

Forex and Interest Rate Outlook

AIB Treasury Economic Research Unit



13th February 2025

- Economic picture remains robust, despite geopolitical concerns, with signs of somewhat stronger global growth in early 2025
- Core inflation remains sticky in many markets, with risks still tilted to the upside for inflation due to ongoing global trade tensions and high domestic wage pressures
- Central banks have initiated rate cutting cycles, and will continue on a cautious downward trajectory in 2025 given current uncertainties
- Main currency pairs exhibiting volatility due to Trump 2.0 impact. Dollar likely to hold most of the gains in the near term, but could lose some momentum later in 2025
- Potential for euro to strengthen post Q1 2025, as political risk (German elections, France fiscal policy) begins to dissipate

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Robust growth picture amid geopolitical uncertainty

Global growth remains robust despite geopolitical risks

Economic data continue to signal robust global growth and easing inflation in recent months, despite current geopolitical risks. Recent PMI and economic surprise indices suggest growth has accelerated somewhat in Q1 2025. Inflation continues to ease across all major economies, but there are signs of a plateauing in some regions such as the US, underpinning the case for central banks to proceed cautiously with rate cuts.

US growth continues at exceptional pace, downside risks emerging

US GDP expanded at a robust pace of 2.8% in 2024. Recent indicators suggest the growth picture has sustained at a similar pace in 2025, with institutional forecasters revising up estimates on the expectation of pro-growth policies from the new Trump administration. Nonetheless, there remains downside risks to the outlook from ongoing global trade tensions, and the durability of both US consumer and government spending, which have been the key drivers of growth in recent years.

Data signal subdued growth in UK and Eurozone

The UK economy bounced back in H1 2024 following a shallow recession in 2023. However, most recent data suggest some loss of momentum in H2 2024, with GDP for Q4 2024 registering a 0.1% increase on a quarterly basis, and rising 1.4% y/y. The Eurozone economy remains on a weak growth trajectory, with sentiment hit by political uncertainty in France and Germany. In Q4 2024, GDP was flat on the quarter and up 0.9% y/y. However, timelier Eurozone data show signs of a slight upturn in activity so far in 2025.

Risks to the outlook centred on geopolitics and tariffs

IMF has revised up slightly its global outlook

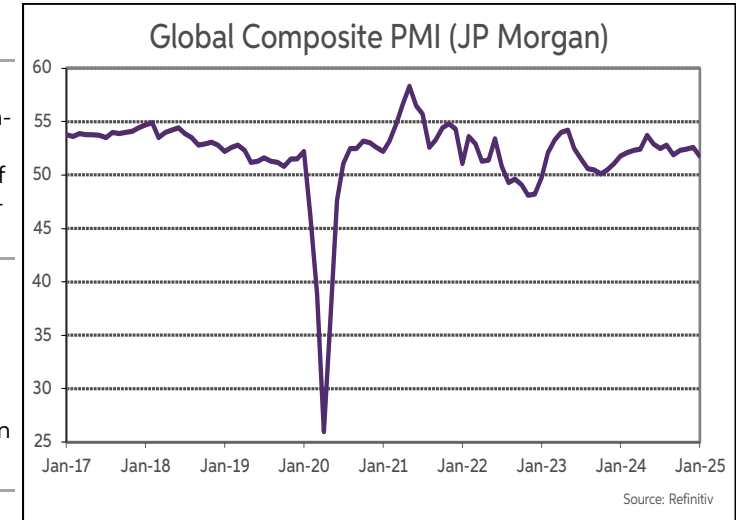
The IMF (Jan' 25) has revised up slightly its global growth outlook to 3.3% in 2025 & 2026, while noting significant downside risks to the outlook, including current geopolitical tensions and sticky inflation. Within this, the US is expected to continue to outperform slower-growing regions in Europe. Advanced economy growth is expected at 1.9% and 1.8% in 2025 and 2026.

Geopolitics, including tariffs the key downside risk to the growth and inflation outlook..

Geopolitical risks remain historically elevated, primarily due to ongoing tensions in the Middle East and policy uncertainty in the US. These risks could likely materialise directly through a spike in inflation via tariffs and indirectly through a decline in consumer and business sentiment, which would dampen global GDP.

Eurozone growth may be dampened by domestic political uncertainty

In addition to trade tensions, the German election at end-February brings further political uncertainty in the Eurozone. This uncertainty may hit consumer and business confidence further, following consecutive years of contraction in German GDP in 2023-24. In France, political uncertainty remains heightened but the new Government has now passed a Budget for 2025, removing this near-term fiscal risk.



