Global Watch

Economic and market update

January 2025

A parting of the ways?

The Fed and ECB both lowered interest rates by 100bps over the second half of 2024 to 3.0% and 4.25%-4.5% respectively. However, while increased concern about the Euro area growth outlook means the ECB seems set to cut the deposit rate by another 100bps this year, the continuing resilience of the US economy as well as the potential impact of president-elect Trump's prospective economic polices is likely to limit the room for Fed rate cuts relative to previous expectations. In the UK, still elevated wage and underlying price pressures means the Bank of England is likely to continue its gradual approach to lowering interest rates having cut by just 50bps to date. The reassessment of the outlook for Fed and ECB policy has contributed to a sharp fall in the euro-dollar exchange rate, which has shed 10 cents to $1.02 since September, with the risks weighted to further weakness. Sterling has also fallen sharply against the dollar since September, shedding 12 cents to around $1.22. About 3 cents of this has come in early January amid a sell-off in UK bonds and equities, with the pound also losing ground to the euro, falling to £0.84 from a multi-year high of £0.82 in mid-December.

US stocks pare post-election gains

US equity markets rallied strongly (+5-9%) over the month or so following the US election in early November, with Trump's promise of tax cuts and pro-growth deregulation seen as positive for the economy. However they have pared back these gains since the Fed's more hawkish than expected monetary policy meeting in mid-December, which has contributed to a further rise in US bond yields (particularly at the long-end of the curve) amid greater uncertainty about the inflation outlook and the path for interest rates ahead.

ECB to lower rates steadily

The ECB stepped up the pace of rate cuts over the latter part of last year, lowering the deposit rate by 25bps for a third consecutive meeting in December (and for a fourth time since June) as it once again downgraded its forecast for GDP in 2025 and projected inflation to settle around target (2%) on a sustained basis. It also said it expected to cut rates further, with the deposit rate now likely to be lowered by another 100bps over the first half of this year. The Fed also reduced rates by 25bps in December, bringing the cumulative reduction since September to 100bps, but signalled a slower pace of cuts in 2025 (50bps) than previously guided (100bps) as it revised up its forecasts for growth and inflation this year. We see the Fed lowering the policy rate to 3.75%-4% over the first half of this year, leaving it just above the top of the Fed's estimate of the range for the neutral interest rate (2.5%-3.5%), though any indication of an early loosening of fiscal policy by the incoming Trump administration may mean the Fed refrains from further easing. We expect the Bank of England to lower rates by 25bps a quarter in 2025, broadly consistent with the rate path indicated in its November Monetary Policy Report.

Dollar in the ascendency

The reassessment of the outlook for Fed and ECB policy rates has resulted in a sharp rise in US yields relative to German yields (the benchmark for Euro area yields) since September. This has contributed to a steep decline in EURUSD, which has fallen by 10 cents to $1.02. Looking ahead, given the scale of ECB rate cuts priced in, and considering its fall to date, EURUSD may consolidate around current levels for now before recovering some ground later in the year. However the risks are weighted to further weakness. A mix of looser fiscal policy and tighter than expected monetary policy in the US, resulting in a further rise in bond yields, would be positive for the dollar generally and could see EURUSD test parity and below. Rising bond yields could trigger a correction in equity markets and financial market disruption more widely, though the dollar might also benefit in such a scenario given its "safe haven" status. An alternative scenario however, which cannot be completely ruled out, is that a further loosening of US fiscal policy triggers concern about the sustainability of government debt, leading foreign investors to demand higher bond yields and a weaker dollar to continue funding the budget deficit.

While UK bond yields have followed US yields higher since September, sterling has followed the euro lower against the dollar over the same period, albeit appreciating modestly vis-à-vis the single currency to a multi-year high of almost £0.82 in December before weakening to £0.84 in early January. We would expect GBPUSD to continue broadly tracking EURUSD, consistent with EURGBP trading in a range of about £0.81 to £0.86 over the coming months. However, as the sell-off in UK assets at the start of 2025 highlights, the pound is vulnerable to investor concern about sluggish growth, elevated domestic inflation and the fiscal position in the UK.

