THE TREASURY HUB
Markets Bulletin

Q1 2024 Review

1. Executive Summary

1.1 Introduction

Welcome to the 2024 first quarter version 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 notable is that the expectation would be for interest rates to be in red but the past few days has seen a spike in rates, especially in the US.

The focus of markets in the first quarter was very much on inflation and its impact on the expected timing of interest rate cuts. And while the consensus was that Central Banks had stalled their tightening of interest rates with the focus firmly on the timing (and number of) rate cuts, the number of cuts expected in 2024 has decreased as the year progressed.

- 3-month Euribor has remained in a relatively tight range around 3.90%, just below 4.00% but it is unlikely that this will move in a material way until the ECB implements its first rate cut
- EUR, UK and US yield curves continue to be inverted (i.e. rates decline after 1 year) but the past few days have seen an upward shift in such curves, especially in the US, on the back of inflation figures that look static
- Oil prices are on the rise again in Q1 (mainly due to an improving economic outlook).

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

Table 1. Key Metric Movements: 2024

Heading	Metric	YTD move	From	To
Interest	3-m euribor	-0.02%	3.93%	3.91%
Interest	EUR 3-year	0.53%	2.55%	3.08%
Interest	GBP 3-year	0.70%	3.92%	4.62%
Interest	USD 3-year	0.92%	4.01%	4.93%
FX	EUR/GBP	-1.47%	0.8672	0.8546
FX	EUR/USD	-2.81%	1.1042	1.074
Equities	ISEQ	13.60%	8765	9957
Equities	FTSE 100	2.60%	7733	7934
Equities	Nasdaq	8.00%	16677	18011
Commodities	Brent Crude	16.71%	77.39	90.32
Commodities	Carbon	-17.64%	78	64.26
Commodities	Gold	13.58%	2062	2342
Inflation	EU Core	-0.20%	3.30%	3.10%
Gilts	IE 10-yr	0.46%	2.41%	2.87%
Gilts	GB 10-yr	0.59%	3.60%	4.19%
Gilts	US 10-yr	0.51%	4.02%	4.53%

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 much better start to the year than previously anticipated with the major US tech stocks, for the most part, releasing strong 2023 financial results
- Government borrowing (gilt) rates have actually risen since year-end on the back of less optimistic outlook for rate cuts in 2024
- Both USD and GBP continue to trade in a remarkably tight range against EUR with JPY continuing to be the currency under pressure
- With less rate cuts likely and politics being a more material factor as the year goes on, vigilance would be well advised.
- Gold has had a record run to new heights over the quarter.

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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 remain negative since year-end with only Services bucking the trend. Construction was below 50 for most of 2023 but has risen for the past 4 months with Manufacturing being a bit more volatile over the same period
- In the UK, all three readings are now in positive territory with Manufacturing in expansion territory for the first time since July 2022.

Table 2. Irish and UK PMI readings

	Ireland	UK
Manufacturing PMI	**49.6**	**50.3**
Services PMI	**56.6**	**53.1**
Construction PMI	**47.4**	**50.2**

1.3 Inflation

Table 3. Selected Inflation Rates

	CPI/Core Inflation
ROI	**4.14%**
EUROZONE	**2.9%**
UK	**4.5%**
US	**3.8%**

Note: Core figures exclude energy, mortgages and food.

Irish core rate continued on its downward trend in March to 4.14%. CPI is even lower at 2.9% in March. Food prices continue to fall while clothing and furniture prices are actually negative on a 12-month basis. **But on a monthly basis, inflation has risen again in the past 2 months.**

Eurozone core inflation which peaked at 5.7% in March 2023 has been static or falling since May of last year. This trend has helped increase expectations of an interest rate cut soon (see Section 3). Inflation is now at 2.4% helped by a decrease in energy prices.

UK core inflation at 4.5% is at its lowest level since January 2022 having been as high as 7.1% last May. Headline inflation has fallen even further – now at 3.4% compared to 11.1% in October 2022. Food inflation continues to fall from 19.1% in March 2023 to a current level of 5.0%.

