Global Watch

May 2024

Economic and Market Update

Bank of Ireland

Summary

The general expectation at the start of 2024 was that the Fed would be in the early stages of easing monetary policy by this stage of the year. However relatively large monthly increases in US consumer prices over the January-March period has dented the Fed's confidence that inflation is on a path back to 2%, resulting in a delay to any cut in interest rates. In contrast, the ECB is increasingly confident that Euro area inflation is heading back to target and has all but confirmed a rate cut in June. The Bank of England (BoE) has also opened the door to a cut in rates soon, as headline inflation has fallen sharply, though the general election scheduled for July 4th rules out a move in June.

The market sees central banks proceeding cautiously in lowering interest rates though, at least initially, with not much priced in by way of policy easing this year and certainly much less than was expected at the beginning of 2024. The ECB is seen cutting rates by 50bps by October, including a quarter-point reduction in June, with a circa 50% chance of third 25bps move by the end of the year. Regarding the BoE and the Fed, not much more than one quarter-point cut in rates is expected by end-year in the case of the former, and essentially just one (in December) in the case of the latter.

With market expectations for policy easing having been pared back considerably, and limited enough divergence seen amongst the main central banks in terms of the pace of future rate cuts, the main exchange rates have continued to trade in well-established ranges. The euro remains in the \$1.05 to \$1.10 and 85p-88p ranges against the dollar and sterling respectively that have been in place over the past year, and the pound has stayed within the \$1.21 to \$1.28 range that has prevailed for most of the same period. While this may continue for a bit longer, we expect the Fed begin to begin cutting rates sooner (September) than the market currently expects, which could see the dollar head lower over the final months of this year and into 2025.

Forecasts

GDP Growth*	2023	2024(f)	2025(f)
Global	3.1%	3.1%	3.2%
US	2.5%	2.6%	1.8%
Euro area	0.5%	0.7%	1.5%
UK	0.1%	0.4%	1.0%

*Annual % change, constant prices
Source: OECD (May 2024)

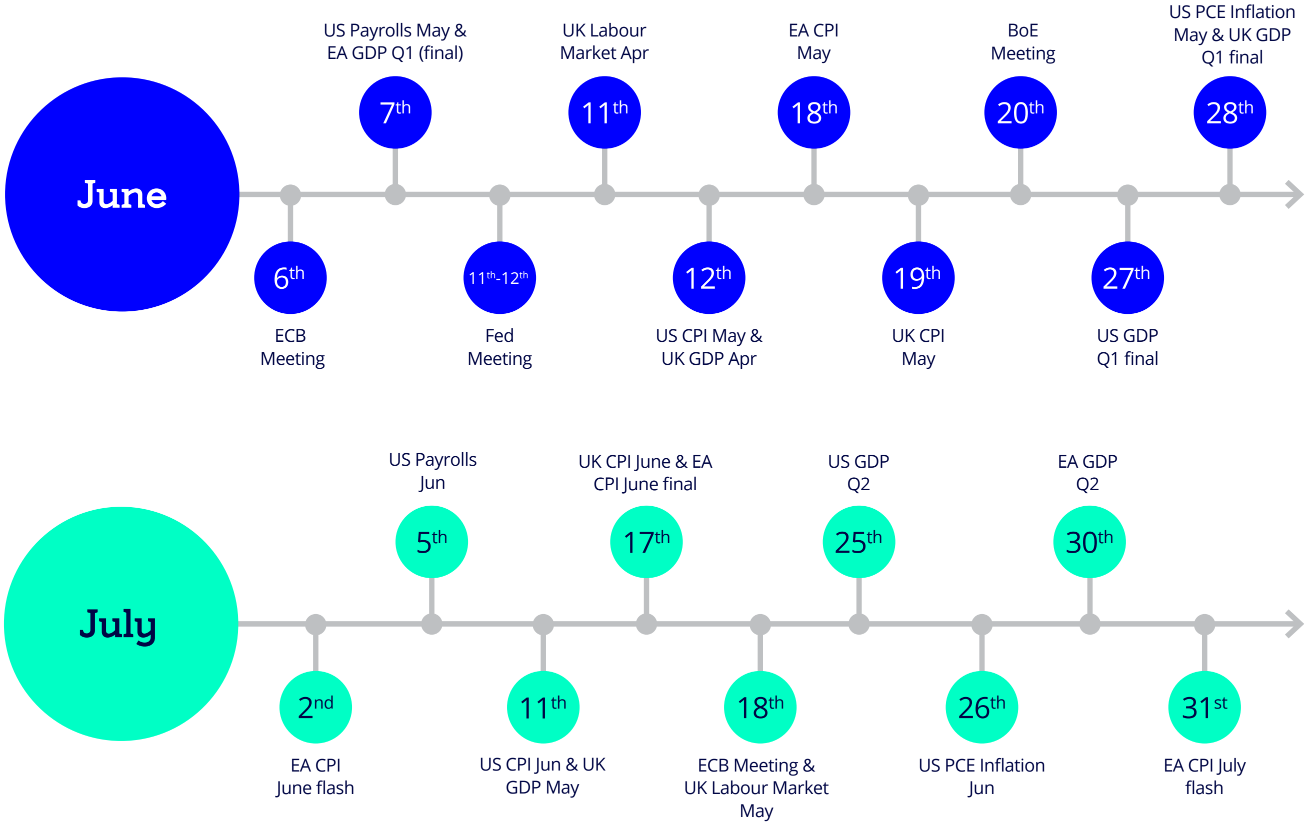
Central Bank Interest Rates (%)	Current	End-Q2 2024	End-Q3 2024	End-Q4 2024	End-Q1 2025
Fed	5.25-5.50	5.25-5.50	5.00-5.25	4.50-4.75	4.25-4.50
ECB	4.00	3.75	3.50	3.25	3.00
BoE	5.25	5.25	5.00	4.75	4.25

