Global Watch

Economic and market update

May 2025

Bank of Ireland

A price to be paid for tariffs

The new US administration's trade policy has resulted in heightened uncertainty and declining consumer and business sentiment, while also denting investor confidence in US assets. Increased tariffs will result in lower growth and higher inflation in the US, and will dampen growth in the Euro area and UK economies. The Fed is likely to stay on hold for now before resuming cutting interest rates later this year. We are pencilling in a 100bps reduction by the first quarter of 2026. We expect the ECB and Bank of England to lower rates further – by 75bps - over the next 6-9 months. The dollar has fallen by 5% on a trade-weighted basis since peaking in January and is likely to remain under pressure absent a marked dialling down of trade tensions. We see EURUSD and GBPUSD trading in ranges of $1.10-$1.20 and $1.30-$1.40 respectively, with EURGBP in a range of £0.82 to £0.87.

'Trump trade' unravels

The "Trump trade" that took hold in markets late last year - which saw US equities, bond yields and the dollar all rise in tandem - has unravelled over the past few months. Investors had clearly not banked on the scale - nor the chaotic nature - of Trump's tariffs policy, which has undermined confidence in US assets. This is most evident in the spike in bond yields and the fall in the dollar that accompanied the sell-off in stocks following the announcement of "reciprocal" tariffs on 2 April. Some calm has returned to markets lately, with stocks higher and the dollar recovering ground.

A tariffs-related hit to growth

As the IMF states in its latest World Economic Outlook, tariffs are a supply shock for the US economy which will reduce growth and increase inflation, while for US trading partners they "act mostly as a negative external demand shock" which will dampen growth. It has reduced its forecast for global GDP growth to 2.8% this year and 3% next year, a cumulative downgrade of around 0.8 percentage points relative to its January 2025 projections.

Further rate cuts ahead

Having left interest rates unchanged again in May, tariff-related inflation concerns are set to keep the Fed on hold for now, but ultimately, weaker growth is likely to see it resume cutting rates later this year. We are pencilling in a 100bps reduction through Q1 2026, though there's a risk supply chain effects and/or fiscal loosening keeps inflation, and hence interest rates, higher for longer. The ECB lowered the deposit rate by another 25bps to 2.25% in April, citing a number of downside risks to inflation. We expect a further reduction of 75bps (to 1.5%) over the second half of this year, with policy on hold thereafter. The Bank of England has been gradually easing policy since August last year, cutting by 100bps over this period. We see a further 75bps reduction by end-Q1 2026.

Dollar on the defensive

The dollar has fallen by 5% on a trade-weighted basis from its peak in early January, with half of the decline occurring since early April. The US administration's trade policy has dented investor confidence in US assets in general and the safe haven status of the dollar in particular. Hence, absent a marked dialling down of trade tensions, the dollar is likely to remain under pressure as overseas investors may be unwilling to continue funding the US current account deficit to the extent required. Moreover, a resumption of Fed rate cuts is likely to weigh on the dollar later this year.

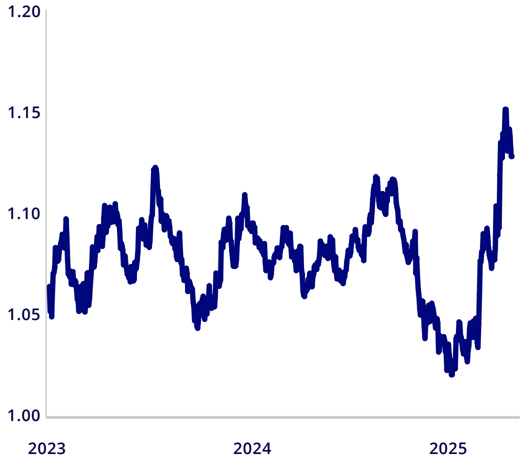
EURUSD rebounds

Having flirted with parity earlier this year, the euro has rebounded against the dollar. The announcement of increased infrastructure/defence spending in Germany propelled it higher in early March, while it rose to $1.15 in late April before giving up ground. We expect the single currency to trade in a range of $1.10 to $1.20 over the next year or so, with a move into the higher end of the range likely over the latter part of 2025. Sterling has also strengthened against the dollar, rising to $1.33 from $1.22 in January. It has lost some ground to the euro though, falling from 82p in late February to almost 87p in mid-April before recovering to 84p. This partly reflects the tendency for sterling to under-perform during periods of heightened volatility in financial markets. We expect the pound to trade in a new higher range of $1.30 to $1.40 against the dollar, and see it remaining between 82p and 87p versus the euro.

