

Forex and Interest Rate Outlook

AIB Treasury Economic Research Unit



11th February 2026

- Global economy has proven to be robust over the past year despite ongoing geopolitical uncertainty, but risks still tilted to the downside
- US growth increasingly imbalanced towards AI investment, with labour market weakening
- Fed and Bank of England on hold at first meetings of the year, but set for further cuts while the ECB sits on the sidelines. Bank of Japan plotting further modest hikes
- Dollar set for further modest weakening. Geopolitics, Fed independence and conditions in the labour market remain to the fore in 2026
- Further modest upside for the euro, while sterling could remain on the defensive amid political uncertainty, and Bank of England policy easing

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Global economy has proven resilient

Global economy has proven resilient..

In recent months, incoming macro data suggest the global economy continues to grow at a solid pace, despite the heightened uncertainty related to US trade and economic policy. Institutional forecasters, including the IMF, have been revising up estimates for global growth, while still noting downside risks.

..but now imbalanced towards AI-related activity

A key driver of this resilience is the surge in AI-related investment. Technology investment as a share of US GDP has risen to the highest level since 2001. Although this surge has been concentrated in the US, it is also generating spillovers globally, most notably to Asia's computer and chip exports. Therefore, the upside surprise to global growth in 2025 was driven by business investment rather than consumption. If this surge in investment ultimately boosts the productive capacity of the economy, then GDP growth could be structurally higher in the medium term. However, given the narrow growth base there are also downside risks if the predicted productivity gains are more slowly realised.

Data continue to signal subdued growth in Europe

In Europe, activity remains subdued outside of the surge in exports to the US in 2025. The latest forward-looking indicators suggest Eurozone and UK growth remained weak in Q4, with the PMIs hovering around the 50 no change level. Consumer and business confidence has also been dampened by the ongoing geopolitical uncertainty.

Geopolitical risks back to the fore in early 2026

Deterioration in US-EU relations a key geopolitical risk in 2026

The spike in geopolitical tensions in 2026 has brought tariffs back to the forefront. The US threatened a 25% tariff on European countries in early January, amid tensions regarding Greenland. In response the EU renewed plans to apply a package of tariffs on US goods. EU leaders also floated the potential to use the "Anti-Coercion Instrument", which could apply restrictions on services trade between the EU and US, and limit the ability of US tech firms to operate in the single market. Overall, the retreat by President Trump was a positive outcome. However, geopolitical risks could act as a drag on the global economy in 2026.

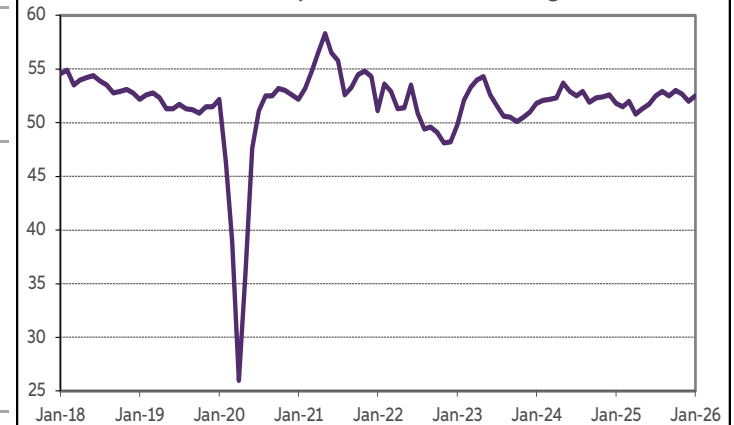
Policy uncertainty also bleeding into financial markets

Global fiscal imbalances, alongside lingering monetary policy uncertainty, including threats to Fed independence, have impacted financial markets. The dollar has weakened further, safe havens such as gold have risen, and sovereign yields curves have steepened. Notably, in Japan, a shift to expansionary fiscal policy has pushed long terms rates higher.