GDP (Vol % Change)

	2023	2024 (e)	2025 (f)	2026 (f)
World	3.3	3.2	3.3	3.3
Advanced Economies	1.7	1.8	1.9	1.8
US	2.9	2.8	2.7	2.1
Eurozone	0.4	0.8	1.0	1.4
UK	0.3	0.9	1.6	1.5
Japan	1.5	-0.2	1.1	0.8
Emerging Economies	4.4	4.2	4.2	4.3
China	5.2	4.8	4.6	4.5
India	8.2	6.5	6.5	6.5
World Trade Growth (%)	0.7	3.4	3.2	3.3
Inflation -CPI				
Advanced Economies (%)	4.6	2.6	2.1	2.0

Sources: IMF World Economic Outlook January 2025

No surprises from first round of central bank meetings for 2025

Some **divergence** in **direction** and **pace** of policy changes

The first round of policy setting meetings for 2025 from the main central banks were very much in line with expectations. The meeting outcomes highlighted some divergence in both the direction and pace of policy changes. On the one hand, the Bank of Japan hiked rates by 25bps to 0.50% and indicated more policy tightening was likely this year. In contrast, the ECB cut rates and left the door open to another cut in March. The BoE also cut rates but emphasised a gradual approach to further easing. Meanwhile, the Fed retained its easing bias but is in no hurry to cut rates further in the near term.

US Fed in no hurry to cut rates again

The US Fed left rates unchanged in January in line with expectations. The target range for the Fed funds rate was maintained at 4.25-4.50%. It was the first time in four meetings that the Fed did not cut rates, having previously reduced them by 100bps in 2024. The outlook for US rates has an added layer of uncertainty this year given the potential for significant changes in US trade, economic and fiscal policy under the Trump administration. Chair Powell has stated that the Fed is in no hurry to ease policy further at this stage and is content that its current interest rate setting is “well positioned”. The market is anticipating around 40bps of easing this year, with the next 25bps cut not fully priced in until October. We view 50bps of rate cuts this year as being a reasonable expectation and this is consistent with the Fed’s own projections.

ECB cuts again in January and indicates **further rates cuts** on the cards this year

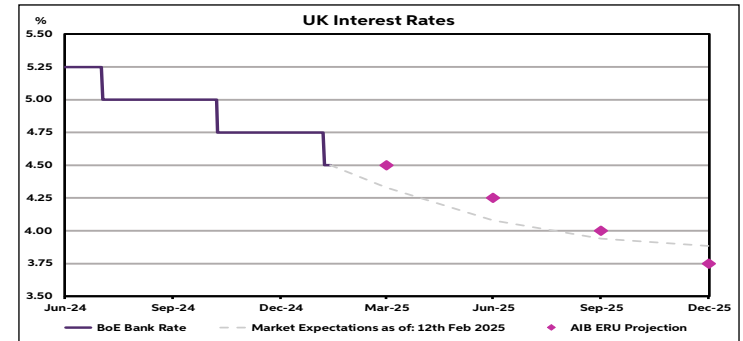
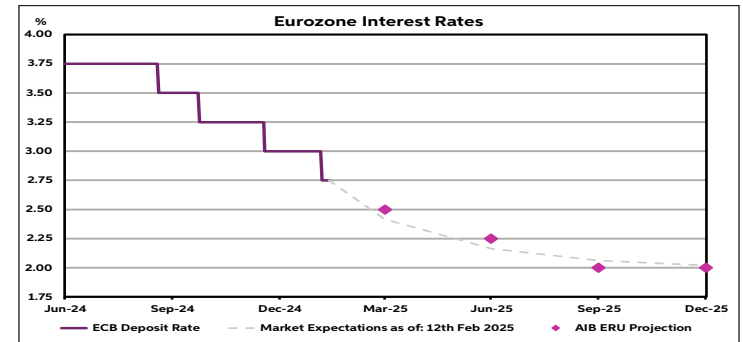
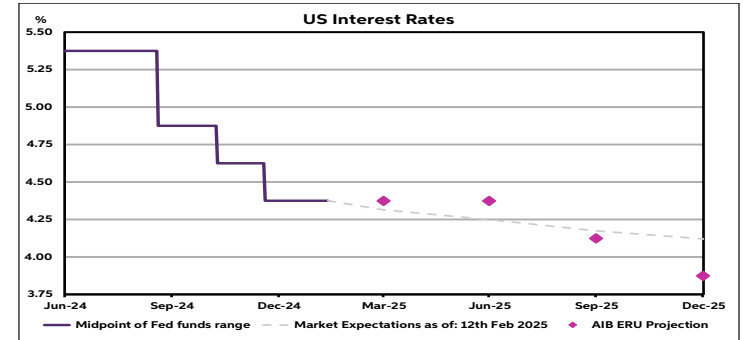
The January ECB Governing Council meeting saw Eurozone rates reduced by 25bps. This represented the fifth 25bps rate cut from the ECB since June 2024. The Depo rate was lowered to 2.75%. The ECB continued to guide a “meeting-by-meeting” and “data-dependent” approach to any further rate cuts. However, President Lagarde stated that the ECB “knows the direction of travel” for rates (i.e. downwards) but the pace/magnitude will be informed by incoming data and ECB staff analysis of the outlook. Interestingly, she left the door open to another rate cut at the next meeting on March 6th by noting the data and updated staff forecasts that the ECB will have by then. The market is pricing in a 25bps cut in March and is not ruling out rates falling below 2% by year end. We envisage rates settling around the 2% by the end of the year.

