

AV AZETS

THE TREASURY HUB Markets Bulletin Summer 2023



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1. Executive Summary

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1.1 Introduction

Welcome to the Summer edition of THE TREASURY HUB Markets Bulletin.

As you are aware, these bulletins cover quite a wide range of topics and are a comprehensive review of all the various interest rate, foreign exchange, commodity and stock markets. In order to continue to refine what we provide to you, with effect from next month we will provide a shorter, sharper bulletin but will remain with this more detailed version every calendar quarter.

As has been the case for most of this year, inflation and its impact on interest rate trends continues to dominate commentary. Central Banks have maintained their tightening actions across the board but the pace is abating and the US looks like it may now have peaked.

- 3-month Euribor continues to climb in line with ECB Base Rates and is now above 3.75%. The last time that it was at this level was in 2008
- EUR, UK and US yield curves are all inverted after 1 year now suggesting the rate peak is close
- Oil prices are holding up despite worries over economic and trade slowdowns
- GBP has strengthened over the Summer
- Stock markets, with the exception of the UK, are having a good year after a poor 2022.

1.2 Markets in a Table: what's up and what's down?

Table 1. Key Metric Movements: 2023

<u>Heading</u>	<u>Metric</u>	<u>YTD move</u>	<u>From</u>	<u>To</u>
<u>Interest</u>	3-m euribor	1.60%	2.16%	3.77%
<u>Interest</u>	EUR 3-year	0.21%	3.23%	3.43%
<u>Interest</u>	GBP 3-year	0.98%	4.54%	5.52%
<u>Interest</u>	USD 3-year	0.55%	3.98%	4.53%
<u>FX</u>	EUR/GBP	-2.69%	0.8850	0.8618
<u>FX</u>	EUR/USD	2.88%	1.0662	1.0978
<u>Equities</u>	ISEQ	23.08%	7293	8976
<u>Equities</u>	FTSE 100	0.54%	7554	7595
<u>Equities</u>	Nasdaq	39.03%	10862	15101
<u>Commodities</u>	Brent Crude	6.25%	82.10	87.23
<u>Commodities</u>	Carbon	3.15%	81	83.55
<u>Commodities</u>	Gold	5.27%	1823	1919
<u>Commodities</u>	Wheat	-17.42%	775	640
<u>Gilts</u>	IE 10-yr	-0.05%	2.98%	2.93%
<u>Gilts</u>	GB 10-yr	0.73%	3.65%	4.38%
<u>Gilts</u>	US 10-yr	0.22%	3.79%	4.01%

Please note that the % moves are in green if the metric has moved upwards and in red if it has moved downwards. It is NOT a statement as to whether this is a positive or negative move as one could be a borrower or depositor, a seller or buyer of currency, etc. Also, the % move for interest rates is in absolute terms while for currency and equities it is expressed in relative terms. **PLEASE NOTE THAT INTEREST RATE TRENDS ARE FROM A DEPOSITOR PERSPECTIVE.**

- EUR short-term interest rates have continued to climb along with ECB Base Rate hikes – the latter now at 4.25% after 9 rate hikes since July 2022. Next ECB meeting in September (as there is no meeting in August) is likely to hold off
- Longer-term interest rates have all shifted upwards in the past few months as markets reassess the rate peak in the current cycle and readjust to the new norm on the interest rate front
- But keep a close eye on the US banking market and real estate prices over there.

1.2 Forward-looking Indices

Forward-looking indicators known as Purchasing Manager Indices or PMIs are useful to monitor the economic outlook for Ireland and the UK. Readings above 50 indicate expansion while below 50 denote contraction.

- Two of the three ROI indicators are positive with Manufacturing bucking the trend by remaining below 50
- In the UK, the landscape is similar with only one of readings (Manufacturing) being negative.

Table 2. Irish and UK PMI readings

	<u>Ireland</u>	<u>UK</u>
Manufacturing PMI	47.0	45.3
Services PMI	56.7	51.5
Construction PMI	50.4	51.7

1.3 Inflation

Table 3. Selected Inflation Rates

	<u>CPI/Core Inflation</u>
ROI	7.08%
EUROZONE	5.5%
UK	6.9%
US	4.8%

Core figures are looked at as they exclude energy, mortgages and food.

Irish rate has been above 6% for each of the past five months now which is higher than the previous seven months. Housing and utilities prices remain high at +15.7%!

Eurozone core inflation peaked at 5.7% in March and is only back 0.2% since then. This is why the ECB has been hiking rates higher than expected at the start of the year.