Central Bank Rates (%)	Current	End-Q1'25	End-Q2'25	End-Q3'25	End-Q4'25
Fed	4.25-4.50	4.00-4.25	3.75-4.00	3.75-4.00	3.75-4.00
ECB	3.00	2.50	2.00	2.00	2.00
BoE	4.75	4.50	4.25	4.00	3.75

Exchange Rates	Current	Q1'25	Q2'25	Q3'25	Q4'25
€/$	1.02	1.01-1.06	1.03-1.08	1.05-1.10	1.05-1.10
€/£	0.84	0.81-0.86	0.81-0.86	0.81-0.86	0.81-0.86
£/$	1.22	1.20-1.25	1.22-1.27	1.24-1.29	1.25-1.30

Euro versus Dollar

Source: Bloomberg

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Stuttering Euro area recovery

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Fed pares back rate cut expectations

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EURUSD reverses course

Forecasts

GDP

GDP Growth*	2023	2024(f)	2025(f)
Global	3.3%	3.2%	3.2%
US	2.9%	2.8%	2.2%
Euro area	0.4%	0.8%	1.2%
UK	0.3%	1.1%	1.5%

*Annual % change, constant prices
Source: IMF (October 2024)

Interest Rates

Central Bank Rates (%)	Current	End-Q1'25	End-Q2'25	End-Q3'25	End-Q4'25
Fed	4.25-4.50	4.00-4.25	3.75-4.00	3.75-4.0	3.75-4.00
ECB	3.00	2.50	2.00	2.00	2.00
BoE	4.75	4.50	4.25	4.00	3.75

Source: Bloomberg, Bank of Ireland Forecasts

Exchange Rates

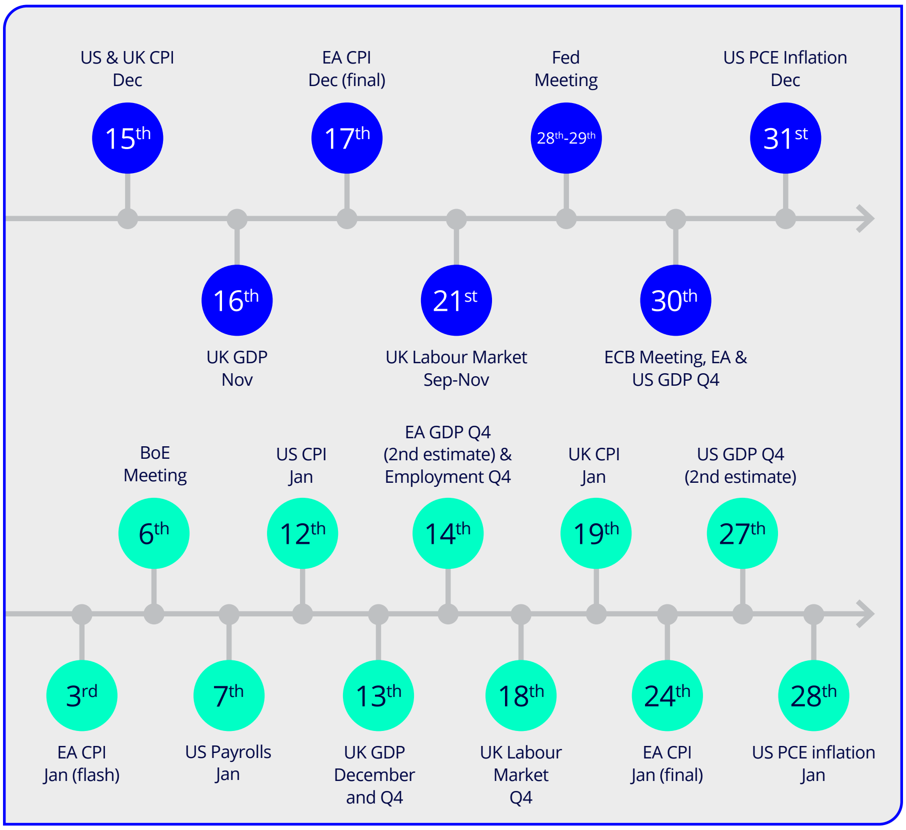
Exchange Rates	Current	Q1'25	Q2'25	Q3'25	Q4'25
€/$	1.02	1.01-1.06	1.03-1.08	1.05-1.10	1.05-1.10
€/£	0.84	0.81-0.86	0.81-0.86	0.81-0.86	0.81-0.86
£/$	1.22	1.20-1.25	1.22-1.27	1.24-1.29	1.25-1.30