BoE cuts rates in February, but communications suggest a **gradual approach** to further easing

The BoE started the year with a 25bps rate cut at its February MPC meeting, reducing the Bank Rate to 4.50%. The central bank has now cut by a total of 75bps since it commenced its tightening cycle last August. The voting breakdown grabbed a lot of attention initially, with two votes for a 50bps cut and one of these being Catherine Mann, who was previously regarded as a ‘hawk’. However, assessing the plethora of BoE communications (statement, minutes, press conference, updated macro forecasts) from its February meeting indicates that it favours a steady approach to further rate cuts. Futures contracts indicate the market sees the potential for rates to fall below 4%. A bank rate of 3.75% by year end would be consistent with the BoE’s ‘steady’ mantra.

Interest Rate Forecasts					
	Current	End Q1	End Q2	End Q3	End Q4
		2025	2025	2025	2025
Fed Funds	4.375	4.375	4.375	4.125	3.875
ECB Deposit	2.75	2.50	2.25	2.00	2.00
BoE Repo	4.50	4.50	4.25	4.00	3.75

Current Rates Reuters, Forecasts AIB's ERU



Trump underpins dollar surge, but waning momentum

Dollar has lost some momentum in recent weeks

The dollar strengthened considerably post the US election, but the greenback has given back some of these gains so far in 2025. The trade-weighted DXY index is now c.1.5% lower compared to the mid-January peak. Against the euro, the dollar is also down c.1.5%, with EUR/USD rebounding from a support level of \$1.02 to trade in the 1.03-1.04 range more recently. The dollar also lost ground against sterling, falling by c.1% compared to its recent peak, with GBP/USD trading in a \$1.24-1.25 range.

..investors might be betting on a more pragmatic approach to tariffs

Notably, despite President Trump now following through on his tariff plans, targeted at large trading partners and specific sectors so far, the dollar has not strengthened further or held gains made prior to his inauguration. This might reflect some retrenchment from the post election “Trump trade”, and also the fact that investors may be pricing in a more pragmatic approach to tariffs, reflected in the 11th hour delay to tariffs on Mexico and Canada.

Near-term strength for dollar, but may lose some momentum thereafter

However, in the short term, it remains more likely that Trump’s policies will prove inflationary, which could limit rate cuts by the Fed and underpin the dollar for now. We expect the greenback to maintain at close to its current levels through Q1, but given much of the expected impact of Trump 2.0 has been pre-emptively priced in by markets, the currency could slowly give back some of these gains later in 2025.