The US core inflation rate steadily declined over 2023 but has stalled at 3.8% for the past 2 months. The headline figure rose in March from 3.2% to 3.5%.

The outlook for the Eurozone and UK on inflation looks ok but there are concerns in the US as the 2% target looks challenging. See Section 3 for further comment.

2. Foreign Exchange (“FX”), Oil & Carbon

2.1 EUR/USD

- Graph 1 looks at the EUR/USD rate trend over the past 12 months
- The high/low range in 2024 to date is 5.73% which is tight by historic standards
- Markets appear to have been more preoccupied by movement in interest rates, equities and even Gold this year compared to FX (bear in mind that, historically, speculation i.e. looking to buy and sell currency to make a quick profit accounted for 90% of all global foreign exchange activity)
- Equally it is probably fair to assume that the lack of volatility means speculators are less attracted to currencies at the moment (as volatility facilitates wider swings and the potential to make (and lose) more money)
- The spike in the past few days in US interest rates has pushed USD lower (it had a daily move of almost 1.5c on April 10th)
- Markets continue to ignore the huge US government deficit which we think must become a factor at some stage
- But until then, USD seems to have support.

Graph 1. EUR/USD: 12-month trend

2.2 EUR/GBP

- Similar trend for EUR/GBP: the high/low range for 2023 being very narrow at 5.73%, has been followed by a range of 2.19% in 2024 to date and an average rate of EUR/GBP0.8564
- Again, like other currency pairs GBP has been supported by relatively high interest rates, lack of speculative activity and political calm
- The trading range from a technical analysis perspective is narrowing (see yellow lines on Graph 2 overleaf) so a break of it either way would be significant.

- Although we have seen recent movement in US interest rates as a result of stubborn US inflation, the trend in both Eurozone and UK inflation has been more stable and downward leading to less volatility, albeit with an increasing likelihood of a slower pace of rate cuts in 2024
- We mentioned in the 2023 review that the average rate for the past 7 years has remained in the EUR/GBP0.8527 to EUR/GBP0.8896 range which is tight. Current year average rate remains in that range.

Graph 2. EUR/GBP: 2-year trend

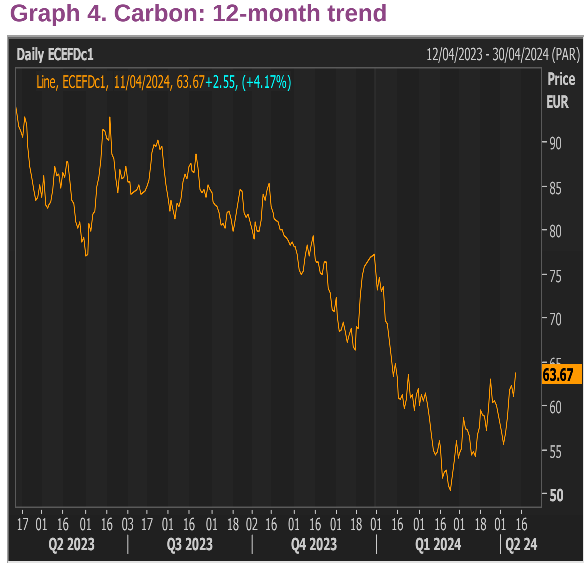
2.3 OIL & CARBON

Brent Crude had quite a volatile Q3/Q4 moving from $96 at the end of September to $73 by mid-December. However, against a backdrop of an expected price cap around $80 by the market at the start of the year, the price has continued to climb and is currently touching $90. If this is sustained, along with a strong USD, the fuel element of inflation is going to rise again. Increasing optimism about global economic growth is a key driver of the price.

The price of Carbon having traded in a downward channel for most of 2023 has since reversed the trend but current prices are still below last years average price.

