THE TREASURY HUB
Markets Bulletin

2023 Review and 2024 Outlook

1. Executive Summary

1.1 Introduction

Welcome to the annual review and outlook 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. Table 1 across sets out the year-to-date movement in a number of key metrics. What is interesting is that of the 16 metrics that we monitor, 7 were "in the red" i.e. lower than at the start of the year while 9 were "in the green".

The stories of the year have been inflation and (its impact on) interest rate trends. Central Banks have stalled their tightening of interest rates and there is now broad consensus that the interest rate cycle has peaked and that the next moves will be a cut.

- 3-month Euribor has entered into a tight range around the 4.00% level but has actually eased back a little in the last 2 weeks of 2023. ECB is still saying that there may be another hike if inflation doesn't come back to 2% but the financial markets do not believe that position
- EUR, UK and US yield curves are all inverted after 1 year and easing faster than in previous months over the past 4 weeks of the year
- Oil fell over the course of the year while Carbon also dropped but rallied recently
- Gold has hit an all-time high.

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

Table 1. Key Metric Movements: 2023

Heading	Metric	YTD move	From	To
Interest	3-m euribor	1.75%	2.16%	3.91%
Interest	EUR 3-year	-0.68%	3.23%	2.55%
Interest	GBP 3-year	-0.58%	4.54%	3.96%
Interest	USD 3-year	0.03%	3.98%	4.01%
FX	EUR/GBP	-2.10%	0.8850	0.8668
FX	EUR/USD	3.39%	1.0662	1.1036
Equities	ISEQ	16.17%	7293	8472
Equities	FTSE 100	1.03%	7554	7632
Equities	Nasdaq	54.85%	10862	16820
Commodities	Brent Crude	-6.16%	82.10	77.04
Commodities	Carbon	-4.63%	81	77.25
Commodities	Gold	12.18%	1823	2045
Commodities	Wheat	-18.97%	775	628
Gilts	IE 10-yr	-0.60%	2.98%	2.38%
Gilts	GB 10-yr	-0.11%	3.65%	3.54%
Gilts	US 10-yr	0.07%	3.79%	3.86%

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.**

- Stock markets have had a mixed year – the UK was more or less flat but Nasdaq up by over 50%
- Wheat prices are 19% down in the year and this is also consistent with falling food inflation
- Government borrowing (gilt) rates have all moved lower with Irish rates well below 2022 year-end levels
- Both USD and GBP traded, yet again, within a tight annual high/low range against EUR in 2023
- Looks like a new norm…but politically 2024 will be challenging in both the UK and US.

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1.2 Forward-looking Indices

Forward-looking indictors 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 now negative with only Services bucking the trend. Construction has been below 50 for all except one month in 2023 with Manufacturing following a broadly similar pattern
- In the UK, the split is exactly the same as for Ireland. Manufacturing has been below 50 since February whereas Constructions fall off has been more recent (since September).

Table 2. Irish and UK PMI readings

	Ireland	UK
Manufacturing PMI	**48.9**	**46.2**
Services PMI	**53.2**	**53.4**
Construction PMI	**44.5**	**46.8**

1.3 Inflation

Table 3. Selected Inflation Rates

	CPI/Core Inflation
ROI	**5.6%**
EUROZONE	**3.4%**
UK	**5.1%**
US	**4.0%**

Note: Core figures exclude energy, mortgages and food.

Irish core rate continued on its downward trend in November to 5.6%. CPI dropped to 3.9% in November (from 8.2% in December 2022).

Eurozone core inflation peaked at 5.7% in March and by November had fallen for 6 months in a row. This trend has sparked the reduction in interest rate expectations (see Section 3). However, inflation having dropped from 8.6% to 2.4% over the year to November eased back up to 2.9% in December.

UK core inflation at 5.1% is now 2.0% back from May's 31-year high although it's a long way from the 1997-2023 average of just under 2%. Headline inflation is also down from a peak level of 11.1% to 3.9%. Food inflation is down from 19.1% in March to 9.2%.