Source: Bloomberg, Bank of Ireland Forecasts

FX**	Current	Q2'24	Q3'24	Q4'24	Q1'25
€/$	1.0850	1.05-1.10	1.08-1.13	1.11-1.16	1.11-1.16
€/£	0.8505	0.84-0.88	0.85-0.90	0.85-0.90	0.85-.90
£/$	1.2750	1.23-1.29	1.25-1.31	1.28-1.34	1.28-1.34

**Current Rate is as of 29 May 2024
Source: Bloomberg, Bank of Ireland forecasts

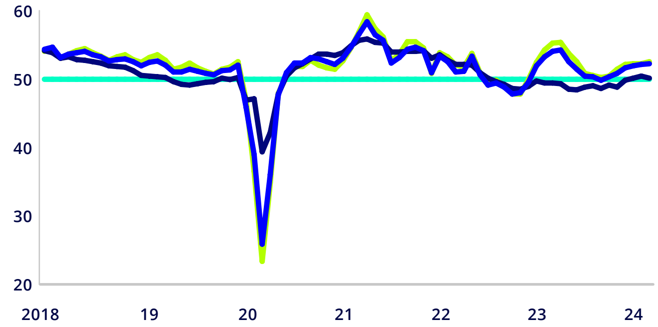
Upcoming Events



Economy

Global economy gaining momentum

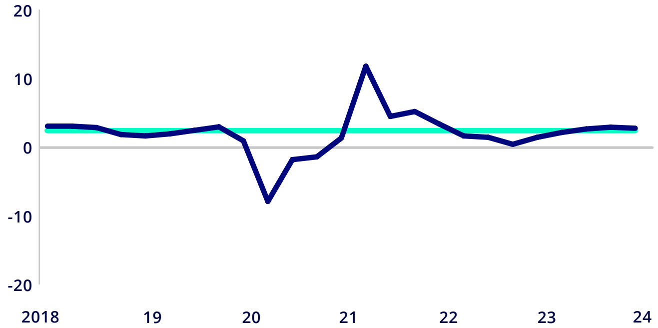
As the OECD notes in its latest Economic Outlook, "global growth proved surprisingly resilient in 2023, with inflation declining more quickly than anticipated, (though) outcomes diverged across countries, with strong growth in the United States and many emerging-market economies offset by a slowdown in most European countries". Moreover, economic activity appears to have gathered momentum in the opening months of 2024 judging by the Purchasing Managers' survey (PMI) data. The global Composite PMI rose for a sixth consecutive month in April to 52.4, its highest level in almost twelve months, led by the services sector but with manufacturing posting modest growth. The OECD expects world GDP growth to average 3.1% this year (the same as last year) and 3.2% next year, supported by declining inflation and monetary policy easing by an increasing number of central banks. It highlights some risks to the outlook however, most obviously the conflict in the Middle East which it says could raise energy prices and thereby boost inflation and dampen growth.