Central Bank Rates (%)	Current	End-Q2'25	End-Q3'25	End-Q4'25	End-Q1'26
Fed	4.25-4.50	4.25-4.50	4.00-4.25	3.50-3.75	3.25-3.50
ECB	2.25	2.00	1.50	1.50	1.50
BoE	4.50	4.25	4.00	3.75	3.50

Exchange Rates	Current	Q2'25	Q3'25	Q4'25	Q1'26
€/$	1.12	1.10-1.15	1.10-1.15	1.15-1.20	1.15-1.20
€/£	0.845	0.82-0.87	0.82-0.87	0.82-0.87	0.82-0.87
£/$	1.33	1.30-1.35	1.30-1.35	1.35-1.40	1.35-1.40

Euro versus Dollar



Source: Bloomberg

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Dollar on the defensive

Forecasts

GDP

GDP Growth*	2024	2025(f)	2026(f)
Global	3.3%	2.8%	3.0%
US	2.8%	1.8%	1.7%
Euro area	0.9%	0.8%	1.2%
UK	1.1%	1.1%	1.4%

*Annual % change, constant prices
Source: IMF (July 2025)

Interest Rates

Central Bank Rates (%)	Current	End-Q2'25	End-Q3'25	End-Q4'25	End-Q1'26
Fed	4.25-4.50	4.25-4.50	4.00-4.25	3.50-3.75	3.25-3.50
ECB	2.25	2.00	1.50	1.50	1.50
BoE	4.25	4.25	4.00	3.75	3.50

Source: Bloomberg, Bank of Ireland Forecasts

Exchange Rates

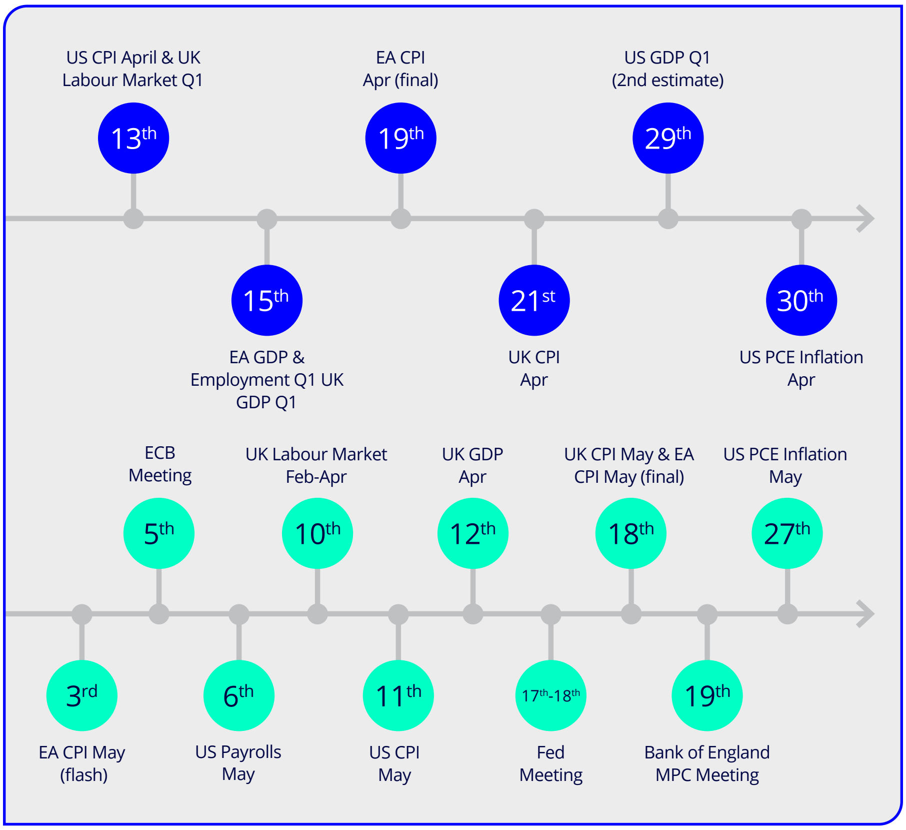
Exchange Rates	Current	Q2'25	Q3'25	Q4'25	Q1'26
€/$	1.12	1.10-1.15	1.10-1.15	1.15-1.20	1.15-1.20
€/£	0.845	0.82-0.87	0.82-0.87	0.82-0.87	0.82-0.87
£/$	1.33	1.30-1.35	1.30-1.35	1.35-1.40	1.35-1.40