The US core inflation rate steadily declined over 2023 but stalled at 4.0% for October and November. The headline figure has fluctuated between 3.0% and 3.7% between June and December.

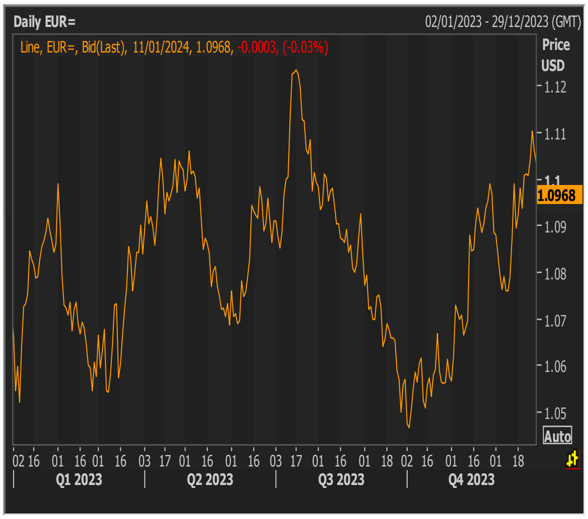
The "stabilization" of inflation data over the past few weeks has led markets to halt (and, indeed, reverse) downward interest rate trends. See Section 3 for further comment.

2. Foreign Exchange, Oil & Carbon

2.1 EUR/USD

- Graph 1 looks at the EUR/USD rate trend this year
- USD has had five periods of strength but all within an annual high/low range of 7.93% which is the tightest annual range since 2019 and the third year since 2013 that it is less than 10%
- Looking back to 2000, it is noticeable that the annual average ranges have been much tighter since the financial crisis with the actual average rate within +/-5cent of EUR/USD1.1000 for the most part
- So the key question going into 2024 is whether this is now the new norm (lower EUR/USD volatility) or the calm before the storm in an election year
- As we have previously referenced, we fear that the markets have ignored the US deficit and borrowing requirement for too long and that it could be a factor which weighs on the USD in 2024
- This is covered off in more detail in Section 5.

Graph 1. EUR/USD: 2023 trend



2.2 EUR/GBP

- Somewhat similar trend for EUR/GBP with the high/low range for 2023 being very narrow at 5.73%, a level last seen in 2018
- GBP was supported in 2023 by both (relatively) high interest rates and a quiet year on the political front
- The former are forecast to fall in 2024 while a general election must be held no later than December 17, 2024
- The trading range from a technical analysis perspective is narrowing (see red lines on Graph 2 overleaf) so a break of it either way would be significant.

- Normally political uncertainty impacts negatively on currencies but with Labour victory all but assured, the markets will likely focus on their policies and associated economic implications. Tighter relationships with Europe wouldn't be surprising and that would be good for GBP. But the possible implosion of the Tories and emergence of a Far Right wing/party would not be positive.
- The average rate for the past 7 years has remained in the EUR/GBP0.8527 to EUR/GBP0.8896 range which is tight.