Global Composite Purchasing Manager's Index Expansion-Contraction Threshold
Manufacturing PMI Services PMI
Source: JP Morgan, S&P Global

US economy proving resilient

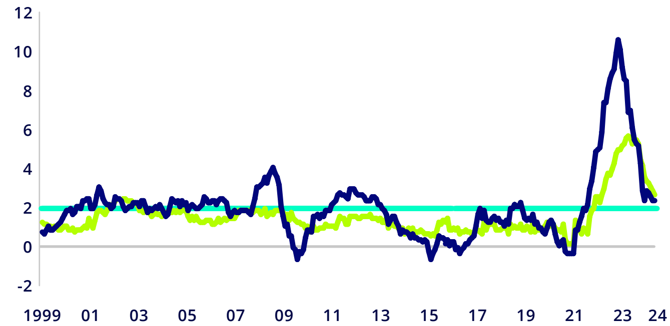
The US economy continues to perform solidly albeit growth moderated in the first quarter of this year, with GDP increasing by 0.4% quarter-on-quarter after expanding by 0.8% in Q4 2023. The underlying picture was better than the headline number suggested though, as consumer spending and investment both grew at a strong pace. While employment has continued to increase, labour demand has softened - job openings are well down from their post-pandemic high - and wage growth has moderated. The decline in inflation, which was particularly sharp over the second half of last year, stalled over the opening months of 2024. The annual rate of headline PCE inflation - the Fed's target measure of inflation – nudged up to 2.7% in March, while core PCE inflation - which excludes energy and food prices - remained at 2.8%. Within core inflation, goods prices are declining in year-over-year terms but services inflation has been sticky recently albeit well off its peak in early 2023. Separate CPI data suggest the decline in inflation resumed in April, with both headline and core inflation edging down from March.



US GDP (annual % change, constant price) Average GDP Growth 2010-2019
Source: BEA

Euro area activity picking up

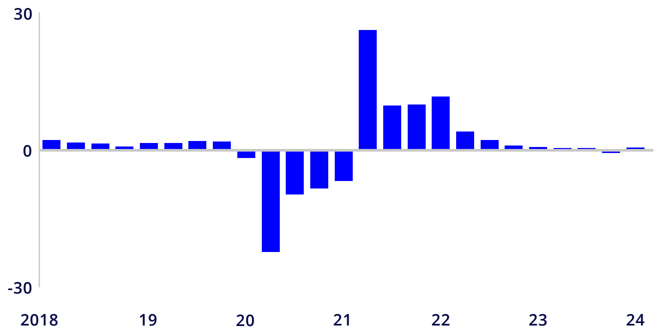
Having flatlined during much of 2023, the Euro area economy gathered some steam in the first quarter of 2024. GDP rose by 0.3% q-o-q, after contracting slightly in the final quart of last year, helped by a pick-up in activity in the zone's three largest economies. A breakdown of Q1 GDP is not yet available, but it looks like the services sector was the main driver of growth judging by PMI data. The latter also suggest the economy will grow again in Q2, with the Composite PMI rising further above the key 50 level in May. Notwithstanding weak growth over the past year, employment has continued to increase and unemployment is at an all-time low (6.5%). Meanwhile, inflation has continued to decline in 2024 to date with headline and core inflation running at 2.4% and 2.7% respectively in April, down from 2.9% and 3.4% at end-2023. Energy prices are currently making a negative contribution to overall inflation, and food and non-energy goods inflation have both slowed sharply, while services inflation is gradually easing. The ECB expects headline inflation to fall to 2.2% in Q4 this year and to dip slightly below the 2% target in mid-2025.



