Weekly Market Brief

AIB Treasury Economic Research Unit

10th - 14th January 2022

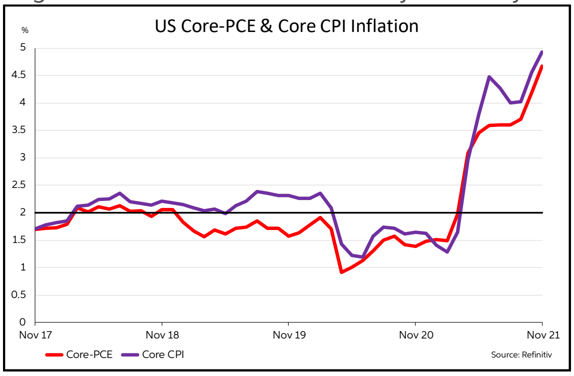
Long Covid

- **The first couple of trading days of the New Year suggested investors are increasingly optimistic that the latest Covid-19 surge won't depress economic activity like earlier waves,** with the Omicron variant proving much milder albeit far more transmissible than previous strains. Stock markets made further ground early this week, having already notched up impressive gains in 2021, while bond yields continued their recent upward march. The release, though, of the Fed minutes from December's FOMC meeting dented investor sentiment and pointed to what could be a tricky year ahead in markets. Investors' confidence was shaken as the minutes showed the Fed considering a faster start to policy tightening, with earlier interest rate increases and a possible quicker than expected rundown of its large balance sheet, as it looks to reverse QE asset purchases. The minutes suggested a rate hike could come as early as March.

- **The Fed is worried about inflation, and the recent further disruption to supply chains as a result of Omicron, increases the risk that the rise in CPI rates will prove longer lasting.** Greater monetary tightening is likely in such circumstances. The Fed's latest interest rate projections published in December pointed to a faster and greater degree of tightening than the market had been anticipating, with 150bps in hikes taking the funds rate to 1.625% by end 2023. The market, though, has been moving more into line with the Fed recently and now sees rates getting to 1.5% or slightly above by end 2023. We have seen a similar hardening of rate hike expectations in Europe since late December. Futures contracts now see the ECB raising rates by 50bps by the end 2023, with the deposit rate rising to zero and money market rates turning positive. In the UK, the market sees the Bank rate increasing close to 1.5% by end 2023, in contrast to expectations last month that it would not rise much above 1%.

- **This hardening of rate hike expectations has put upward pressure on bond yields, with curves also steepening.** Ten year yields have risen by circa 25bps in the US, Eurozone and UK since Christmas. Given that rates have firmed in most markets, the main currency pairs have seen little movement recently. Sterling is somewhat stronger while the yen a bit weaker, with rates not expected to rise in Japan. A considerable amount of monetary tightening has now been priced in for the US and UK in 2022-23, while the rate hikes priced in for euro markets do not seem consistent with recent policy guidance from the ECB. It would seem markets believe that inflation could remain elevated well into next year.

- **Inflation can be expected to be the key driver of interest rate markets in 2022 given the influence it is likely to exert on monetary policy.** Markets are going to have to be patient, though, as it is likely to be later in the year before it is clear whether or not underlying inflationary pressures are moderating. Meanwhile, although the Omicron variant may dampen growth somewhat at the start of this year, this should prove short-lived. Economies are learning to live with Covid. The more lasting impact of the virus may be on prices given that the disruption it has caused to production processes, supply chains and labour markets is proving far more enduring than the hit to economic activity. This may be where 'long Covid' is felt most in economies.



- **Fittingly, the main data highlight this week will be the latest CPI inflation reading in the US.** In November, headline CPI jumped to 6.8%, its highest level in almost 40 years, on the back of more broad based price increases than in previous months. The core rate rose to 4.9%. The consensus is that prices continued to rise sharply in December, with headline and core CPI forecast to increase by 0.4% and 0.5% in the month, lifting the annual rates to 7.1% and 5.4% respectively. Elsewhere in the US, retail sales are expected to fall by 0.1% in December, although, they will remain at very elevated levels. Meanwhile, having risen above its pre-Covid level in November, industrial production is projected to increase by 0.3% in December. Finally, the University of Michigan measure of consumer sentiment is expected to be relatively unchanged in January.

- **In the UK, the main release of note will be the monthly reading of GDP for November.** Growth all but came to a halt in October, rising by 0.1%. Worryingly, health output made the biggest contribution to GDP, adding 0.3 percentage points to output, meaning without it, the economy would have contracted. It is envisaged the economy regained some momentum in November, with GDP rising by 0.4%. However, the reprieve is set to be short lived. The surge in cases due to Omicron is likely to result in a fall in output, albeit a fairly shallow and short lived contraction.