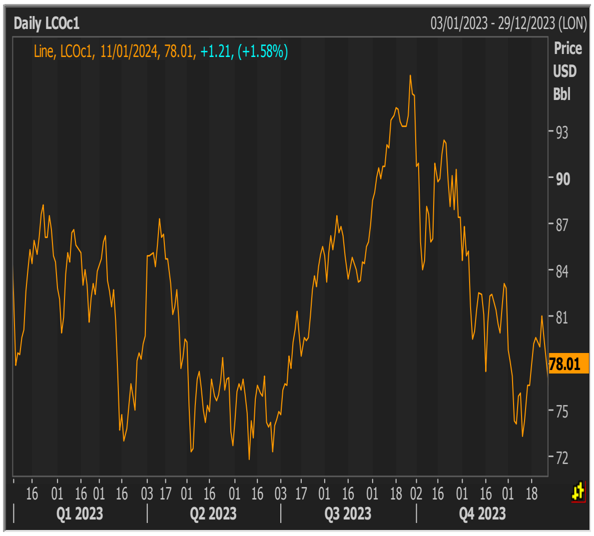
Graph 2. EUR/GBP: 2023 trend

2.3 OIL & CARBON

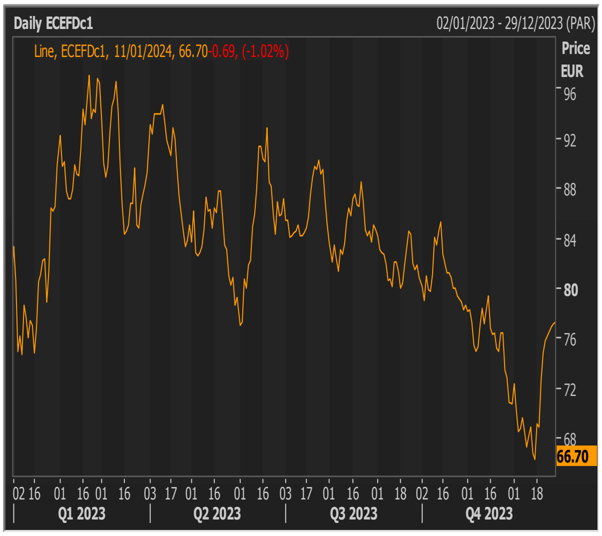
Brent Crude having traded in a fairly tight range in the first half of 2023 ($72-$88)spiked to $96 at the end of September falling rapidly to almost $73 by mid-December. Prices driven by geo-politics, supply (OPEC striving to scale back to drive prices up but US shale production negates that impact) and demand (declining economic outlook or not?). Geo-political risks remain very high into 2024.

The price of Carbon as per Graph 4 traded in a downward channel for most of 2023 and even broke down through a support level in November. It has since recovered but remains within the downward range

Graph 3. Brent Crude: 2023 trend



Graph 4. Carbon: 2023 trend



3. Interest and Economic Review

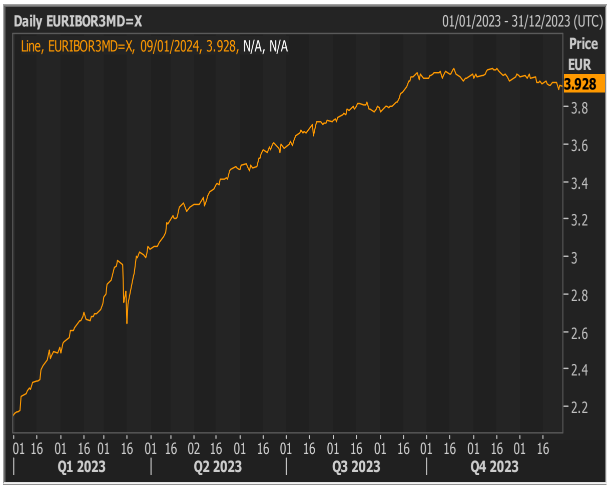
3.1 EUR Short-term Rates

Interest rates were the story of the year 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 Euribor rate has climbed steadily this year in line with hikes in the ECB Base Rate. The ECB has raised the Base Rate on six occasions from 2.50% in December 2022 to 4.50% currently (the ECB Deposit Rate being 50bp lower)
- The graph below shows the 2023 trend which has followed the ECB Deposit Rate up to recently
- However, since the end of November the rate has started to taper off ever so slightly which would be in keeping with the view that the rate hiking cycle has ended
- Market predictions for the first cut (of 25bp) centre around the March or April meetings
- The more stubborn inflation is, the further out this date will become.

