Global Watch

March 2023

Economic and Market Update

Bank of Ireland

Summary

- Economic activity in the opening months of this year has held up better than anticipated, with labour markets also proving resilient and underlying inflation remaining elevated.
- The main central banks have raised interest rates further, though they have also become more circumspect about future moves as developments in the banking sector add an additional layer of uncertainty to the economic outlook.
- The banking sector woes have contributed to a notable change in market expectations for interest rates. The Fed is now seen embarking on a rate-cutting cycle fairly soon.
- We don't envisage the Fed lowering rates this year and expect the ECB to hike rates further over the coming months.
- After falling below parity last autumn, the euro has rebounded strongly against the dollar as the ECB has accelerated monetary policy tightening and we expect it to trend gradually higher over the remainder of this year.
- Sterling has been trading in a narrow range against the euro since the start of this year. We see the pound continuing in this vein for a while longer albeit with a slight weakening bias.

Forecasts

GDP Growth*	2022	2023(f)	2024(f)
Global	3.2%	2.6%	2.9%
US	2.1%	1.5%	0.9%
Euro area	3.5%	0.8%	1.5%
UK	4.0%	-0.2%	0.9%

*Annual % change, constant prices
Source: OECD (March 2023)

Central Bank Interest Rates (%)	Current	End-Jun 23	End-Sep 23	End-Dec 23	End-Mar 24
Fed	4.75-5.0	5.0-5.25	5.0-5.25	5.0-5.25	5.0-5.25
ECB (Deposit Rate)	3.00	3.50	3.50	3.50	3.50
BOE	4.25	4.50	4.50	4.50	4.50

Source: Bloomberg, Bank of Ireland Forecasts

FX**	Current	Q2'23	Q3'23	Q4'23	Q1'24
€/$	1.09	1.07-1.11	1.08-1.12	1.10-1.14	1.12-1.16
€/£	0.88	0.86-0.90	0.86-0.90	0.87-0.91	0.87-0.91
£/$	1.24	1.22-1.26	1.22-1.26	1.23-1.27	1.25-1.29

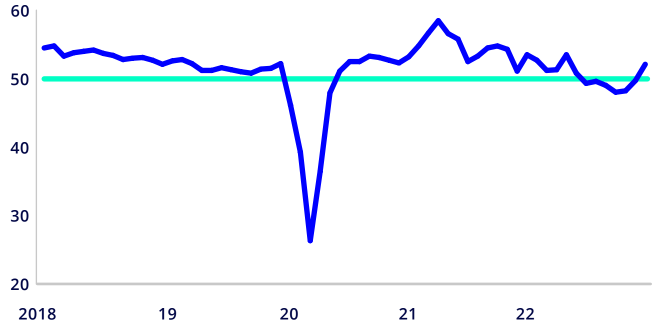
**Current Rate is as of 31st March 2023
Source: Bloomberg, Bank of Ireland forecasts

Upcoming Events

Economy

Global

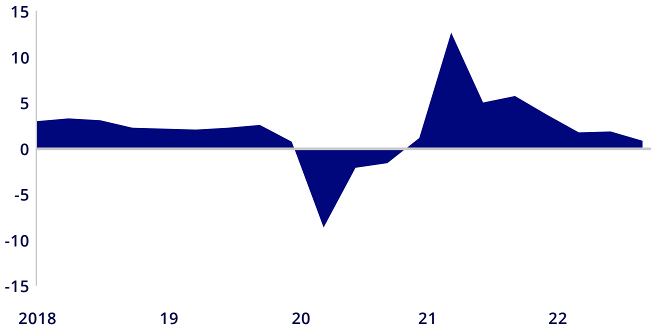
According to the OECD, global GDP growth moderated to 3.2% in 2022 from almost 6% in 2021. High frequency data suggest the world economy began 2023 on a relatively soft note, albeit the Global Composite PMI did return to expansionary territory (>50) in February for the first time since July last year. While the OECD expects growth to slow further to 2.6% in 2023, this is a slight upgrade on its previous forecast (though its latest projections pre-date the turmoil in the banking sector) as an easing of inflationary pressures is seen contributing to a pick-up in activity as the year progresses.