Also worth noting the upside risks, including the potential for cessation to ongoing conflicts

Ongoing geopolitical conflicts in Ukraine and the Middle East could also impact the global economic outlook. However, these events bring two-sided risks for the economy. A cessation of the conflict in Ukraine could be a positive for Europe in particular, providing an immediate confidence boost and a structural lift to investment from reconstruction. The big picture though, is that the global economy has weathered the impact of these conflicts since the initial fallout from the invasion of Ukraine in 2022.

Global Composite PMI (JP Morgan)



Source: Refinitiv

GDP (Vol % Change)

| | 2024 | 2025 (e) | 2026 (f) | 2027 (f) |
|------------------------|------|----------|----------|----------|
| World | 3.3 | 3.3 | 3.3 | 3.2 |
| Advanced Economies | 1.8 | 1.7 | 1.8 | 1.7 |
| US | 2.8 | 2.1 | 2.4 | 2.0 |
| Eurozone | 0.9 | 1.4 | 1.3 | 1.4 |
| UK | 1.1 | 1.4 | 1.3 | 1.5 |
| Japan | -0.2 | 1.1 | 0.7 | 0.6 |
| Emerging Economies | | | | |
| China | 5.0 | 5.0 | 4.5 | 4.3 |
| India | 6.5 | 7.3 | 6.4 | 6.4 |
| World Trade Growth (%) | 3.6 | 4.1 | 2.6 | 3.1 |
| Inflation -CPI | | | | |
| Advanced Economies (%) | 2.6 | 2.5 | 2.2 | 2.1 |

Sources: IMF Economic Outlook Update, January 2026

Interest Rate Outlook

ECB on hold, with BoE and Fed expected to ease policy in 2026

Central banks continue to operate in a volatile global policy environment.

The first round of meetings for 2026 from the main central banks concluded in line with expectations. The Fed, ECB, BoE and BoJ all kept their respective interest rates unchanged. The ECB meeting was uneventful, and indications are that it could be on hold this year. The Fed meeting was also lacking in any surprises, with the tone suggesting that while the Fed retains an easing bias, near term cuts are unlikely. In contrast, the BoE had a more dovish tone than expected with another cut likely sooner rather than later. Meanwhile, the BoJ, retains a hawkish bias. Around 50bps of hikes from the BoJ is on the cards this year.

Fed retains an easing bias, but near term rate cut unlikely

The Fed, as expected, left rates unchanged in January, in a 3.50-3.75% range. The most recent 25bps rate cut occurred in December. The Fed has cut by a total of 175bps in its current easing cycle. The main message from the January FOMC is that while the Fed retains an easing bias, it is not contemplating any near term rate cuts. The Fed's current (published in Dec'25) rate projections for this year is for one 25bps rate cut. The market is envisaging a more aggressive pace of easing for 2026. Futures contracts are pricing in around 50bps, with the next 25bps cut expected by June. An additional issue to factor in for the Fed's outlook is the new Chair, Kevin Warsh, who could be in place by mid-year. His recent comments have been dovish in tone. Our view is that 50bps of cuts by year end is a reasonable expectation, with the risks tilted to more rather than less easing.