UK core inflation eased back 0.2% from May's 31-year high. Headline inflation still high at 7.9%. Food inflation still running at +17.3%.

The US core inflation rate, with one exception, has slowed every month since September of last year. The headline figure fell for the 12th month in a row (from 8.5% to 3.0%). The US appears to be seeing the ultimate objective (lower inflation) being realised before the other major nations.

US interest rates look pretty certain to peak soon (if not already there) based on these inflation trends – we don't see any cuts there this year barring a major recession/banking crisis (which is possible).

Eurozone inflation still high so while ECB may pause hikes at next meeting, there remains a risk of another hike in Q4.

UK remains in the trickiest situation, with inflation still so high and economic growth outlook not good.

2. Foreign Exchange, Oil & Carbon

2.1 EUR/USD

- We monitor the 5-year trend in Graph 1 to look at the EUR/USD rate trends in more recent times
- The key takeaway from the graph is that the USD strengthening which persisted from mid 2021 to Q3 2022 has reversed significantly
- **But since the low point in EUR/USD at the end of September 2022, it has weakened almost 15% to its current level**
- The future direction of USD remains quite dependent on interest rate trends/anticipated peak points in the cycle, inflation, US banking fears and economic outlook. This will be further complicated from the end of this year as the 2024 US Presidential election also gathers pace!
- See Section 3 for further wider comment.

Graph 1. EUR/USD: 5-year trend



2.2 EUR/GBP

- Similar to EUR/USD, the outlook for EUR/GBP is also subject to the influence of inflation, interest rates, economic outlook and politics
- With politics moving into the background in 2023, the range has narrowed
- GBP strengthened over the past few months mainly due to UK interest rates continuing to rise when expectations had previously been that they may stall a little sooner
- **Graph 2 overleaf is the 2023 to date trend in EUR/GBP which highlights how this has settled into a relatively narrower range this year.**

- This graph shows that the range that prevailed to May was broken downwards (stronger GBP) and touched EUR/GBP0.8500 at one stage before recovering back again
- Difficult to see it moving very materially either way for now. Politics will re-emerge as a driver in 2024.

Graph 2. EUR/GBP: 2023 to date

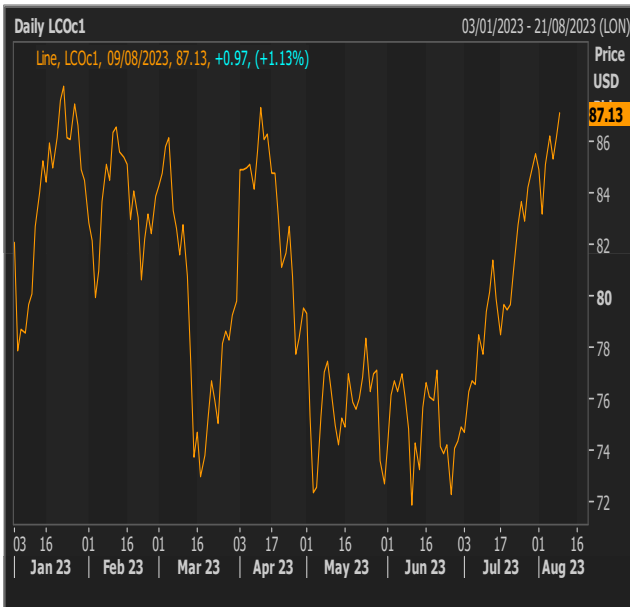


2.3 OIL & CARBON

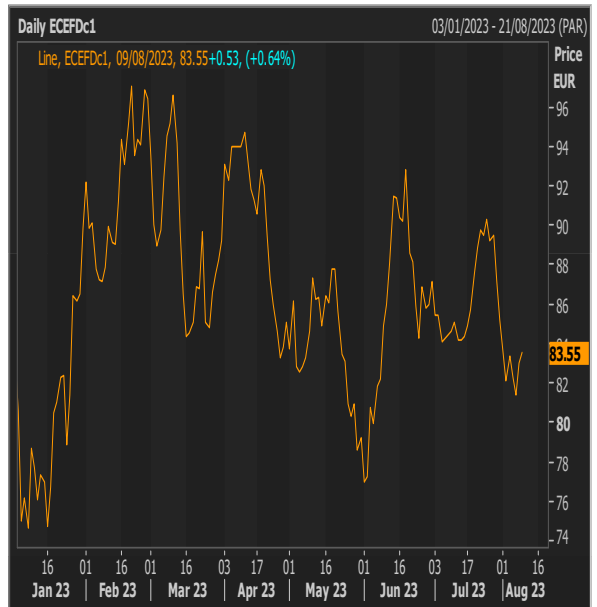
Brent Crude is jumping between USD 72 and USD 87 for most of the year. Hard to see it breaking back towards USD 72 in the short term (given that it has increased by \$14pbl in 6 weeks).