**Current Rate as of 9 May 2025
Source: Bloomberg, Bank of Ireland forecasts

Upcoming Events

May

June

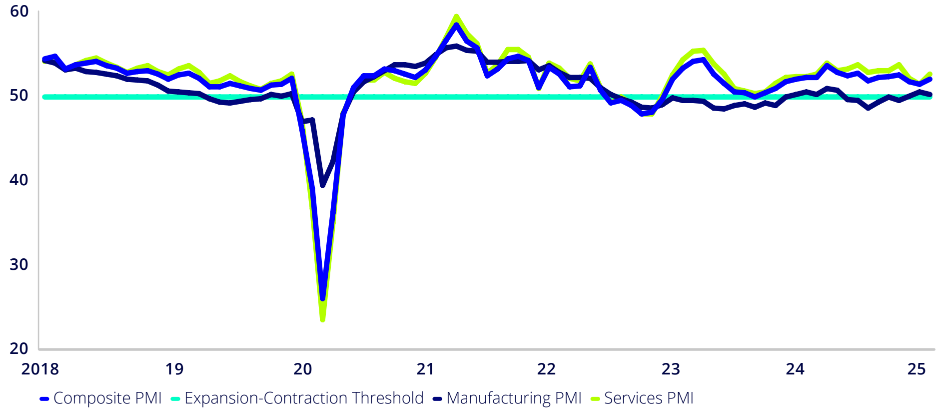


Economy

Trump's tariffs to lower global growth

Global GDP growth remained resilient in 2024, at just over 3%, while inflation eased further, allowing central banks to lower interest rates following a tightening of monetary policy in 2022-2023. Purchasing Managers' survey data (PMIs) point to a moderation in growth in the opening months of 2025. The composite PMI averaged 51.8 in January-March, down from 52.4 in Q4 2024, as an improvement in manufacturing - probably reflecting a front-running of production ahead of threatened tariffs by the US – was offset by slower services activity. In its April World Economic Outlook, the IMF lowered its forecasts for the world economy following the "Liberation Day" reciprocal tariffs announced by Donald Trump on April 2nd. It expects global GDP growth of 2.8% this year and 3% next year, a cumulative downgrade of around 0.8 percentage points relative to its January 2025 forecasts. The IMF says tariffs are a "supply shock" for the US economy which will reduce growth and increase inflation, while for US trading partners "they act mostly as a negative external demand shock" which will weaken growth. Downside risks dominate the outlook, according to the IMF, including prolonged trade policy uncertainty and financial market volatility.

Global PMIs

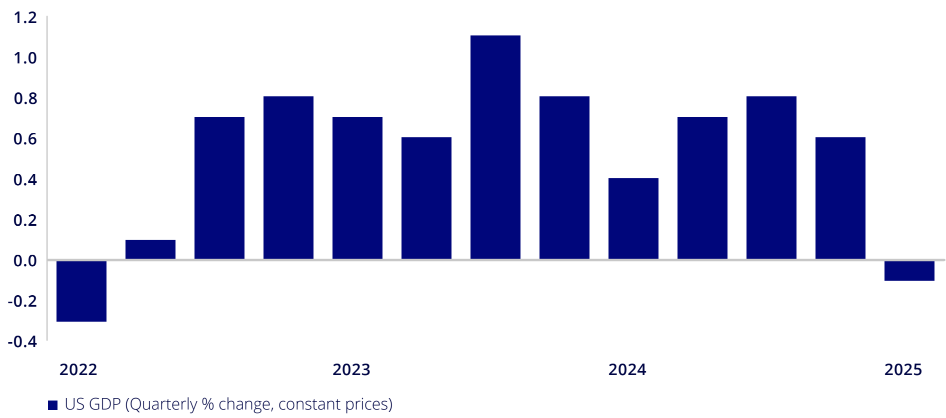


Source: JP Morgan, S&P Global

Slower growth, higher inflation in the US

Having expanded at a solid pace through 2024, the US economy slowed noticeably in the opening quarter of 2025 with GDP contracting by 0.3% at an annualised rate (or -0.1% q-o-q non-annualised). Consumer spending slowed following exceptionally strong gains over the second half of last year, while net exports made a sizeable negative contribution to growth due to a jump in imports, probably reflecting a front-running of tariffs. On the other hand, business investment rebounded in Q1, having fallen in Q4 on the back of uncertainty ahead of the November presidential election.