Source: JP Morgan, S&P Global

US

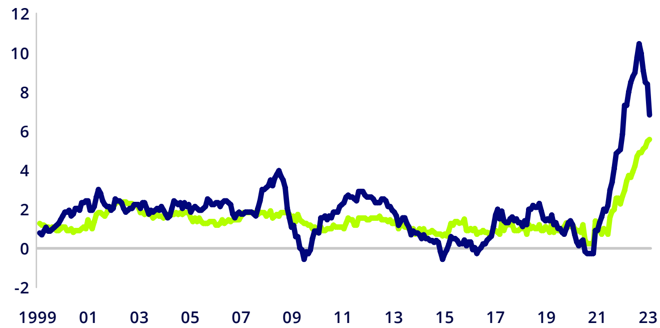
GDP growth in the US slowed to 2.1% last year, from 5.9% in 2021, reflecting a combination of the rebound from the pandemic running its course, a squeeze on household spending from high inflation, and tighter financial conditions as the Fed raised interest rates. The latter will continue to dampen growth in 2023, but declining inflation - headline PCE inflation has fallen by more than 1.5 percentage points from its peak of 7% last June - will help ease the burden on household incomes. The labour market has remained resilient so far, with the economy continuing to add jobs and unemployment remaining low although wage growth has moderated.



Source: BEA

Euro area

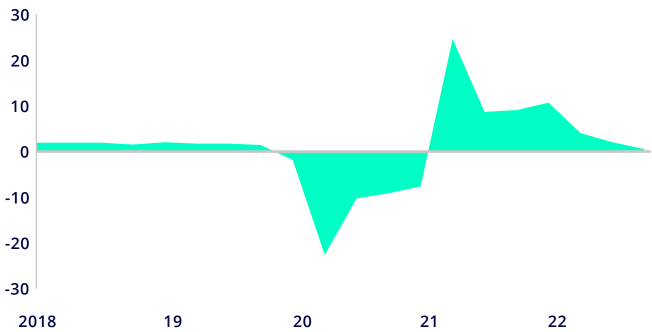
2022 was very much a year of two halves for the Euro area economy. The lifting of COVID-19 public health restrictions contributed to a strong increase in GDP over the first half of the year, but this gave way to much more subdued activity over the remainder of 2022 with output stalling in the final quarter. Headline inflation has fallen by almost 4 percentage points in recent months and is likely to decline further over the course of this year. This will support consumer spending, but higher interest rates and a weaker global economy are still likely to dampen overall GDP growth in 2023.



Source: Eurostat

UK

Having expanded at a solid pace in the first quarter of 2022, the UK economy effectively stalled over the remaining three quarters of the year. The impact of high inflation and tighter monetary policy was exacerbated by the fall-out from September's ill-fated 'mini-budget', which contributed to a decline in consumer and business confidence and spike in mortgage interest rates (with the latter weighing on the housing market). Nonetheless, high frequency data suggest the economy is holding up better than anticipated, while an expected deceleration in inflation during 2023 on the back of falling energy bills will ease the 'cost of living' pinch on households and contribute to a recovery in consumer spending.