CPI Inflation (%) CPI Inflation Excluding Energy and Food (%) ECB Inflation Target
Source: Eurostat

UK economy emerges from recession

The UK economy emerged from recession in Q1, with GDP increasing by 0.6% q-o-q having declined in each of the final two quarters of 2023 (by a cumulative 0.4%). Consumer spending rose slightly in the quarter, after falling sharply over the second half of last year, helped by a boost to real incomes from declining inflation, while private investment rose strongly. The latest PMI data point to another increase in GDP in Q2, albeit at a slower pace than Q1. The weakening of the economy during 2023 has taken a toll on the labour market though. Employment fell by 178,000 q-o-q, or by -0.5%, in Q1 according to the Labour Force Survey, and unemployment rose to 4.3% from 3.8% in Q4. Timelier HMRC data, based off income tax receipts, shows the number of employees in April was up 0.5% on the year, the softest pace of growth since the pandemic. The decline in inflation has gathered pace recently, with the headline rate down to 2.3% in April from 4% in December. Energy prices are making a negative contribution to the annual inflation rate, and dis-inflation in both food and manufactured goods prices is continuing apace, while services inflation is coming down gradually from elevated levels.

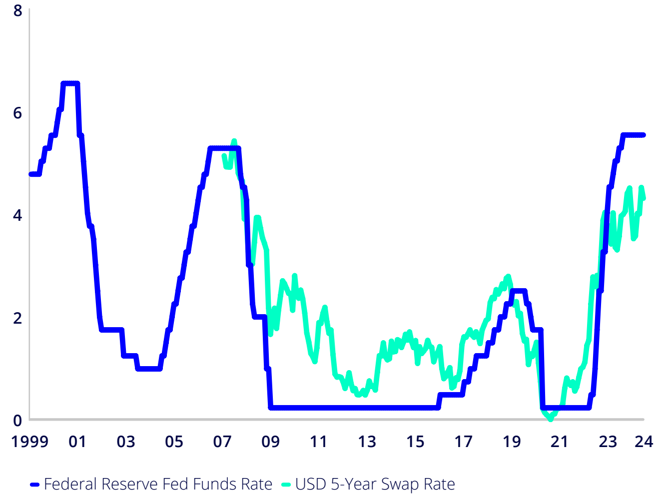


UK GDP (annual % change, constant prices)
Source: ONS

Interest Rates

Fed easing delayed

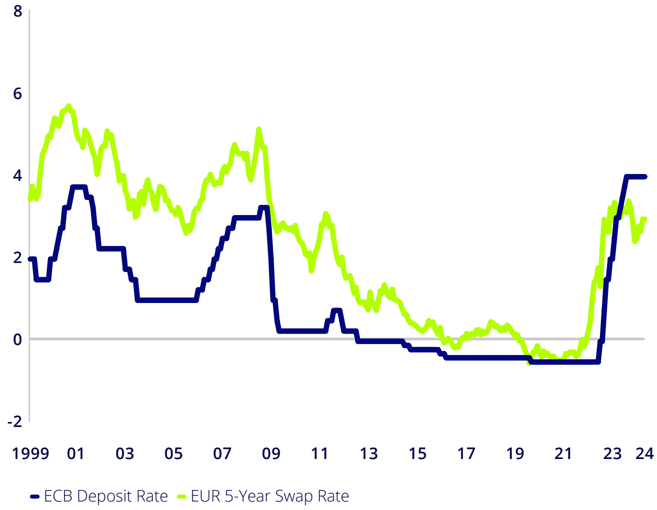
A sharp fall inflation over the second half of 2023 raised expectations at the start of 2024 that the Fed would cut interest rates in a series of steps starting in the spring. Indeed, Fed Chair Powell said in January that a few more "good" inflation readings would allow the central bank to begin easing policy. In our previous Global Watch, we thought the Fed would commence cutting rates in June and ease by around 125bps in total this year. However a series of relatively large monthly readings for headline and core consumer prices over the opening quarter of the year stalled the decline in year-on-year inflation rates, prompting a change of stance from the Fed which now says it does not expect to lower interest rates until it has renewed confidence that inflation is on a path back to 2%. Data for April suggests the decline in inflation has resumed, but the Fed will need more than one months' worth of data to be convinced this is the case. Still, with some signs that economic activity is moderating and labour demand also slowing, inflation should continue to decline over the remainder of this year. Hence we think the Fed will be able to start lowering rates in the second half of 2024, with a first cut expected in September.