Graph 3. Brent Crude: 12-month trend

Graph 4. Carbon: 12-month trend



3. Interest and Economic Review

3.1 EUR Short-term Rates

Interest rates, having barely moved for almost 15 years, were the man focus of markets in 2023 and this has continued into 2024. 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

- Given the talk of the top of the interest rate cycle being reached since last year, it is no surprise that the 3-month Euribor rate has plateaued since Q3 2023 (last ECB Base Rate hike was in September 2023).
- 3-month Euribor tends to track the ECB Base Deposit Rate and this currently sits at (and has peaked at?) 4%
- As the financial markets await the first interest rate cut, not surprisingly 3-month Euribor has stayed around 3.90% to 4.00% range pending the first rate cut
- This cut is now expected at the June ECB meeting hence why we expect to see 3-month Euribor fall over the second half of the year.

Graph 5. 3-month Euribor: 12-month 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 2023 50bp (0.50%) below its January 2023 opening level
- But this has since reversed as market expectation of the timing (and number of interest rate cuts) has been pushed out and revised downwards respectively.

Graph 6. EUR 3-year swaps: 12-month trend

3.3 Summary

- There appears to be little doubt now that the current EUR interest rate cycle is over as inflation continues to track downwards towards 2%
- Accordingly, the focus is now on when the ECB Base Rate will be cut and this is now expected to be at the next meeting on June 6 where a cut of 0.25% is expected
- As there are no ECB monetary policy meetings in August or November, after June there are only 4 meetings to year-end
- The implication of this is that the maximum possible number of rates cuts this year is 5
- We don't expect a cut in July so the actual number will be 3 or 4 and the markets, on balance, expect 3 cuts this year at this point in time
- The interest rate curve remains inverted with 1-year, 3-year and 5-year rates (ex margin) at 3.68%, 3.05% and 2.84% respectively.

3.4 UK and US Interest Rates

- **Graph 7 below shows, that the UK 3-year rate has ebbed and flowed a little over the past few weeks in line with US market sentiment to a certain extent.**

Graph 7. GBP 3-year swaps: 12-month trend

Graph 8. USD 3-year swap rates: 12-month trend

- US rates followed the same trend as the other major currencies over 2023 with a peak at the start of Q4 2023 declining quite quickly thereafter as markets anticipated as many as 7 cuts in the Fed Rate in 2024
- This was also partly-driven by the fact that the US was the first of the major currency blocs to raise interest rates implying that they were further along the interest rate cycle than others
- However, this was turned on its head since the start of February as it became apparent that inflation was not falling as fast as markets had previously anticipated with a resulting reduction in the number of expected rate cuts. This has resulted in the US 3-year rate moving UP from just below 4.00% in mid-January to 4.90% currently
- A move of this level was not anticipated 3 months ago and, accordingly, the management of USD debt has increased in importance again
- The implied 1-year rate in 1 year's time in the US is 4.80% (compared to 3.82% in early January) meaning that the yield curve has moved upwards across the board over Q1 2024
- As outlined in Section 1.3, US core inflation has been stuck at 3.8% for the past two months with headline inflation actually increasing from 3.2% to 3.5%
- But this has also been accompanied by an improving economic outlook with the hoped for “soft landing” looking more likely than a US recession at this point in time
- This, in turn, has had a knock-on impact on gilt, oil and equity markets
- We have previously referenced what we see as a major problem in the US real estate area due to a large volume of loans to be refinanced at higher rates than when they were first taken out prior to any interest rate increase. The recent rise in fixed rates will only exacerbate that problem
- The unemployment rate dipped from 3.9% to 3.8% in March but their participation rate (% of adult population working or seeking work) is 62.7% which is low by the standards of other countries
- Average hourly earnings are easing slightly but remain marginally above 4% higher year on year
- GDP growth was +3.4% in Q3 2023 but with the consumer being the main driver of US growth, it is notable that credit card debt is at a record high of USD1.13trillion by Q4 2023 while the household savings rate is now at 3.6% (this was 32% at the start of the pandemic)
- Our concern here is that both credit card debt and savings rates are higher and lower respectively than pre 2008 financial crisis. When one layers in the record deficits being incurred by the US government, unless US exports roar ahead, the question must be asked “where will US economic growth come from”?