**Current Rate as of 10 January 2025
Source: Bloomberg, Bank of Ireland forecasts

Upcoming Events

January

February

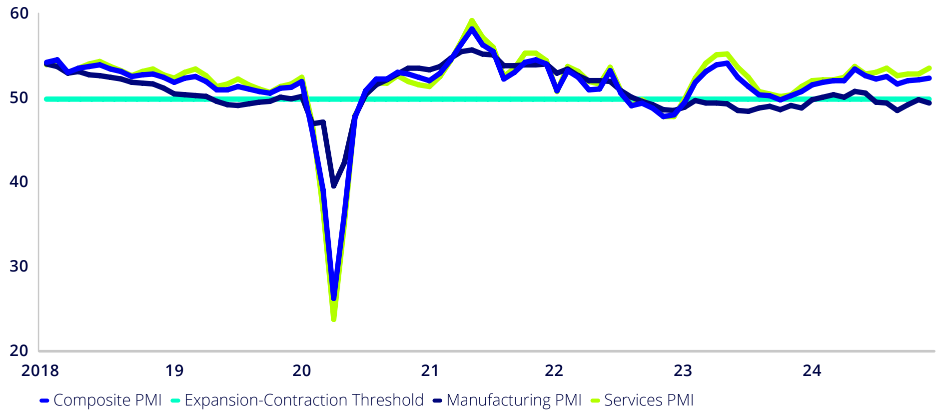


Economy

Solid global growth

The world economy is expanding at a solid but relatively modest pace amid a decline in inflation and easing monetary conditions. The global composite PMI is running above the key 50 level, with services still the main driver of growth and manufacturing continuing to struggle. The IMF in its October World Economic Outlook projected 'stable but underwhelming' global GDP growth of 3.2% in both 2024 and 2025, unchanged from its July forecast as an upward revision to growth in the US economy was offset by a downward revision to Euro area growth. The IMF warned that the risks were tilted to the downside, related among other things to the potential for sudden bouts of volatility in financial markets and an intensification of protectionist policies. This has come more sharply into focus following Donald Trump's decisive victory in the US presidential election, given his economic agenda of tariffs, tax cuts, deportations and deregulation. While it remains to be seen when, whether and to what extent Trump carries through with these policies, an IMF scenario analysis of a package of measures broadly along the lines proposed by the US president-elect – taking effect from the middle of this year – shows they would have a negative impact on global GDP, lowering growth by almost 1 percentage point in 2025 and by almost half a percentage point in 2026. Interestingly, the analysis suggests the impact on global inflation would be "muted" reflecting the "role of both demand and supply factors in the scenario."

Global PMIs

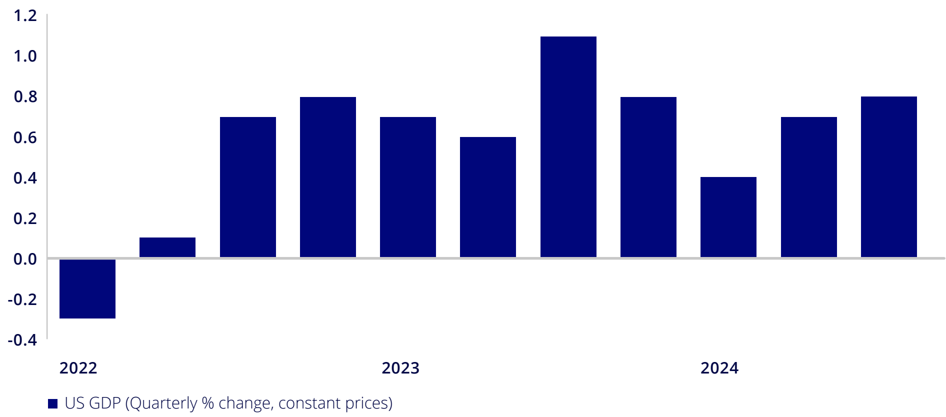


Source: JP Morgan, S&P Global

US economy remains resilient

The US economy expanded at a brisk pace in 2024, facilitated by relatively strong growth in both productivity and the labour force. GDP rose by an average of 0.6% a quarter over the first three quarters of the year and looks to have posted something similar in Q4, only marginally lower than the average quarterly growth rate (0.8%) in 2023. Both consumer spending (particularly) and business investment continue to underpin growth, offsetting ongoing weakness in the interest rate-sensitive residential and non-residential construction sectors. Labour demand is softening though, evident in more moderate jobs growth, declining job vacancies and slowing wage growth. Headline consumer price inflation (as measured by the personal consumption deflator) fell steadily over the course of 2024, and at 2.4% in November was close to the Fed's 2% target, while core inflation has come down more gradually and has been sticky recently at 2.7%-2.8%.

US Quarterly GDP Growth (%)



