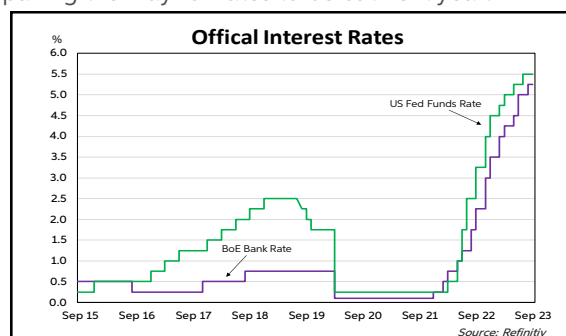


Recession Required for Rate Cuts

- **Markets are of the view that we have seen the last ECB rate hike, following Thursday's 25bps increase, which brought the key deposit rate up to 4%.** The ECB commented that the marked tightening of monetary policy since July 2022 will have a substantial impact in terms of bringing inflation back down to its 2% target in a timely manner. It warned, though, that rates will need to be maintained at current levels for a sufficiently long period of time to ensure their inflation goal is met, suggesting that monetary easing is not on the horizon anytime soon. Markets, though, are of a different view and see rates starting to be cut by mid-2024, with the deposit rate being lowered to 3% by Q3 2025. However, the latest set of ECB staff macro forecasts would not seem to be consistent with rate cuts next year. Inflation is seen averaging 3.2% in 2024, while the economy is projected to regain momentum, with GDP growth picking up to 1% next year and 1.5% in 2025.
- **As the ECB notes, though, the risks to its growth forecasts are tilted to the downside.** The Eurozone economy has stagnated over the past year. It expanded by a meagre 0.1% in both the first and second quarters of 2023. This followed a 0.1% contraction in GDP in Q4 of last year. Survey data suggest the economy has lost further momentum in recent months. The services PMI averaged 54.4 in the second quarter, but declined to 50.9 in July, and 47.9 in August. The latter reading was the quickest pace of contraction in the sector since February 2021. Meantime, the manufacturing PMI averaged 44.7 in Q2, and stayed well in contraction territory, at 42.7 and 43.5, respectively, in July and August. The EC economic sentiment index, which has been trending lower since the start of the year, fell to 93.3 in August, its lowest level since November 2020.
- **The available hard data for Q3 have also been weak.** Retail sales fell by 0.2% in July, and were 1% lower in year-on-year terms. Meanwhile, industrial production declined by 1.1% in July. Monetary aggregates also continued to weaken in July, with M3 money supply falling by 0.4% and credit growth to households slowing to 1.7% in year-on-year terms. Overall, the data suggest that GDP could contract in Q3. It is clear that the combination of the sharp tightening in financial conditions on the back of ECB rate increases, elevated inflation and a slowdown in global growth are all weighing heavily on the Eurozone economy.
- **The ECB expects activity to pick up momentum as real incomes rise on the back of falling inflation, higher wages and a strong labour market.** However, employment growth is slowing and the lagged effects of monetary tightening combined with subdued global growth are significant headwinds for the economy. Stagflation could remain the order of the day for the Eurozone into next year, with a risk that the economy could fall into recession. It may well be that markets believe a recession is on the cards for the Eurozone, as this would accelerate the path for a return of inflation to 2%, paving the way for rates to be cut next year.
- **This week, the focus will be on the latest monetary policy meetings of the US Federal Reserve, the Bank of England, and the Bank of Japan. The Fed is widely expected to leave interest rate policy on hold this Wednesday.** Futures contracts, though, indicate that the market is of the view that there is around a 50% chance that the Fed will opt to raise rates in Q4. Thus, investors will be paying very close attention to Chair Powell's remarks at the post-meeting press conference, and to the updated interest rate dotplot. The dotplot will also be looked to for guidance on the extent of rate cuts next year. Currently, futures contracts suggest that US rates will be cut by 75bps to 4.50-4.75% by end 2024. **Similarly, the BoJ is likely to leave interest rates unchanged.** Given recent speculation that the BoJ may exit its negative interest rate policy by year end, though, the main focus will be on the post-meeting press conference with Governor Ueda.
- **Meanwhile, the BoE is expected to hike by 25bps on Thursday, bringing the Bank rate up to 5.5%.** Market expectations for the peak in UK rates has been pared back sharply in recent weeks, on the back of some dovish comments from BoE officials. Futures contracts are currently pricing in a peak of circa 5.6% in the UK, compared to a high of circa 6.5% seen earlier this summer. Thus, the expected UK rate hike this week may be the last in this tightening cycle, but this will be heavily dependent on incoming inflation data. Headline UK inflation has fallen recently, but the core rate has been quite sticky. The former stood at 6.8% in July, down from 7.9% in both May and June, while the latter was unchanged in July, at 6.9%, and just below the 7.3% peak registered in May. Both are forecast to be little changed in August, with headline CPI rising to 7.1%, and core-CPI declining slightly to 6.8%. Elsewhere in the UK, retail sales (Aug) and consumer confidence (Sep) are due.
- **Meantime, the flash PMIs for September in the US, Eurozone and UK will be released on Friday.** As noted above, the Eurozone PMIs have been weak so far in Q3, with both sectors in contraction mode in August. Similarly, the UK PMIs were below 50 in August, as was the manufacturing sector in the US. Furthermore, the US services PMI fell to 50.5 in August, its lowest level since February. **The consensus is for very weak PMI readings across the board in September also, little changed from August's levels.** Finally, a raft of housing market data are due in the US this week.