Source: Bloomberg

ECB to cut in June

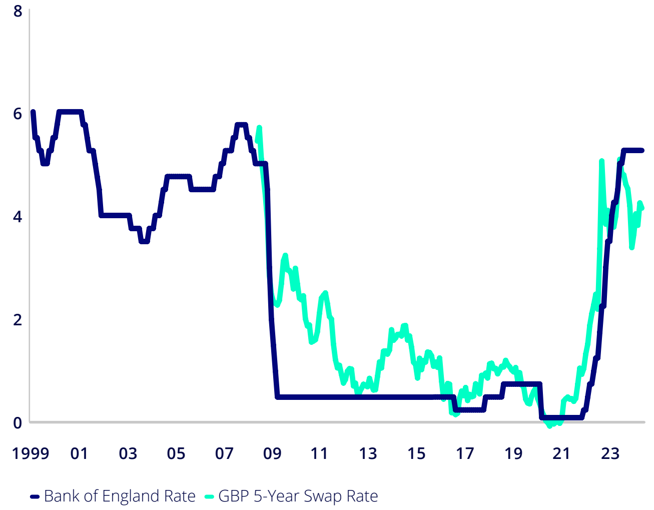
In our Global Watch earlier this year, we expected the ECB to begin cutting interest rates in June and lower them by a cumulative 125bps in 2024. Inflation has continued to decline over the opening months of the year and the ECB is increasingly confident that it is on track to reach its 2% target, with Christine Lagarde saying recently there's a "strong likelihood" rates will be cut in June. The ECB is more circumspect about the path for rates beyond June, although they are almost certain to fall further as the central bank continues to dial back the current restrictive stance of monetary policy. The indications at this stage are that the ECB may cut rates for a second time in September and again in December, coinciding with its updated quarterly growth and inflation projections. This would leave the deposit rate - now officially the ECB's main policy rate - at 3.25% by year-end, still above estimates of the neutral interest rate (which are in the vicinity of 2%). With inflation expected to return to 2% and the pace of growth only gradually picking up, there's plenty of scope for the ECB to lower rates further in 2025.



Source: Bloomberg

BoE opens door to rate cut

Headline inflation in the UK has fallen sharply in recent months and is running just above the 2% target, although underlying inflation is still relatively elevated. The Bank of England (BoE) expects headline inflation to pick up a little in the short-term but to decline again towards the end of this year and into 2025, and has opened the door to a cut in interest rates soon with Governor Bailey saying following the May meeting that a cut in June wasn't "ruled out" albeit nor was it "a fait accompli". While the subsequent release of slightly firmer than expected inflation data for April had seen the market pare back the chances of a rate cut next month in any case, the decision by Prime Minister Sunak to call a general election for early July all but rules it out. Previously we thought the BoE would first cut rates in August and we still expect this to be the case. Moreover, the BoE has said monetary policy will be restrictive for a time after rates are cut, given it is starting from quite a restrictive level already, which suggests it can continue to lower rates beyond August.

