Global Watch

January 2024

Economic and Market Update

Bank of Ireland

Summary

There has been a sea-change in market expectations for interest rates since our last Global Watch in late October. Back then the main central banks were seen keeping policy rates “higher for longer” in the face of elevated inflation, sending US Treasury yields to levels (5%) last seen in 2007. Three months later and, following a much sharper than anticipated decline in inflation over the latter part of 2023, the market now expects a series of interest rate cuts in 2024 starting in the second quarter of the year.

Indeed in December the market was pricing in policy easing beginning as soon as March. Central banks have pushed back on expectations for an early move in rates, with some limited success, while acknowledging that they are likely to lower them this year as inflation falls further towards target. Current market pricing has the Fed and ECB easing by around 125-150bps in 2024 and the Bank of England cutting by about 100bps. Although the timing and pace of rate cuts is uncertain, this seems reasonable enough to us and would see an unwinding of some of the substantial increase in rates (450-550bps) over the past 18-24 months or so.

The main currency pairs have traded in relatively narrow ranges in recent months and the monetary policy outlook suggests it could be more of the same in 2024. However we think the dollar will gradually weaken against both the euro and sterling this year, leaving the single currency-pound exchange rate within the tight range that has prevailed for an extended period now. Of course, 2024 is election year in the US, and in lots of other places too, and it seems the list will now include the UK as well, which could lead to increased volatility in markets generally throughout the year.

Forecasts

GDP Growth*	2023(e)	2024(f)	2025(f)
Global	2.9%	2.7%	2.9%
US	2.5%	1.5%	1.7%
Euro area	0.6%	0.9%	1.5%
UK	0.5%	0.7%	1.2%

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

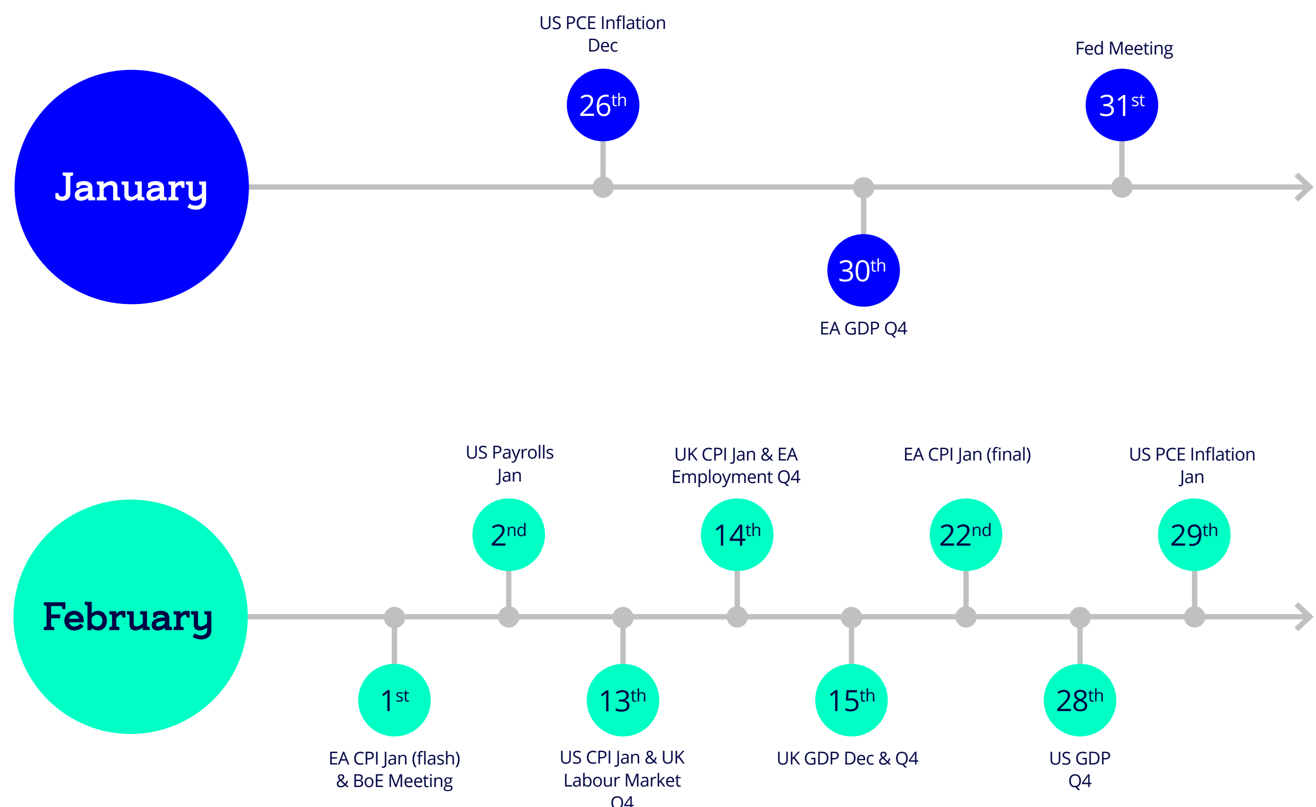
Central Bank Interest Rates (%)	Current	End-Mar 24	End-Jun 24	End-Sep 24	End-Dec 24
Fed	5.25-5.50	5.25-5.50	5.00-5.25	4.50-4.75	4.00-4.25
ECB (Deposit Rate)	4.00	4.00	3.75	3.25	2.75
BOE	5.25	5.25	5.25	4.75	4.25