US Quarterly GDP Growth (%)



Source: BEA

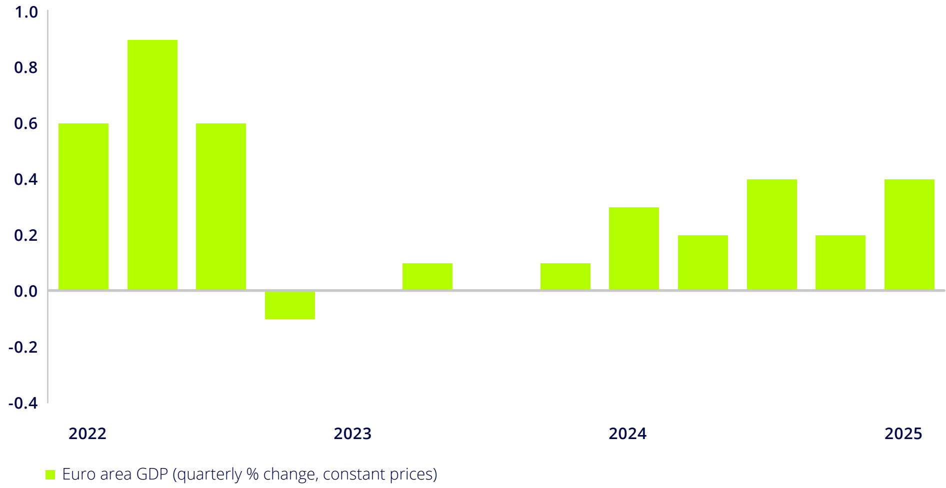
Economy

Trump's erratic trade policy has resulted in heightened uncertainty and declining consumer and business sentiment. It has also dented investor confidence, reflected in falls in US stocks, bonds, and the dollar. The significant increase in tariffs is likely to have sizeable effects on growth and inflation, lowering the former and raising the latter. Higher import prices could push up inflation (currently running at 2.3%) by 1-2% points over the course of this year, before it falls back again in 2026. Weaker growth will have an impact on the labour market, resulting in some decline in employment and an increase in the unemployment rate (currently 4.2%).

Negative demand shock to the Euro area

Euro area GDP growth surprised to the upside in Q1 2025, according to the 'flash' reading, accelerating to 0.4% q-o-q from 0.2% in Q4 2024 (helped by a return to growth in the German and French economies, both of which contracted at the end of last year). Employment growth has weakened recently, although unemployment has still fallen to a record low (6.2%), while inflation has slowed to 2.2%, just shy of the ECB's 2% target.

Euro area Quarterly GDP Growth (%)



Source: Eurostat

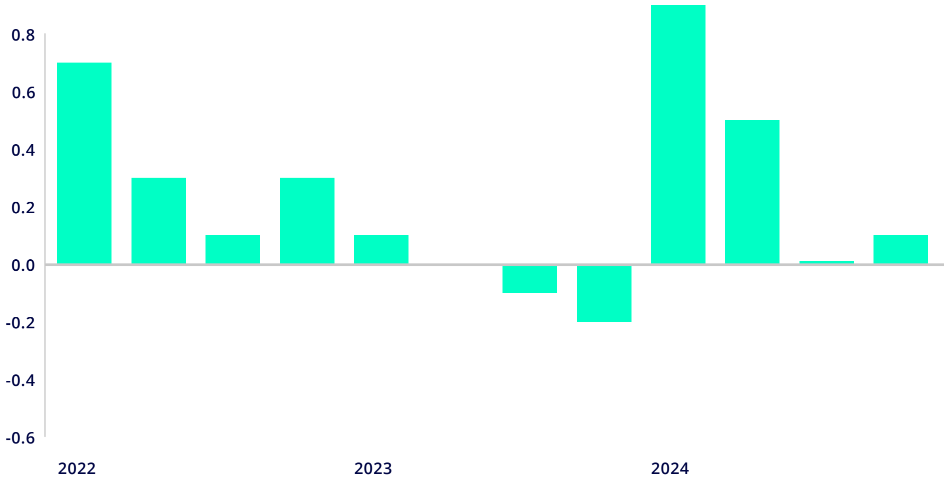
Projections for GDP growth in 2025 as a whole have been lowered. The 10% tariff imposed by the US, which could yet rise to 20%, will reduce demand for Euro area exports and dampen economic activity, though lower interest rates will provide some offset. Increased infrastructure and defence spending in Germany, along with increased EU defence spending generally, should boost growth, albeit probably not until 2026 onwards as it will take time for funds to be deployed and hence the impact on GDP to build. Weaker growth in the short-term, increased competition from China (as trade formerly with the US is diverted elsewhere, including the EU), and the euro's appreciation will all put downward pressure on inflation, which may fall below 2% over the coming months.