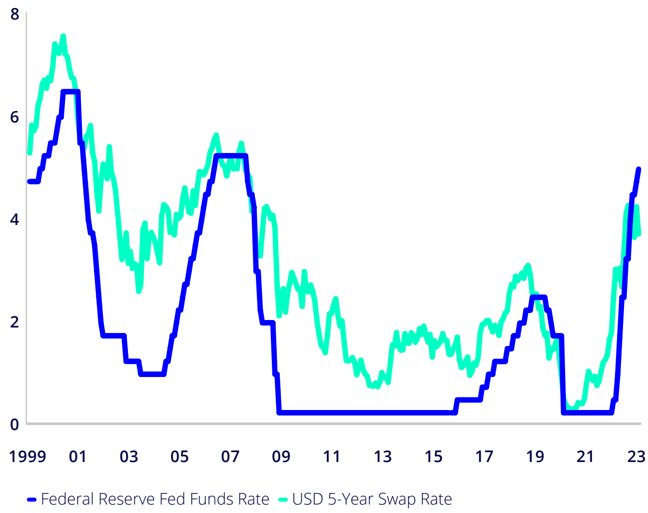


Source: ONS

Interest Rates

Fed

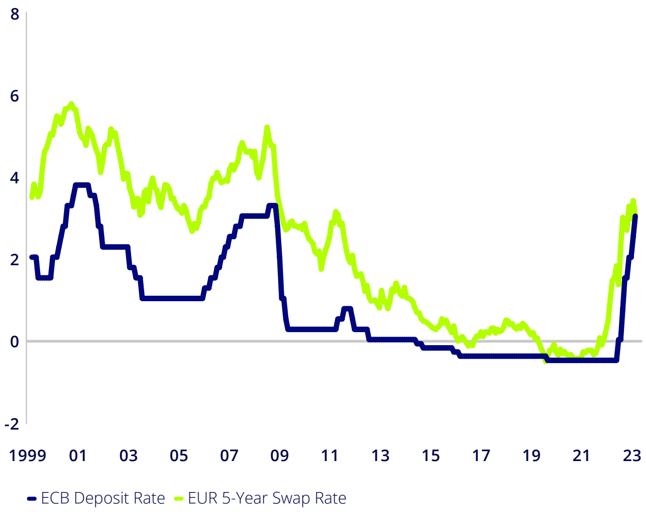
The Fed raised interest rates by 25bps at its first meeting of 2023 in early February and seemed set to hike by 50bps in March following stronger than expected labour market and inflation data. However the collapse of Silicon Valley Bank and the spill-over to financial markets limited the increase to 25bps, with the Fed noting that "these developments are likely to result in tighter credit conditions…and to weigh on economic activity, hiring, and inflation (though) the extent is uncertain." In relation to future rate moves, the Fed said some "additional firming" may still be needed, with its updated projections pointing to one further 25bps increase (to 5%-5.25%). While the peak in rates may be close at hand, the Fed has indicated it is unlikely to cut them anytime soon, given inflation is still "too high" and expected to remain well above target through this year. This is at odds with current market pricing, which envisages the Fed lowering rates from around the middle of this year.



Source: Bloomberg

ECB

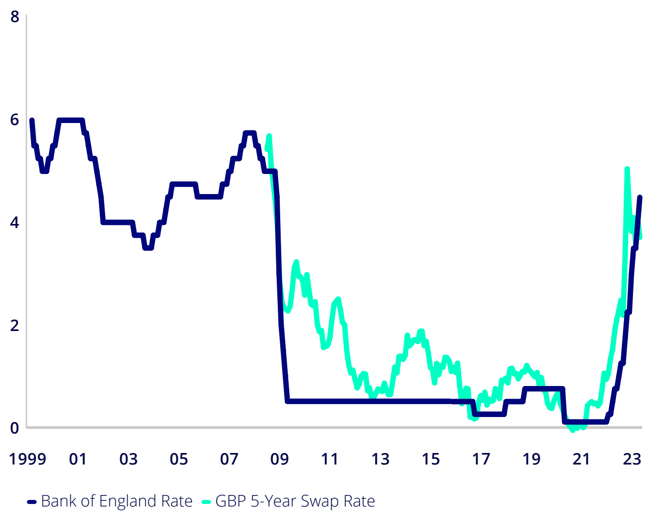
The ECB raised interest rates by 50bps in March and noted that, on the basis of its updated forecasts - which show inflation remaining above the 2% target over most of the period 2023-2025 - further rate increases would be warranted. However the forecasts were prepared prior to the turmoil in the banking sector and, given the resulting uncertainty, the ECB refrained from giving any formal guidance on the future path for rates, saying it would make its decisions on a meeting-by-meeting basis. The market is pricing in a further 50bps increase in rates by July this year, around 50bps less than expected immediately before the banking shock. The latter is likely to have a dampening effect on growth and inflation, but perhaps not enough to prevent the need for some more policy tightening.



Source: Bloomberg

Bank of England

The MPC increased interest rates by 25bps to 4.25% in March. It noted that there had been "large and volatile moves in global financial markets" due to stresses in the banking sector, and said it would "monitor closely the effect on credit conditions" and the impact on the economy. While it expects headline inflation to fall sharply this year, largely due to lower energy prices, it said the extent to which domestic inflationary pressures ease - underlying inflation is currently running at over 6% - will depend on, among other things, the impact of rate increases to date, adding that "if there were to be evidence of more persistent (price) pressures, further tightening…would be required". The market expects the MPC to hike once more, to 4.50%, and sees it starting to lower rates by year-end.

