction mode since July 2022 and deteriorating further throughout Q4. In contrast, the services PMI rose to 51.6 in December, up from 49.5 in November. Both sectors are forecast to be little changed in January. Like-wise in the UK, the manufacturing PMI has printed in contraction territory during Q4, while the services sector was above the key 50 threshold. A slight dis-improvement is pencilled in for the services sector at the start of 2025. The UK manufacturing PMI is forecast to be unchanged. Meanwhile, the US PMI surveys were on an upward trajectory at the end of 2024 and this trend may continue in January. The main focus will be on whether the manufacturing PMI can move back above the 50 mark, given the services PMI has been well in expansion mode in recent months.



- **Meantime, an update on the labour market will feature in the UK.** Having softened in the first half of the year before tightening somewhat over the summer months, labour market conditions appear to have weakened slightly again recently. This is perhaps best illustrated by the unemployment rate, albeit there are question marks in relation to its accuracy. It peaked at 4.4% in April/May, before declining to 4.1% in August. However, it rose to 4.3% in September and stayed at that level in October also. At the same time, average earnings growth remains elevated, albeit, it has cooled slightly since the start of the year. It was at +5.2% y/y in the three months to October, after rising in the last two months, but this compares to +5.9% y/y in January. The consensus is for the unemployment rate to rise to 4.4%, while average earnings growth is projected at +5.6% y/y. Meantime, consumer confidence for January will be released. It deteriorated at the start of Q4, before rebounding slightly in November and December. However, a modest decline to –19.0 is pencilled in for the month.
- **Elsewhere, consumer confidence is also due in the Eurozone.** In contrast to the UK, Eurozone consumer confidence has waned throughout Q4, falling in November and December. A marginal increase is anticipated in January to –14.2 from-14.5. Meanwhile, the German ZEW economic sentiment indicator is expected to fall to 15.3 in January, from 15.7. In the US, a holiday shortened week is relatively quiet. **However, markets will be focused on remarks from President Trump at his inauguration and to any executive orders issued as he moves back into the White House.** On the monetary policy front, the BoJ meeting will garner attention, amid growing speculation that the MPC will opt to raise rates by 25bps to 0.50%.

Interest Rate Forecasts

	Current	End Q1 2025	End Q2 2025	End Q3 2025
Fed Funds	4.375	4.125	3.875	3.625
ECB Deposit	3.00	2.50	2.25	2.00
BoE Repo	4.75	4.50	4.25	4.00
BoJ OCR	0.25	0.50	0.50	0.50

Current Rates Reuters, Forecasts AIB's ERU

Exchange Rate Forecasts (Mid-Point of Range)

	Current	End Q1 2025	End Q2 2025	End Q3 2025
EUR/USD	1.0291	1.07	1.08	1.08
EUR/GBP	0.8438	0.83	0.84	0.84
EUR/JPY	160.72	161	161	160
GBP/USD	1.2191	1.28	1.28	1.28
USD/JPY	156.16	150	150	149

Current Rates Reuters, Forecasts AIB's ERU

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ECONOMIC DIARY

Monday 20th - Friday 24th January

Date	*UK & Irish Time*		*Release*	*Previous*	*Forecast*
This Week:	**ECB Speakers:**		**Lagarde** (Wed); **Lagarde,** Cipollone (Fri)		
	BoE Speakers:				
	Fed Speakers:				
			World Economic Forum (Mon 20th - Fri 24th)		
Mon 20th	**US:**		**Martin Luther King Day (Bank Holiday)**		
	US:		**President Trump Inauguration**		
	GER:	07:00	Producer Price Inflation (December)	+0.5% (+0.1%)	+0.2% (+1.1%)
Tue 21st	**UK:**	07:00	ILO Unemployment Rate (November)	4.3%	4.4%
	UK:	07:00	Employment Change November)	+173,000	
	UK:	07:00	Claimant Count (December)	+300	
	UK:	07:00	Average Earnings (November)	(+5.2%)	(+5.6%)
			- Ex-Bonus	(+5.2%)	(+5.5%)
	GER:	10:00	ZEW Economic Sentiment (January)	15.7	15.3
Wed 22nd	***IRL:***	***11:00***	***Residential Property Price Index (November)***	***+0.8% (+9.7%)***	
Thu 23rd	***IRL:***	***11:00***	***New Dwelling Completions (Q4 2024)***	***Q4'23: 10,223***	
	US:	13:30	Initial Jobless Claims (w/e 13th January)	+217,000	+215,000
	EU-20:	15:00	Flash Consumer Confidence (January)	-14.5	-14.2
	JPN:	23:30	CPI Inflation (December)	(+2.9%)	
			- Core CPI	(+2.7%)	(+3.0%)
Fri 24th	**JPN:**		BoJ rate Decision	+0.25%	+0.50%
	UK:	00:01	Gfk Consumer Confidence (January)	-17.0	-19.0
	JPN:	00:30	Flash Jibun Composite PMI (January)	50.5	
	FRA:	08:15	Flash HCOB Composite PMI (January)	47.5	47.7
	GER:	08:30	Flash HCOB Composite PMI (January)	48.0	48.0
	EU-20:	09:00	Flash HCOB Composite PMI (January)	49.6	49.7
			- Manufacturing / Services	45.1 / 51.6	45.3 / 51.5
	UK:	09:30	Flash Composite PMI (January)	50.4	50.0
			- Manufacturing / Services	47.0 / 51.1	47.0 / 50.7
	US:	14:45	Flash S&P Composite PMI (January)	55.4	
			- Manufacturing / Services	49.4 / 56.8	
	US:	15:00	Existing Home Sales (December)	4.15m / 4.8%	4.20 / +1.2%
	US:	15:00	Final Uni. Michigan Consumer Sentiment (Jan)	73.2	73.5

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