Economy

Subdued growth in the UK

While the UK economy barely grew in H2 2024, available data point to firmer activity in the first quarter of 2025. GDP in January-February was up 0.6% on Q4, while the Composite PMI rose through the quarter, reaching a 5-month high of 51.5 in March, though it fell back quite sharply in April according to the flash reading. The labour market has loosened recently, with job vacancies lower and unemployment nudging higher, but wage growth still remains elevated Having fallen below 2% in late 2024, inflation has picked up since, reaching 2.6% in March, mainly due to higher energy price inflation.

UK Quarterly GDP Growth



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

Forecasts for annual GDP growth in 2025 have been lowered to around 1% or slightly less, broadly in line with the 2024 outturn but down from previous projections of close to 1.5%. Increased government spending and firmer consumer spending on the back of rising real incomes will provide support to the economy this year. However, US tariffs of 10% (which remain in place after the UK-US trade deal), weaker global growth, and elevated uncertainty will dampen exports and investment. Inflation is likely to pick up in the near-term, due to higher domestic energy bills, but should begin to ease again heading into year-end.

Central Banks

Fed on hold for now

Having cut interest rates by 100bps over the final four months of 2024, the Fed remained on hold at each of its three meetings in 2025 to date, including most recently in May. Stickier than expected inflation has stayed the Fed's hand, while the new US administration's trade policy means it is likely to remain in "wait and see" mode for a while longer yet. As Fed Chair Powell has noted, inflation will be higher and growth lower as a result of tariffs. He has also cautioned that while the increase in inflation is likely to be temporary - as tariffs are a once-off increase in the price level - there's a risk it proves more persistent. Given this, the message from the Fed is that it's appropriate to keep interest rates at their current "moderately restrictive" level for now. But ultimately, weaker growth and higher unemployment are likely to see it resume cutting rates. We expect a 100bps reduction in rates by the first quarter of 2026, starting with a 25bps cut in Q3.

Further ECB rate cuts ahead

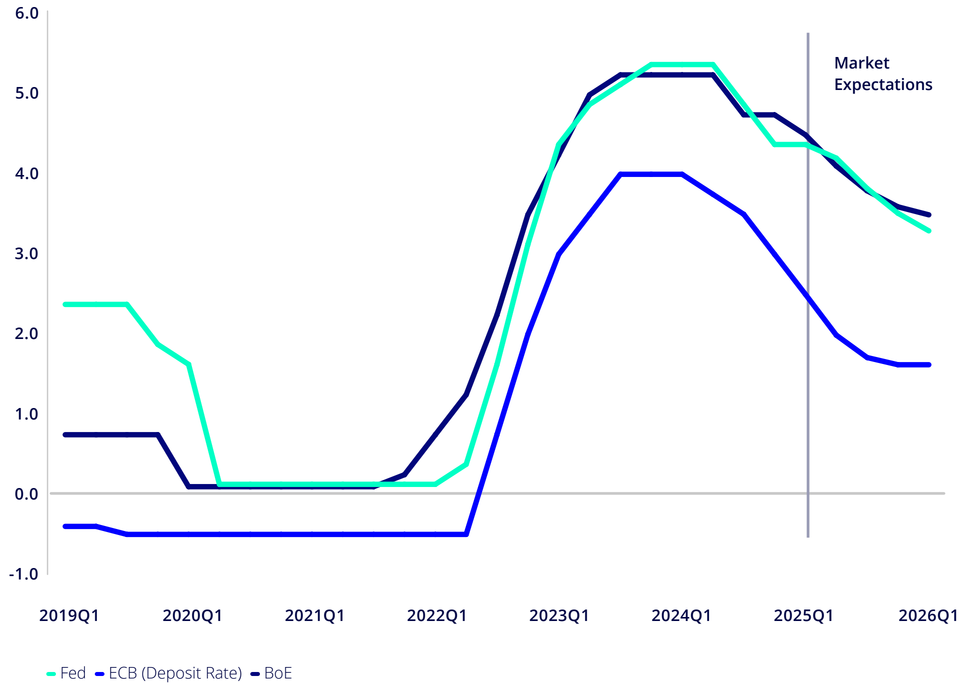
The ECB lowered the deposit rate by another 25bps to 2.25% at is April meeting - bringing the cumulative reduction since June last year to 175bps – noting that the disinflation process in the Euro area remains "well on track". It said the outlook for growth has "deteriorated owing to rising trade tensions", with increased uncertainty, lower confidence among households and businesses, and volatile financial markets all likely to weigh on the economy. At the same time, it cited a number of downside risks to inflation, including lower global energy prices, the appreciation of the euro, and weaker domestic and external demand. With the deposit rate still at the top of the ECB's estimate of the range for the neutral interest rate (1.75% to 2.25%), there's scope for further cuts to insure against downside risks to growth. We expect the ECB to lower the deposit rate by another 75bps (to 1.5%) over the remainder of this year, before policy goes on hold thereafter.