Source: BEA

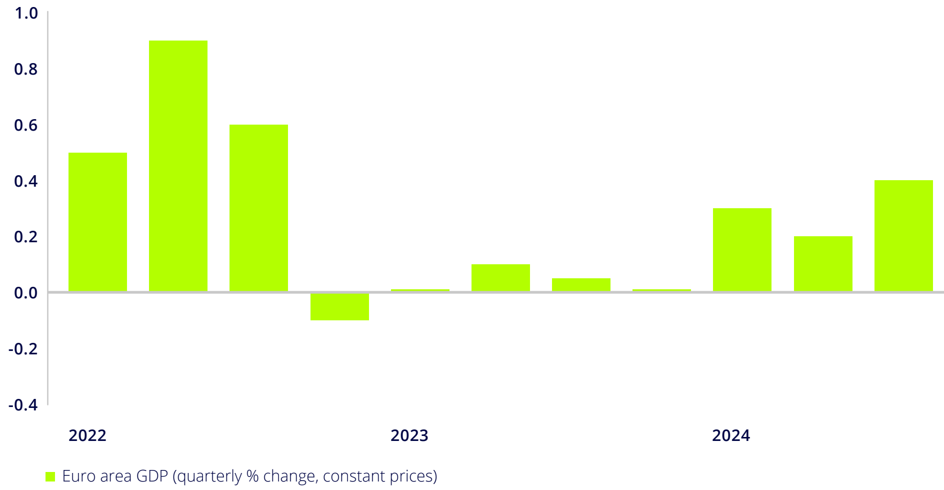
Economy

Most forecasts see GDP growth easing towards 2% in 2025, from around 2.8% in 2024, and core inflation falling further through the course of this year, though the outlook is obviously clouded by uncertainty over economic policy following Trump's election victory. The IMF's scenario analysis suggests Trump's policies would cut US GDP growth to 1.1% and 1.4% in 2025 and 2026 respectively, compared to growth of 2.2% and 2.0% in its baseline projection, while the impact on inflation would be mild, boosting the annual headline rate by a couple of tenths in both 2025 and 2026, as demand and supply effects largely offset each other.

Stuttering Euro area recovery

The Euro area economy grew at a moderate pace in 2024. GDP rose by 0.3% and 0.2% q-o-q in Q1 and Q2 respectively, with growth picking up to 0.4% in Q3 on the back of firmer consumer spending (though the latter could reflect an 'Olympics effect' and so may not be sustained). However, the latest Purchasing Managers' data suggest economic activity weakened towards the end of Q3 and stagnated in Q4 (the composite PMI has fallen below the key 50 'no change' level, dragged down by weakness in Germany and France). Forecasts for GDP growth in 2025 have been marked down, with the economy generally seen expanding by not much more than 1% this year. Concerns about the outlook have increased following the US election, as any imposition of tariffs would weigh on an already weak economy. While IMF analysis suggests the direct effect of tariffs on the Euro area economy would be small enough, the impact would be amplified by greater uncertainty and disruption in financial markets in the event of a 'trade war', resulting in a hit to GDP of almost 1% by 2026.

Euro area Quarterly GDP Growth (%)



Source: Eurostat

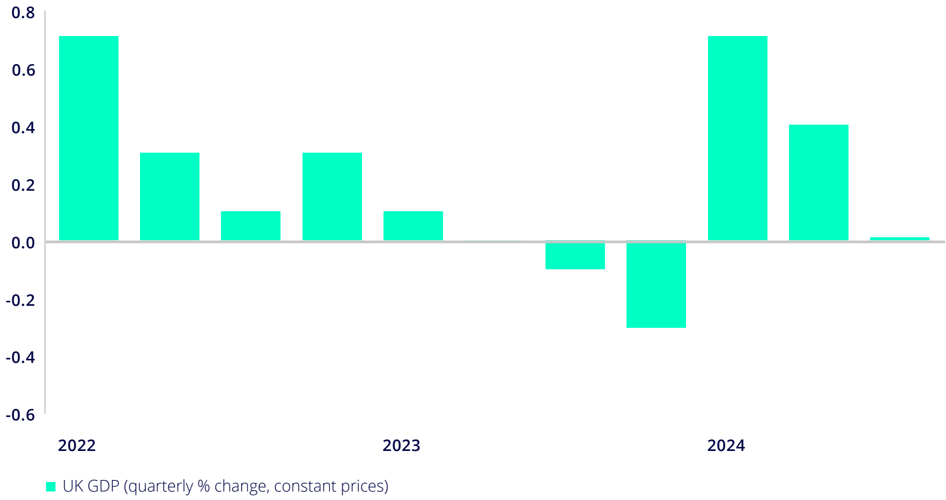
Employment rose further in 2024 but at a slightly slower pace than in 2023. Survey data (including the PMIs) point to continued slowing ahead, which would put upward pressure on the unemployment rate – currently running at a record low of 6.3% – and downward pressure on wage growth. The ECB's wage tracker already points to a slowdown in wage growth this year, with pay agreements reflecting lower expected inflation ahead. Headline inflation has risen from a low of 1.7% in September to 2.4% in December, largely due to an increase in energy price inflation. Core inflation has been 'sticky' at 2.7% in recent months, but should decline through the course of 2025 as positive base effects, soft demand, and slowing wage growth bear down on services inflation in particular.