Source: Bloomberg, Bank of Ireland Forecasts

FX**	Current	Q1'24	Q2'24	Q3'24	Q4'24
€/$	1.08	1.07-1.12	1.10-1.15	1.12-1.17	1.14-1.19
€/£	0.85	0.84-0.89	0.84-0.89	0.85-0.90	0.85-0.90
£/$	1.27	1.25-1.30	1.27-1.32	1.28-1.33	1.30-1.35

**Current Rate is as of 25th January 2024
Source: Bloomberg, Bank of Ireland forecasts

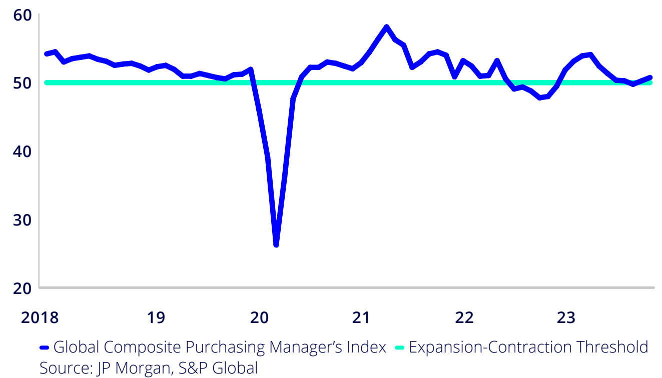
Upcoming Events



Economy

Global

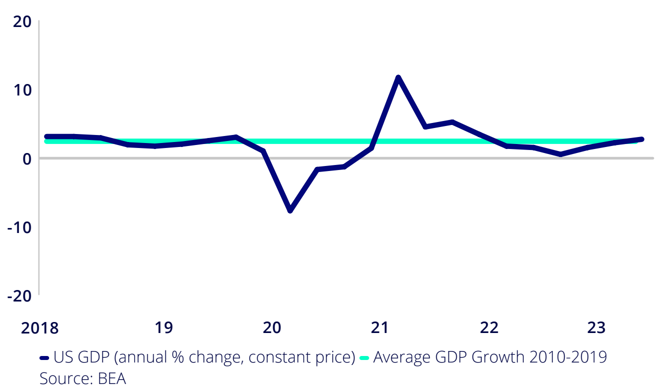
The pace of growth in the world economy slowed in the second half of last year in response to tighter monetary policy. The global composite PMI declined steadily over this period and has been hovering just above the key 50 level recently, with services activity moderating following a post-pandemic bounce and manufacturing remaining weak. The OECD in its latest Economic Outlook expects GDP growth to average 2.9% for 2023 as a whole, down from 3.4% in 2022, and sees it moderating a little further to 2.7% this year. The latter, as the OECD notes, would be the "lowest annual rate (of growth) since the global financial crisis other than the first year of the pandemic". More positively, inflation globally is projected to fall further in 2024 and is seen back on target in most advanced economies in 2025.