Easing political risk could support euro, but tariffs a near term drag

ECB to maintain a steady rate-cutting cycle

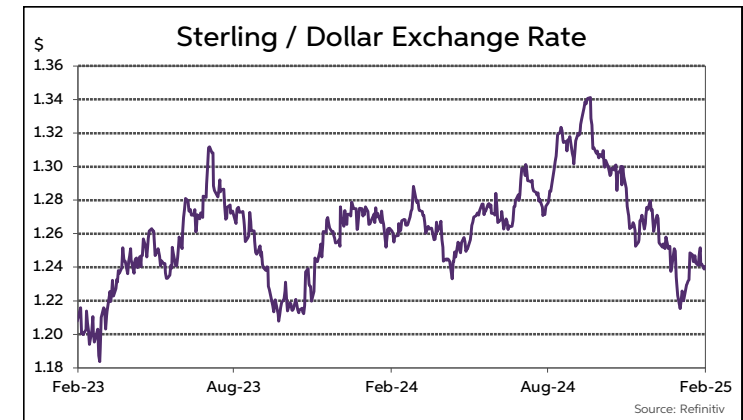
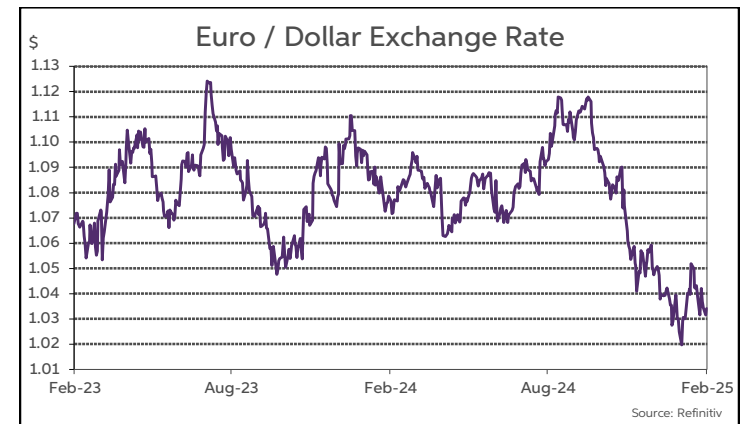
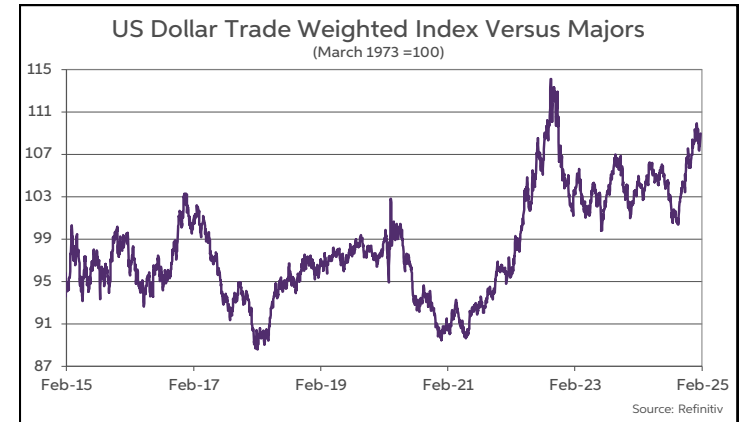
The ECB has embarked on a steady rate-cutting cycle, with an initial 25bps cut in June 2024, followed by successive cuts between September and January. With the Deposit rate now at 2.75%, and markets pricing in further aggressive cuts in 2025 to bring the rate potentially below 2%, the divergence from US rates has weighed on the Euro. Our expectation is that the deposit rate will trough at 2%, with a cautious outlook on ECB rate cuts could provide some support to the currency later in the year.

Fragile economic data might temper Euro gains, but political risks may be easing

Political uncertainty in France and Germany has also weighed on the euro in recent months. In particular, the euro weakened in the aftermath of softer sentiment and activity surveys, which showed waning confidence in the largest Eurozone economies, at the turn of the year. While Eurozone data remain weak, there have been tentative signs of improvement, while the passing of a Budget in France has lessened political risk, for now.

Euro remains near current levels in Q1 and strengthens modestly from there

Overall, we expect the euro to remain within its current range in the near term, with a lower end of the range of parity to reflect the imminent risk of US tariffs. EUR/USD is expected in the range of \$1.00-1.06 in Q1 2025, strengthening modestly to \$1.03-1.09 by Q4 2025.



Rate cuts and uncertain macro to weigh on sterling

Weak macro environment a drag on sterling

Sterling has lost ground in recent weeks, with UK macro data suggesting growth weakened in H2 2024. The Bank of England's apparent dovish pivot and rate also weighed on the currency. However, while slightly lower year-to-date, cable troughed at \$1.21 in mid-January and has since gained ground to \$1.24-25 range in mid-February, while sterling has also strengthened against the euro from mid-range 84-85p to the lower range of 83-84p.