ECB on hold and may remain this way throughout 2026

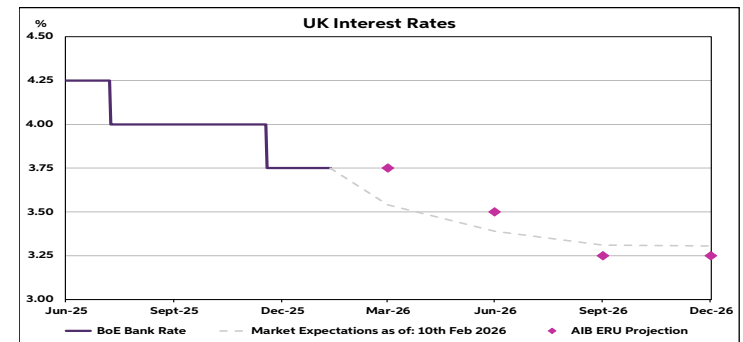
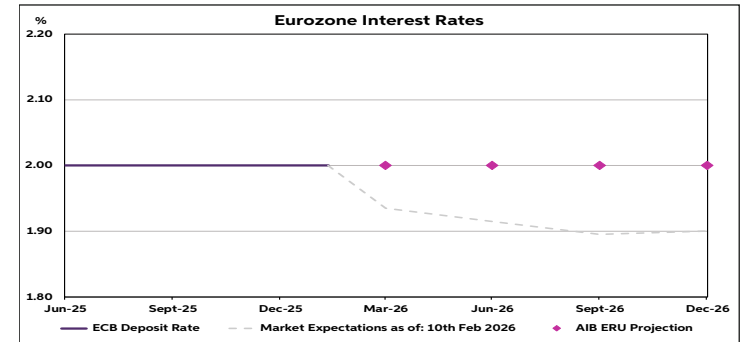
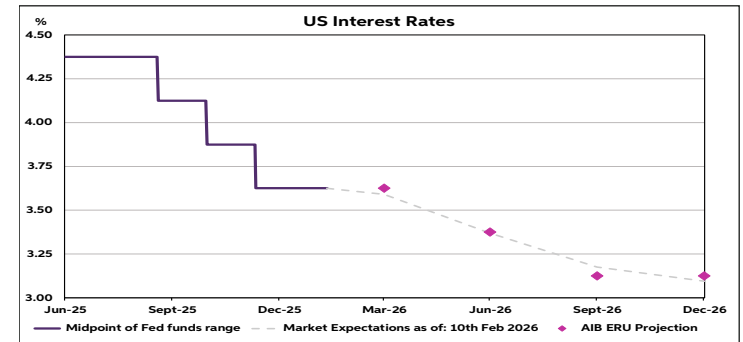
The ECB left policy on hold in February, with the Depo rate kept at 2.00%, for a fifth consecutive meeting. The ECB lowered rates by 200bps during its easing cycle. President Lagarde's press conference was uneventful and did not offer any fresh insight on the ECB's outlook for rates. Instead, she once again repeated the ECB's view that policy is in a "good place". Overall, the tone from the ECB in February suggests that it is content with its current policy setting and is not envisaging any near term rate changes. Current futures contract pricing suggests the market's judgement is that the ECB's easing cycle is complete. Our view since the start of last year has been that the deposit rate would settle at 2%. The February ECB meeting reinforces our outlook that 2% will be the trough and it will remain at this level throughout 2026.

Another BoE rate cut now likely sooner rather than later

The BoE kept the Bank Rate at 3.75% in February, having cut rates in December. Once again, it was a close call, with the vote split 5:4. Overall, the tone from the BoE was more dovish than expected and indicates that a rate cut is likely sooner rather than later. Of the five voting for no change, for two of them (which includes Gov. Bailey) they appear to be leaning towards cutting rates, but want to see more evidence that inflation is on a sustained path to the 2% target. In a recent interview, Gov. Bailey stated that the March meeting was a "50:50" call in this regard. Therefore, a rate cut is on the cards, if not in March than by April. The market is pricing a total 50bps of easing this year, which would see the Bank Rate end the year at 3.25%. In our view, this is a plausible outcome. Indeed, Gov. Bailey stated this was a "reasonable market curve".

| | Interest Rate Forecasts | | | | |
|--------------------|-------------------------|----------------|----------------|----------------|----------------|
| | Current | End Q1 2026 | End Q2 2026 | End Q3 2026 | End Q4 2026 |
| Fed Funds | 3.625 | 3.625 | 3.375 | 3.125 | 3.125 |
| ECB Deposit | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 |
| BoE Repo | 3.75 | 3.75 | 3.50 | 3.25 | 3.25 |

Current Rates Reuters, Forecasts AIB's ERU



Forex Market Outlook

Dollar has lost further ground in 2026, as we expected

Dollar has lost further ground of late

The dollar has seen renewed falls in the early part of 2026, with the trade-weighted DXY index down c.1.5% since January 1st. Against the euro, the dollar is also down c.1.5% over the same period, and has tested briefly above the key \$1.20 level recently. The dollar also lost similar ground against sterling, with GBP/USD trading around \$1.37 of late.

