Weekly Market Brief

AIB Treasury Economic Research Unit

12th February-16th February 2018

Volatility is back in return to normality

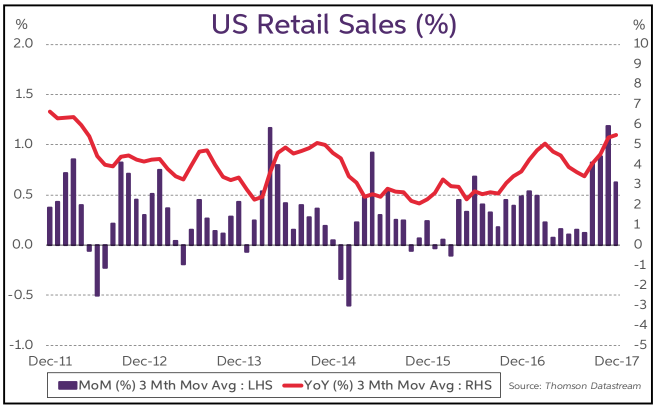
- **We had warned in recent weeks that markets looked to be heading for much more turbulent times given stretched valuations, a prolonged period of directional trading, very low volatility and signs of a return of irrational exuberance in certain instances,** all in the context of central banks winding back extremely accommodative monetary policies. In the end, it was a pick-up in earnings growth in the US that triggered major falls in stocks and the return of volatility in markets. The ironic thing is that the pick-up in wage growth may prove a statistical quirk that could unwind in next couple of months. Either way, even if it wasn't the wage data, we feel something else would have eventually unnerved stock markets, as they were ripe for a correction.

- **What we are seeing is a return to more normal trading conditions in markets, involving volatility and risk taking across all asset classes,** as central banks struggle with how to normalise monetary policy in the context of continuing low inflation and without undermining the strengthening recovery of the global economy. **Bond yields look to be on an upward trajectory, which is a challenge for equity markets with stretched valuations,** most notably in the US. But, higher yields are being driven by favourable economic developments, not concerns about asset quality and credit risk, which is a long-term positive for markets.

- Hence, **we do not see major spill-over effects into the real economy.** Interest rates may be rising, but only modestly and off a very low base. Monetary policy is set to remain accommodative, supporting growth. Neither do we see this as the start of a major market crash. Granted, **US and Japanese markets are now in correction territory, having fallen by more than 10%.** However, this has only returned them to November levels. Both the DJIA and Nikkei are still up 32% since President Trump's election win in 2016, while the S&P 500 is 23% higher.

- **It would appear, though, that the easy ride for investors is over, with much trickier trading conditions in store.** Bond yields are likely to rise somewhat further and credit spreads should widen. Stock markets could see further losses (especially in the US) and will likely need to see continued good corporate earnings reports to start moving higher again. We can expect more fluctuations in markets, as they are buffeted by both positive and negative forces. **Volatility is back then, in a return to more normal market trading conditions.**

- **In the week ahead, there is a light schedule on both sides of the Atlantic.** Of the data which are due, US retail sales grew by a very strong 2.7% in Q4 last year, aided by strong pre-Christmas spending and a jump in auto sales. Another healthy increase is expected in January. The timelier February Michigan measure of consumer sentiment is predicted to remain at a high level, suggesting consumption will continue to grow at a robust pace. **In terms of the output side of the US economy, industrial production data for January are due.** A further solid increase is forecast, following Q4's 2% rise.



- **Retail sales are also due in the UK, with a pick-up from December's post-Black Friday drop predicted.** At the same time, CPI inflation look set to edge lower (forecast: 2.9%). With some signs of upward pressure on wages in the UK, a further softening in inflation could see real wage growth return to positive territory this year, providing some good news for consumers. **In the Eurozone, industrial production is expected to have been flat in December,** meaning the sector grew by around 1% in Q4 as a whole. The schedule also includes a first look at Q4 GDP for Germany (+0.6%) and Italy (+0.4%). No changes to Eurozone Q4 GDP (+0.6%) are expected from the second reading of the data. Finally, in Japan, GDP data are expected to show another increase in growth in the fourth quarter.