Source: JP Morgan, S&P Global

US

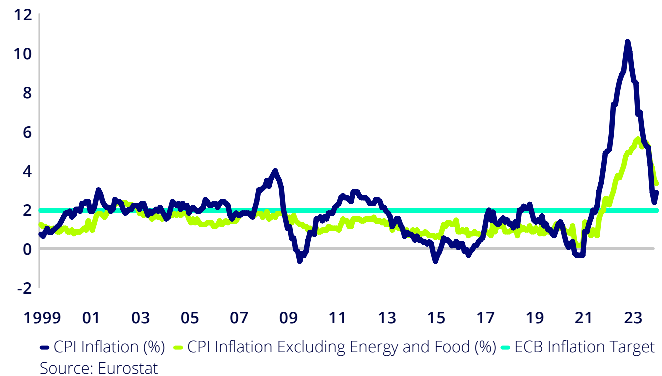
The US economy proved surprisingly resilient in 2023 with GDP growth averaging 2.5% for the year as a whole, up from 1.9% in 2022. Following a very strong third quarter, the pace of activity stepped down in the final quarter of last year, and the OECD expects growth to moderate to 1.5% this year as the full impact of higher interest rates plays out. While the labour market remains relatively tight, job openings have fallen, unemployment has crept up and wage growth has moderated. Inflation has declined steadily, notwithstanding the relative strength of economic activity, with the annual headline and core rates running at 2.7% and 3.2% respectively in Q4, down from 5.9% and 5.1% in the corresponding quarter of 2022. Shorter-term inflation dynamics paint an even more favourable picture, with core prices rising at an annualised rate of 2% over the three months to December.



Source: BEA

Euro area

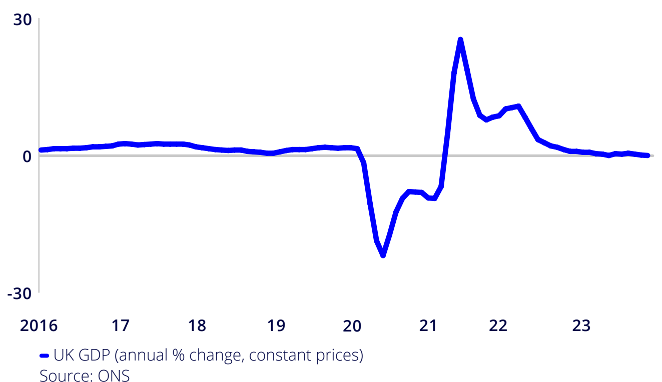
High interest rates and weak global growth are weighing on the Euro area economy. GDP contracted slightly in the third quarter, having risen very modestly in the first two quarters of last year, and the PMI data - which shows the composite index continuing to run below the key 50 level - point to another small fall in Q4. The OECD expects growth to have averaged just 0.6% in 2023, down from almost 3.5% in 2022, but sees it picking up to 0.9% this year as lower inflation boosts real incomes and spending. The labour market has been resilient to date in the face of slower growth, with unemployment at a record low of 6.4%. Both headline and core inflation fell sharply over the latter part of 2023 to end the year at 2.9% and 3.4% respectively, down from 9.2% and 5.2% at the end of 2022, while weak demand and subdued growth generally should result in a further decline over the course of 2024.



Source: Eurostat

UK

Falls in consumer spending and investment saw the UK economy contract slightly in the third quarter of last year, with GDP declining by 0.1% leaving it just 0.3% higher than in the corresponding quarter in 2022. The latest PMI data suggest output was more or less flat in Q4, but may pick up a bit at the start of 2024 helped by strengthening services sector activity (the services PMI jumped to a 12-month high of 53.8 in January). The OECD expects GDP growth to remain relatively subdued in 2024 at 0.7%, albeit up slightly from 0.5% in 2023, before strengthening to 1.2% in 2025 as lower inflation boosts incomes and spending. Inflation fell sharply in the final quarter of 2023, to around 4%, helped by lower energy prices and a decline in underlying inflation. The latter has fallen to around 5% from a peak of 7% in May last year, though services inflation is still running north of 6% reflecting robust wage growth.