Political uncertainty has weighed on the dollar

Aside from lingering concerns regarding weakness in the labour market, political uncertainty has again been to the fore in the dollar moves in 2026. Fears of potential further military actions by the US administration, notably, Greenland, allied to domestic concern around Fed independence and a perception of bias in the White House towards a weaker dollar have contributed to the fall. Comments from President Trump, stating "I would want it to... just seek its own level" provided an impetus for the dollar to reach multi-year lows in January, before Treasury Secretary Bessant clarified that the US government has "a strong dollar policy".

Risks still to the downside for the dollar

There remains obvious risks to the downside for the dollar. The policy trajectory of the Fed could be a key driver here, with a newly-dovish Chair expected in to be situ by mid-year. The strength of the US economy will be in focus, with clear signs of a slow down in the labour market, and growth becoming increasingly reliant on AI. Finally, the political noise from the White House could provide an unhelpful backdrop for the currency in the run up to US mid term elections. This could spur a more sustained break above \$1.20 vs. the euro, reflected in a top end of our range at \$1.23 for year-end.

ECB holding rates in 2026, slight upward bias for EUR/USD

ECB happy on the sidelines for now

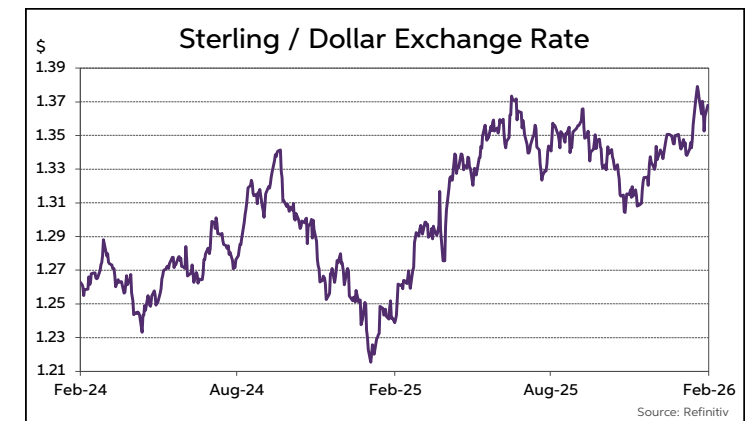
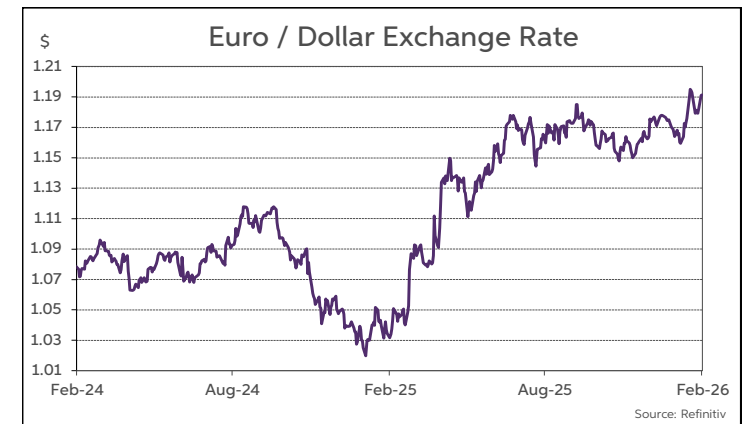
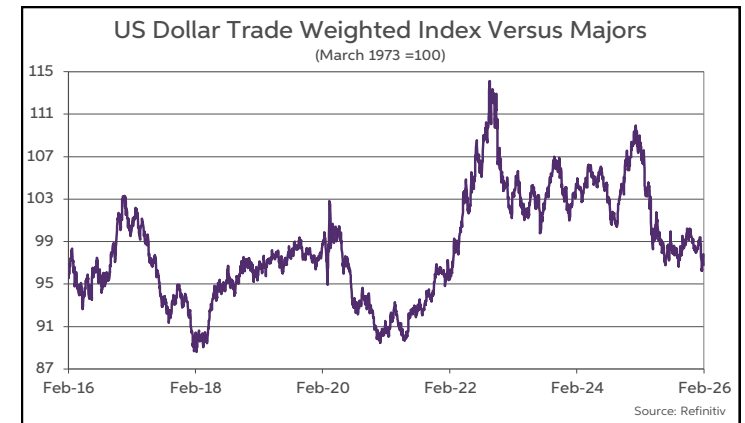
The ECB has been on hold for several months and we expect the deposit rate to remain at 2% in the near term. President Lagarde's comments at the February press conference indicate that the central bank is very content that its current interest rate settings are appropriate, with risks to the inflation outlook broadly balanced at present.