Economy

UK growth stepped down in Q3

GDP growth in the UK stagnated in Q3 2024, falling to 0% (q-o-q) from 0.4% in Q2 and 0.7% in Q1. While the headline GDP number may exaggerate the extent of the slowdown – as consumer spending and business investment both posted solid increases in the quarter – more timely hard (e.g. retail sales) and soft (e.g. PMIs) data point to a moderation in the pace of economic activity from the first half of last year. The PMIs have softened recently, with the composite index falling for a fourth consecutive month in December (to just above the key 50 level) led by a decline in the services index. GDP growth in 2024 is still likely to have been close to 1%, reflecting the solid first half of the year. It is seen picking up towards 1.5% this year, supported by last October's budget which according to the Office for Budget Responsibility (OBR) represented "one of the largest fiscal loosenings in recent decades." The OBR sees the budget measures – a mix of increased government spending, increased taxes and higher borrowing – boosting GDP by 0.6 percentage points at its peak in 2025-26, while the Bank of England expects a similar impact. The threat of a 'global trade war' poses a downside risk to the outlook – estimates from the National Institute for Economic and Social Research (NIESR) suggest that retaliatory tariffs of 10% between the US and its trading partners (if implemented from early this year) could knock around 1% point off UK GDP growth in 2025.

UK Quarterly GDP Growth



Source: ONS

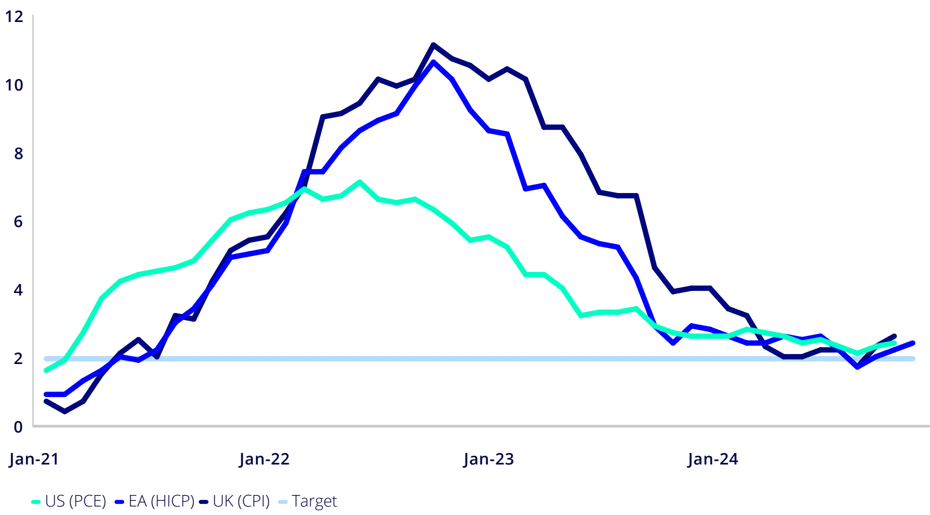
Headline inflation rose from a low of 1.7% in September to 2.6% in November, mainly reflecting higher energy price inflation, while core inflation ticked up to 3.5% (from 3.2%), though this is still more than 1.5% points lower than in November 2023. A sizeable portion of the decline in core inflation is due to a continuing fall in goods inflation, but there has also been a deceleration in services inflation though it remains elevated at around 5%. Wage growth has moderated as well – to just over 5% from a peak of almost 8% in Q3 2023 – and should ease further given the recent loosening of the labour market, while the increase in employer national insurance announced in the budget may also dampen pay growth. Slowing wage growth should contribute to a moderation in services inflation – and hence overall inflation – during 2025, though a potential trade war is an upside risk to the inflation outlook.

Central Banks

Central banks lowering rates

The main central banks have lowered interest rates in recent months as headline inflation has fallen close to target and core inflation has come down substantially over the past year. The Fed and ECB both cut rates by 100bps over the second half of 2024, while the Bank of England (BoE) Monetary Policy Committee (MPC) reduced its policy rate by 50bps over this period. However the market expects a marked divergence in the pace of rate cuts over the course of 2025. The ECB is expected to lower the deposit rate by almost 100bps to 2.0% by the end of this year, but the Fed and BoE MPC are seen reducing their respective policy rates by just 25bps and 50bps respectively (to 4.0-4.25% and 4.25%) over the same period.