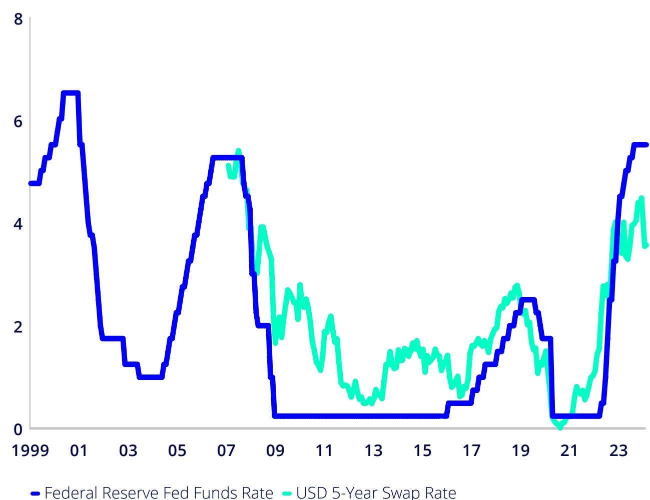


Source: ONS

Interest Rates

Fed

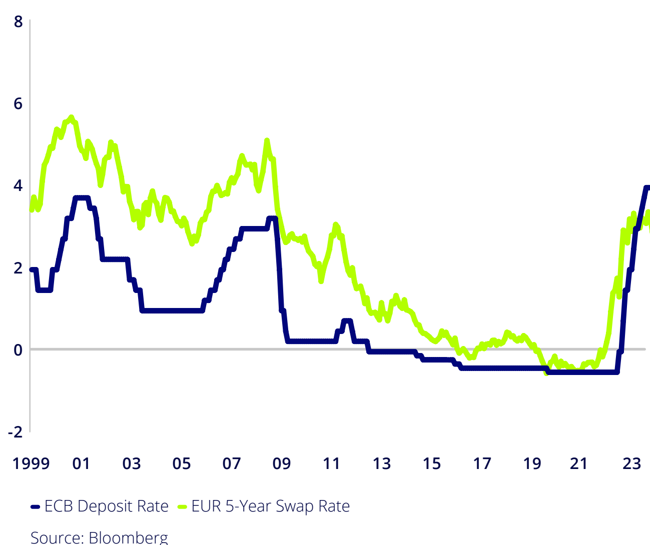
The Fed kept interest rates unchanged in a range of 5.25%-5.50% for a third consecutive meeting in December. Given the "progress" to date in lowering inflation, it acknowledged that rates have probably peaked but said policy may need to remain restrictive "for some time" to ensure inflation returns sustainably to 2%. By the same token though, the Fed's interest rate "dot plot" showed the median expectation was for a 75bps reduction in rates by the end of 2024 and a further 100bps decline in 2025. The market is pricing in a more aggressive easing of policy for this year though - it sees a first full 25bps cut at the April 30th - May 1st meeting and expects a cumulative reduction of at least 125bps by end-December. In our October Global Watch we saw the Fed lowering rates by around the middle of this year and easing by a total of 125bps in 2024. This still seems reasonable to us although there's a chance a first cut may come a little earlier than mid-year.



Source: Bloomberg

ECB

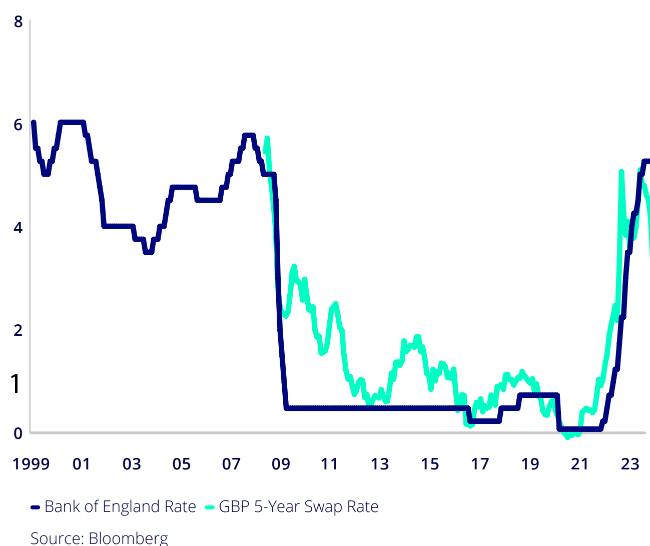
The ECB has left interest rates on hold at each of its three meetings since it last hiked in September, reiterating on each occasion that the current level of rates, if maintained for "sufficiently long", is "sufficiently restrictive" to return inflation to 2%. However following the much larger than anticipated decline in inflation over the latter part of 2023, the market sees a good chance that the ECB will begin easing policy in April. The ECB has been pushing back against expectations for an early move down in rates - saying it needs more information, particularly in relation to wage developments, to be confident that inflation will continue to decline in line with its latest forecasts - while at the same time acknowledging that it is likely to lower them this year, with its President, Christine Lagarde, indicating that this could happen "in the summer". Back in October we thought the ECB would begin cutting rates in Q3 and lower them by 75bps by end-December. Given the sharp decline in inflation, however, we now think it is likely to cut rates sooner - in June - and by more - 125bps - than we had expected.