3.5 Summary

- **Fixed interest rates (which are a better indictor of the future direction of rates) have all increased in Q1 2024**
- **The result of all of this is that markets have revised upwards where they think interest rates will be by 2027: US expectation before the recent inflation data was 3.6% compared to 2.6% previously. UK rates are now expected to be closer to 3.50% while Eurozone rates are expected to settle at between 2.25% and 2.50%**
- **The key takeaway from this is that we do not expect a return to the rates that prevailed for 15 years so with Eurozone rates expected to bottom out around 2.50%, it would imply all-in borrowing rates of 5.5% to 6.0%. Companies would be well advised to consider this in the context of hurdle rates for investment decisions and the overall cost of capital looking forward**
- **In addition to all of the above, the geo-political outlook remains volatile as there are elections in many parts of the world in 2024 from US and UK to India.**

4. Wealth Management

4.1 Gold

Graph 9. Gold: 12-month trend

- Gold has been the story of 2023/24 in many ways on the wealth management front. It was generally perceived as a safe haven in turbulent times
- However, there has been a drive by Chinese asset holders to liquidate some of their holding of US Government Bonds and switch such holdings into Gold which has driven the price higher
- It is up over 28% since the start of October.

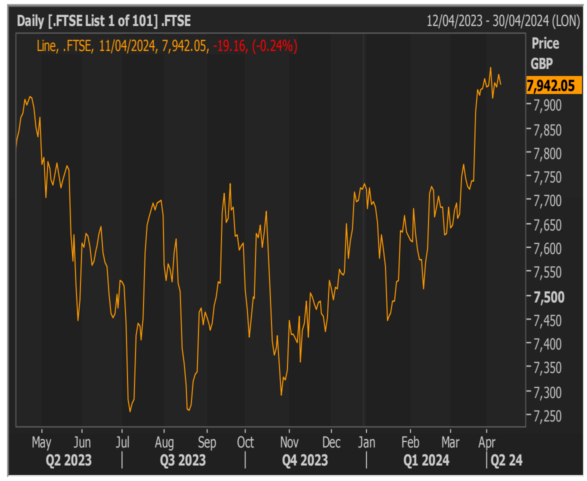
4.2 Equity Markets

- As a general comment, equity markets have had a stellar start to the year defying the odds.
- The ISEQ was up 23% in 2023 and has risen by a further 14% in 2024 breaching the 10,000 mark in the past few days
- The downside is the ever-decreasing number of participants in it.

Graph 10. ISEQ: 12-month trend

In the UK, the FTSE had a more turbulent time over the course of 2023 and was the worst performer of the three indices that we monitor but it too has had a positive start to 2024. UK economic data has not been great but a lot of the FTSE 100 companies are global in nature and are not dependant on the UK consumer.

Graph 11. FTSE: 12-month trend



Graph 12. NASDAQ: 12-month trend

NASDAQ remains the star performer on the equity front but driven by 7 stocks: Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla. Within that Nvidia is the top performer with the share price up by 84% this year, from USD492 to USD906. Tesla is going into reverse by comparison with stock price down from USD250 to USD175 over the year to date.

Interest rate and economic outlooks have a significant bearing on the likely future direction of the various indices. Recent FT articles cited the US market as operating on a forward PE of 20.08 times versus 14.7 times for MSCI Europe index suggesting there may be more value in Europe for now.

5. 2023 Irish Banks Results

Each year we summarise the financial results of the Irish banks. The table below sets out the key statistics for the past 3 years and gives an idea of how the banks are faring.

5.1 Summary Statistics

Table 4. Summary 2023 Statistics for BOI, AIB and PTSB

	BOI 2021	BOI 2022	BOI 2023	AIB 2021	AIB 2022	AIB 2023	PTSB 2021	PTSB 2022	PTSB 2023
Net Interest Margin	1.86%	1.96%	3.01%	1.58%	1.74%	3.11%	1.51%	1.54%	2.32%
Cost/Income	58%	54%	42%	64%	57%	39%	82%	84%	66%
Customer Loans (€bn)	76.0	72.0	80.0	56.5	59.6	67.0	14.2	19.5	20.9
Customer Deposits (€bn)	93.0	99.0	100.0	92.9	102.4	104.8	20.0	21.7	23.0
Loan to Deposit	82%	73%	80%	61%	58%	63%	75%	90%	93%
LCR	181%	221%	196%	203%	192%	199%	274%	178%	220%
NSFR	144%	163%	157%	160%	164%	159%	170%	154%	155%
CET 1	16%	15.4%	14.3%	16.6%	16.3%	15.8%	15.1%	15.2%	14.0%
SME Lending ROI €bn	7.1	7.0	8.7	18.7	19.4	20.0	0.225	1.00	1.00+
S&P Credit Rating		A-	A		A-	A		BBB	BBB+

