

## Twists and Turns

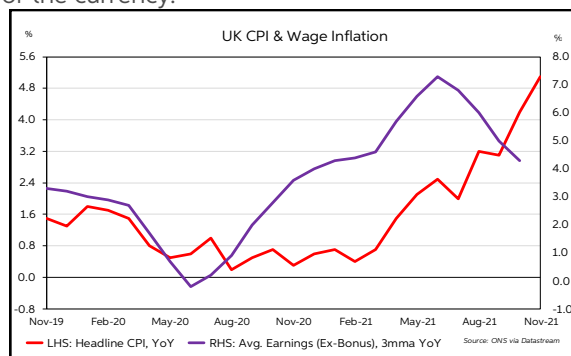
■ **The dollar and sterling made good gains in the second half of 2021, on the back of a firming of rate hike expectations in both countries.** The dollar made significant ground against a broad range of currencies, rising by more than 5% on a trade-weighted basis. The euro fell from \$1.22 last June to a low of \$1.12 in November. Meanwhile, sterling strength was less pronounced, though, the euro has declined to below 84p from around 87p in the middle of 2021. The general view had been that both the dollar and sterling would remain well underpinned in 2022, with the Fed and BoE embarking on rate tightening cycles. Rates are expected to rise by close to 100bps in both economies in the coming year.

■ **Sterling has been firm over the past month, with the euro dropping towards a key support level of 83p in early January.** The dollar, though, has lost ground against a broad range of currencies since the start of the year. The EUR/USD rate has risen to near \$1.15, while cable has climbed above \$1.37 from \$1.32 just before Christmas. One explanation is that the market ended 2021 very long the US currency. Traders may now be looking to exit dollar positions after the gains made in H2 2021 and with the market having moved to price in a considerable amount of Fed tightening over the course of 2022-23. It is also the case that rates are rising in other countries as well, lessening the dollar's attractiveness. Indeed, many central banks have already started to tighten policy.

■ **It could also be a more general signal by markets that the worst of the Pandemic is behind us.** The dollar is typically a counter-cyclical currency, which strengthens at times of stresses in the world economy and loses ground as global growth recovers. Expectations that the risks to economic activity posed by Covid-19 are abating, resulting in solid global growth, should reduce demand for safe-haven currencies, like the dollar. Headwinds for the dollar, such as concerns about the large US fiscal and balance of payments deficits can also come to the fore in such circumstances. We don't envisage a major fall in the dollar though, as it should be supported by higher US interest rates. Thus, the EUR/USD rate may trade in a \$1.13-1.17 range in the coming months.

■ **Sterling has not been a popular currency in recent years as a result of concerns over Brexit, but it did stage a good recovery in 2021 as these worries subsided.** Market positioning was still quite short the currency entering this year, so it is no surprise that it has appreciated further recently. It could continue to outperform in the coming months while market positioning adapts to a more hawkish policy stance by the Bank of England. The 83p level is a strong support level for the euro, though, which will be a challenge for sterling to overcome. Furthermore, there are mounting risks to UK growth from the spring onwards as a result of a tightening of both monetary and fiscal policy, including higher taxes, as well as further increases in energy bills. This could limit the upside for the currency.

■ **Turning to the week ahead, there is a busy data schedule in the UK.** The main release of note will be the latest CPI inflation data for December. Inflation has surged in the UK in 2021, with headline CPI rising to 5.1% in November from 4.2% previously, while the core rate accelerated to 4% from 3.4%. The headline rate is projected to edge higher in December, to 5.2%, with the core rate forecast to be unchanged. Indeed, CPI inflation is not expected to peak until April of this year, at around 6-6.5%.



■ **An update on conditions in the labour market is due as well.** Despite the conclusion of the furlough scheme in September, the unemployment rate fell from 4.3% to 4.2% in October. The latest report is set to show the unemployment rate remained at this level in November. Other indicators suggest the labour market is very tight also, as average earnings remained elevated, above 4% in October. Furthermore, the claimant count fell by 50k, and the number of PAYE employees rose by 257k in November, while job vacancies remained well over a million, suggesting that the demand for labour remains strong. Thus, another elevated inflation reading and another round of strong jobs market data will likely increase expectations of a rate hike from the BoE at its next policy meeting in February. Elsewhere, retail sales are forecast to fall by 0.6% in December, due to the rapid rise in Covid cases owing to the Omicron variant. Consumer confidence is set to decline in January as a result also.