Central Banks

BoE to continue lowering rates

The Bank of England (BoE) Monetary Policy Committee (MPC) has been slowly lowering interest rates since August last year, as it responds to relatively subdued economic growth on the one hand but still elevated albeit declining wage growth and services inflation on the other. The MPC cut rates by a further 25bps to 4.25% at its May meeting, taking the cumulative reduction to date to 100bps, and reiterated that a "gradual and careful approach to the withdrawal of monetary policy restraint remains appropriate". Rates at 4.25% are still quite restrictive - updated BoE estimates suggest the neutral interest rate is around 3% - so there's room to lower them further assuming domestic inflationary pressures continue to moderate. In this regard, the MPC is putting weight on its own surveys showing lower pay settlements in 2025, which should result in a deceleration in wage growth and an accompanying decline in services inflation. Moreover, it expects the tariffs imposed by the US to dampen growth and inflation in the UK. We see the MPC lowering rates by another 75bps through end-Q1 2026, in steps of 25bps each quarter, though there's a risk it moves a bit faster than this.

Central Bank Policy Rates (%), End-Quarter



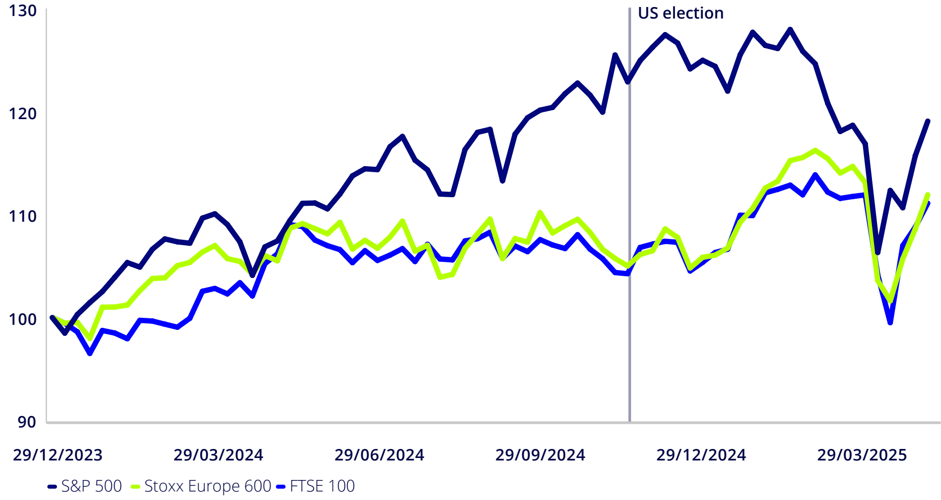
Source: Bloomberg

Markets

Trump's tariffs spook markets

The "Trump trade" that took hold in markets ahead of and following November's US presidential election - which saw US equities, bond yields and the dollar all rise in tandem - has unravelled over the past few months. While tax cuts and pro-growth deregulation were considered positive for the US economy, investors had clearly not banked on the scale - nor the chaotic nature - of Trump's tariffs policy. This has ignited fears of a recession in the world's largest economy and dented confidence in US assets, evident in the spike in long-dated Treasury yields and the fall in the dollar that accompanied the sell-off in stocks following the April 2 reciprocal tariffs announcement. Indeed, the fear of a spiralling of bond yields prompted the subsequent climbdown on tariffs on April 9.

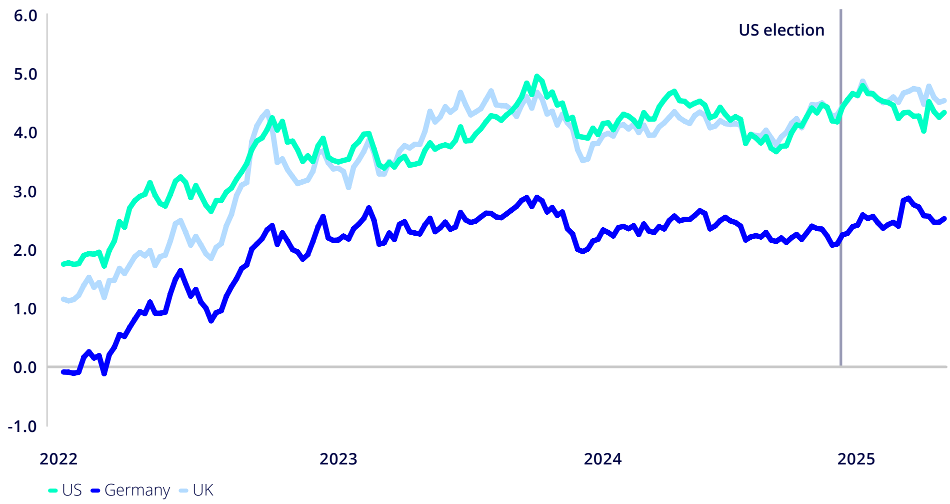
Equity Indices (End-2023=100)