Source: Bloomberg

Bank of England

The Bank of England Monetary Policy Committee (MPC) left interest rates on hold for a second consecutive meeting in December, though three of its nine members again dissented in favour of a quarter point increase to 5.50%. For the minority, elevated wage and services inflation called for further policy tighening. For the other six members the decision to hike or to hold rates was "again finely balanced" - between the risks of not tightening policy enough when inflationary pressures in the economy could prove persistent, and the risks of tightening policy too much given the full impact of higher interest rates was still to come through - but in the end they opted to maintain the status quo. Following the larger than expected fall in inflation recently, the market sees the MPC lowering rates in May-June and easing by around 100bps by year-end. Much may depend on how quickly core inflation declines from its still very elevated level, and we wouldn't be surprised if a first rate cut comes a bit later than the market expects, perhaps early in the third quarter of the year.

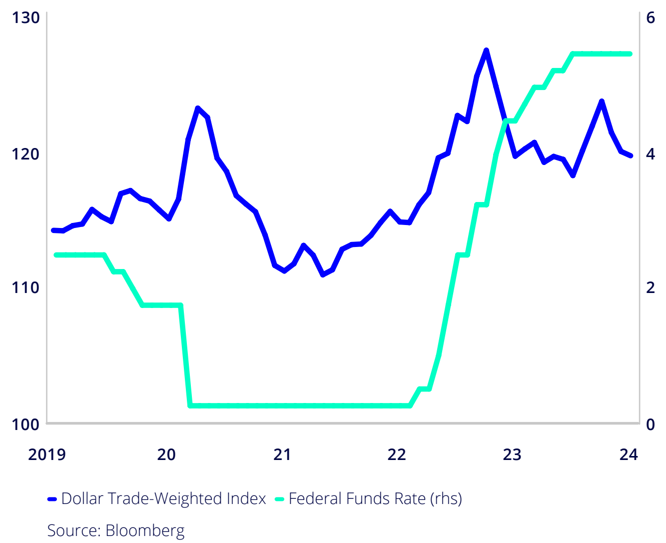


Source: Bloomberg

Currencies

Dollar

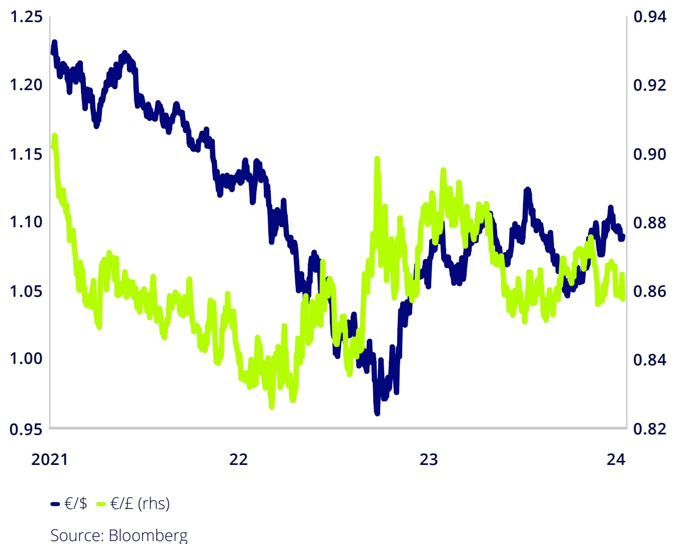
The second six months of 2023 was something of a game of two halves for the dollar. The "higher for longer" interest rate narrative that drove US bond yields to levels last seen in 2007 saw it strengthen to a 2023 high in October. This was followed by an abrupt fall in bond yields over the final weeks of the year, amid decelerating inflation and dovish Fed commentary, with the dollar following suit. The latter has treaded water at the start of 2024 and remains down around 4% from October. Looking ahead, we see the dollar weakening further, although not dramatically so, if as we expect the Fed is the first of the main central banks to signal it intends to begin easing policy. This is more likely to be the case if the Fed is cutting rates in the context of a "soft landing" for the US economy - this would probably see risk assets rally and the dollar lose ground as is normally the case in such an environment. Other factors that could impact the dollar's performance include the possibility of the Bank of Japan beginning to exit its ultra-loose monetary policy and potential investor concern about the gaping US budget deficit, both of which would weigh on the currency. The run up to the presidential election in November - which seems set to be a head-to-head between Biden and Trump - is likely to be accompanied by heightened uncertainty, which could lead to increased volatility in currency markets.