Interest Rate Forecasts

	Current	End Q1 2018	End Q2 2018	End Q3 2018
Fed Funds	1.375	1.625	1.875	1.875
ECB Deposit	-0.40	-0.40	-0.40	-0.40
BoE Repo	0.50	0.50	0.50	0.75
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 2018	End Q2 2018	End Q3 2018
EUR/USD	1.2259	1.22	1.19	1.17
EUR/GBP	0.8877	0.89	0.88	0.87
EUR/JPY	133.55	135	134	135
GBP/USD	1.3809	1.37	1.35	1.34
USD/JPY	108.92	111	113	115

Current Rates Reuters, Forecasts AIB's ERU

AIB

ECONOMIC DIARY

Monday 12th February—Friday 16th February 2018

AIB Treasury Economic Research

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Date	*UK & Irish Time (GMT)*		*Release*	*Previous*	*Forecast*
This Week:	**Fed Speakers:**		Mester (Tuesday)		
	ECB Speakers:		Mersch (Wednesday); Praet, Lautenschläger (Thursday); Cœuré (Friday)		
Mon 12th	**JPN:**		National Foundation Day (Market Holiday)		
	US:	19.00	Federal Budget (January)	-$23.0bn	
	JPN:	23.50	Domestic Wholesale Prices (January)	(+3.1%)	(+2.7%)
Tue 13th	**FRA:**	07.45	Non-Farm Payrolls (Q4)	+0.2%	
	UK:	09.30	CPI (January)	+0.4% (+3.0%)	-0.6% (+2.9%)
			- Ex-Food % Energy	+0.3% (+2.5%)	-0.9% (+2.6%)
	UK:	09.30	PPI Output Prices (January)	+0.4% (+3.3%)	+0.2% (+3.0%)
			- Input	+0.1% (+4.9%)	+0.8% (+4.3%)
	US:	11.00	NFIB Small Business Optimism (January)	104.9	
	JPN:	23.50	GDP (Q4: First Reading)	+0.6% / +2.5% s.a.a.r.	+0.2% / +0.9%
Wed 14th	**GER:**	07.00	GDP (Q4: First Reading)	+0.8%	+0.6%
	GER:	07.00	Final HICP (January)	(+1.6%) (p)	(+1.6%)
	ITA:	09.00	GDP (Q4: First Reading)	+0.4%	+0.4%
	EU-19:	10.00	GDP (Q4: Second Reading)	+0.6% (+2.7%) (p)	+0.6% (+2.7%)
	EU-19:	10.00	Industrial Production (December)	+1.0% (+3.2%)	0.0% (+4.2%)
	IRL:	***11.00***	***Residential Property Prices (December)***	***+1.1% (+11.6%)***	***0.0% (+12.0%)***
	US:	13.30	CPI (January)	+0.1% (+2.1%)	+0.3% (+2.0%)
			- Ex-Food & Energy	+0.3% (+1.8%)	+0.2% (+1.7%)
	US:	13.30	Retail Sales (January)	+0.3%	+0.3%
			- Ex-Autos	+0.4%	+0.4%
			- Ex-Gas, Autos & Building Materials	+0.3%	+0.4%
	JPN:	23.50	Core Machinery Orders (December)	(+4.1%)	(+2.2%)
Thurs 15th	**FRA:**	06.30	ILO Unemployment Rate (Q4)	9.7%	9.3%
	IRL:	***11.00***	***CPI (January)***	***-0.1% (+0.4%)***	***-0.3% (+0.6%)***
	IRL:	***11.00***	***Goods Trade Balance (December)***	***€3.5bn***	***€3.6bn***
	US:	13.30	Empire State/NY Fed Index (February)	17.7	18.0
	US:	13.30	Initial Jobless Claims (w/e 10th February)	221,000	228,000
	US:	13.30	Philly Fed Index (February)	22.2	22.0
	US:	13.30	PPI (January)	-0.1% (+2.6%)	+0.4% (+2.5%)
	US:	14.15	Industrial Production (January)	+0.9%	+0.4%
			- Capacity Utilisation	77.9%	78.0%
	US:	15.00	NAHB Homebuilders' Sentiment (February)	72	72
Fri 16th	**UK:**	09.30	Retail Sales (January)	-1.5% (+1.4%)	+0.4% (+2.4%)
	US:	13.30	Housing Starts (January)	-8.2% / 1.192m s.a.a.r.	+3.8% / 1.237m
			- Permits	-0.2% / 1.300m s.a.a.r	0.0% / 1.300m
	US:	13.30	Export / Import Prices (January)	-0.1% / +0.1%	+0.3% / +0.5%
	US:	15.00	Prelim' Michigan Consumer Sent' (February)	94.4	95.5

♦ *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