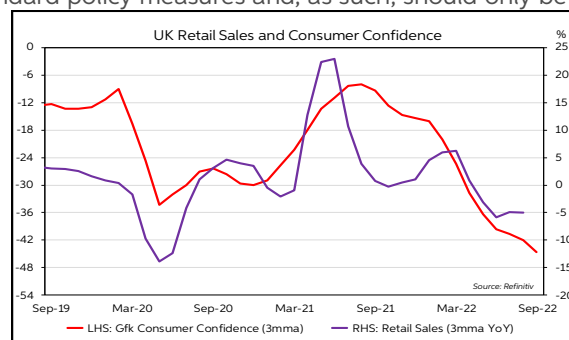


## On the QT

- **A decade or more of zero or negative interest rates, combined with quantitative easing (QE), has resulted in a mispricing of risk over a prolonged period of time across many asset classes.** This is becoming more apparent now as central banks tighten monetary policy aggressively. One consequence of QE and super low interest rates had been to force pension funds and others to use leverage to offset very low bond yields, that made it very difficult for them to meet their liabilities. The difficulties being experienced in the UK Gilt market can be traced back initially to the BoE announcement in early August that it was going to commence quantitative tightening (QT) in October and start selling its large gilt portfolio built up from QE. Obviously, the surge in new bond supply arising from the mini-Budget announced in late September, as well as questions around the sustainability of the UK public finances, poured oil on the gilt fire.
- **But, trouble was coming anyway for leveraged pension funds as Gilt prices fell in the face of the prospect of QT, not to mention high inflation which also weighs on long-dated bond prices.** Indeed, while the surge in inflation has its origins in supply chain difficulties, the impact of the war in Ukraine on commodity prices and an unleashing of pent-up demand post COVID, overly accommodative monetary conditions with too much money chasing too few goods has added to inflation dynamics. Meantime, the impact of exceptionally loose monetary conditions has also been evident in the house price and stock market booms of the past decade, governments' ability to build-up high levels of cheap debt and very tight spreads in credit markets.
- **All this is now unwinding as monetary conditions are tightened and borrowing costs surge.** The IMF this week warned of the risk that financial turmoil could erupt as rates rise, with widespread debt distress in vulnerable emerging markets, a risk that is being compounded by dollar strength and a flight into quality assets. Unwinding QE is going to prove a difficult exercise for central banks. Even in the US, the Fed has not been able to run down its holdings of mortgage backed securities as quickly as it had envisaged. The ECB has avoided any mention of embarking on QT. No doubt the problems in regard to leverage and the use of liability-driven investment strategies are also present in EU markets. It is hard to see the BoE commencing any large scale QT programme later this month. Instead, central banks may have to be patient, and allow their large bond portfolios roll off as they mature.
- **The lessons from the past decade of extremely loose monetary policies comprising, zero or negative interest rates and QE are clear.** These policies were initially introduced as emergency measures to help stabilise financial systems and lay the basis for economic recovery, which was justifiable. However, they then became part of the toolkit to fight low inflation, especially in Europe and Japan. Leaving such loose policies in place for long periods of time leads to a mispricing of assets, the mis-allocation of capital and weakens financial stability. Withdrawing these policies after a long period causes major dislocation as markets correct. They are non-standard policy measures and, as such, should only be put in place for short periods of time.
- **This week, the UK will remain in focus, with a number of key data points due for release.** Headline CPI inflation eased slightly to 9.9% y/y in August. The core rate edged up to 6.3% y/y. Price pressures have become more broad based, with services inflation rising to 5.9% y/y, its highest level since 1992. Although the recently announced Government plan to cap household energy bills will limit the rise in inflation this winter and into next year, CPI is still projected to rise further. The consensus is for a modest increase to 10.0% y/y in headline CPI in September. The rapid rise in prices this year has weighed heavily on household disposable incomes. As a result, consumer confidence has been at all-time lows in the UK for a number of months. A further decline in the index to -52 is pencilled in for October. Very weak consumer confidence and lower disposable incomes have seen retail sales fall in seven of the last eight months, including by a substantial 1.6% in August. A 0.5% contraction is forecast for September.
- **In the US, industrial production data for September will feature.** Industry has performed relatively well in 2022, particularly in the first half of the year. However, more recently output has softened, and leading indicators of production such as the manufacturing PMI and ISM have weakened somewhat. A slight increase of 0.1% in industrial production is expected in September. Elsewhere a slew of housing market metrics, including, housing starts, existing home sales (Sep) and homebuilder sentiment (Oct) will provide an update on the sector, which has weakened considerably.
- **In the Eurozone, the final reading of HICP is set to confirm prices rose by 10% y/y in September.** Meanwhile, consumer confidence is forecast to deteriorate further in October, from already very subdued levels.



|             | Interest Rate Forecasts |        |        |        |
|-------------|-------------------------|--------|--------|--------|
|             | Current                 | End Q4 | End Q1 | End Q2 |
|             | 2022                    | 2022   | 2023   | 2023   |
| Fed Funds   | 3.125                   | 4.375  | 4.625  | 4.625  |
| ECB Deposit | 0.75                    | 2.00   | 2.75   | 2.75   |
| BoE Repo    | 2.25                    | 3.75   | 4.50   | 4.50   |
| 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 Q4 | End Q1 | End Q2 |
|         | 2022   | 2022   | 2023   | 2023   |
| EUR/USD | 0.9725                                       | 0.96   | 0.99   | 1.02   |
| EUR/GBP | 0.8701                                       | 0.89   | 0.90   | 0.90   |
| EUR/JPY | 144.27                                       | 142    | 148    | 151    |
| GBP/USD | 1.1175                                       | 1.08   | 1.10   | 1.13   |
| USD/JPY | 148.33                                       | 148    | 149    | 148    |

