Weekly Market Brief

AIB Treasury Economic Research Unit

17th – 21st July 2023

Holy Grail Coming into View ?

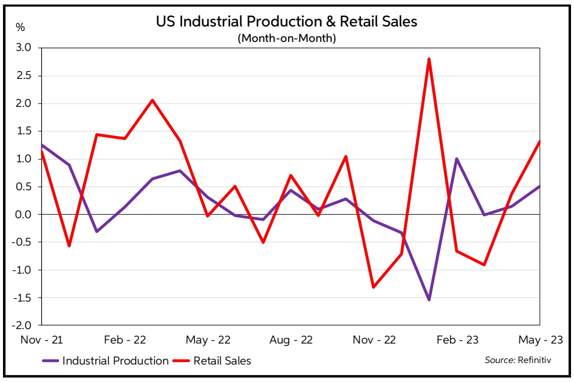
- **Markets are becoming increasingly confident that the Federal Reserve will manage to engineer a soft landing for the US economy.** This means that Fed interest rate hikes act to bring down inflation, but without pushing the economy into recession and generating a sharp rise in unemployment. Historically, this has proved a difficult task to achieve. Fed Chair Powell had warned that the path was narrow to achieve such an outcome, especially with the Fed hiking rates by 500bps so far. However, the S&P 500 and NASDAQ stock market indices have risen by 16% and 25%, respectively, since the spring as more and more US data point in the direction of a soft landing. This would also soon allow the Fed to bring its rate hiking campaign to an end.

- **The CPI data for June were particularly encouraging.** The headline CPI rate dropped to 3% from 4% in May, and 4.9% in April, and it is now well below its peak of 9.1% reached a year ago. Meanwhile, the core CPI rate, which excludes food and energy, declined to 4.8% from 5.3% in May, and 5.5% in April, and a peak of 6.6% last September. This is still a high rate, but it looks set to fall further in the coming months, both on positive base effects as large increases from last year drop out of the annual rate, and on easing price rises this summer. The core CPI rate rose by 0.2% in June, the smallest one-month gain since August 2021, and similar low rises are likely in the coming months, reflecting moderating price pressures. We can also expect to see a marked deceleration in the Fed's preferred measure of inflation, the core PCE rate.

- **While the pace of growth in the US has slowed, the economy is still continuing to perform quite well.** Although the momentum of job creation has slackened, growth in non-farm payrolls still averaged almost 250,000 in the past three months. The unemployment rate has remained close to 50-year lows, standing at 3.6% in June. GDP grew by 2% annualised in the first quarter of the year, and data point to another solid increase in the second quarter. It is now anticipated that GDP will rise by 1.6% in 2023, down only slightly from 2.1% in 2022. The resilience of the economy to date in the face of a sharp rise in interest rates is being attributed to a number of factors, including the high level of job vacancies post the COVID-19 pandemic, which has seen employment continuing to expand, and strong household balance sheets with savings at elevated levels. The expansionary stance of fiscal policy, as well as a pick-up in wage growth and widening of firms' profit margins, have also supported activity. However, it should be noted that the full impact of higher rates has yet to be felt in the real economy.

- **The fall back in inflation despite the continuing solid economic growth and a very tight labour market has been referred to by some commentators as 'immaculate disinflation'.** Much of the rise in inflation in 2021-2022 was due to supply side shocks emanating from COVID-19 and the War in Ukraine, more than excessive demand and high wage growth. As these supply shocks abate, inflation has fallen back. Markets believe that the deceleration in inflation will allow the Fed to put monetary policy on hold, after it delivers one final, well signalled, 25bps hike at its policy meeting at the end of this month. There is still a long way to go, though, to get core inflation back down to its 2% target, so it will be quite some time before rate cuts come on to the agenda.

- **This week, we get further updates on economic activity in the US for Q2, including retail sales and industrial production.** Retail sales rose by 0.3% in May, having rebounded by 0.4% in April, after contracting in both February and March. The control group measure, a key core spending indicator, has also increased so far in Q2. The consensus is for both headline and control sales to rise by 0.4% and 0.2%, respectively, in June. Meanwhile, industrial production contracted by 0.2% in May, following a sharp 0.5% increase in output in April. A slight 0.1% rise in production is forecast in June, meaning output increased by 0.6% in Q2 overall. A slew of housing market data are also due, including housing starts, existing home sales (June) and homebuilder sentiment (July).



- **In the UK, all eyes will be on the CPI inflation data for June.** Inflation has proven to be much stickier than expected, surprising to the upside in recent months. Headline CPI remained at 8.7% in May, with food inflation in particular at very elevated levels, running at 18.3%. Meantime, core CPI inflation has accelerated so far in Q2, indicating that underlying price pressures are very strong. Core-CPI rose to 6.8% in April, before climbing to 7.1% in May, with both services and goods inflation moving higher. A fall in headline inflation to 8.2% is pencilled in for June. However, the core rate is expected to remain elevated, at 7.1%. Elsewhere, retail sales are forecast to rise by 0.2% in June, although this would still leave them 1.5% lower in year-on-year terms. Meantime, consumer confidence is projected to deteriorate for the first time in six months, in July, from already low levels. **Elsewhere, a sharp slowdown in Chinese GDP is expected in Q2.**

- **The flash reading of Eurozone consumer confidence is also due next week.** In contrast to the UK, it is envisaged Eurozone consumer confidence will maintain upward momentum, in July, albeit improving only marginally. Elsewhere, the final reading of Eurozone HICP inflation is set to confirm the headline rate fell to 5.5% in June, but that the core rate rose to 5.4% from 5.3%.