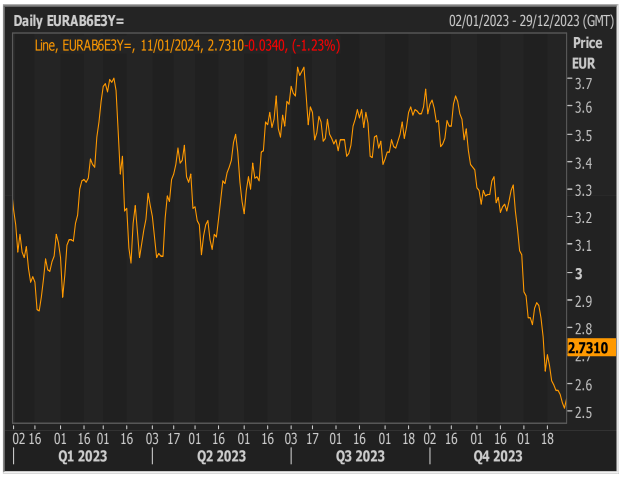
Graph 5. 3-month Euribor: 2023 trend



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) ended the year 50bp (0.50%) below its January opening level
- The decline from mid-October has been significant – down from 3.63% to 2.54% - in response to falling inflation rates and an expectation that this trend would continue but it has tapered off over the first two weeks of the New Year.

Graph 6. EUR 3-year swaps: 2023 trend



3.3 Summary

- The conclusion is that the current EUR interest rate cycle looks like it is over and the focus is now on when the ECB Base Rate will be cut
- The yield curve (line joining fixed rates from 1 year out) is negative meaning that fixed rates for longer terms are lower than fixed rates for shorter periods. This is another indicator that an interest rate cycle has peaked
- But the key item in rates being cut is how quickly the inflation rate can fall to 2% again and we see this as a challenge given how strong employment markets remain (current unemployment level is below the trough that preceded the financial crisis in 2008)
- And the EU labour force participation rate (% of the adult population available for work) has climbed steadily over the past 25 years
- Credit has continued to tighten across the EU according to the most recent ECB Bank Lending Survey and this is expected to continue into 2024.

3.4 UK and US Interest Rates

- **Graph 7 below shows, that the UK 3-year rate rose by over 2.30% between February and June but is back by almost the same amount since**.

Graph 7. GBP 3-year swaps: 2023 trend

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

- US rates have followed the same trend as the other major currencies since the end of Quarter 1 with a peak in the rate around the end of Quarter 2 falling quite quickly thereafter
- The pace of the decrease in rates in the US is slower than in the UK and this, in one sense, is somewhat surprising as the Fed was the first to raise its rates
- Nevertheless, the implied 1-year rate in 1 year's time is 3.82% (compared to 4.08% four weeks ago) and is in line with where the comparable UK rate is currently forecast to be (EU figure is 2.42% reflecting the fact that rates peaked at a lower level in the EU compared to the US)
- The debate about if/when inflation may trend close enough to 2% to facilitate a cut in Fed rates continues to rage as recent strong employment and inflation data supported the interest rate view of “higher for longer”
- On the lending front, there is a significant amount of debt, which had been fixed at interest rates close to 0% (pre margin), to be refinanced between now and 2025
- This is a major problem in the US real estate area as higher rates are combined with both lower occupancy and rents leading to much more challenging debt service conditions
- The unemployment rate continues to hold at 3.7% with 6.27 million people unemployed
- But their participation rate (% of adult population working or seeking work) dropped to 62.5% and this remains low by the standards of other countries
- Average hourly earnings remain 4% higher year on year which ought to continue to keeping inflation higher and this is against a backdrop of no change in the minimum wage of $7.25 since 2009
- Household debt is at a record high in Q3 2023 while the stock of excess savings accumulated during the pandemic and which has supported economic growth thus far is largely depleted
- Retail sales are up by 4.09% year-on-year but consumer confidence remains fragile and is close to levels last seen in 2008/09
- The market remains split on whether US can have a soft landing or not but, for now, the data looks ok. See Section 5 for more on the US outlook and associated downside risks which we believe are large.