The price of Carbon shows similar trends with six “peak to trough” moves of circa €8 since February. In general, the range is moving downwards since Q1 2023 but break through €80 might be a challenge in the short term.

Graph 3. Brent Crude: 1-year trend



Graph 4. Carbon: 1-year trend



3. Interest and Economic Review

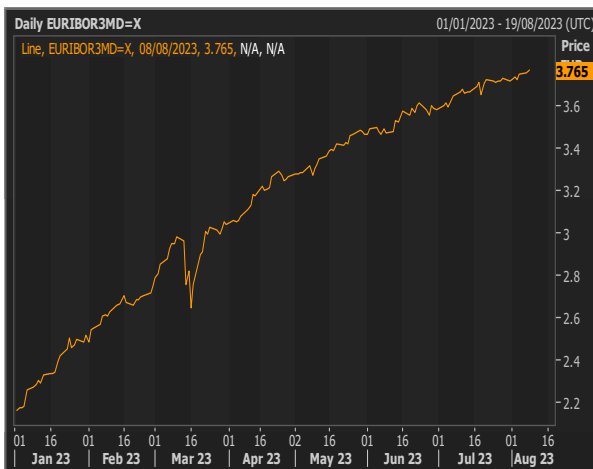
3.1 EUR Short-term Rates

Interest rates have dominated so much of the business and economic news in 2023 having been a “non-story” for almost a decade and a half. The Euribor rate that we monitor for the purposes of this bulletin (as it is the most relevant one for variable rate debt) is the 3-month rate.

Key Observations

- The 3-month rate which drives the pricing of variable rate loans has climbed steadily this year in line with hikes in the ECB Base Rate. The ECB has raised the Base Rate on five occasions this year from 2.50% in December 2022 to 4.25% currently
- At the start of the year the markets were forecasting a peak around 3.50% so the rate has overshot significantly
- **We have previously predicted that deposit rates would slowly increase in the second half of the year and that has started to happen after the last ECB meeting on August 2nd.**

Graph 5. 3-month Euribor: 2023 trend



3.2 EUR Medium-term Rates

- We always look at 3-year swap rates as they are a better indicator of the future direction of interest rates
- The EUR fixed rate curve (before margin) is inverted at 1-year meaning that longer-term rates (2-years +) are LOWER than shorter-term rates. The 1-year rate is 4.00% but the 3-year rate is 3.45%
- The ECB has this week stated that underlying inflation is starting to fall and that is being interpreted as meaning that they are unlikely to hike at the next meeting in September. Barring significant economic slowdown, we remain of the view that we will see EUR interest rates remaining in the 3%-4% range for some time.

Graph 6. EUR 3-year swaps: 2-year trend



3.3 Summary

- The all-in cost of debt is now hitting between 7% and 8% on average for most businesses although it can vary between banks and so it is important to talk to us about borrowing rates
- Credit has continued to tighten and making loan applications is more difficult, less is being advanced and lenders are taking much longer to make lending decisions
- **Increasing amount of comment on falling real estate prices and the impact on the US banks (which will have a knock-on impact on European banks) along with concerns about a slowing economy.**

3.4 UK and US Interest Rates

- BOE Base Rate was as low as 0.10% in March 2020 due to the pandemic but it has been hiked on 14 occasions since December 2021 with the current rate at 5.25%, last seen in February '08
- **As Graph 7 below shows, the UK 3-year rate has risen by 1.75% since the start of February in contrast to other countries.**

Graph 7. GBP 3-year swaps: 1-year trend



Graph 8. USD 3-year swap rates: 2023 trend



- US rates have been quite erratic in the trend this year as market views ebbed and flowed around whether and when inflation might peak
- One of the key features in the US yield curve is that US 1-year rate is currently 5.61% but the implied 1-year rate in 1 year's time is 4.33% which is a prompt predicted fall in rates. In part, this also reflects the fact that the US was the first major economy to increase interest rates
- We remain of the view that the possibility of US recession has increased and that it is linked to a concern that the US banking sector will have further fallout - in a recent US report, it was stated that the national office vacancy rate was 16.1% with it being as high as 30% in some cities, San Francisco being particularly impacted
- The follow-on problem is that there is estimated to be \$1.5trillion of real estate debt to be refinanced by 2025...and if that is coming off a very low interest rate base into a much higher rate environment and occupancy rates are low it can only spell a huge problem for US banks
- Even consumer sentiment on house buying is poor with a recent survey saying that the sentiment that "it was a bad time to buy a house" hit a 13-year high
- This week Moody's cut the credit ratings of 10 small and medium-sized banks and put some larger ones on CreditWatch with a view to potentially downgrading them
- **Meanwhile, Fitch cut the rating on US Government debt from AAA to AA+**
- So, it is increasingly looking like the Fed has one more hike at best, but more than likely is finished
- The employment market remains quite tight with unemployment holding at 3.5% (5.84m unemployed). The labour participation rate remains just above 62%
- Housing starts have been negative on a month-on month basis for 9 of the past 12 months
- June retail sales were +1.4% compared to +10.3% in July 2022.