Annual Consumer Price Inflation (%)



Source: BEA, Eurostat, ONS

Fed pares back rate cut expectations

The Fed lowered interest rates by a quarter-point to a range of 4.25%-4.5% at its December meeting, its third consecutive cut bringing the cumulative reduction since September to 100bps. It guided a further 50bps cut in rates in 2025 in its updated Summary of Economic Projections (SEP), 50bps less that in its September SEP as it revised up its forecasts for growth and inflation this year. The Fed also said that, given the reduction in rates to date, the stance of monetary policy is closer to neutral and so "significantly less restrictive" (albeit still "meaningfully restrictive"), hence it "can be more cautious" as it considers the "extent and timing" of additional rate reductions. This suggest it will now slow down the pace of cuts, with further reductions depending on a renewed decline in core inflation. The opening quarter of this year should see underlying inflation resume its descent, assuming the outsized increase in prices in the first quarter of 2024 is not repeated this year, which in turn should allow for a reduction in rates to 3.75%-4.0% - just above the top of the Fed's 2.5%-3.5% estimate of the range for the neutral interest rate - over the opening half of this year. Thereafter, the path for rates may depend on the economic policies pursued by the incoming Trump administration.

ECB to end restrictive policy

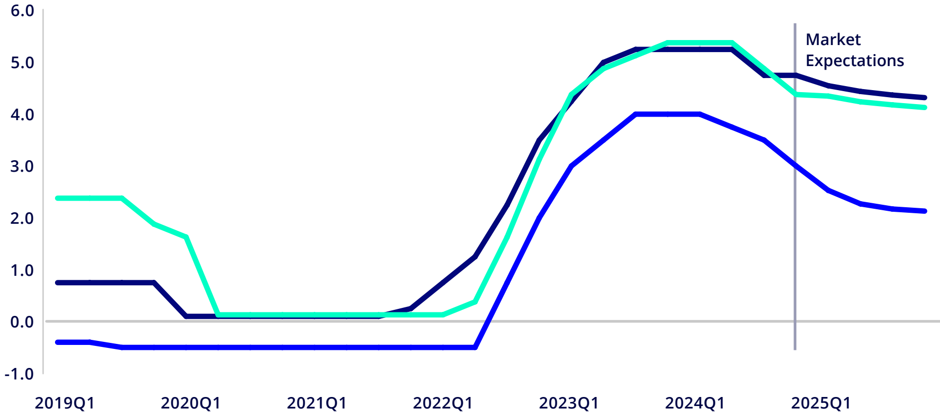
The ECB cut the deposit rate by 25bps (to 3%) for a third consecutive meeting in December, and for a fourth time since June, saying it now expects inflation to "settle at around (the) 2% target on a sustained basis" as it once again lowered its forecast for GDP in 2025 (to 1.1% from 1.3% previously). Hence it dropped its reference to the need to keep monetary policy "sufficiently restrictive to return inflation sustainably" to target, saying the direction of travel for interest rates is clear with further cuts expected. With policy still "restrictive" according to the ECB, interest rates are likely to be lowered to a neutral level - generally considered to be around 2% - over the first half of this year, implying a 25bps reduction at each of its four meetings over this period assuming it continues to move in quarter-point steps. The ECB also acknowledged that there are downside risks to the inflation outlook related to potentially weaker than expected growth, be it because the economic recovery continues to fall shy of forecasts or because of increased uncertainty triggered by geopolitical events including protectionist policies in the US. If such downside risks were to materialise, the ECB would have to adopt an accommodative policy stance - which would mean lowering rates to below 2% - in order to avoid a potential undershoot of the 2% inflation target.

Central Banks

Gradual BoE rate cuts

Having cut interest rates by 25bps for a second time in November, the Bank of England Monetary Policy Committee (MPC) voted 6-3 to stay on hold at 4.75% in December with the three dissenters favouring an immediate 25bps reduction in rates. In his post meeting comments, the BoE Governor, Andrew Bailey, said that, while the path for interest rates is "downwards, we can't tell you by how much or when particular moves are going to take place." For the six members that voted to stay on hold in December, they remained concerned about elevated private sector wage growth and services inflation, both of which are currently running at rates inconsistent with meeting the 2% inflation over time. For the three members who voted to cut rates, they saw weak demand in the economy putting downward pressure on wages and prices and are concerned that an "unduly restrictive" monetary policy stance risks undershooting the 2% inflation target over the medium-term. In its most recent (November) projections, the MPC revised up its forecasts for GDP growth and inflation in 2025, largely on account of the measures announced in the autumn budget, with growth seen slowing again in 2026-2027 and inflation - after rising to 2.8% over the second half of this year - expected to fall back to the 2% target by early 2027. This in turn was conditioned, among other things, on interest rates declining to 3.75% by the end of 2025, which still seems a reasonable path for rates for the year ahead.