Source: Bloomberg

Some semblance of calm has returned to markets recently. US and European stocks are off their April lows but still remain well down from their year-to date highs in February/March. US long-dated yields have fallen again but have not fully reversed the remarkable 50bps increase that occurred in the week following the announcement of reciprocal tariffs. Equivalent UK yields have also fallen back, having tracked US yields much of the way higher, while yields on German 10-year bonds – which have been a "safe haven" for investors - are lower, and have now reversed most of the spike that occurred in early March following the relaxation of Germany's "debt brake" to allow for increased government spending. Yield curves have steepened, with short-dated yields declining relative to long-dated yields, as markets have priced in more aggressive rate cuts by the main central banks. This has also seen short-maturity swap rates fall close to their lows to date in this rate-cutting cycle.

Government 10-Year Bond Yields (%)



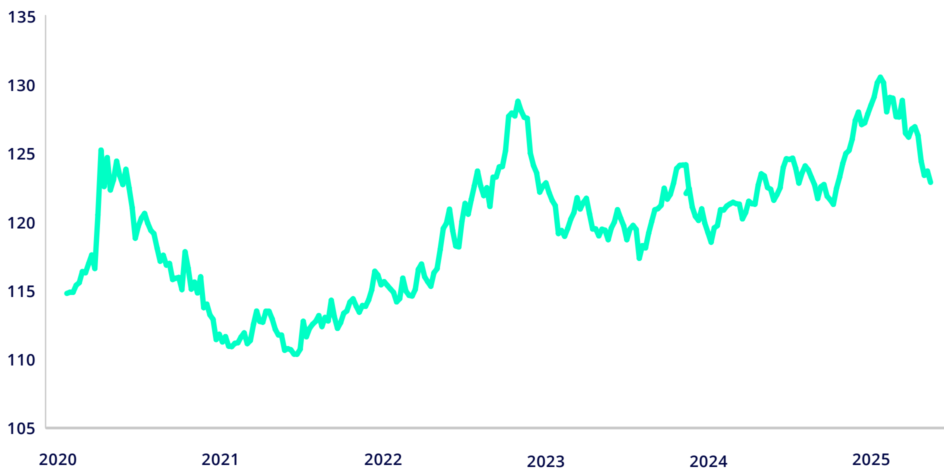
Source: Bloomberg

Markets

Dollar on the defensive

The dollar has fallen by about 5% on a trade-weighted basis from its peak in early January, with half of the decline occurring since early April. The new administration's trade policy has dented investor confidence in US assets in general and the safe haven status of the dollar in particular. Hence, absent a marked dialling down of trade tensions, the dollar is likely to remain under pressure over the coming months, amid doubts about the willingness of overseas investors to continue funding the large US current account deficit to the extent required. The implications of tax cuts for already elevated public deficit and debt levels could exacerbate concerns in this regard. Moreover, an easing of Fed policy later in the year is also likely to weigh on the dollar.

Dollar Trade-Weighted Exchange Rate



Source: Bloomberg

A "Mar-a-Lago Accord"?