	Interest Rate Forecasts			
	Current	End Q3	End Q4	End Q1
		2023	2023	2024
Fed Funds	5.375	5.375	5.625	5.625
ECB Deposit	4.00	4.00	4.00	4.00
BoE Repo	5.25	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	End Q4	End Q1
		2023	2023	2024
EUR/USD	1.0657	1.08	1.09	1.10
EUR/GBP	0.8593	0.86	0.87	0.87
EUR/JPY	157.64	159	159	158
GBP/USD	1.2402	1.26	1.25	1.26
USD/JPY	147.86	147	146	144
Current Rates Reuters, Forecasts AIB's ERU				

Date	UK & Irish Time		Release	Previous	Forecast
This Week:	ECB Speakers:	Schnabel, Labe (Thu); de Guindos (Fri)			
	BoE Speakers:				
	Fed Speakers:	Daly, Cook (Fri)			
Mon 18th	IRL:	11:00	Residential Property Price Index (July)	+0.6% (+2.2%)	+0.1% (+1.3%)
	US:	15:00	NAHB Homebuilder Sentiment (September)	50.0	50.0
Tue 19th	EU-20:	10:00	Final HICP Inflation (August)	-0.1% (+5.3%)	+0.6% (+5.3%)
			- Ex-Food & Energy	+0.3% (+6.2%)	+0.3% (+6.2%)
			- Ex-Food, Energy, Alcohol & Tobacco	+0.3% (+5.3%)	+0.3% (+5.3%)
	US:	13:30	Housing Starts (August)	+1.452m / +3.9%	+1.440m
			- Building Permits (August)	+1.443m / +0.1%	+1.445m
Wed 20th	JPN:	00:50	Trade Balance (August)	-¥78.7bn	-¥659.1bn
			- Exports	(-0.3%)	(-1.7%)
	CHINA:	02:15	1Yr Loan Prime Rate (September)	3.45%	
			- 5Yr Loan Prime Rate	4.20%	
	GER:	07:00	Producer Prices (August)	-1.1% (-6.0%)	+0.2% (-12.8%)
	UK:	07:00	CPI Inflation (August)	-0.4% (+6.8%)	+0.7% (+7.1%)
			- Core-CPI Inflation	+0.3% (+6.9%)	+0.7% (+6.8%)
	UK:	07:00	PPI Input Price Inflation (August)	-0.4% (3.3%)	
			- PPI Output Price Inflation	+0.1% (-0.8%)	
US:	19:00	Fed FOMC Interest Rate Announcement	5.25-5.50%	5.25-5.50%	
US:	19:30	Fed FOMC Post-Meeting Press Conference			
Thu 21st	FRA:	07:45	INSEE Business Climate (September)	99	100
	UK:	12:00	BoE Interest Rate Announcement		
			- Bank Rate	5.25%	5.50%
	US:	13:30	Initial Jobless Claims (w/e 11th September)	+220,000	+225,000
	US:	13:30	Philly Fed Business Index (September)	12.0	-0.7
	EU-20:	15:00	Flash Consumer Confidence (September)	-16.0	-16.5
	US:	15:00	Existing Home Sales (August)	+4.07m / -2.2% s.a.a.r.	+4.10m
Fri 22nd	JPN:		BoJ Interest Rate Decision	-0.10%	-0.10%
	UK:	00:01	Gfk Consumer Confidence (September)	-25.0	-27.0
	JPN:	00:30	CPI Inflation (August)	(+3.3%)	
			- Core CPI Inflation	(+3.1%)	(+3.0%)
	JPN:	01:30	Flash Jibun Composite PMI (September)	52.6	
	UK:	07:00	Retail Sales (August)	-1.2% (-3.2%)	+0.5% (-1.2%)
			- Ex-Fuel	-1.4% (-3.4%)	+0.6% (-1.3%)
	SPA:	08:00	GDP (Q2: Final Reading)	+0.4% (+1.8%)	+0.4% (+1.8%)
	FRA:	08:15	Flash HCOB Composite PMI (September)	46.0	46.1
	GER:	08:30	Flash HCOB Composite PMI (September)	44.6	44.8
	EU-20:	09:00	Flash HCOB Composite PMI (September)	46.7	46.3
			- Services / Manufacturing	47.9 / 43.5	47.5 / 44.0
	UK:	09:30	Flash CIPS / S&P Composite PMI (September)	48.6	48.6
			- Services / Manufacturing	49.5 / 43.0	49.0 / 43.0
	US:	14:45	Flash S&P Composite PMI (September)	50.2	
			- Services / Manufacturing	50.5 / 47.9	50.3 / 47.8

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

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