Balance of risks slightly to the downside for sterling

The BoE cut by 25bps in August, November and February, with splits on the MPC committee. Our expectation of a continued steady easing cycle by the BoE to move rates to 3.75% by Q4 2025 is slightly ahead of current market pricing, implying the currency could come under some pressure in the coming months. The uncertain growth outlook also poses a downside risk.

Slight strength for euro against sterling

Sterling is expected to maintain current levels versus the euro in the near term, and the pair is likely to remain largely range bound as relative macro fundamentals are unlikely to drive a significant break-out from the current range. We have EUR/GBP holding around 83p in Q1 2025 but drifting to around 85p by Q4 2025. We expect cable (GBP/USD) to strengthen to around \$1.25-1.26 by end-2025 from the current \$1.23-1.24 range.

Slight upside for yen as BoJ hikes rates

Yen has been volatile over the past year

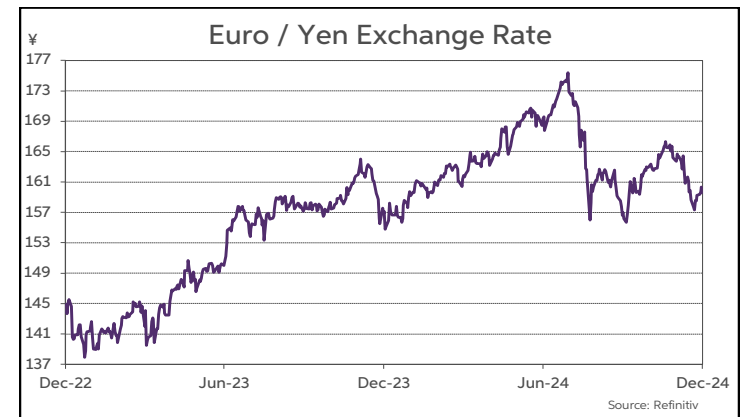
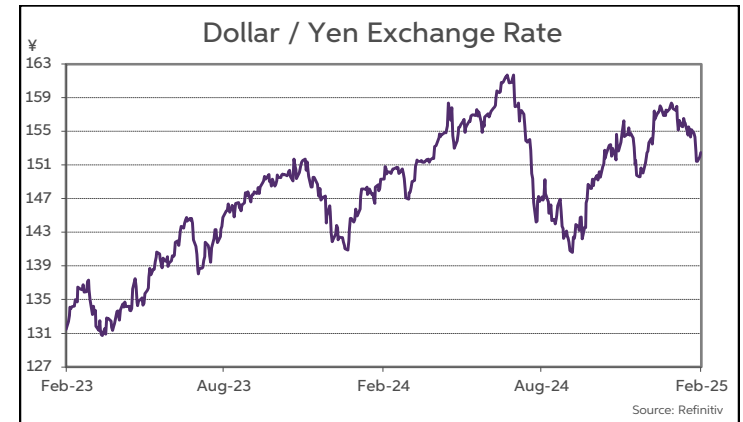
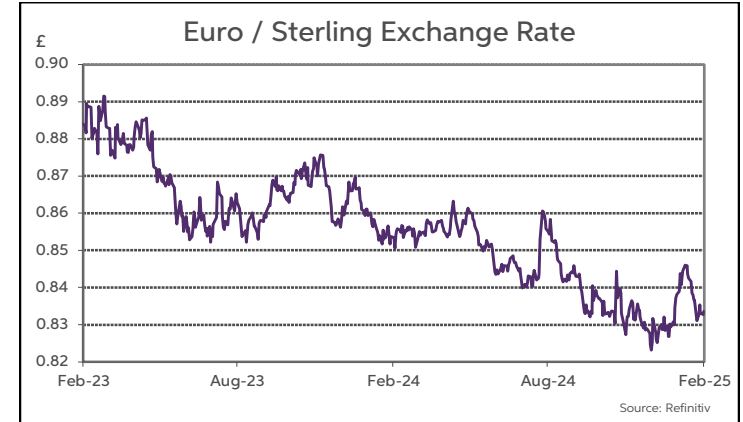
The yen has seen sharp fluctuations throughout 2024 as investors digested incoming economic data and the Bank of Japan began to normalise monetary policy. Following fluctuation in H1 2024, the currency did settle into a tighter range against the dollar in H2, but has lost ground since the US elections.

