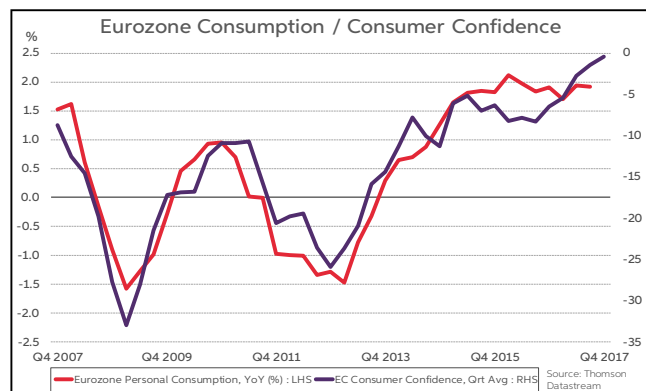


## Flatten to Deceive?

- **One of the financial market developments which has caught much attention this year has been the flattening of the US yield curve.** This is causing some concern as the curve inverted ahead of every US recession since 1960. We are still some distance from this happening, as the current spread between two and ten year yields is over 50bps. However, if the Fed delivers its projected 75bps in rate hikes in 2018, then the curve may invert next year. The current US expansion will become the longest on record if it lasts until early 2019. Naturally, there are concerns that the flattening curve may be signalling that a downturn in the economy could be coming.
- Caution is warranted, though, as these are unusual times in monetary policy, with rates at extremely low levels and QE on-going. **The moves in US yields over the past year look somewhat odd.** Two year Treasury yields have risen by some 60bps, which is reasonable enough with the Fed hiking rates by 75bps in 2017. However, ten year yields have fallen by 20bps, with 30-year yields down 40bps over the period. Such declines are unusual in the early stages of a monetary tightening cycle. However, **other factors may be at work at the long end of the market**, such as the decline in core PCE inflation to 1.4% this year, on-going high levels of QE globally dampening yields and the relatively high yields on long-dated US paper proving very attractive to investors.
- **A downturn in the US economy in 2018 seems most unlikely given the current momentum in activity, improving global growth, interest rates remaining low and fiscal policy about to be loosened.** Therefore, the Fed can be expected to deliver on its projected 75bps of tightening in 2018. The long end of the US bond market would appear to be dependent on a continuing very benign inflation backdrop to sustain current yield levels. Thus, investors would be well advised to pay particularly close attention to wage growth and core inflation measures next year. Any pick-up in these indicators would cause the whole of the yield curve to shift upwards.
- In terms of the immediate future, **a busy Eurozone data schedule this week features a raft of December survey data**, which follow on from last week's very strong PMIs. Flash EC consumer confidence has continued to improve, rising in November to its highest level since January 2001. It is expected to rise yet further, suggesting that consumer spending growth has accelerated.
- **At a national level, the German Ifo will garner attention.** It hit an all-time high in November and it looks set to remain at this level, suggesting a pick-up in growth in the Eurozone's largest economy in Q4. The French INSEE, Italian ISTAT and Belgian NBB indices are also forecast to suggest that growth in their respective economies improved in Q4, which augers well for the Eurozone as a whole.
- **In the US, a relatively light calendar includes the Fed's preferred core-PCE measure of inflation.** It has remained subdued in recent months, well below its 2% target rate. **It is forecast to edge up to 1.5% in November**, from 1.4%. At the same time, personal consumption is predicted to record another solid increase. Existing home sales have struggled for much of this year, however they are forecast to record a third consecutive rise in November. Housing starts are set to decline, after recording a strong increase in October. The NAHB homebuilders' index is expected to have held close to a 12-year high in December.
- **There is not much to look forward to data-wise in the UK this week.** Public finance data for November are the main release. The figures have tended to outperform versus market expectations in recent months. A slight improvement in the deficit compared to November 2016 is forecast (£8.90bn vs £9.04bn). The CBI indices for December (industrial orders & distributive trades) and final Q3 GDP are also due.