Central Bank Policy Rates (%), End-Quarter



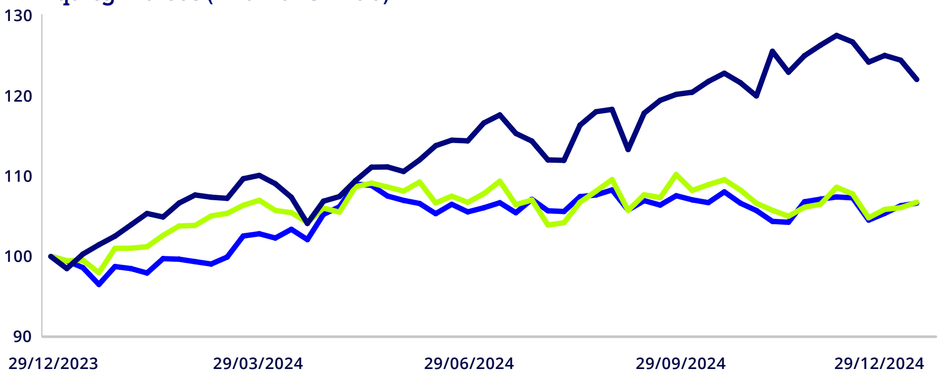
Fed ECB (Deposit Rate) BoE
Market expectations as of late August
Source: Bloomberg

Markets

US equities pare post-election gains

US equity markets rallied strongly (+5-9%) over the month or so following the US election in early November, with Trump's promise of tax cuts and pro-growth deregulation seen as positive for the economy. However they have pared back these gains since the Fed's more hawkish than expected monetary policy meeting in mid-December, which has resulted in a further rise in US bond yields (particularly at the long-end of the curve) amid greater market uncertainty about the inflation outlook and the path for interest rates ahead. Equity valuations are stretched though following another year of double-digit gains in 2024, leaving stocks vulnerable to a correction in the event of a further sustained rise in bond yields in response to higher than expected inflation and interest rates.

Equity Indices (End 2023 = 100)



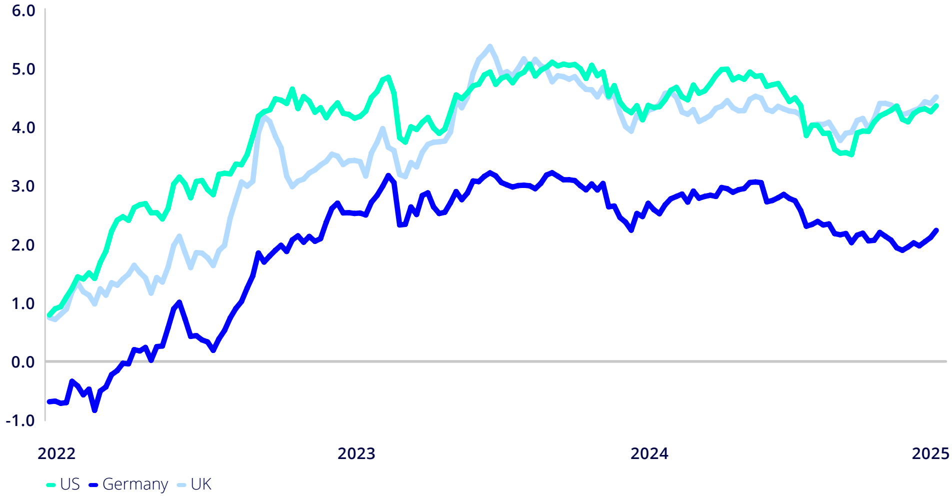
S&P 500 Stoxx Europe 600 FTSE 100
Source: Bloomberg

Markets

Sharp increase in US yields since September

US bond yields jumped initially following the outcome of the election as investors reacted to the potential impact of Trump's prospective polices. They fell back again for a time in late November-early December before resuming their ascent just ahead of and following last month's Fed meeting. The reassessment of the outlook for Fed policy since mid-September - when the market was pricing in sub 3% interest rates by end-2025, more than 100bps lower than currently expected - has resulted in a rise in yields of the order of 90-120bps across the curve in the intervening period. Rising yields in turn have contributed to a marked appreciation of the dollar exchange rate, which has risen by 7% to a multi-decade high on a trade-weighted basis.

Government 2-Year Bond Yields (%)