■ **Consumer confidence will feature in the Eurozone too.** Similar to the UK, the Omicron wave is anticipated to have knocked confidence across the bloc as well. Meanwhile, the final reading of HICP inflation is set to confirm inflation rose to 5% in December. The latest ECB meeting minutes are due also, and may provide the market with more details regarding the central bank's decision to end PEPP from March. **Across the Atlantic, we will get a slew of updates on the US property market, including, housing starts, existing home sales (Dec), and homebuilder sentiment (Jan).**

	Interest Rate Forecasts			
	Current	End Q1	End Q2	End Q3
		2022	2022	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	End Q2	End Q3
		2022	2022	2022
EUR/USD	1.1434	1.14	1.14	1.15
EUR/GBP	0.8350	0.83	0.83	0.84
EUR/JPY	130.09	130	130	130
GBP/USD	1.3691	1.37	1.37	1.37
USD/JPY	113.75	114	114	113

Current Rates Reuters, Forecasts AIB's ERU

Date	UK & Irish Time	Release	Previous	Forecast
<b>This Week:</b>	<b>ECB Speakers:</b>	<b>Lagarde</b> , Panetta (Mon); de Guindos (Tue); <b>Lagarde</b> (Fri)		
	<b>BoE Speakers:</b>	<b>Bailey</b> , Cunliffe (Wed); Mann (Fri)		
	<b>Fed Speakers:</b>			
	<b>World Economic Forum (Virtual Event), 17th-21st January</b>			
<b>Mon 17th</b>	<b>US:</b>	<b>Martin Luther King Day (Market Holiday)</b>		
	<b>CHINA:</b> 02:00	GDP (Q4: First Reading)	+0.2% (+4.9%)	+1.1% (+3.6%)
	<b>CHINA:</b> 02:00	Industrial Output (December)	(+3.8%)	(+3.6%)
	<b>CHINA:</b> 02:00	Retail Sales (December)	(+3.9%)	(+3.7%)
	<b>ITA:</b> 09:00	Final HICP (December)	+0.5% (+4.2%)	+0.5% (+4.2%)
<b>Tue 18th</b>	<b>JPN:</b> 03:00	BoJ Rate Decision	-0.10%	-0.10%
	<b>UK:</b> 07:00	ILO Employment (November)	+149,000	+128,000
		- Unemployment Rate (November)	4.2%	4.2%
	<b>UK:</b> 07:00	Average Weekly Earnings (3mnths to Nov)	(+4.9%)	(+4.2%)
		- Ex-Bonus	(+4.3%)	(+3.8%)
	<b>UK:</b> 07:00	Claimant Count (December)	-49,800	
	<b>GER:</b> 10:00	ZEW Economic Sentiment (Jan)	29.9	32.7
	<b>US:</b> 13:30	NY Fed / Empire State Index (January)	31.9	28.0
	<b>US:</b> 15:00	NAHB Homebuilder Sentiment (January)	84	84
<b>Wed 19th</b>	<b>UK:</b> 07:00	CPI (December)	+0.7% (+5.1%)	+0.3% (+5.2%)
		- Core	+0.5% (+4.0%)	+0.2% (+4.0%)
	<b>GER:</b> 07:00	Final HICP (December)	+0.3% (+5.7%)	+0.3% (+5.7%)
	<b>UK:</b> 09:30	PPI Input Prices (December)	+1.0% (+14.3%)	+0.7% (+13.7%)
		- Output Prices	+0.9% (+9.1%)	+0.6% (+9.4%)
	<b>UK:</b> 11:00	CBI Trend Orders (January)	21	
	<b>IRL:</b> 11:00	<b>CPI (December)</b>	<b>+0.6% (+5.3%)</b>	<b>+0.3% (+5.3%)</b>
	<b>IRL:</b> 11:00	<b>Residential Property Prices Index (November)</b>	<b>+1.4% (+13.5%)</b>	<b>+1.0% (+14.0%)</b>
	<b>US:</b> 13:30	Housing Starts (December)	+1.7m / +11.8%	+1.7m / -0.9%
		- Building Permits	+1.7m / +3.9%	+1.7m / -1.7%
	<b>JPN:</b> 23:50	Trade Balance (December)	-¥955.6Bn	-¥784.1Bn
		- Exports	(+20.5%)	(+16.0%)
<b>Thu 20th</b>	<b>GER:</b> 07:00	Producer Prices (December)	+0.8% (+19.2%)	+0.9% (+19.4%)
	<b>FRA:</b> 07:45	INSEE Business Climate (January)	111.0	111.0
	<b>EU-19:</b> 10:00	ECB Meeting Minutes (15-16th December)		
	<b>EU-19:</b> 10:00	Final HICP (December)	+0.4% (+5.0%)	+0.4% (+5.0%)
		- Ex-Food & Energy	+0.1% (+2.7%)	+0.1% (+2.7%)
	<b>US:</b> 13:30	Initial Jobless Claims (w/e 10th January)	+230,000	+215,000
	<b>US:</b> 13:30	Philly Fed Index (January)	15.4	19.0
	<b>US:</b> 15:00	Existing Home Sales (December)	+6.5m / +1.9%	+6.5m / +0.5%
	<b>JPN:</b> 23:30	CPI (December)	+0.2% (+0.6%)	+0.1% (+0.9%)
		- Core	+0.2% (+0.5%)	+0.1% (+0.6%)
<b>Fri 21st</b>	<b>UK:</b> 00:01	Gfk Consumer Confidence (January)	-15	-16
	<b>UK:</b> 06:00	Retail Sales (December)	+1.4% (+4.7%)	-0.6% (+2.9%)
		- Ex-Fuel	+1.1% (+2.7%)	-0.5% (+1.1%)
	<b>EU-19:</b> 15:00	Flash Consumer Confidence (January)	-8.3	-9.0

◆ Month-on-month changes (year-on-year shown in brackets)