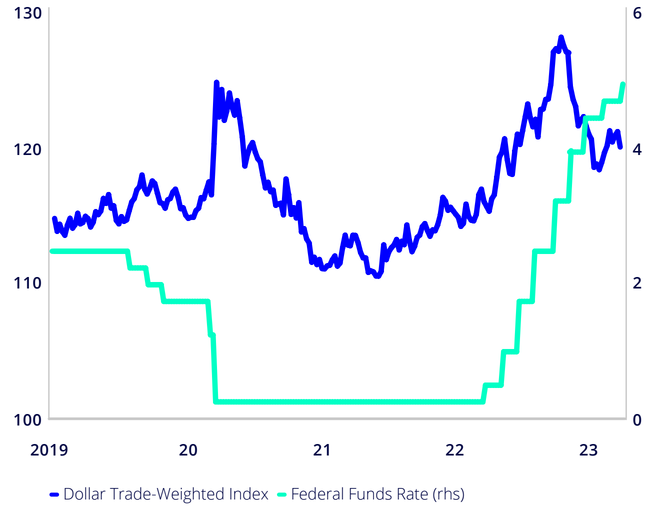


Source: Bloomberg

Currencies

Dollar

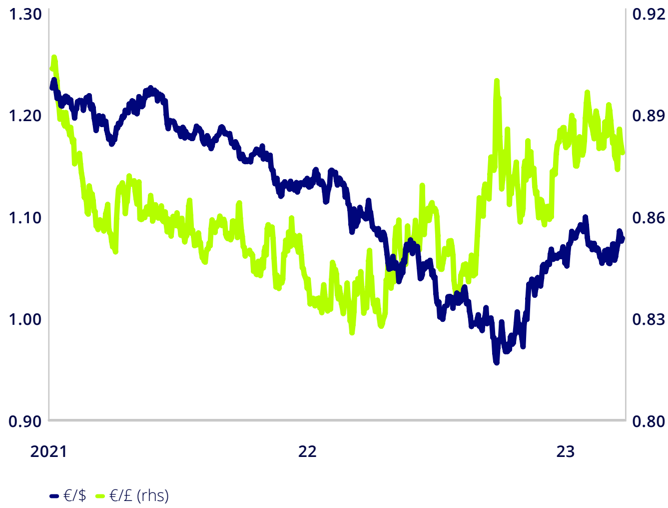
The first six months of the Fed's interest rate-hiking cycle (which began in March 2022), during which it raised its key policy rate by 300bps, was accompanied by an appreciation of the dollar, but this was partially reversed subsequently as the Fed stepped down the pace of rate increases. The recent turmoil in the banking sector, though originating in the US, saw the dollar temporarily gain a little ground given the more risk-averse environment. It has also led the market to price in a series of Fed rate cuts beginning early in the second half of the year, which if this were to come to pass would weigh on the dollar. Tighter credit conditions as a result of the banking shock may do some of the Fed's job in terms of dampening economic activity and helping to bring down inflation, but this is a reason to think it might be done raising rates rather than an argument for lowering them. We don't expect the Fed to cut rates this year, hence we see the dollar 'holding its own' for a while longer yet.



Source: Bloomberg

Euro

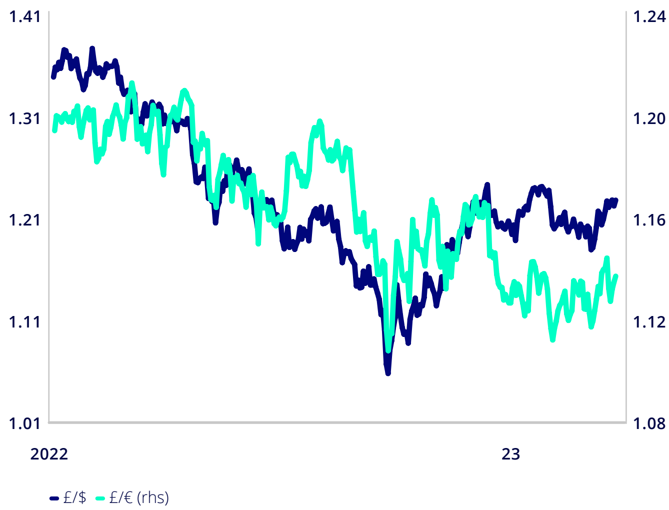
The euro fell to a circa 20-year low of $0.95 in September last year (from around $1.13 at the start of 2022) as the ECB lagged the Fed in raising interest rates, but has recovered strongly since then as the former has stepped up the scale of tightening, trading up to a 2023 to date high of $1.10 in early February. We expect the single currency to make modest gains against the dollar over the remainder of this year as the ECB raises rates further in response to elevated underlying inflation (which has continued to set new record highs recently), even if developments in the banking sector weigh on economic activity to some extent. It is likely to accelerate its gains against the dollar if, as we expect, the ECB lags the Fed in cutting interest rates, though this is perhaps more of a story for 2024.



Source: Bloomberg

Sterling

Having fallen sharply in the immediate aftermath of last September's ill-fated 'mini-budget' the pound has regained ground against both the euro and the dollar. It has tended to move broadly in lockstep with the euro against the dollar more recently, leaving it trading in a relatively narrow range against the single currency albeit with a slightly weakening bias. We see this continuing to be the case for the most part, with the pound eking out modest gains against the dollar over the remainder of this year. The Bank of England is more advanced than the ECB in terms of hiking rates (having begun earlier and done more), and is likely to raise rates by less from here (and to be ahead of the ECB in commencing any rate-cutting cycle). Hence we expect sterling to gradually weaken against the euro over the rest of this year and into 2024.



Source: Bloomberg

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