European assets outperforming, perhaps benefitting from de-dollarisation trend

So far in 2026, European risk assets continue to outperform their US counterparts, perhaps reflecting some debasement of the dollar, albeit precious metals such as gold appear to have benefitted most. With EU fiscal expansion and increased defence spending expected to boost growth in 2026, this theme may continue to support European assets alongside a general 'de-dollarisation' trend.

Euro to make further modest gains against the dollar

We expect the euro to make modest gains versus the dollar in 2026 from the current \$1.18-1.19 range to \$1.20 by year-end. However, a further Eurozone growth catalyst will be required to enable EUR/USD to make a sustained break through the key resistance of \$1.20, as the pair has not traded consistently above this level since 2014.



Forex Market Outlook

Politics a potential catalyst for weakness in sterling

Sterling under pressure as political uncertainty spikes

Sterling and gilts have lost ground recently as political uncertainty has come to the fore. Speculation has emerged that the Labour party could replace Keir Starmer as Prime Minister in the coming months. Indeed, the currency continues to exhibit more cyclical volatility than the other majors, reflecting bouts of political upheaval since the Brexit referendum. Meanwhile, the available hard data for the final quarter of the year were mixed. The monthly reading of GDP contracted by 0.1% m/m in October, amid weaker activity levels in the services sector, but rebounded by 0.3% m/m in November.

BoE set for further cuts in 2026 as inflation eases

The BoE held rates in February with an ongoing 5:4 split on the MPC. Our expectation is for a continued steady easing cycle by the BoE, of 50bps in 2026, perhaps more front-loaded than the market is currently pricing in. This, combined with weak current GDP growth prospects, could act as a drag on sterling in the near term, particularly against the euro.

Sterling to remain close to current levels in the near term

Sterling is expected to be modestly lower through 2026 versus the euro. However, the pair is likely to remain largely range-bound as relative macro fundamentals are unlikely to drive a notable break-out from the current range. EUR/GBP is expected to move towards 88p by Q4 2026, with risks of a sharper rise if the political situation deteriorates. However, we see the potential for GBP/USD to hold at around \$1.36 through 2026, reflecting dollar weakness.