Source: Bloomberg

Euro

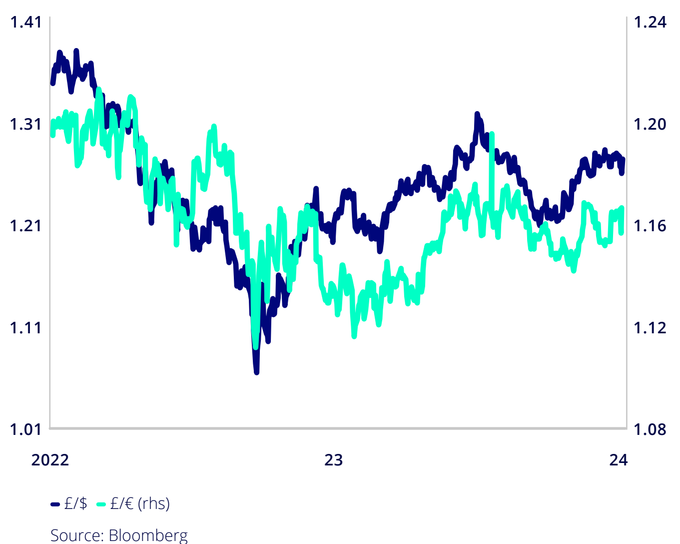
Having recovered from a brief sojourn below parity in late 2022, the euro traded in a relatively narrow range in 2023 with $1.05 to $1.10 containing most of the price action. It is currently hovering in the upper end of this range, after strengthening in the final couple of months of last year. With the market expecting the ECB and Fed to both begin lowering interest rates in the first half of this year, and to ease policy by a broadly similar amount by end-2024, there wouldn't seem to be a strong case for EURUSD to break decisively out of its recent range. Indeed, the latest consensus forecast is for it to end 2024 at around $1.11, which is not much changed from where it closed out 2023. However given our dollar view outlined above, we expect the euro to gain some ground against the US currency over the course of this year, gradually moving up into the upper half of the $1.05 to $1.25 range that has prevailed for much of the period since 2015.



Source: Bloomberg

Sterling

After falling to almost parity against the dollar in the midst of the "mini-budget" debacle in September 2022, sterling staged an impressive rally over the following months, rising to a 2023 high of over $1.31 in July. Like the euro, it fell back quite sharply against the US currency in August-September, trading down to $1.20, before rebounding in the final months of the year, closing out 2023 at about $1.27. Indeed, given that the pound moved almost in lockstep with the euro against the dollar, the pair was confined to a narrow range of £0.85 to £0.88 over this period. With the UK economy forecast to hold up reasonably well, and interest rate cuts perhaps slower to materialise than elsewhere, we expect sterling to strengthen against the dollar over the course of 2024. We don't think it will break new ground against the euro though, with a trading range of about £0.84 to £0.90 expected to prevail this year. That said, the Prime Minister, Rishi Sunak, has indicated that a general election is likely to be held in the second half of 2024, which could introduce some volatility into the pound.



Source: Bloomberg

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