Current Rates Reuters, Forecasts AIB's ERU

| Date              | UK & Irish Time                              |       | Release   | Previous           | Forecast         |
|-------------------|--|-------|---|--------------------|------------------|
| <b>This Week:</b> | <b>ECB Speakers:</b>                         |       | De Guindos, Lane (Mon); Schnabel (Tue)  |                    |                  |
|                   | <b>BoE Speakers:</b>                         |       | Cunliffe (Wed); Mann (Thu)  |                    |                  |
|                   | <b>Fed Speakers:</b>                         |       | Kashkari, Bostic (Tue); Bullard, Kashkari, Evans (Wed); Jefferson, Cook, Bowman (Thu); Williams (Fri) |                    |                  |
|                   | <b>EU Leaders Summit (20th-21st October)</b> |       |   |                    |                  |
| <b>Mon 17th</b>   | <b>ITA:</b>                                  | 09:00 | Final HICP (September)  | +1.7% (+9.5%)      | +1.7% (+9.5%)    |
|                   | <b>US:</b>                                   | 13:30 | NY Fed / Empire State Index (October)   | -1.50              | -5.0             |
| <b>Tue 18th</b>   | <b>CHINA:</b>                                | 03:00 | Industrial Output (September)   | (+4.2%)            | (+4.5%)          |
|                   | <b>CHINA:</b>                                | 03:00 | Retail Sales (September)  | (+5.4%)            | (+3.3%)          |
|                   | <b>CHINA:</b>                                | 03:00 | GDP (Q3)  | -2.6% (+0.4%)      | +3.5% (+3.4%)    |
|                   | <b>GER:</b>                                  | 10:00 | ZEW Economic Sentiment (October)  | -61.9              | -66.0            |
|                   | <b>US:</b>                                   | 14:15 | Industrial Production (September)   | -0.2% (+3.7%)      | +0.1% (+4.5%)    |
|                   |  |       | - Manufacturing Output  | +0.1%              | +0.2%            |
|                   |  |       | - Capacity Utilisation  | 80.0%              | 79.7%            |
|                   | <b>US:</b>                                   | 15:00 | NAHB Homebuilder Sentiment (October)  | 46                 | 43               |
| <b>Wed 19th</b>   | <b>UK:</b>                                   | 07:00 | CPI Inflation (September)   | +0.5% (+9.9%)      | +0.4% (+10.0%)   |
|                   |  |       | - Core CPI  | +0.8% (+6.3%)      | +0.5% (+6.4%)    |
|                   | <b>UK:</b>                                   | 07:00 | PPI Input Price Inflation (September)   | -1.2% (+20.5%)     |                  |
|                   |  |       | - PPI Output Price Inflation (September)  | -0.1% (+16.1%)     |                  |
|                   | <b>EU-19:</b>                                | 10:00 | Final HICP Inflation (September)  | +1.2% (+10.0%)     | +1.2% (+10.0%)   |
|                   |  |       | - Ex-Food & Energy  | +0.9% (+6.1%)      | +0.9% (+6.1%)    |
|                   | <b>US:</b>                                   | 13:30 | Housing Starts (September)  | +1.575m / (+12.2%) | +1.48m / (-6.0%) |
|                   |  |       | - Building Permits  | +1.542m / (-8.5%)  | +1.53m / (-7.7%) |
| <b>Thu 20th</b>   | <b>JPN:</b>                                  | 00:50 | Trade Balance (September)   | -¥2,817bn          | -¥2,167bn        |
|                   |  |       | - Exports   | (+22.1%)           | (+27.1%)         |
|                   | <b>GER:</b>                                  | 07:00 | Producer Prices (September)   | +7.9% (+45.8%)     | +2.0% (+45.2%)   |
|                   | <b>FRA:</b>                                  | 07:45 | INSEE Business Climate (October)  | 102                | 101              |
|                   | <b>US:</b>                                   | 13:30 | Initial Jobless Claims (w/e10th October)  | +228,000           | +235,000         |
|                   | <b>US:</b>                                   | 13:30 | Philly Fed Index (October)  | -9.9               | -5.0             |
|                   | <b>US:</b>                                   | 15:00 | Existing Home Sales (September)   | +4.8m / -0.4%      | +4.7m / -2.3%    |
| <b>Fri 21st</b>   | <b>UK:</b>                                   | 00:01 | Gfk Consumer Confidence (October)   | -49                | -52              |
|                   | <b>JPN:</b>                                  | 00:30 | CPI Inflation (September)   | (+3.0%)            | (+3.0%)          |
|                   |  |       | - Core CPI  | (+2.8%)            | (+3.0%)          |
|                   | <b>UK:</b>                                   | 07:00 | Retail Sales (September)  | -1.6% (-5.4%)      | -0.5% (-5.0%)    |
|                   |  |       | - Ex-Fuel   | -1.6% (-5.0%)      | -0.3% (-4.0%)    |
|                   | <b>UK:</b>                                   | 09:30 | Mortgage Approvals (September)  | +74,340            |                  |
|                   | <b>EU-19:</b>                                | 15:00 | Flash Consumer Confidence (October)   | -28.8              | -30.3            |

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

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