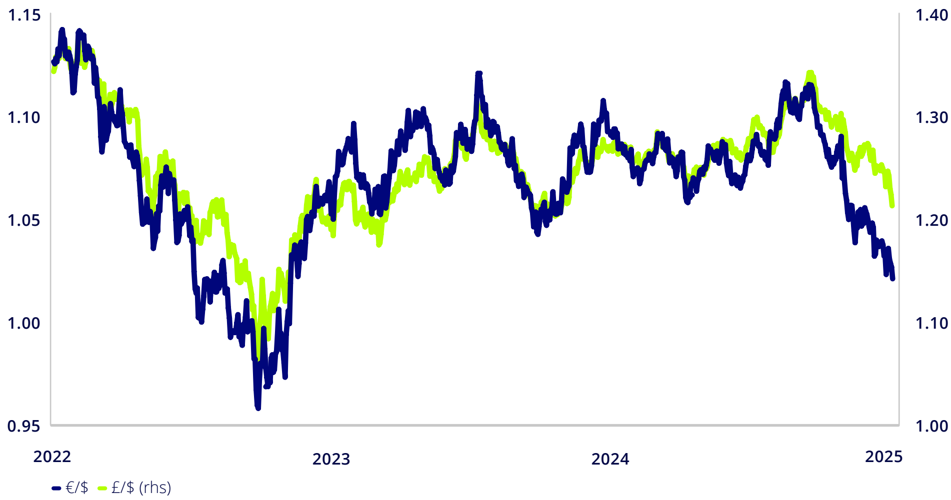


Source: Bloomberg

EURUSD reverses course

German bond yields have fallen sharply *relative* to US yields since September (despite backing up over the past month), by some 75bps in the case of 2-year yields. This has contributed to a sharp fall in the EURUSD exchange rate, which has weakened from a 2024 high of $1.12 in mid-September to $1.02. Given the scale of ECB rate cuts currently priced in by the market, together with our view that the Fed will lower rates by a bit more (and sooner) than the market currently expects, the euro may consolidate around current levels for now before settling within a $1.05 to $1.10 range later in the year (well below the $1.11-$1.17 range we had previously expected to prevail in 2025).

Euro and Sterling versus Dollar

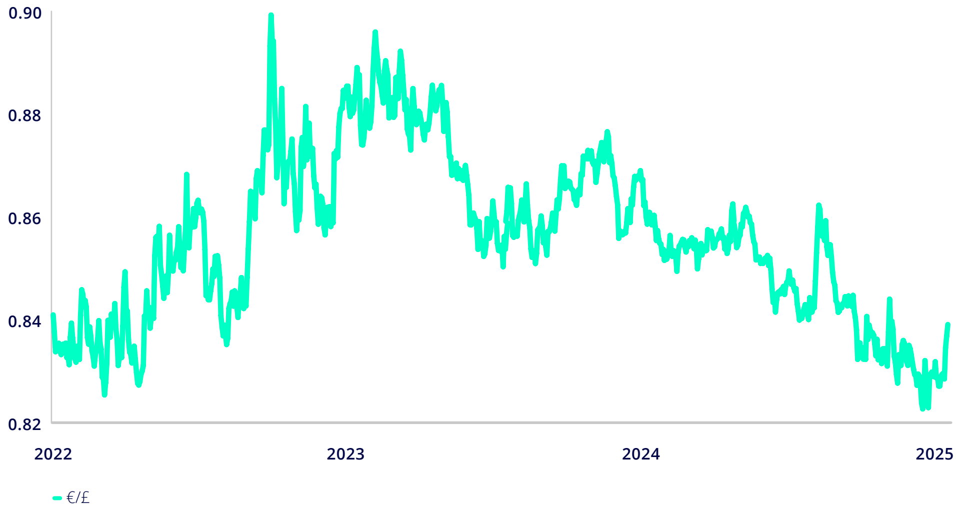


Source: Bloomberg

Markets

However the risks to EURUSD are to the downside. A mix of looser fiscal policy (via tax cuts) and tighter monetary policy (in response to inflationary pressures resulting from fiscal stimulus and tariffs) in the US, both contributing to higher bond yields, would be positive for the dollar and could see EURUSD fall to parity and below for a time. Rising bond yields could also trigger a correction in equity markets and financial market disruption more generally, though the dollar might still benefit in such a scenario given its "safe haven" status. An alternative scenario however, which cannot be completely ruled out, is that a further loosening of US fiscal policy (resulting in an increase in the budget deficit from already elevated levels of c.8% of GDP) triggers heightened concern about the sustainability of government debt levels (currently amounting to some 120% of GDP), which in turn leads foreign investors to demand higher bond yields and a weaker dollar to continue funding the deficit.

Euro-Sterling Exchange Rate



Source: Bloomberg

Sterling under pressure

While UK bond yields have followed US yields higher since September, sterling has followed the euro lower against the dollar over the same period. It has shed about 12 cents to just under $1.22, with about 3 cents of this coming in early January amid a sell-off in UK bonds and equities. This also saw the pound give up some of the (modest) gains it had made against the single currency since September, falling to £0.84 from a multi-year high of £0.82 in mid-December. We would expect GBPUSD to continue broadly tracking EURUSD, consistent with EURGBP trading in a range of about £0.81 to £0.86 over the coming months. However, as the sell-off in UK assets at the start of 2025 highlights, the pound is vulnerable to investor concern about sluggish growth, elevated domestic inflation, and the fiscal position in the UK.

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