3.5 Summary

- **The expectation of future interest rates is now quite different between the major economies: the forecast 1-year rate in 12 months time is 3.38% in the EU, 4.33% in the US and 5.59% in the UK**
- **So the cost of doing business in the UK is likely to remain high – add a 3% margin to cost of funds and you're looking at an all-in cost of funds of over 8.5%**
- **We still believe that ECB will stall for breath now at 4.25% as the risk of recession is growing – anecdotal evidence from Germany suggests a material slowdown in activity**
- **On a broader level, Maersk, the container shipping giant, warned last week that the contraction in global trade would be longer and deeper than they previously feared with global container demand falling by 1% to 4% this year**
- **PMI readings as set out in Section 1 are mixed with services sector holding up but manufacturing readings indicating contraction**
- **But our biggest fear is another banking crisis in the US linked to large real estate write offs**
- **Interest rates are probably at levels which are more akin to "normal" as the negative interest rate environment that prevailed for so long should not be described as such. This new norm will prevail, so we don't expect to see Central Banks slashing rates like they did in 2008-2010 this time.**



4. Wealth Management

4.1 Gold

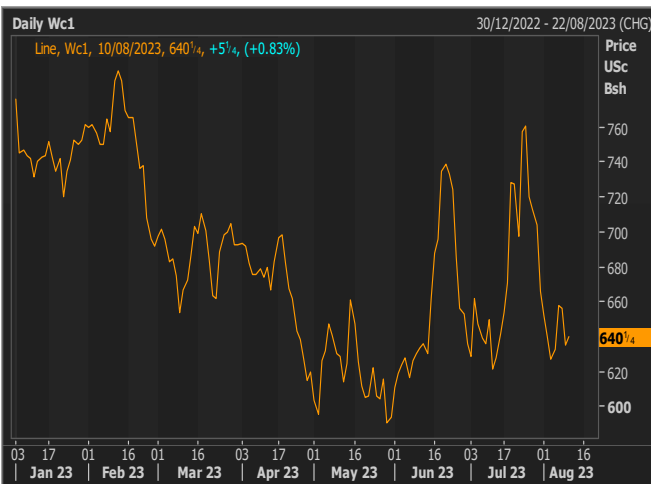
Graph 9. Gold prices: 2023 trend



- We have kept Gold on this bulletin as it's a perceived safe haven in turbulent times. Given our fears about possible US banking problems, we will continue to include it.

4.2 Wheat

Graph 10. Wheat prices: 2023 trend



- Wheat has jumped round a bit over the Summer
- But current levels are well below the price that prevailed before the invasion of Ukraine when it was circa 750c/bsl

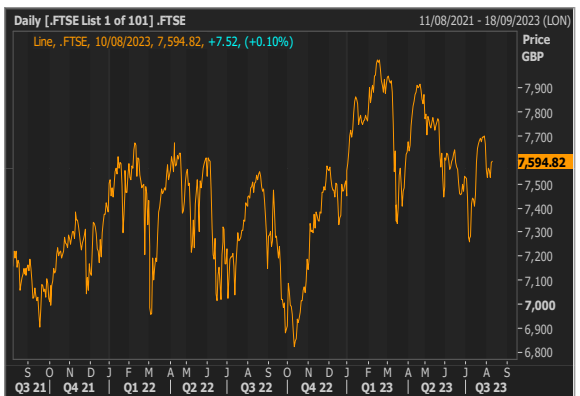
4.3 Equity Markets

- Equity markets have rebounded very well after last year's reversal, and it is fair to say that the strength of the rebound has surprised a lot of analysts
- However, it was reported on Bloomberg recently that 2023 year end forecasts for the DOW on Wall Street vary by 50%!!.

Graph 11. ISEQ: 1-year trend



Graph 12. FTSE: 1-year trend



Graph 13. NASDAQ: 1-year trend