3.5 Summary

- **Fixed interest rates (which are a better indictor of the future direction of rates) have all eased back considerably over the last quarter of 2023 with yield curves having turned negative in general**
- **The interpretation of this is that short-term rates will drop over the coming months**
- **On the economic growth front, the UK is barely in positive GDP growth territory for a few quarters with the EU probably in recession when we see the Q4 2023 data. The US is holding up much better so far**
- **In Ireland we have experienced four successive quarters of GDP decline but it is acknowledged that the metric is prone to material influence by multinational data which can distort trends**
- **So, the overall economic outlook is slightly negative which would generally lead to a cut in interest rates….in the absence of inflationary pressures..but that is not the case for now**
- **In addition to all of the above, the geo-political outlook remains fragile.**

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.
- It is up over 12% since the start of October, with a view that China is selling US government bonds and buying gold instead

4.2 Wheat

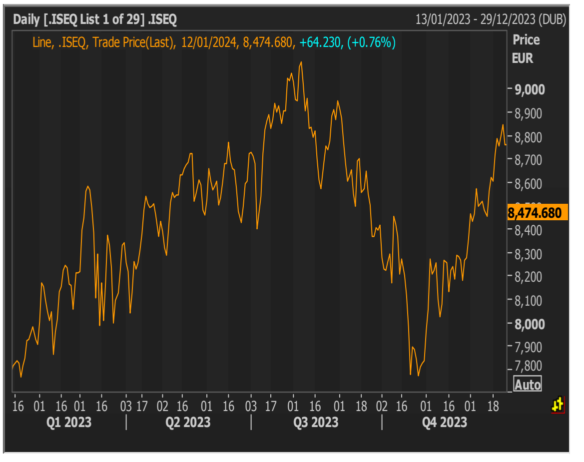
Graph 10. Wheat prices: 2023 trend

- Wheat prices reversed their downward trend of the year in November and broken out of that range
- But the year-end price was 19% lower than the price at the start of the year
- This would be consistent with falling food inflation.

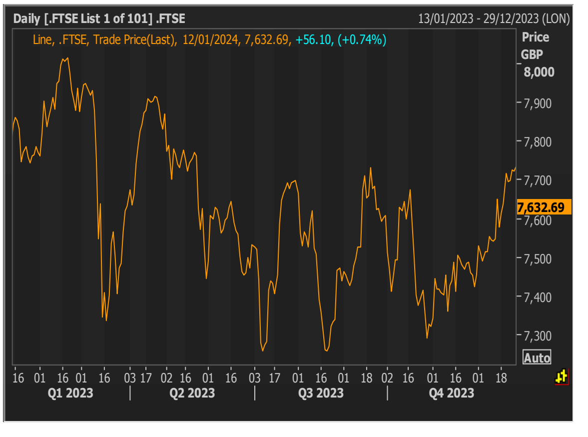
4.3 Equity Markets

- Equity markets have had something of a topsy turvy year but finished well:
- ISEQ was up 16%
- FTSE was up 1%
- NASDAQ was up a stunning 55%.

Graph 11. ISEQ: 2023 trend



Graph 12. FTSE: 2023 trend



Graph 13. NASDAQ: 2023 trend

5. 2024 Outlook

At the star of each year we look at possible trends to emerge over the course of the year with the occasional "interesting" prediction on the crystal ball front! Below is ours for 2024 but is just that: an opinion. A number of people over the years are attributed with the quote: "It is difficult to make predictions, especially about the future!" So, bear that in mind. But we welcome feedback at all times.

5.1 Interest Rates

- Straightforward evaluation in all geographies – will inflation fall fast enough to facilitate faster interest rate cuts
- Secondary issue for some central banks is the possibility of a recession
- **We think the former looks optimistic and that the markets are pricing in rate cuts too quickly** so that would suggest that current fixed rates may offer some value if borrowers are so inclined. First ECB rate cut more likely to be in May or June
- Current EUR rates and implied 1 year rates (semi-annual, zero coupon basis) are:

Table 4. Euro Fixed and implied 1-year Rates

EUR Rates (annual)		Implied rates in			
	Now	1 Year	2 Year	3 Year	4 Year
1 Year	3.510	2.274	2.231	2.271	2.420
2 Year	2.890	2.253	2.251	2.345	2.450
3 Year	2.670	2.256	2.305	2.388	2.521
4 Year	2.570	2.299	2.350	2.460	2.550

5.2 Banking Trends

- Irish banks to remain conservative in their lending
- Uncertain external environment will lead to more "stress-testing" of loan applications and slower lending processes again
- Against this backdrop we see the negotiation of solid 5-7 year facilities to be of more strategic importance than at any time since the financial crisis
- A lot of ESG-type regulations coming down the tracks and fast from ECB. BER ratings going to be an increasingly important factor in both new (building/development) loans (minimum B requirement) and, in due course, in refinancing existing real estate loans
- Non-banks to continue to finance property-related loans but won't be cheap
- Irish bank credit ratings to remain in good shape
- Internationally biggest story could be US banking and their real estate loans. $117bn of office loans to be either repaid or refinanced in the US in 2024. Study in December found that 40% of office loans on US bank balance sheets were "under water" while delinquencies on Commercial Mortgage Backed Securities were at 6.0 % at the end of November versus 1.7% one year earlier
- These also need falling interest rates to help..and we think that will be slower than expected. So, this represents a real threat to US banks in 2024.

5.3 Foreign Exchange Trends

- Difficult to call these given that annual ranges in both EUR/GBP and EUR/USD have been narrow for a few years
- Currencies benefit from stable politics, higher (relative to their peers) interest rates, trade trends, etc. These could go either way for a few major currencies
- GBP could hold up especially if Labour get in with ease and make pro-Europe soundings
- USD normally benefits from a safe haven status (in event of geo-political issues) but possible banking issues and government debt levels (see below) have potential to weaken it
- Lot of intra-year volatility last year even if in tight ranges so may make sense to make greater use of order levels in managing FX risk in 2024 should this 2023 trend continue.

5. 2024 Outlook

5.4 Ireland Macroeconomic

- Economy facing a lot of uncertainties:
    - Corporation tax take will start to come under pressure
    - Deficit in housing is a major crisis
    - Possible swing to Left politically….and well left of centre at that. Would be a first in Irish politics so economic ramifications not clear
    - Material infrastructure spend to futureproof against climate changes
    - Tight labour market suggest we need more immigration but of people with the required skill sets (the birth rate is also falling: from 21.36 per 1,000 people in 1980 to 11.33 in 2023). Also there needs to be a closer look at the labour market participation. 1 in every 3 adults in Ireland is NOT available for work compared to 1 in 4 in the EU and almost 1 in 5 in the UK. Why?
    - Industry consolidation – bad for consumers. We have 3-4 major players in retail banking, telecoms, insurance and even pensions now (as IORPS II has effectively led to closure of a lot of company-sponsored schemes in favour of master trusts) and most of these players are quoted companies. (interestingly the food retail sector has 5 main players but is arguably more competitive. 4 of the 5 are privately-owned!)
    - Expect further SME fall out, especially in hospitality, from recent changes such as 12% hike in minimum wage, increase sick pay entitlements, etc.
    - As a result, SMEs will have to look at increased productivity to stay afloat….AI?
    - But any structural shift from SME to larger companies would not be good in broad socio-economic terms for the country and could make us more uncompetitive more quickly internationally.

- On the plus side
    - Public finances are in decent shape
    - Savings rates are high
    - Corporate and personal debt are low relatively speaking (the former is arguably too low)
    - Banks Balance Sheets are in good shape.