	Interest Rate Forecasts			
	Current	End Q4 2017	End Q1 2018	End Q2 2018
Fed Funds	1.375	1.375	1.375	1.625
ECB Deposit	-0.40	-0.40	-0.40	-0.40
BoE Repo	0.50	0.50	0.50	0.50
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 Q4 2017	End Q1 2018	End Q2 2018
EUR/USD	1.1780	1.17	1.16	1.15
EUR/GBP	0.8837	0.88	0.88	0.87
EUR/JPY	132.31	132	132	132
GBP/USD	1.3326	1.33	1.32	1.32
USD/JPY	112.30	113	114	115

Current Rates Reuters, Forecasts AIB's ERU

Date	UK & Irish Time (GMT)	Release	Previous	Forecast	
<b>This Week:</b>					
<b>Mon 18th</b>	<b>EU-19:</b>	10.00	Final HICP (November) - Ex-Food & Energy	(+1.5%) (p) (+1.1%)	(+1.5%) (+1.1%)
	<b>UK:</b>	11.00	CBI Industrial Orders Survey (December)	17	
	<b>US:</b>	15.00	NAHB Homebuilders' Sentiment (December)	70	70
<b>Tue 19th</b>	<b>GER:</b>	09.00	Ifo Business Climate (December)	117.5	117.5
	<b>US:</b>	13.30	Current Account (Q3)	-\$123.1bn	-\$118.0bn
	<b>US:</b>	13.30	Housing Starts (November) - Building Permits	13.7% / 1.290m s.a.a.r. +7.4% / 1.316m s.a.a.r.	-3.1% / 1.250m -2.7% / 1.280m
<b>Wed 20th</b>	<b>GER:</b>	07.00	PPI (November)	+0.3% (+2.7%)	+0.2% (+2.6%)
	<b>EU-19:</b>	09.00	Current Account (October)	€37.8bn	
	<b>UK:</b>	11.00	CBI Distributive Trades Survey (December)	26	
	<b>BEL:</b>	14.00	NBB Leading Business Indicator (December)	1.6	
<b>US:</b>	<b>US:</b>	15.00	Existing Home Sales (November)	+2.0% / 5.48m s.a.a.r.	+1.6% / 5.53m
	<b>US:</b>	15.00	Existing Home Sales (November)	+2.0% / 5.48m s.a.a.r.	+1.6% / 5.53m
<b>Thurs 21st</b>	<b>JPN:</b>		BoJ Interest Rate Announcement	-0.1%-0%	-0.1%-0%
	<b>FRA:</b>	07.45	INSEE Business Climate (December)	112	113
	<b>UK:</b>	09.30	PSNB Ex-Interventions (November)	Nov'16: £9.04bn	£8.90bn
	<b>US:</b>	13.30	GDP (Q3: Final Reading)	3.3% s.a.a.r.	3.3%
	<b>US:</b>	13.30	Initial Jobless Claims (w/e 16th December)	225,000	234,000
	<b>US:</b>	13.30	Chicago Fed National Activity Index (November)	0.65	
	<b>US:</b>	13.30	Philly Fed Index (December)	22.7	21.8
	<b>US:</b>	15.00	Leading Indicators Index (November)	+1.2% / 130.4	+0.3% / 130.8
	<b>EU-19:</b>	15.00	Flash EC Consumer Confidence (December)	0.1	0.2
<b>Fri 22nd</b>	<b>GER:</b>	07.00	GfK Consumer Sentiment (January)	10.7	10.8
	<b>FRA:</b>	07.45	Consumer Spending (November)	-1.9%	+1.4%
	<b>FRA:</b>	07.45	GDP (Q3: Final Reading)	+0.5%	+0.5%
	<b>ITA:</b>	09.00	ISTAT Business Confidence (December)	110.8	
	<b>ITA:</b>	09.00	Consumer Confidence (December)	114.3	
	<b>UK:</b>	09.30	GDP (Q3: Final Reading)	+0.4% (+1.5%) (p)	+0.4% (+1.5%)
	<b>US:</b>	13.30	Personal Income / Consumption (November) - Core PCE Prices	+0.4% / +0.3% (+1.4%)	+0.4% / +0.4% (+1.5%)
	<b>US:</b>	13.30	Durable Goods Orders (November)	-0.8%	+2.0%
	<b>US:</b>	15.00	Final Michigan Consumer Sentiment (December)	98.5 / 96.8 (p)	97.2

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

All forecasts AIB ERU, historical data in the Economic Diary derived from publicly available sources

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