Upside for yen as BoJ signals further hikes

Yen has strengthened in 2025

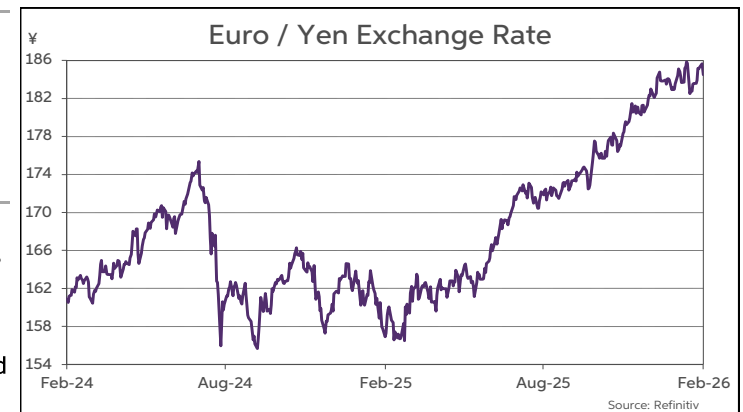
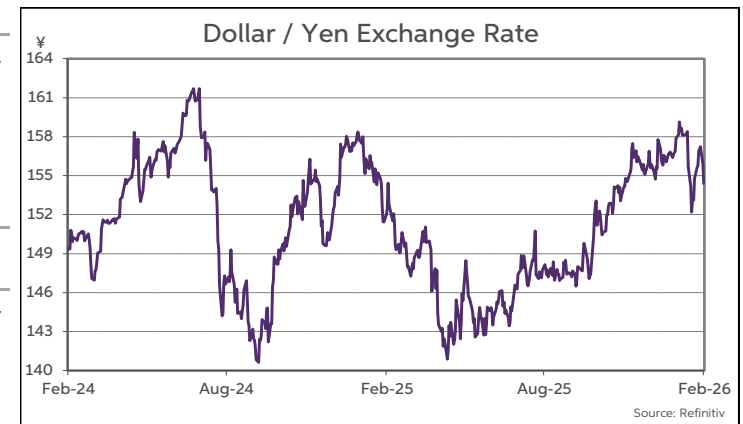
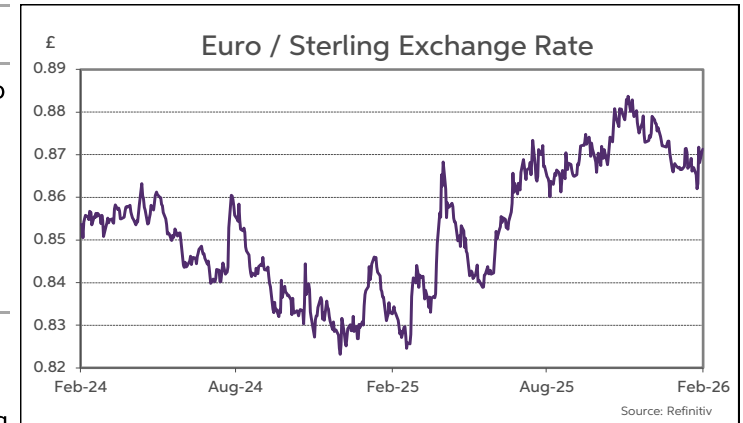
The yen has traded in a wide range over the past year, most recently driven by a shift towards expansionary fiscal policy by PM Takaichi. Since the beginning of 2026 the yen is down near 1% versus the euro, but has regained ground against the dollar of late, on the back of speculation of official intervention by US and Japanese authorities after the pair reached ¥160 in mid-January.

Political and fiscal policy uncertainty has weakened the currency

The landslide election of PM Takaichi, with a focus on reviving the “Abenomics” approach to fiscal spending, has raised concerns about Japan’s debt sustainability, pushing up government yields and driving a fall in the yen. However, the Bank of Japan (BoJ) is also expected to raise rates further in 2026, dampening the effects of fiscal policy. Markets are pricing in c50 bps of hikes by the BoJ in 2026.

Yen expected to strengthen slightly in the near term as rate differentials reduce vs. trading partner