- **There is a quieter look to the Eurozone schedule this week.** Both of the main releases, industrial production and the unemployment rate, are expected to continue on their recent trends, with the former edging higher, and the latter slightly lower in November. Meanwhile, full year 2021 German GDP data should cast some light on growth in Q4.

Interest Rate Forecasts	Current	End Q1 2022	End Q2 2022	End Q3 2022
Fed Funds	0.125	0.25	0.50	0.75
ECB Deposit	-0.50	-0.50	-0.50	-0.50
BoE Repo	0.25	0.50	0.75	1.00
BoJ OCR	-0.10	-0.10	-0.10	-0.10

Current Rates Reuters, Forecasts AIB's ERU

Exchange Rate Forecasts (Mid-Point of Range)	Current	End Q1 2022	End Q2 2022	End Q3 2022
EUR/USD	1.1340	1.12	1.11	1.11
EUR/GBP	0.8356	0.83	0.82	0.82
EUR/JPY	131.14	131	131	131
GBP/USD	1.3566	1.35	1.35	1.35
USD/JPY	115.64	117	118	118

Current Rates Reuters, Forecasts AIB's ERU

ECONOMIC DIARY

Monday 10th - Friday 14th January

AIB Treasury Economic Research

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Date	*UK & Irish Time*		*Release*	*Previous*	*Forecast*
This Week:	**ECB Speakers:**		**Lagarde** (Tue); de Guindos (Thu); **Lagarde** (Fri)		
	BoE Speakers:				
	Fed Speakers:		**Powell,** Mester, George, Bullard (Tue); Brainard, Barkin, Evans , Harker (Thu); Williams (Fri)		
Mon 10th	**EU-19:**	09:30	EU Sentix Index (January)	13.5	12.0
	EU-19:	10:00	Unemployment Rate (November)	7.3%	7.2%
Tue 11th	**ITA:**	09:00	Retail Sales (November)	+0.1% (+3.7%)	
Wed 12th	**CHINA:**	01:30	CPI (December)	+0.4% (+2.3%)	+0.2% (+1.8%)
	JPN:	05:00	Economy Watchers Poll (December)	56.3	
	EU-19:	10:00	Industrial Production (November)	+1.1% (+3.3%)	+0.3% (+0.6%)
	IRL:	***11:00***	***Unemployment Rate (December)***	***5.2%***	***5.2%***
			- Covid-19 Adjusted Rate	***6.9%***	***7.0%***
	US:	13:30	CPI (December)	+0.8% (+6.8%)	+0.4% (+7.1%)
			- Core	+0.5% (+4.9%)	+0.5% (+5.4%)
Thu 13th	**ITA:**	09:00	Industrial Output (November)	-0.6% (+2.0%)	+0.5% (+3.7%)
	US:	13:30	Initial Jobless Claims (w/e 3rd January)	+207,000	+210,000
	US:	13:30	PPI Final Demand (December)	+0.8% (+9.6%)	+0.4% (+9.8%)
			- Ex-Food & Energy	+0.7% (+7.7%)	+0.5% (+8.0%)
Fri 14th	**CHINA:**	03:00	Trade Balance (December)	+$71.7Bn	+73.4Bn
			- Exports	+22.0%	+20.0%
	UK:	07:00	GDP (November)	+0.1% (+4.6%)	+0.4%
	UK:	07:00	Industrial Production (November)	-0.6% (+1.4%)	+0.2% (+0.5%)
			- Manufacturing Output	+0.0% (+1.3%)	+0.2% (+0.3%)
	UK:	07:00	Goods Trade Balance (November)	-£13.9Bn	-£14.1Bn
			- Non-EU	-£8.6Bn	
	FRA:	07:45	Final HICP (December)	+0.2% (+3.4%)	+0.2% (+3.4%)
	SPA:	08:00	Final HICP (December)	+1.2% (+6.7%)	+1.2% (+6.7%)
	GER:	09:00	Full Year GDP (2021)	2020: (-5.0%)	2021: (+2.7%)
	US:	13:30	Retail Sales (December)	+0.3% (+18.2%)	-0.1% (+19.3%)
			- Ex-Autos	+0.2%	+0.2%
			- Ex-Gas & Autos	+0.2%	
	US:	14:15	Industrial Production (December)	+0.5% (+5.3%)	+0.3% (+4.4%)
			- Manufacturing Output	+0.7%	
			- Capacity Utilisation	76.8%	77.0%
	US:	15:00	Preli. Michigan Consumer Sentiment (January)	70.6	70.2

♦ *Month-on-month changes (year-on-year shown in brackets)*