Interest Rate Forecasts

	Current	End Q3 2023	End Q4 2023	End Q1 2024
Fed Funds	5.125	5.375	5.375	5.375
ECB Deposit	3.50	4.00	4.00	4.00
BoE Repo	5.00	5.50	5.75	5.75
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 Q3 2023	End Q4 2023	End Q1 2024
EUR/USD	1.1231	1.12	1.13	1.14
EUR/GBP	0.8568	0.86	0.87	0.87
EUR/JPY	155.55	159	161	162
GBP/USD	1.3106	1.30	1.30	1.31
USD/JPY	138.48	142	142	142

Current Rates Reuters, Forecasts AIB's ERU

ECONOMIC DIARY

Monday 17th - Friday 21st July

Date	UK & Irish Time		Release	Previous	Forecast
This Week:	**ECB Speakers:**		**Lagarde,** Lane (Mon); Panetta (Tue)		
	BoE Speakers:		Ramsden (Wed)		
	Fed Speakers:				
			G20 Finance Ministers & Central Bank Governors Meeting (Mon-Tue)		
Mon 17th	**CHINA:**	03:00	Industrial Output (June)	(+3.5%)	(+2.7%)
	CHINA:	03:00	Retail Sales (June)	(+12.7%)	(+3.2%)
	CHINA:	03:00	GDP (Q2)	+2.2% (+4.5%)	+0.5% (+7.3%)
	CHINA:	03:00	Urban Area Unemployment Rate (June)	5.2%	
	ITA:	09:00	Final HICP (June)	+0.1% (+6.7%)	+0.1% (+6.7%)
	US:	13:30	NY Fed / Empire State Index (July)	6.6	-7.0
Tue 18th	***IRL:***	***11:00***	***Residential Property Prices (May)***	***+0.0% (+3.6%)***	***+0.2% (+3.1%)***
	US:	13:30	Retail Sales (June)	+0.3% (+1.6%)	+0.4% (+1.5%)
			- Ex-Autos	+0.1%	+0.3%
			- Control Group	+0.2%	+0.2%
	US:	14:15	Industrial Production (June)	-0.2% (+0.2%)	+0.1% (+0.4%)
			- Manufacturing Output	+0.1%	+0.0%
			- Capacity Utilisation	79.6%	79.5%
	US:	15:00	NAHB Homebuilder Sentiment (July)	55	55
Wed 19th	**UK:**	07:00	CPI Inflation (June)	+0.7% (+8.7%)	+0.4% (+8.2%)
			- Core CPI Inflation	+0.8% (+7.1%)	+0.4% (+7.1%)
	UK:	07:00	PPI Output Prices (June)	-0.3% (+4.1%)	
			- Input Prices	-1.5% (+0.5%)	
	EU-20:	10:00	Final HICP Inflation (June)	Flash: +0.3% (+5.5%)	+0.3% (+5.5%)
			- Ex-Food & Energy	Flash: +0.4% (+6.8%)	+0.4% (+6.8%)
			- Ex-Food, Energy, Alcohol & Tobacco	Flash: +0.3% (+5.4%)	+0.3% (+5.4%)
	US:	13:30	Housing Starts (June)	+1.63m / +21.7%	+1.48m / -9.1%
			- Building Permits	+1.5m / +5.6%	+1.51m / +0.6%
Thu 20th	**JPN:**	00:50	Total Trade Balance (June)	-¥1,372bn	-¥46.7bn
			- Exports	(+0.6%)	(+2.2%)
	GER:	07:00	Producer Prices (June)	-1.4% (+1.0%)	-0.4% (+0.0%)
	FRA:	07:45	INSEE Business Climate (July)	100	99
	US:	13:30	Initial Jobless Claims (w/e 10th July)	+237,000	+245,000
	US:	13:30	Philly Fed Business Index (July)	-13.7	-10.7
	EU-20:	15:00	Flash Consumer Confidence (July)	-16.1	-16.0
	US:	15:00	Existing Home Sales (June)	+4.3m / +0.2%	+4.2m / -1.9%
Fri 21st	**UK:**	00:01	Gfk Consumer Confidence (July)	-24	-26
	JPN:	00:30	CPI Inflation (June)	+0.1% (+3.2%)	(+3.3%)
			- Core CPI Inflation	+0.4% (+2.7%)	
	UK:	07:00	Retail Sales (June)	+0.3% (-2.1%)	+0.2% (-1.5%)
			- Ex-Fuel	+0.1% (-1.7%)	+0.1% (-1.6%)
	UK:	11:00	CBI Distributive Trends - Orders (July)	-15	

AIB Treasury Economic Research

Oliver Mangan
Chief Economist

John Fahey
Senior Economist

Daniel Noonan
Economist

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