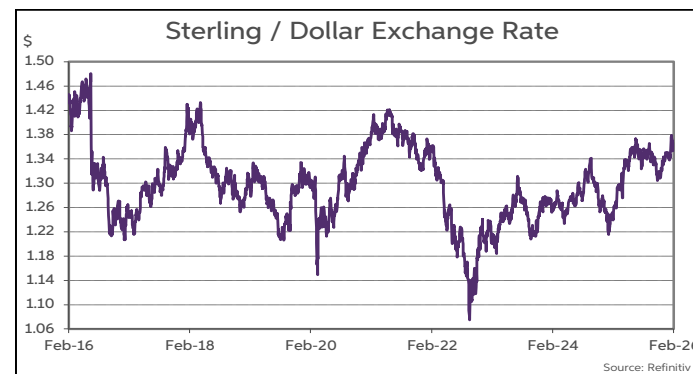
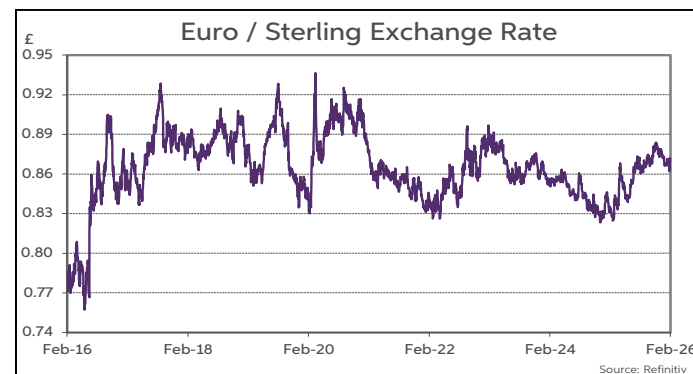
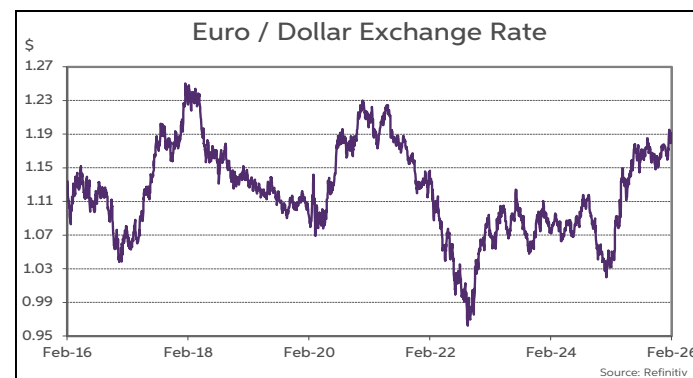
The yen is expected to appreciate modestly as political uncertainty recedes post election. We see the currency strengthening towards a range of ¥152-158 by Q4 2026 versus the dollar, from the current ¥154-156 corridor. Versus the euro, the currency is expected to remain relatively static, trading in the ¥183-189 range out to Q4-2026. BoJ rates will be a key catalyst, with current sticky inflation raising the risk of more rate hikes than currently priced in, which could support the currency further.



Summary of Exchange Rate Forecasts

("Spot" Forecasts for end Quarter can be taken as Mid-Point of expected Trading Range)

| | Current | Q1-2026 | Q2-2026 | Q3-2026 | Q4-2026 |
|-------------------------|---------|-----------|-----------|-----------|-----------|
| Euro Versus | | | | | |
| USD | 1.192 | 1.16-1.22 | 1.17-1.23 | 1.17-1.23 | 1.17-1.23 |
| GBP | 0.870 | 0.84-0.90 | 0.85-0.91 | 0.85-0.91 | 0.85-0.91 |
| JPY | 182.72 | 183-189 | 184-190 | 183-189 | 183-189 |
| CHF | 0.91 | 0.92 | 0.93 | 0.94 | 0.94 |
| US Dollar Versus | | | | | |
| JPY | 153.29 | 153-159 | 153-159 | 152-158 | 152-158 |
| GBP | 1.371 | 1.34-1.40 | 1.33-1.39 | 1.33-1.39 | 1.33-1.39 |
| CAD | 1.35 | 1.37 | 1.36 | 1.35 | 1.36 |
| AUD | 0.71 | 0.70 | 0.70 | 0.69 | 0.69 |
| NZD | 0.61 | 0.60 | 0.60 | 0.60 | 0.60 |
| CNY | 6.91 | 7.09 | 7.10 | 7.10 | 7.10 |
| Sterling Versus | | | | | |
| JPY | 210 | 214 | 212 | 211 | 211 |
| CAD | 1.85 | 1.87 | 1.85 | 1.84 | 1.85 |
| AUD | 1.93 | 1.96 | 1.94 | 1.97 | 1.97 |
| NZD | 2.26 | 2.28 | 2.27 | 2.27 | 2.27 |



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