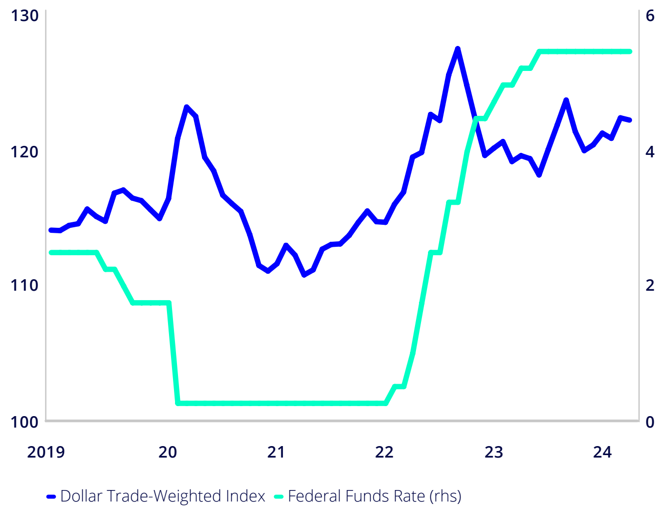


Source: Bloomberg

Currencies

Dollar to give up recent gains

The dollar's trade-weighted exchange rate has strengthened in 2024 to date as Fed rate cut expectations have been pared back dramatically following firmer than expected US inflation readings over the opening three months of the year. It gained almost 2.5% in the first quarter and took another leg higher over the first half of April as the Japanese yen fell to a near 4-year low against the US currency (prompting Bank of Japan intervention to support its currency), but slightly softer than expected US inflation data for April has seen it lose some ground since. The dollar should remain reasonably firm over the next few months as the Fed is unlikely to ease policy until later in the year, though we expect it to lose ground once the Fed signals it is ready to start lowering interest rates. There may be some volatility in the currency ahead of November's presidential election, but beyond November the main driver of the dollar is likely to be Fed monetary policy and how interest rates evolve during 2025.



Source: Bloomberg

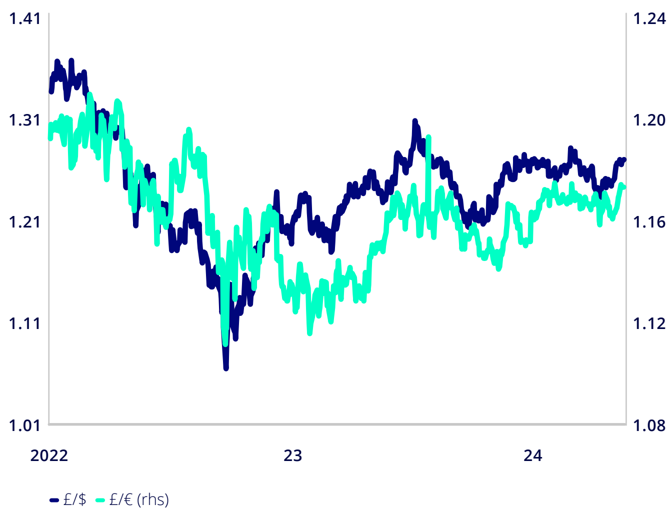
EUR/$ to strengthen gradually

While the euro has lost ground against the dollar since the start of this year, at around $1.08 it remains comfortably within the $1.05 to $1.10 range that has prevailed since the beginning of 2022 even as the ECB is set to begin lowering interest rates ahead of the Fed . Part of the reason is that, while the market has pared back considerably the scale of expected Fed rate cuts in 2024, it has priced out a good portion of the policy easing it had expected from the ECB this year as well. This is reflected in the differential between German and US government 2-year bond yields - which captures changes in ECB and Fed rate expectations - remaining in a tight range in recent months, consistent with the relative stability in the EUR/$ exchange rate. In our last set of forecasts we had expected EUR/$ to move up to a range of $1.10 to $1.15 in Q2 and to strengthen further over the second half of the year (as the Fed led the way in lowering interest rates). This hasn't come to pass clearly, though we still think the euro will gain ground over the second half of this year as the Fed joins the ECB in cutting rates and growth in the Euro area economy gradually picks up but slows in the US.

Source: Bloomberg

Sterling to gain ground against $

Sterling has been moving broadly in tandem with the euro against the dollar for a while now. This is evident in the performance of the pound against the single currency over the past eighteen months or so, with the pair trading in a relatively narrow range during this period (one has to go back to before the global financial crisis in 2008 to find a similar period of stability in this cross). The earlier than expected calling of the general election for early July has had little impact on sterling - perhaps because it has looked for some time now that Labour will form the next government (the party also says it will "deliver economic stability with tough spending rules, so we can grow our economy and keep taxes, inflation and mortgages low", which should reassure financial markets) though we may still see some volatility in the currency during the course of the campaign. Beyond July, we expect sterling to continue to move broadly line with the euro, particularly given Bank of England and ECB interest rates probably won't diverge much, and so see it strengthening against the dollar over the remainder of this year and into 2025.



Source: Bloomberg

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