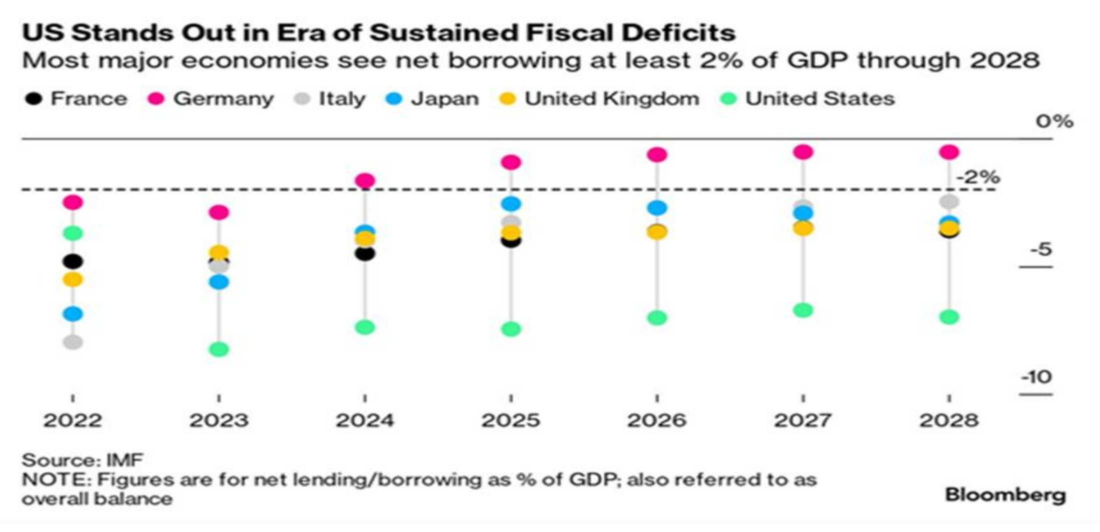
Overall, probably in decent shape but incoming government could be facing challenging times…and their policies could be interesting to put it mildly. Probably a slower year than currently projected in economic terms

5.5 Other Areas

- AI will be one of the main stories as it is increasingly used by a wider population
- But watch its misuse in elections globally
- Greentech has to speed up as global warming impacts not only from a weather perspective but starts feeding into financial services (insurance and banking will be first ones to react but it will impact most of us via those routes)
- Geo-politics will be huge – not just the outcome of election (Europe, UK, US) but developments in Ukraine, Taiwan, Red Sea, etc.
- As a result, we think that disruption to logistics channels is a higher than currently forecast risk. The action would be to increase key components safety stock but that ties up working capital!
- The growth in Government Debt globally but especially in the US is the elephant in the room.
- Graph overleaf from Bloomberg highlights the scale of forecast deficits as a % of GDP for established economies from 2022 to 2028
- US is expected to run deficits of 8% in 2022 and 7% in 2023
- The cost of servicing their debt is expected to grow from 8% of tax revenues in 2019 to 12 % by 2028
- This, in turn, means the US cannot afford to be global policeman….but the consequences of this happening are also huge.

5. 2024 Outlook

Graph 14. Fiscal Deficits 2022-2028



- So the question is: at what point do markets demand a higher premium from the US to buy its bonds?
- And what would be the impact of this on emerging market capital markets?
- It also means that governments cannot continue to insure everyone from the fallout of wars, global warming, etc.
- And the wealth gap also needs to be finally tackled. If governments need to raise more money then they are going to have to start taxing the super rich, partly to address the wealth divide that prevails in just about every economy
- And, finally, migration due to climate change will become a growing issue..and also a reason why we will see more elections resulting in higher support for Right Wing parties.

5.6 The Crystal Ball!!

- Supply chain shock as a result of problems in Panama Canal/Suez Canal/Straits of Djibouti
- If Trump is precluded from standing for President, then Biden steps down also
- US Banking problems again – unsure if it will be linked to regional banks/real estate or other financial system issues to do with valuation/liquidity/asset price bubble
- Nearshoring continues at pace due to geo-politics. (China has been replaced by Mexico as the largest source of imports into the US in November 2023 with the latter share down from 21% pre-pandemic to 13.9%). This could also have an impact on Chinese economics and, therefore, politics as the large middle class suffer from economic tightening
- UK starts overtures to get closer to EU again but Farage comes with a strong run in the election with new Right-wing party
- Gold hits new highs as geo-politics heightens its safe haven value.