Note: AIB SME Lending figure is a combination of Corporate and SME

5.2 Overall Trends

- Very large increase in Net Interest Margin (which is the difference between what they pay out on deposits and what they earn on loans)
- No surprisingly this is mainly driven by two components:
  - Slow pace in passing on the benefit of interest rate hikes to depositors (although in some parts of their business they were also slower in passing on the cost of hikes to borrowers)
  - Very large excess of deposit balances over loan balances (€20bn for BOI and almost €38bn for AIB) enabled these banks to place deposits safely with ECB earning income of 4% by the last quarter of 2023 compared to a significantly lower cost of funding these deposits (by paying customers lower rates of interest on deposits placed WITH the bank)
- All of this led to a material increase in profitability: BOI PBT was up from €1.0bn to €1.9bn, AIB PBT was even stronger, up from €0.9bn to €2.4bn, while underlying PBT for PTSB was €45m and €166m in 2022 and 2023 respectively
- Growth in Customer loans at an organic level was largely stagnant with increases primarily driven by acquisition of various parts of the KBC and Ulster Bank loan books as they exited the Irish market
- LCR=Liquidity Coverage Ratio and measures the % of high quality liquid assets maintained by it to ensure that they have an ability to meet their short-term obligations (cash outflows for 30 days). It is a measure to see how safe a bank would be in the event of a run on it
- NSFR =Net Stable Funding Ratio and measures the stability of its funding in the long-term in order to fund its long-term assets
- CET1 is the Common Equity Tier 1 ratio and looks at the % of equity that a bank has relative to its loan books. The decrease in 2023 represents the banks paying out higher dividends as a result of strong profits.

5.3 Lending/Funding Trends

- Sectoral breakdown of loans advanced provided by both AIB and PTSB shows the former with a higher exposure to natural resources while the latter has quite high exposure (relatively speaking) to agriculture

5. 2023 Irish Banks Results

5.3 contd

- Property is a material component of both BOI and AIB loan portfolios with gross loans of €7.2bn and €9.2bn respectively
- Non-performing loans continue to fall in general
- AIB deposits mainly boosted by personal savings with corporate levels static
- All banks had their long-term credit ratings raised by S&P in 2023.

5.4 Summary

- The two main banks are now hugely profitable again and have balance sheets that are the opposite of what they were in 2008, with deposits well in excess of loans
- It could be argued that the level of lending in the economy, especially when considers the growth in both population and GDP over the past 15 years, is too low
- Separate Central Bank lending data shows that net lending (new loans less loan repayments) to SME's fell for the fifth consecutive quarter in December 2023
- Our own data taken from the same set of statistics every year shows that taking 2010 as the Base year, lending to SMEs at the end of 2023 was 42% of the 2010 figure and, as mentioned above, if one was to take account of growth in GDP and population, the relative decline is even greater
- When tied into the growth of personal deposits and corporate deposits over the same periods, what we see is an economy that is still suffering the effects of the financial crisis in its attitude to borrowing
- And the large increase in interest rates over the past 2 years (admittedly from unsustainable low levels) is more likely to give momentum to this trend
- This conservatism is further exemplified by the fact that the majority of mortgages are now on fixed rates e.g. 58% of all ROI mortgages advanced by AIB were fixed at the end of 2023
- Mortgage borrowing will increase over time as housebuilding activity also increases but there is a real element of "catch up" in that space
- Overall we do not see any dynamic emerging to change the trend of higher deposits and lower borrowing for now.

Table 5. Trends in Lending to SMEs: 2010-2023