Bank of Japan expected to continue to hike rates, supportive of yen

Interest rate hikes by the Bank of Japan in July, October and January has seen the base rate move from -0.1% to the current 0.5%. Markets are pricing in a further c.30bps of rate hikes by end-2025. Accompanied by a more hawkish BOJ outlook, this could support the yen in the near term versus the dollar, although this upside risk is balanced by the potential for stronger US growth and inflation which may limit this upside potential for the yen.

Yen expected to strengthen slightly in the near term

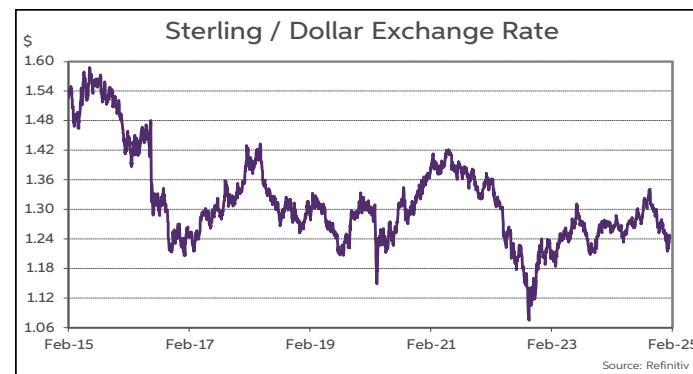
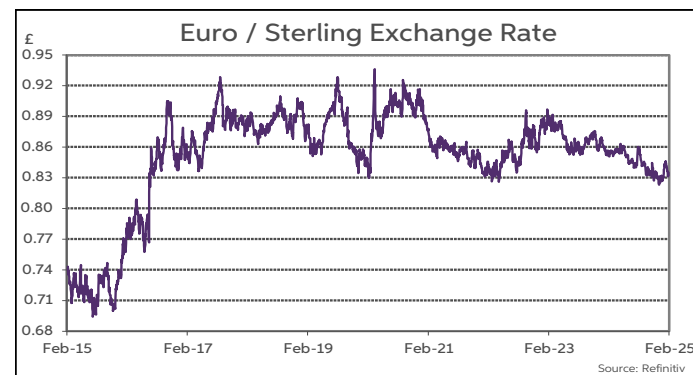
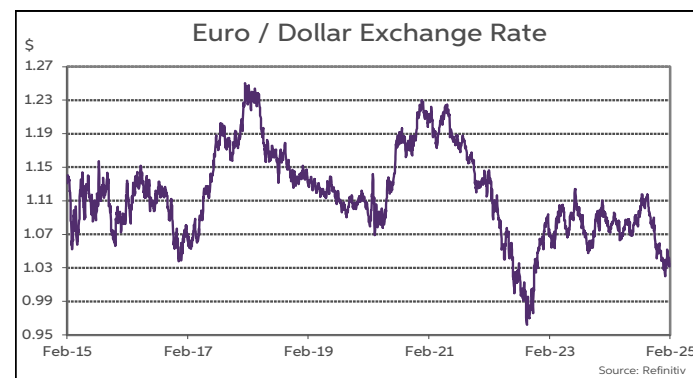
The yen is expected to trade close to its current range in the near term. Thereafter, we see a modest appreciation in the yen as US rates edge lower, and Japanese rates move in the opposite direction, towards a range of ¥145-151 by Q4 2025, from the current ¥152-156 range. Versus the euro, the currency is expected to be range-bound, trading in the \$154-160 range throughout 2025.



Summary of Exchange Rate Forecasts

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

	Current	Q1-2025	Q2-2025	Q3-2025	Q4-2025
Euro Versus					
USD	1.035	1.00-1.06	1.01-1.07	1.02-1.08	1.03-1.09
GBP	0.834	0.80-0.86	0.80-0.86	0.81-0.87	0.82-0.88
JPY	160.18	152-158	154-160	154-160	154-160
CHF	0.95	0.94	0.95	0.96	0.97
US Dollar Versus					
JPY	154.70	147-153	147-153	146-152	145-151
GBP	1.241	1.22-1.28	1.23-1.29	1.23-1.29	1.23-1.29
CAD	1.43	1.43	1.43	1.42	1.41
AUD	0.63	0.63	0.63	0.64	0.65
NZD	0.56	0.57	0.57	0.58	0.59
CNY	7.31	7.30	7.30	7.25	7.25
Sterling Versus					
JPY	192	187	189	187	186
CAD	1.78	1.77	1.79	1.78	1.76
AUD	1.98	1.98	2.00	1.96	1.93
NZD	2.21	2.19	2.21	2.17	2.13



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