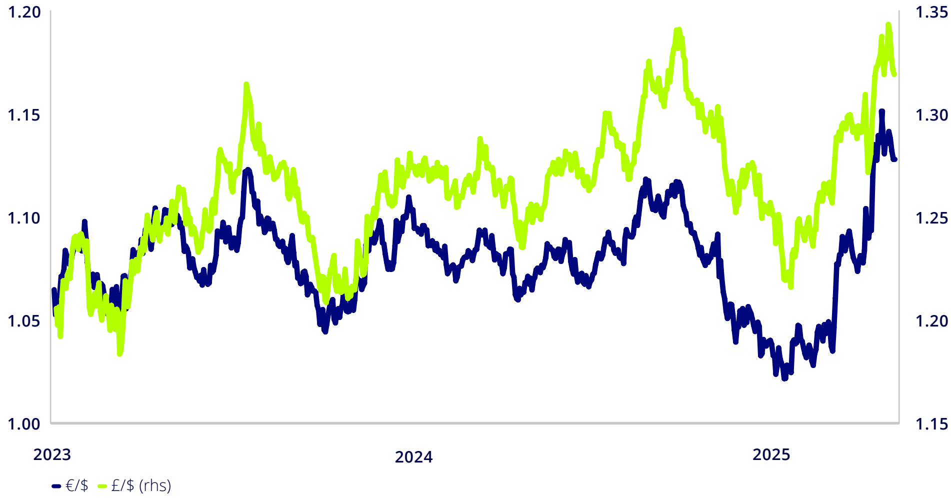
One risk to the dollar relates to the so-called 'Mar-a-Lago Accord', a proposal put forward last year by Steve Miran – now Chair of the Council of Economic Advisers - to reduce the US trade deficit by weakening the 'overvalued' dollar. This envisaged the US first imposing tariffs on trading partners, then essentially coercing them into 'agreeing' to weaken the dollar – via foreign central banks selling some of their dollar FX reserves - in return for a reduction in tariffs. However, it's not obvious why China (the largest holder of dollar reserves) or Europe would agree to strengthen their currencies at this juncture given their reliance on exports and/or weak economic growth. Moreover, foreign central bank holdings of dollar reserves are dwarfed by holdings of US assets by non-US private investors. They could well "take fright" at an attempt to weaken the dollar, leading to renewed turmoil on financial markets including rising bond yields. After the experience of the past month or so, presumably this is something the US administration would want to avoid.

Markets

Euro on the front foot

Having flirted with parity against the dollar over the opening couple of months of this year, the euro has rebounded strongly in the intervening period. The announcement of increased infrastructure/defence spending in Germany propelled it higher in early March, while the 'flight from the dollar' saw it strengthen to a circa 3.5 year high of $1.15 (and to record a high on a trade-weighted basis) in late April before giving up some ground. We expect the single currency to trade in a range of $1.10-to $1.20 over the next year or so, with a move up into the higher end of this range likely over the latter part of 2025 as the ECB comes to the end of its easing cycle and the Fed resumes lowering rates.

Euro and Sterling versus Dollar

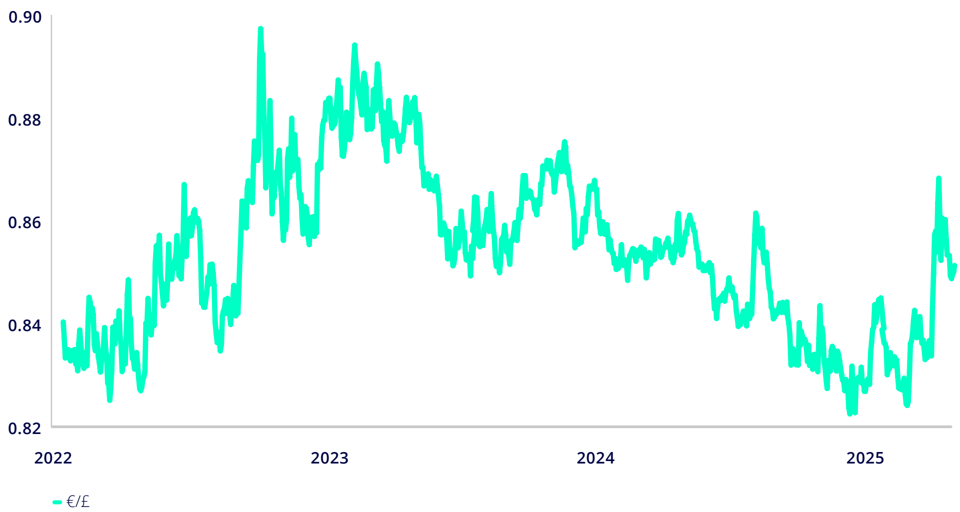


Source: Bloomberg

Mixed fortunes for sterling

Like the euro, sterling has also strengthened against the dollar since earlier this year, rising to $1.33 from a low of $1.22 in January. It has lost ground to the single currency though, falling from 82p in late February to a circa 15-month low of almost 87p in mid-April before recovering to 84p. This partly reflects the tendency for sterling to underperform during periods of heightened volatility in financial markets, which also tends to increase the focus on the UK's sizeable budget deficit (of around 4% of GDP). We expect the pound to trade in a new higher range of $1.30 to $1.40 against the dollar over the coming months, and see it remaining between 82p and 87p versus the euro. Renewed turmoil in markets and increased concerns about the public finances (amid weaker UK growth) could weigh on the pound, while higher than expected interest rates (because of sticky inflation) would support the currency.

Euro-Sterling Exchange Rate



Source: Bloomberg

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